

Congress of the United States  
U.S. House of Representatives  
Committee on Small Business  
2361 Rayburn House Office Building  
Washington, DC 20515-6515

**Memorandum**

To: Members, Subcommittee on Agriculture, Energy, and Trade  
From: Committee Staff  
Date: December 11, 2017  
Re: Hearing: “Bridging the Entrepreneurial Gap: Addressing Barriers to Small Business Formation and Growth”

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On Monday, December 11, 2017 at 9:30 A.M., the Subcommittee on Agriculture, Energy, and Trade of the Committee on Small Business will meet at the Village of Deerfield Hall in Deerfield, Illinois to examine regulations that inhibit entrepreneurs. The hearing will provide Subcommittee Members with an opportunity to examine recent trends in entrepreneurship and how removing regulatory barriers could improve entrepreneurship and the American economy.

**I. Recent Entrepreneurship Trends**

In 2015, 679,072 new businesses were established in the United States.<sup>1</sup> These businesses created 3 million jobs.<sup>2</sup> Because the average new business had roughly 4.5 employees, almost all new businesses fit the criteria to be considered a small business.<sup>3</sup>

Entrepreneurship and the formation of small businesses has declined by almost 50 percent since 1978.<sup>4</sup> The rate of decline accelerated during and immediately after the Great Recession, and in 2010, there were more business deaths than births.<sup>5</sup> The businesses created

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<sup>1</sup> U.S. DEP’T OF LABOR, BUREAU OF LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, NUMBER OF ESTABLISHMENTS LESS THAN 1 YEAR OLD, MARCH 1994–MARCH 2015 (2016) [hereinafter Startup Statistics], available at [https://www.bls.gov/bdm/entrepreneurship/bdm\\_chart1.htm](https://www.bls.gov/bdm/entrepreneurship/bdm_chart1.htm).

<sup>2</sup> UNITED STATES DEP’T OF LABOR, BUREAU OF LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, BUSINESS ESTABLISHMENT AGE (2016), available at <https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm>.

<sup>3</sup> *Id.* There are numerous ways the Federal government defines “small business.” For the purposes of this memorandum, we will use the Small Business Office of Advocacy definition of a small business as an independent business having fewer than 500 employees. SMALL BUSINESS ADMINISTRATION, OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2016) [hereinafter Advocacy FAQ], available at [https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016\\_WEB.pdf](https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf).

<sup>4</sup> In 1978, there were 12 new businesses created for each existing business, while in 2011 there were only 6.2 new firms created for each established business. IAN HATHAWAY, MARK E. SCHWEITZER, AND SCOTT SHANE, FEDERAL RESERVE BANK OF CLEVELAND, THE SHIFTING SOURCE OF NEW BUSINESS ESTABLISHMENTS AND NEW JOBS 2 (2014), available at <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2014-economic-commentaries/ec-201415-the-shifting-source-of-new-business-establishments-and-new-jobs.aspx>.

<sup>5</sup> According to the Federal Reserve, the Great Recession lasted from December 2007 until June 2009. [https://www.federalreservehistory.org/essays/great\\_recession\\_of\\_200709](https://www.federalreservehistory.org/essays/great_recession_of_200709). 1 UNITED STATES DEP’T OF LABOR, BUREAU OF

just after the Great Recession were also concentrated in a select few metropolitan areas. From 2010-2014, there were only 166,460 net new startups created, with half of them were located in 20 counties.<sup>6</sup> On the contrary, from 1992 to 1996, there were approximately 420,850 net new startups created; half of them were located across 125 counties in the United States. Additionally, the population in 1992 was only 83 percent of the United States population in 2010, meaning the business formation rate per capita has fallen considerably.<sup>7</sup>

Although the general entrepreneurship landscape may appear to be in decline, recent trends indicate that entrepreneurship and business formation are slowly improving. According to the 2016 Kauffman Index of Entrepreneurship Series, startup activity, local small business activity, and the growth of entrepreneurship have all recovered since the Great Recession.<sup>8</sup> Additionally, the survival rate of new businesses after their first five years in operation fully recovered by 2014.<sup>9</sup> While these are positive indicators toward greater entrepreneurship, these recent statistics still exist within the previously mentioned long-term decline in entrepreneurship.<sup>10</sup> Therefore, it is important to further understand how depressed entrepreneurship can affect broader issues in the United States economy.

## II. Entrepreneurship and Economic Indicators

Entrepreneurship has a pronounced positive effect on economic growth and other primary economic indicators. One of the first individuals to make the connection between entrepreneurship and economic growth was 18<sup>th</sup> century economist, Adam Smith, who said that entrepreneurship would lead to an increase in innovation, productivity, and economic growth.<sup>11</sup> Although Adam Smith's theory was published back in 1776, the correlation between entrepreneurship and economic growth can be seen in the United States today. In 1997, the number of businesses less than one year old per capita was ten percent higher than in 2015.<sup>12</sup> Although the GDP growth rate was an impressive 4.5 percent in 1997, the decline in business formation coincided with an anemic GDP growth rate of 2.6 percent in 2015.<sup>13</sup>

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LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, QUARTERLY ESTABLISHMENTS BIRTHS AND DEATHS, 1993-2015 (2016), available at [https://www.bls.gov/bdm/entrepreneurship/bdm\\_chart5.htm](https://www.bls.gov/bdm/entrepreneurship/bdm_chart5.htm).

<sup>6</sup> ECONOMIC INNOVATION GROUP, THE NEW MAP OF ECONOMIC GROWTH AND RECOVERY (2016) [hereinafter EIG Map], available at <http://eig.org/recoverymap#mapBusiness>.

<sup>7</sup> This number was calculated using the June 1992 population of 256 million and the June 2010 population of 309 million. <http://www.census.gov/data/datasets/2016/demo/popest/nation-total.html>, <http://www.census.gov/data/datasets/time-series/demo/popest/intercensal-1990-2000-national.html>.

<sup>8</sup> EWING MARION KAUFFMAN FOUNDATION, KAUFFMAN INDEX ENTREPRENEURSHIP SERIES (2017), available at <http://www.kauffman.org/kauffman-index/profiles?loc=US&name=united-states&breakdowns=startup-activity|overall,main-street|overall,growth|overall#indicator-panel-se-index>.

<sup>9</sup> *Id.*

<sup>10</sup> *State of the Small Business Economy: Hearing Before the H. Comm. on Small Business*, 115<sup>th</sup> Cong. (2017) (testimony of Victor Hwang), available at <https://www.govinfo.gov/content/pkg/CHRG-115hhrg24071/pdf/CHRG-115hhrg24071.pdf>.

<sup>11</sup> Randall G. Holcombe, *Entrepreneurship and Economic Growth*, MISES INSTITUTE, QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS (July 30, 2014), available at <https://mises.org/library/entrepreneurship-and-economic-growth>.

<sup>12</sup> This number was calculated by using the number of businesses established in 1997 (639,114) and in 2015 (679,072) divided by the population in the United States during that time (272,647,000 in 1997 and 322,060,000 in 2015). Startup Statistics, *supra* note 1. UNITED STATES CENSUS BUREAU, UNITED STATES POPULATION CLOCK, (2017), available at <https://www.census.gov/popclock/>.

<sup>13</sup> U.S. DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, NATIONAL ECONOMIC ACCOUNTS, (2017) available at <https://www.bea.gov/national/>.

The connection between entrepreneurship and innovation also holds true today. According to a report issued by the Small Business Administration Office of Advocacy, in 2002 small businesses invented and managed an average of 10.01 products, and large businesses invented and managed an average of 21.44 products.<sup>14</sup> Although larger businesses invented roughly twice as many products, the products-to-employee ratio was significantly higher for small businesses than their larger counterparts. In terms of the number of patents obtained per dollar spent on research and development (R&D), small young businesses obtained 2.41 times more patents than large young businesses for every dollar spent on R&D, and small-young businesses obtained 2.5 more patents than small-old businesses.<sup>15</sup> This means that larger and older businesses have to invest more in research and development to produce the same amount of innovation as smaller and younger businesses.

Entrepreneurship is also a primary contributor to job creation. Business startups account for about 20 percent of gross job creation, and high-growth businesses account for almost half of gross job creation in the United States.<sup>16</sup> Furthermore, with small businesses accounting for 63 percent of net new job creation, it is the younger and smaller businesses that propel not only economic growth and innovation, but also job growth in the United States.<sup>17</sup>

### **III. Regulatory Barriers to Entrepreneurship**

Clearly, there are inherent benefits associated with a healthy entrepreneurship sector. Consequently, when entrepreneurship declines, economic growth, innovation, and job creation suffer. However, there are several regulatory barriers limiting entrepreneurship.

Regulatory burdens disproportionately affect smaller and newer businesses. In a 2017 Gallup poll, government regulation was listed as the top concern for small businesses and entrepreneurs.<sup>18</sup> In a ranking of the friendliest regulatory environments to start a business in, the United States came in 51<sup>st</sup>, with countries like Greece and Chile receiving similar scores.<sup>19</sup> Burdensome regulations harm small businesses, entrepreneurship, and dampen the benefits associated with a thriving small business and entrepreneurship sector.

One set of regulations that has a profound effect on new business formation is occupational licensing. In the 1970s, only 10 percent of individuals who worked required licenses.<sup>20</sup> By 2008, that number increased to almost 30 percent.<sup>21</sup> This prohibits new entrants

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<sup>14</sup> JOSE PLEHN-DUJOWICH, PRODUCT INNOVATIONS BY YOUNG AND SMALL FIRMS 11, SBA, OFFICE OF ADVOCACY (2013), available at <https://www.sba.gov/sites/default/files/files/rs408tot.pdf>.

<sup>15</sup> *Id.*

<sup>16</sup> Ryan Decker, John Haltiwanger Ron Jarmin & Javier Miranda, *The Role of Entrepreneurship in US Job Creation and Economic Dynamism*, J. OF ECON. PERSPECTIVES 28:3 (2014), available at <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3>.

<sup>17</sup> Advocacy FAQ, *supra* note 3.

<sup>18</sup> GALLUP, *Optimism Among Small-Business Owners Soars* (March 13, 2017), available at [http://www.gallup.com/poll/205898/optimism-among-small-business-owners-soars.aspx?g\\_source=SMALL\\_BUSINESS\\_INDEX&g\\_medium=topic&g\\_campaign=tiles](http://www.gallup.com/poll/205898/optimism-among-small-business-owners-soars.aspx?g_source=SMALL_BUSINESS_INDEX&g_medium=topic&g_campaign=tiles).

<sup>19</sup> THE WORLD BANK, DOING BUSINESS, MEASURING BUSINESS REGULATIONS, ECONOMY RANKINGS (2017), available at <http://www.doingbusiness.org/rankings>.

<sup>20</sup> Morris Kleiner, *Why License a Florist*, N.Y. TIMES (May 28, 2014), available at [https://www.nytimes.com/2014/05/29/opinion/why-license-a-florist.html?\\_r=0](https://www.nytimes.com/2014/05/29/opinion/why-license-a-florist.html?_r=0).

<sup>21</sup> *Id.*

from establishing new businesses in certain industries, which can decrease innovation. Because many licenses are only valid in one state, occupational licensing may also be contributing to the record low mobility rates in the United States. While moving rates were around 20 percent from the 1940s until the 1990s, the moving rate in 2016 was a mere 11.2 percent.<sup>22</sup>

Federal permitting is another cumbersome regulatory process that stifles entrepreneurship. Small manufacturers can be subject to various permits regarding air emissions, storm water pollution prevention, waste generation and disposal, and hazardous materials transportation.<sup>23</sup> Similarly, a refinery may be required to obtain four permits for air, five permits for wetlands, and five permits for water.<sup>24</sup> The pipeline industry must navigate all of the following agencies, which have overlapping jurisdictions: the Environmental Protection Agency (EPA) and the Pipeline and Hazardous Materials Safety Administration (PHMSA), both regulating storage tanks and spill response; the Transportation Security Administration and the U.S. Coast Guard, both regulating security requirements; EPA and the Occupational Safety and Health Administration (OSHA), both regulating worker safety; PHMSA and OSHA, both regulating safety within plants and labeling; and EPA and the United States Army Corps of Engineers, both regulating water and wetlands.<sup>25</sup> With so much regulatory overlap, it is almost impossible for small businesses to be sure they have all the proper permits to begin a project.

#### **IV. Conclusion**

Entrepreneurship has a profound effect on innovation, job growth and economic growth. However, the United States has seen a long-term decline in entrepreneurship that accelerated during the Great Recession. The geographic concentration of business formation is increasing, meaning that large sections of the United States are experiencing significantly lower levels of entrepreneurship than both the national average and certain metropolitan areas. One of the largest impediments to entrepreneurship is burdensome regulations. By reducing regulatory burdens, unnecessary barriers could be removed to help promote entrepreneurship which leads to innovation, job growth, and increased economic growth.

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<sup>22</sup> UNITED STATES CENSUS BUREAU, AMERICANS MOVING AT HISTORICALLY LOW RATES (2016), available at <https://www.census.gov/newsroom/press-releases/2016/cb16-189.html>.

<sup>23</sup> Am. Coatings Ass'n, *Comment to Department of Commerce on Docket Number: 170302221-7221-01 – Impact of Federal Regulations on Domestic Manufacturing*, 2 (Mar. 31, 2017), available at <https://www.regulations.gov/document?D=DOC-2017-0001-0100>.

<sup>24</sup> Am. Petroleum Inst., *Comment to Department of Commerce on the Request for Information on the “Impact of Federal Regulations on Domestic Manufacturing;”* 82 *Fed. Reg.* 12,786; *March 7, 2017*, 3 (Apr. 1, 2017), available at <https://www.regulations.gov/document?D=DOC-2017-0001-0126>.

<sup>25</sup> Nat'l Ass'n of Mfrs., *Comment to Department of Commerce on Notion, Request for Information: Impact of Federal Regulations on Domestic Manufacturing (Docket No. 170302221-7221-01)*, 6 (Mar. 31, 2017), available at <https://www.regulations.gov/document?D=DOC-2017-0001-0146>.