

THE SMALL BUSINESS ADVOCATE

In This Issue

Federal Regulatory Compliance
Costs Small Business Twice as
Much per Employee1

New! Economic Research
Listserv8

Message from the Acting Chief Counsel

Women + Small Business =
Economic Progress3

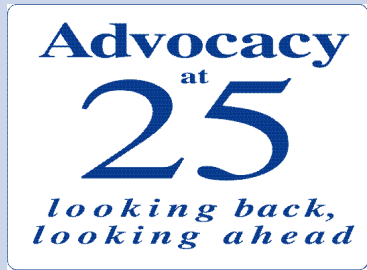
Advocacy's 25th Anniversary

Small Business in the
Knowledge-Based Economy . . .2

Oct. 23 Symposium in
Pictures4

Regulatory News

Think Tanks Ask OMB to
Reconsider Agency Data
and Analyses6



Federal Regulatory Compliance Costs Small Business Twice as Much per Employee

A new study produced under contract to Advocacy shows that federal regulatory costs on U.S. business grew to \$497 billion in 2000, and these costs fell disproportionately on small business. The study is called *The Impact of Regulatory Costs on Small Firms* and was written by W. Mark Crain of George Mason University's Center for the Study of Public Choice and Thomas D. Hopkins of the Rochester Institute of Technology's College of Business. The publication builds on a 1995 report by Hopkins, *Profiles of Regulatory Costs*, which was Advocacy's first effort at calculating regulatory costs by firm size.

The new report compares the cost of regulation on small versus large firms across four broad industrial sectors—manufacturing, trade

(wholesale and retail), services, and other. It groups federal regulations into four types—those having to do with tax compliance, workplace practices, economic regulation, and environmental protection. Hopkins and Crain's results show that in 2000 federal regulations cost firms with fewer than 20 employees nearly \$7,000 per employee annually. Compliance costs for medium size firms (20 to 499 employees) and for large ones (500+ employees) were \$4,320 and \$4,460 per employee, respectively. All told, mandated spending on regulatory compliance that doesn't show up in the federal budget amounts to \$843 billion, or 8 percent of gross domestic product. Of this total,

Continued on page 7



Thomas D. Hopkins discusses the impact of regulatory costs on small firms at Advocacy's 25th Anniversary symposium. See pages 4-5 for highlights.

Small Business and the Knowledge-Based Economy

David Birch, the renowned economist and president of the research firm Cognetics, Inc., cemented his reputation for iconoclastic analyses in the mid-1970s, around the time that the Office of Advocacy was getting started. (Some of Advocacy's first research contracts went to him.) His 1979 book, *The Job Generation Process*, showed the importance of small firms in creating jobs and helped give recognition and respectability to the field of small business research. Despite his considerable accomplishments since then, Birch expects that his epitaph will probably read, rightly or wrongly, "David Birch discovered that small firms create most of the jobs."

Birch reflected on his research during Advocacy's 25th anniversary symposium.

Small Business and Job Creation. In 1979, when Birch published the idea that small businesses create most of the jobs, the reaction was a mixture of shock and disbelief. Large businesses were supposed to dominate the world, weren't they? "Here was this nerd coming up with the idea that small firms were more important than large ones," says Birch. "The huge corporations began aiming their cannons."

But others were reaching the same conclusions. The findings indicated that the United States was leading the charge. Over the years since, other countries have been catching up: women business owners are now a major force in Sweden, for example. The United States was lucky—or perhaps particularly poised—to be there first.

Birch classified businesses in *Wild Kingdom* terms. The large, publicly traded firms that have shed millions of jobs over the past two decades are elephants. Small Main Street businesses that create jobs when they start up but then grow

very little are mice. And fast-growing businesses that start small, then double in size and double again, are the gazelles. For the past 25 years, the most effective job creators have been the gazelles and the mice. And of those, the gazelles have been the prolific: some 350,000 of these fast-growing companies have created as many jobs in the recent past as the mice, which number in the millions.

Underlying this shift in economic vitality and the importance of small firms is the knowledge revolution of the past quarter century—the shift to a knowledge-based economy in which the source of value has shifted from factories and warehouses to knowledge.

Some years ago, Birch was discussing his small business job creation findings with a Canadian historian: "He took me through history, showing that restructurings like the one we're in now happen every 200 years or so. The last was the Industrial Revolution in 1810-1820. 'What you're observing is the next revolution,' he told me. 'What happens during these revolutions is that the old order crumbles and the new one emerges.'"

Surviving in the Knowledge-Based Economy. Small business has a key role here. In the current revolution, Birch says, the raw material is not steel or rail lines, but knowledge—brainpower. And it's not just the high tech businesses that propel most of the growth—it's the businesses that make efficient use of knowledge, including the tools of technology. The new order emerges through the experiments of thousands of companies—mostly small ones—that try out new ideas, new products, services, and processes in the changing marketplace. Some of the ideas that are particularly well adapted to the emerging market will make gazelles of the companies that capitalize on

The Small Business Advocate

Editor Rebecca Krafft

Managing Editor Rob Kleinsteuber

Contributing Editors Kathryn J. Tobias, John McDowell

Photographers Jim Henderson, Hans Petersen

Production Assistant Darlene Moyer-Mahmoud

The Small Business Advocate (ISSN 1045-7658) is published monthly by the U.S. Small Business Administration's Office of Advocacy and is distributed to Small Business Administration field staff and members of the U.S. Congress. *The Small Business Advocate* is available without charge from the Office of Advocacy, U.S. Small Business Administration, Mail Code 3114, Washington, DC 20416. Back issues are available on microfiche from the National Technical Information Service, 5285 Port Royal Road, Springfield, VA 22161.

Send address changes to: *The Small Business Advocate*, Mail Code 3114, U.S. Small Business Administration, Washington, DC 20416. Include your current address label.

The Small Business Advocate online: www.sba.gov/advo/news/

Electronic delivery of *The Small Business Advocate* is available by visiting www.sba.gov/advo/news/. Subscriber information will be kept confidential and not used for any purpose except for newsletter delivery. To discontinue print delivery of *The Small Business Advocate*, send an e-mail with your current mailing information to advocacy@sba.gov or call (202) 205-6533.



Federal Recycling Program
Printed on recycled paper.

them—and will in turn shape the emerging order.

Evidence of this new era is in business statistics. Beginning in the 1975 to 1980 period, employment trends reversed themselves. "The Fortune 500 grew every year until 1980 and declined every year after," Birch says. He also observed that the U.S. economy hasn't added industrial jobs since 1953. While the work force has grown from 50 million workers to 123 million, all the net growth has been on the

Continued on page 3

Message from the Acting Chief Counsel

Women + Small Business = Economic Progress

by Susan M. Walthall, Acting Chief Counsel, Office of Advocacy

As a woman and acting chief counsel for Advocacy, I took great interest in a report released at the Office of Advocacy's 25th anniversary celebration in October. *Women in Business, 2001* shows that women were majority owners of 5.4 million businesses employing more than 7 million workers in 1997. Women have made great strides toward economic equality, particularly because of their strong entrepreneurial drive. The report shows that women still have a way to go to reach economic equality in all aspects of business, but it also contains very good news about the impact of business ownership by women on overall household income and wealth.

Women's role as business owners has been on the rise for some decades now. Between 1976 and 2000, women's share of total self-employment went from 22 percent to 38 percent. While the number of all U.S. firms rose 6 percent between 1992 and 1997, the number of women-owned firms rose by 16 percent. Women-owned business revenues increased by 33 percent compared with an increase of 24 percent for all firms, but women-owned businesses commanded only

a small share of total business income relative to their numbers.

Women's representation in management has also been increasing. In 1999, women made up 46 percent of total decision-making power: 9.4 million women were in executive, administrative, and managerial occupations. A large gender disparity remains, however, between female and male executives' earnings. In 1999, only 5 percent of women executives earned more than \$80,000, compared with 23 percent of men executives.

The report contains very good news about the implications of business ownership for overall economic well-being. A recent study sponsored by the Office of Advocacy (see box) showed that households with businesses have higher incomes and accumulate more wealth than those without. This finding also holds true for women-headed households. In 1998, the average income of women-headed households with a business was \$60,892, more than 2.5 times that of such households without a business. And in 1998, the average net worth of women-headed households with a business was \$739,600, nearly six times those without.

While *Women in Business, 2001* does not seek to explain the reasons for many of these trends, it pulls together data from a variety of sources to create an in-depth account of women's business involvement. I hope that researchers in think tanks and academia will take these numbers as food for thought for future research on women's entrepreneurship, business ownership, and continuing progress toward equal participation in the American economy.

For More Information

The complete text of *Women in Business, 2001* is available on the Office of Advocacy website, www.sba.gov/advo. The study on wealth and income (George Haynes, Charles Ou, and Anne Heidema, *Wealth and Income: How Did Businesses Fare from 1989 through 1998?*) is located at www.sba.gov/advo/research. Technical questions may be addressed to Dr. Ying Lowrey, senior economist, Office of Advocacy at (202) 205-6947, or by e-mail to ying.lowrey@sba.gov.

Small Business, from page 2
knowledge side.

Where are we now? Birch sees the nation in a recession now, as has happened about every 10 years. "During the last two recessions in the 1980s and 1990s, we found that small firms do better in recessions than large firms," Birch says. "Large firms do massive layoffs; small firms adjust earlier and more quickly and actually create growth while large firms are collapsing.

Small firms are good shock absorbers in recessionary times, and it's important that Congress get this message as they move to create economic stimulus packages."

What of the future? Over the long term, Birch thinks his historian friend is right. "We're in the middle of a revolution, a transition period. These periods don't go on forever. After 20 to 30 years, the new order will begin to establish itself. The successful upstarts will

become the formidable firms." Once the upstarts have become the established order, Birch says, it will again be tough for the small firms to compete. They will be less dominant, although they will continue to be shock absorbers during recessions.

"I think this new order will hold until about the year 2200," says Birch, "when all hell will break loose again."

Highlights of Advocacy's 25th Anniversary Symposium



Advocacy staffers Harriett Lyles (retired), Greg Somers, Barbara George, Luckie Wren, and Angela Hamilton greet participants in Advocacy symposium.



Four former chief counsels, Jere Glover, Tom Kerester, Frank Swain, and Milt Stewart, field audience questions.



Current and former Advocacy economists Brian Headd, Bob Berney and Fred Tarpley review small firm research.



SBA Administrator Hector Barreto brings greetings and looks ahead to new SBA directions.



Booth depicting small business growth and Advocacy history attracts the attention of long-time small business advocates Alan Chvotkin and Jody Wharton.



Acting Chief Counsel Susan Walthall moderates panel on small business economic contributions featuring David Birch, Bruce Phillips, and Julie Weeks.

Reviewing Great Progress; Rising to New Challenges



Office of Information and Regulatory Affairs Administrator John Graham describes current OIRA initiatives.



Symposium participants direct questions to panel in the Chamber of Commerce's Hall of Flags.



Association and media representatives Karen Kerrigan, Kent Hoover, and Giovanni Coratolo meet Advocacy chief counsel nominee Tom Sullivan.



Assistant Advocate Claudia Rodgers introduces regulatory flexibility panel: Tom Kelly, Richard Williams, Jeff Longworth, Norm Littler, and Adele Abrams.



Smile everyone! Twenty-eight of Advocacy's current staff of 30 pose in the lobby of the Federal Office Center.

Regulatory News

Think Tanks Ask OMB to Consider Objectivity, Consistency of Agency Data and Analyses

by Dr. Radwan Saade, Regulatory Economist, Office of Advocacy

The Office of Management and Budget (OMB) has asked for comments on its draft *Report to Congress on the Costs and Benefits of Federal Regulations*. The statutory report is a widely used source on the gains and losses associated with federal regulations.

In years past, OMB's draft report has presented agencies' estimates and a variety of summaries of the costs and benefits of federal regulations. The current draft report is quite different: It presents no new information on the magnitude of costs and benefits and instead asks for comments on a variety of methodological questions:

1. Should we assess older regulations?
2. Should we focus on specific statutes or categories of regulations?

3. Should we seek to develop a better way to estimate the aggregate cost of federal regulation?

4. How should we estimate effects on state, local, and tribal government, small business, wages, and economic growth?

5. How can we improve the estimates of costs and benefits of major regulations?

6. How should we treat EPA's aggregate estimates of the benefits of the Clean Air Act?

The report's methodology has come under scrutiny before, and researchers welcome the invitation to comment on it. Indeed, institutions that are often at odds with each other agree on the need to improve it, in particular by ending its reliance on unexamined agency-supplied data.

The Mercatus Group at George

Mason University commented that "The report should present OMB's objective estimates of the benefits and costs of individual regulatory actions. These estimates should be based on consistent measurement techniques and a transparent explication of assumptions." In addition, "OMB should identify in a concise but comprehensive manner variations in agency methodologies used to estimate benefits and costs of individual regulations. It should present a 'report card' for agency analyses that highlights their strengths and weaknesses."

For More Information

OMB's draft report can be found at www.whitehouse.gov/omb/fedreg/2001.html. Susan Dudley, Joseph Johnson, and Jay Cochran prepared the Mercatus Group comment, located at www.mercatus.org. Robert Hahn and Robert Litan prepared the AEI/Brookings comment, found at www.aei.brookings.org/publications/reganalyses. Related questions may be directed to the Office of Advocacy's regulatory economist, Radwan Saade, at (202) 205-6878 (ph.) or radwan.saade@sba.gov.

The Dollar Impact of Revised Methodology

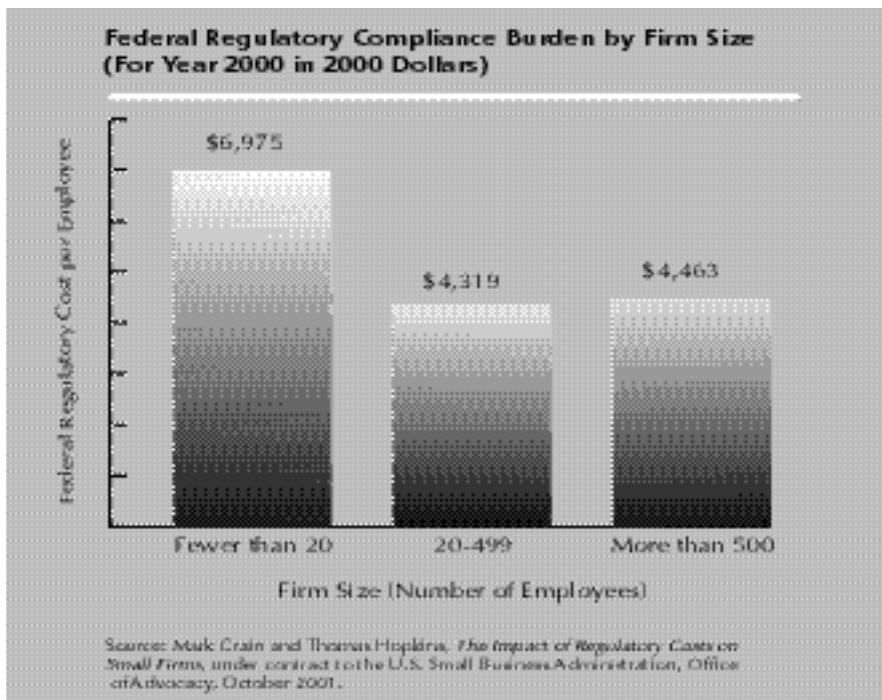
The Environmental Protection Agency's aggregate estimates of the benefits of the Clean Air Act are important because they constitute a significant portion of the total benefit estimates of federal regulations. A revision of OMB's methodology in dealing with EPA's estimates would introduce dramatic changes in past pictures of the benefits of federal regulations.

By way of example, the Mercatus Group's comments cited OMB's 1998 costs and benefits report. In it, EPA estimated the Clean Air Act's benefit for the period 1970–1990 at \$22 trillion and the value of the monetized benefit for 1990 at \$1.25 trillion per year. This estimate implies that the average citizen was willing to pay more than 25 percent of personal income per year to obtain the monetized benefits of the Clean Air Act. The Mercatus Group points out several key factors that could lead to such a high estimate: the use of an unrealistic baseline, the uncertainties in magnitudes and causation of effects, improper accounting for latency effects, and exaggerated valuation of health benefits.

Both Mercatus and AEI/Brookings call on OMB to be more proactive in ensuring that agencies' estimates of costs and benefits follow its guidelines and that OMB make transparency a guiding principle in explaining assumptions. The convergence of these two think tanks on this issue in and of itself emphasizes the urgent need for OMB to come up with a realistic estimate of the benefits of the Clean Air Act.

The American Enterprise Institute/ Brookings Institution Joint Center for Regulatory Studies had a similar comment on the question, how can OMB improve its cost/benefit estimates of significant regulations? AEI/Brookings responded: "The answer is simple. OMB experts should say what they really believe about the costs and benefits of significant regulations rather than taking the agency num-

Continued on page 8



Impact of Compliance Costs on Small Business

Continued from page 1

\$497 billion fell on business and \$346 billion fell on consumers or other governments.

The study indicates that compliance costs with respect to firm size differ by industry. In the manufacturing sector, small firms bear a significantly higher regulatory burden (more than double the cost per employee) than large and medium size firms do. The trade sector showed the least cost differential between large and small firms.

Even here, however, the cost per employee in small wholesale or retail firms exceeded those for medium and large firms by 11 percent and 18 percent, respectively.

Environmental regulation is a particular source of concern for the services sector. Environmental regs cost small service firms three to four times more per employee than in medium size and large firms. In all industry sectors, tax compliance costs fell disproportionately on small firms.

“Small business is the backbone of our economy,” says Hopkins.

“Such success is remarkable given the disproportionate burdens that government regulations place on them. Small firms annually spend close to \$7,000 per employee to comply with regulations enforced by over 60 federal agencies. That is over 50 percent more than the burden facing larger firms. Whether all this regulation is delivering the protections intended in reasonable ways deserves closer attention in light of the size of its cost,” he notes.

Crain observes that the impact of regulatory policies is harder to pinpoint than that of fiscal policies, though they are no less burdensome or costly. He advises that “Paying more attention to the real costs of regulations would assist in rationalizing the process of promulgating regulations. The impact of regulations on business and citizen activities is no less real than the impact of fiscal programs.”

Regulatory Review Acquires New Urgency

The Hopkins/Crain report was released at Advocacy’s 25th anniversary symposium on Oct. 23. Hopkins was a featured speaker, and he noted that attitudes toward regulation have shifted; hence distributing the burden equitably is more important than ever.

“In the wake of Sept. 11,” Hopkins said, “the world is looking to Washington as never before to tighten regulatory controls across many facets of everyday life. Given the added burden likely to ensue, it is all the more important to get regulatory priorities straight, to cut back on unnecessary regulations and revamp those that hit some harder than others. Because the government will have to throw on new costs, it is all the more important to make the regulatory burden less uneven.”

For More Information

A research summary and the full Hopkins/Crain report are available at www.sba.gov/advo/research/#regulation.

Technical questions may be addressed to Radwan Saade, regulatory economist, at (202) 205-6878, or by e-mail at radwan.saade@sba.gov.

Get the Latest in Small Business Research—Faster!

There's no reason to wait to find out about new small business research findings. Advocacy's newest Listserv will notify you of the availability of new research as soon as it is posted on our website.

To add yourself to the Listserv, all you need do is visit Advocacy's website (www.sba.gov/advo) and scroll down to "What's New" to sign up for "Small Business Research," or any one of our other e-mail Listservs. You'll receive notifications of new research from Advocacy, delivered right to your e-mail in-box, as soon as it is available.

Advocacy now has four Listservs to help you work smarter:

***NEW* Small Business Research.** Now you can be updated each time we release research reports on small business issues. For the latest in cutting-edge research, sign-up now!

• Newsletter. Receive the *Small Business Advocate* via e-mail. It's

everything you get in the printed version—faster!

• Press Releases. When Advocacy has news of interest about small business, you'll read it before it hits the papers.

• Regulatory Communications. Receive notices on regulatory communications from Advocacy to federal agencies, Advocacy testimony before Congress, and more.

Think Tanks, from page 6

bers as given. Short of that, OMB should point to analyses, such as those done at the AEI Brookings Joint Center, which provide a credible alternative to a regulatory impact analysis (RIA) provided by an agency."

AEI/Brookings also recommended that "Congress should pass a law requiring that all regulatory agencies comply with OMB guidelines when analyzing the impact of economically significant regulations.... Currently, OMB has no effective mechanism for enforcing its guidelines and it needs one."

While OMB has traditionally asked for comments to its draft

reports, the current draft is a departure from previous ones in that it explicitly asks for comments as to how to deal with agencies' estimates. OMB should be commended for that and encouraged to adopt new measures to ensure that the executive branch, the Congress, and the public are presented with more accurate estimates of the costs and benefits of federal regulations. Whether OMB decides to do all the analyses in-house or to issue specific guidelines for agencies to follow, either should be an improvement as long as the end result relies on accurate data and is based on sound methodology.

U.S. Small Business Administration
Office of Advocacy
Mail Code 3114
409 Third Street, S.W.
Washington, DC 20416

Official Use
Penalty for Private Use, \$300

Return Service Requested

<p>FIRST CLASS POSTAGE AND FEES PAID U.S. Small Business Administration Permit No.G-82</p>
--