

Why The Big Talk About Small Business Is Wrong

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NEW YORK (AP) — Mitt Romney says they're "job creators" and vows to come to their aid as president. Newt Gingrich visited them on his "jobs and growth" bus tour. President Barack Obama calls them "the engine of our economy."

If there's one thing Republicans and Democrats agree on, it's that small business is the answer to what ails the economy. On these tiny bundles of entrepreneurial energy, they say, rides the nation's hope for lower unemployment and faster economic growth.

But the work of several economists suggests that most small businesses are not particularly adept at creating jobs, at least not the best jobs. The work also suggests their role in generating national wealth has been exaggerated.

The problem is that not all small businesses are created equal. Businesses just getting off the ground contribute most of the country's job growth, but older small businesses cut as many as they add.

Think Bill Gates and Paul Allen huddled together late nights developing Microsoft, not the corner liquor store.

"I don't want to pick on dry cleaners and restaurants and small manufacturing firms, but they're not a big source of job creation," says John Haltiwanger, an economist at the University of Maryland.

Politicians like to say that small companies create two of every three jobs in a given year. That's less impressive when you consider that almost all the 6 million companies in the U.S. — 99.9 percent of them — are small businesses, with fewer than 500 workers.

What's more, two-out-of-three masks the fact that most small businesses eliminate more jobs than they create in a given year, either through layoffs, closings or bankruptcy.

And many of the rest, the ones that don't shrink or shut down, don't offer much hope for the millions of Americans looking for jobs.

Many small companies — outfits like florists, hardware stores and barbershops — tend to grow with the U.S. population, not faster. So they don't speed the economic recovery the way an exploding new industry might.

According to an August study by two University of Chicago economists, most small business owners just want to be their own boss and never expect to hire more than a few employees.

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In fact, the more you study the numbers, the more you wonder what the politicians are getting so excited about.

Haltiwanger and two other economists showed, in a study of 32,000 companies over 30 years, that small businesses no more than five years old — that's about 40 percent of them — are the only ones that create more jobs each year than they cut.

In 2005, for instance, more than 99 percent of the 2.5 million net new private-sector jobs in the United States came from these startups, according to the U.S. Census Bureau.

But the 60 percent of small businesses that have been around more than five years act as a slight drag on the number of jobs available in the United States. They have cut about 0.5 percent more staff than they have added in a typical year, according to Haltiwanger.

By contrast, big businesses, the ones that get all the headlines for layoffs, have hired more than they have cut — about 0.1 percent in a typical year.

Economist Charles Kenny of the New America Foundation, a nonpartisan research group, goes as far as suggesting that Washington should stop offering certain incentives to small business owners, such as loan guarantees and write-offs on taxes for home offices. He says the money would be better spent subsidizing research and development.

"If you want jobs, you have to focus on the innovative firms trying to provide something new and different," he says.

The country's unemployment rate is 8.3 percent, the lowest in three years. But the U.S. still has 5.6 million fewer jobs than before the recession. Assuming the pace of hiring from last year continues, it will take three years to recover all the lost jobs.

Small businesses aren't helping much. They cut more workers than they hired in all but three months last year, and contributed zero to job gains again in January, according to a survey by the National Federation of Independent Business.

To change that record, Republicans say Obama needs to cut federal rules and paperwork that are burdensome for small businesses that don't have human resource departments, legal staff and vast resources like big businesses.

To comply with federal regulations on the environment, for instance, companies with fewer than 20 workers spent \$4,101 per worker in 2008, or 4½ times more than companies employing 500 or more, according to the Small Business Administration.

The same study showed these businesses spent three times more per worker on tax preparation than did their larger counterparts.

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"As regulatory complexity increases, it's hard on small firms," says William Dunkelberg, chief economist at the National Federation of Independent Business, a group closely allied with Republicans. "We need to get government out of the way."

But many economists think the root of the job problem is deeper.

Again, it's the difference between old small businesses and new small ones, and the U.S. is not creating enough of the new ones.

It was true even before the Great Recession: The number of startups less than a year old was no higher in the boom year of 2006 than it was 30 years ago, when the economy was much smaller, according to the Census Bureau. And the ones that are launching are hiring fewer people, too.

The grim takeaway is that the U.S. could struggle with high unemployment long after a pickup in economic growth.

Even the idea that small businesses play an outsized role in the economy has come under attack lately.

A study from the left-leaning Center for Economic and Policy Research shows that the self-employed worker, that rugged exemplar of the small businessperson, accounted for less of the working population in the U.S. than in the other 20 rich countries tracked, except for Luxembourg.

Another study by economists at Harvard and Dartmouth suggests that might not be such a bad thing because poorer countries are more likely to have a higher share of their workers self-employed.

Adding fuel to the argument, Kelly Edmiston, an economist at the Federal Reserve Bank of Kansas City, showed that workers at small businesses are more likely to lose their jobs and less likely to have vacation days, retirement plans and a range of other benefits, including health care. Some 41 percent of companies employing less than 100 people offered no medical insurance at all.

So, myths about job creation aside, why isn't the U.S. launching more startups? The risky economy, regulations or health care costs — a bigger burden for small companies — could be scaring them off.

Haltiwanger thinks demographics may be at work. He says businesses are often started by people in their 30s and 40s. So as the population ages and more baby boomers retire, the number of startups falls.

"We're a roll-the-dice economy. It has a lot of spillover effects," he says. "But we're not experimenting enough."

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