

## Small Businesses Most Likely to Lead Economic Recovery

by Brian Headd, Economist

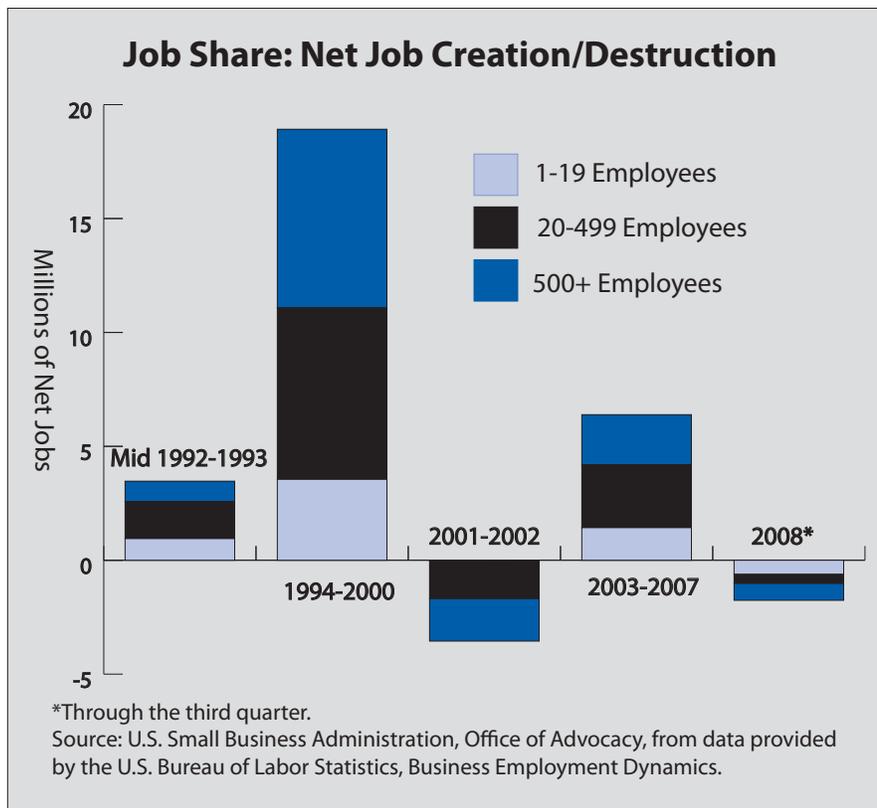
During the last year the media has begun to pay close attention to the role small business plays in job generation. That is because amid the mountain of previously disappointing economic statistics, small businesses provide some interesting contrasts. While recent job losses are widespread, small businesses' historical overall rate of net job creation makes them a key player in solving our labor market woes. And the number of newly self-employed, whether by choice or not, still offer glimmers of hope.

Unless your age is measured in single digits, you probably have direct knowledge that the labor market has had its ups and downs.

The U.S. Bureau of Labor Statistics (BLS) reports that nonfarm, private sector employment peaked in December 2007 at 115.8 million then fell to 109.5 million by May 2009. During this period, job losses from mass layoffs (more than 50 layoffs from one location) numbered 3.6 million, up 66 percent over the preceding 18 months. The loss of over 6 million net jobs is a problem that needs a solution.

Where will the new jobs come from? There may be clues in the recoveries from the two most recent economic downturns, in 1991 and 2001.

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## Recovery, from page 1

When considering small business employment, remember that there are two kinds of small businesses: those without employees (or non-employer businesses), and those with paid employees (or employer businesses). The Office of Advocacy estimates that in 2008 there were 23.1 million nonemployer and 6.1 million employer businesses.

When the economy struggles, the number of nonemployers tends to increase at higher rates, while the number of employer businesses stagnates or declines. For example, when the economy was humming along during the late 1990s, non-employers had annual increases in the 2 to 3 percent range; as the economy limped along from 2007 to 2008, they increased an estimated 8.1 percent or 1.7 million. The change in the number of employers is not nearly as sharp. Employers have tended to have annual increases of 0.75 percent to 1.5 percent when the economy has done well and negative to flat when the economy struggles. Employer firms contracted by -0.5 percent during the 1991 downturn and grew 0.1 percent in the 2001 period.

Nonemployer growth is not simply a response to economic factors; many personal factors cause people

to go into business for themselves too. For instance, self-employment rates increase with age, income, and generally with education. The number of employer business startups is affected by the economy, but again, probably less so than one might guess. BLS's Business Employment Dynamics data show that the business startup rate (percent of businesses that were new in the quarter) for the first three quarters of 2008 averaged 2.8 percent, versus 3.0 percent in 2007 and 3.2 percent in 2006. But new businesses are only part of the job creation story. Employment created by startups (minus the job losses from firm exits) accounted for 30 percent of the private-sector net employment increase from 1993 to 2007, while continuing businesses provided the remaining 70 percent.

The 1.7 million increase in non-employers is a lifesaver for many individuals and families. But since a large portion of nonemployers work less than full-time, when we talk about expanding the job market, we are most interested in employer firms. In the aftermath of the 1991 downturn, firms with 20-499 employees led the employment expansion, while the smaller and larger size classes struggled. During the 2001 downturn, larger firms (500 or more employees)

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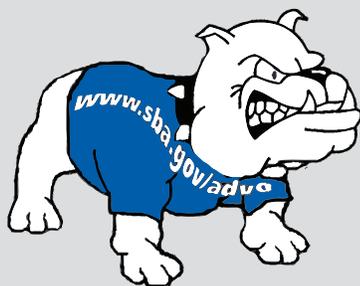
experienced the greatest net employment losses, followed by firms with 20-499 employees. The smallest firms, with fewer than 20 employees, weathered that storm.

The current downturn is shaping up more like 1991 than 2001. Data from the Bureau of Labor Statistics attributed 35 percent of the net job loss during the first three quarters of 2008 to firms with fewer than 20 employees, whereas in 2001 through 2002 they accounted for less than one percent of the net loss.

So a labor solution is more likely to be found by studying the 1991 downturn rather than the 2001 dip. Our best hope for job creation may shape up to be expansion of existing firms with 20-499 employees.

## Advocacy Blog Features Capitol Hill Updates

Do you need to know what's happening on Capitol Hill that may affect small business? The Office of Advocacy's blog, The Small Business Watchdog, now gives you this information all in one place.



This new feature will allow you to find the webcasts of important small business-related congressional hearings and committee markups, updated weekly.

To see the latest Capitol Hill Connection, visit The Small Business Watchdog at <http://weblog.sba.gov/blog-advo>.

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## Message from the Acting Chief Counsel

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### When We All Work Together, Good Things Happen

by Shawne McGibbon, Acting Chief Counsel for Advocacy

The Office of Advocacy's job is to deliver data-driven input on small businesses to Congress, federal agencies, and the White House. Our office's role is part of a multipronged approach to smart regulation—rules that implement the intentions of Congress while providing flexibility to prevent small businesses and their employees from suffering undue harm. This role is all the more critical in today's challenging economy.

As small businesses' representative within government, Advocacy helps small entities navigate complex, voluminous regulations. These regulations can stretch to dozens and dozens of detailed pages of precise legal prose in the *Federal Register*. These draft regulations are hard work for seasoned lawyers to unravel, let alone business owners from all walks of life.

Through our research, Advocacy provides policymakers with an accurate picture of small businesses' contributions and challenges in communities across the country. Our research probes the effects on small business of major trends in health insurance, international trade, education and training, and veterans' issues. Advocacy economists also commission data directly from the U.S. Bureau of the Census in order to fill gaps in the available economic data on small business.

Our research also shows that small businesses are leaders in tackling some of our toughest problems. Innovative small businesses are at the forefront of developing green technologies, providing telecommunications services, and advancing medical research and service delivery. How do we know this? In addition to the colorful success stories of daring entre-

preneurial startups like Google and Starbucks (which were both once very, very small), Advocacy research confirms that small firms are a significant source of innovation. And, small firms often tend to specialize in high tech, high growth

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**“Advocacy works hand-in-hand with Congress and the federal agencies to ensure economic growth and prosperity for communities across the country.”**

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industries, such as biotechnology, pharmaceuticals, information technology, and semiconductors.

Why is this important for policymakers? Because the laws they write and the regulations that implement these laws can affect the extent to which a small business thrives and contributes to the economy. As House Small Business Committee Chairwoman Nydia Velázquez recently wrote, “In a scramble to meet deadlines, agencies rushing to make new regulations brush small businesses' voices aside too often. As agencies craft new rules, it is important that there be a formal step in the process that requires close consideration of how small firms will be affected.”

In cooperation with the Office of Information and Regulatory Affairs (OIRA), Advocacy fulfills a critical part of this formal review. As Chairwoman Velázquez stated, “SBA's Office of Advocacy and OIRA work hand in hand to make sure federal agencies comply with the law and minimize the burden to small firms.” This edition of the newsletter provides two current

examples of Advocacy's involvement in rulemaking: in the workplace safety rules concerning the use diacetyl in food processing and in the protection of the red-legged frog's critical habitat in California.

Advocacy also provides small business input on legislation. This occurred in April in response to the Consumer Product Safety Improvement Act. Advocacy listened to small businesses' concerns regarding the Act and conveyed these concerns in a comment letter. This public comment asked for flexibility in allowing small toymakers to implement the new law, and it also requested that the Consumer Product Safety Commission supply a guide to business on how to comply with the new law.

Advocacy's small business information-gathering efforts stretch beyond the Beltway. Our office makes a strong effort to reach out to small business owners and their representatives through the office's regional advocates located in each of the 10 federal regions. In addition, Advocacy's assistant chief counsels host roundtables to gather insight into the day-to-day problems foreseen by industries facing potentially harmful regulatory action. Federal policymakers and congressional staff often attend these gatherings to get a closer read of a proposal's anticipated impact.

Through this participatory approach—bringing information to policymakers and suggesting alternatives that minimize negative impacts on small businesses while still meeting legislative and regulatory goals—Advocacy works hand-in-hand with Congress and the federal agencies to ensure economic growth and prosperity for communities across the country.

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## Regulatory News

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### Small Business Review Panel on Diacetyl Calls on Small Business

by Bruce Lundegren, Assistant Chief Counsel

The small business review panel assessing a plan by the Occupational Safety and Health Administration (OSHA) to regulate employee exposure to diacetyl conducted two conference calls for small business representatives on May 19 and 20. During these conference calls, small business representatives provided input into OSHA's draft proposed rule. The Office of Advocacy coordinated the participation of many of the small business representatives.

Diacetyl is a naturally occurring chemical that gives butter its familiar taste. For that reason, diacetyl is commonly synthesized and added to a host of flavorings and other products to give them a buttery flavor or aroma. Diacetyl was in the news a few years ago when several workers in the microwave popcorn industry developed a respiratory ailment called *bronchiolitis obliterans*. According to OSHA, *bronchiolitis obliterans* is an inflammation and scarring of the lung that can result in a permanent loss of lung function. OSHA believes that airborne exposure to diacetyl or some similar compound may be the cause

of this disease, although it is still studying the issue. Diacetyl is also a by-product of the fermentation process, so it is found naturally in small quantities in beer, wine, and dairy products. However, there do not appear to be any instances of anyone in any of these industries ever becoming ill from exposure to diacetyl at these low levels.

OSHA was required to convene the review panel by the Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996. SBREFA requires OSHA to convene a review panel for any rule that is expected to "have a significant economic impact on a substantial number of small businesses" before the agency can proceed to a proposed rule. The panel itself consists of officials from OSHA, the Office of Advocacy, and the Office of Information and Regulatory Affairs within the Office of Management and Budget. The panel is assisted in its work by small business representatives from potentially regulated industries. In this case, representatives from a variety of industries that use or have potential exposures to diacetyl reviewed

the draft proposed rule and offered their recommendations to the panel.

The current version of OSHA's draft proposed rule would apply only to facilities that manufacture flavorings or food products that contain diacetyl, and not to the end users of such products (whose exposures are typically low) or for naturally occurring diacetyl. However, the draft proposal also considers whether OSHA should expand the rule to cover any exposures to diacetyl from any source. It was clear from the conference calls that many small businesses have already implemented safety controls for diacetyl exposure, switched to substitute products, or believe they have very low exposures.

The panel is required by SBREFA to issue its final report to the head of OSHA within a strict 60-day time frame, so the final report of the diacetyl panel is expected no later than July 2. Please contact Assistant Chief Counsel Bruce Lundegren at (202) 205-6144 or [bruce.lundegren@sba.gov](mailto:bruce.lundegren@sba.gov) if you have any questions or require additional information.

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### Proposed Critical Habitat for the California Red-Legged Frog Poses Significant Costs for Small Farms

by Jamie Belcore Saloom, Assistant Chief Counsel

On May 26, the Office of Advocacy filed comments with the U.S. Fish and Wildlife Service (FWS) regarding the impacts of proposed critical habitat for the California red-legged frog on small farms in the state of California.

On September 16, 2008, FWS published a proposed revised designation of approximately 1.8 mil-

lion acres of critical habitat and announced its intention to publish its economic analysis and initial regulatory flexibility analysis (IRFA) for the proposed rule at a later date. On April 28, 2009, FWS published its draft economic analysis and IRFA of the proposal. The analysis identifies 499 small farms that will be significantly affected

by the proposed critical habitat designation. It also concludes that 16,725 acres of farmland owned by small farming operations would be taken out of production under the proposed critical habitat designation. FWS estimates that taking that farmland out of production would cost each of the 499 affected

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## Legislative News

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### Consumer Product Safety Improvement Act Update

by Anna Rittgers, Mercatus Fellow

Congress passed the 2008 Consumer Product Safety Improvement Act (CPSIA) in response to several high-profile safety recalls of children's products. This law is one of the most important revisions to consumer product safety legislation since the 1971 creation of the Consumer Product Safety Commission (CPSC). It contains many enhanced product safety measures and standards, including lead testing requirements and phthalate bans, and imposes strict compliance deadlines and penalties for noncompliance on manufacturers, importers, and sellers of children's products.

Since the passage of CPSIA, the Office of Advocacy has heard from numerous affected small businesses complaining that the law and resulting regulations were confusing

and overly burdensome. In April 2009, Advocacy issued comments in response to a CPSC notice of inquiry regarding Section 103 of the CPSIA. This provision of the law requires that manufacturers and importers of children's products place permanent, distinguishing labels on their products and packaging by August 14, 2009; these would enable both manufacturers and consumers to ascertain the specific source of a children's product in instances of a consumer safety recall. Small businesses expressed concerns regarding the costs of complying with Section 103's tracking label requirements. Advocacy asked the CPSC to entertain reasonable alternatives and study the impacts of the regulation pursuant to the Regulatory Flexibility Act in the hope of minimizing the

impact of the regulation on small entities. Advocacy also asked the CPSC to allow small entities some flexibility in determining what is practical regarding the location, nomenclature, appearance, and arrangement of information on labels. As part of its comments, Advocacy asked the CPSC to issue compliance guides to assist small businesses in their compliance efforts.

On May 19, the CPSC denied an industry request for a stay of the labeling requirements. As such, the Section 103 labeling requirements will go into effect on August 14, as required by the CPSIA statute.

Advocacy's comments and a fact sheet may be found on our website at [www.sba.gov/advo/laws/comments](http://www.sba.gov/advo/laws/comments).

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small farms between \$313,000 and \$338,000, with the total impact on small farms estimated at between \$156 million and \$169 million.

The Endangered Species Act gives FWS considerable discretion to consider economic impacts when making a final designation of critical habitat for an endangered species. Under Section 4(b)(2) of the Act, the secretary of the interior may exclude any area of proposed critical habitat from a final critical habitat designation if he determines that the benefits of such an exclusion would outweigh the benefits of inclusion. FWS has used its discretion to exclude areas from critical habitat in many instances, particularly in light of significant impacts to small entities affected by critical habitat.

To reduce the burden on small businesses, Advocacy recommended that FWS consider exercising its discretion to exclude the 16,725 acres of small business-owned farmland that would be taken out of production as a result of this critical habitat designation. Because the size of this exclusion would be very small compared to the 1.8 million acres proposed for designation as critical habitat, it appears unlikely that excluding these areas would result in the extinction of the species. Excluding these lands would provide the opportunity for the 499 small farms affected by the proposed designation to continue their operations, while allowing for sufficient critical habitat to promote the recovery of the red-legged frog.

Advocacy's comments and a fact sheet on the topic may be accessed at [www.sba.gov/advo/laws/comments](http://www.sba.gov/advo/laws/comments). For additional information, contact Assistant Chief Counsel Jamie Belcore Saloom at (202) 205-6890 or [jamie.belcore@sba.gov](mailto:jamie.belcore@sba.gov).

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## Research Notes

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### An Interview with Charles Ou, Senior Economist and Small Business Finance Expert, on his Retirement from 32 Years of Federal Service

By Kathryn Tobias, Senior Editor

**Q: You came to this country as a young man. What were your first impressions?**

A: I came in 1962. It was impressive—such a big country! When I flew from California to Chapel Hill, North Carolina, all I saw on the way were vast farmlands. In the taxi from the airport to the UNC-Chapel Hill campus, we drove across hills with trees everywhere; it was so very pretty. I came from Taiwan, a tiny island, one-quarter the size of the state of Virginia. You don't have many tall trees on the island—mostly subtropical bushes, not big oak trees.

**Q: Who or what influenced your career choice?**

A: It happened by accident. My father wanted me to study commerce to help him run his grocery store after high school; he had a successful grocery store in our town. So, I passed the entry exam to the best commercial high school in Taipei. (A six-year vocational course, rather than general education.) However, during senior high school, I also studied on my own for college entrance exams. I passed the exam and got accepted to the Taiwan National University. So I went to college instead of taking a job offer from the Bank of Taiwan. It must have been a disappointment for my father!

After finishing college, I had one job offer from a big bank and another offer as an assistant instructor at my alma mater. I decided to take the academic position, and also decided that I needed go abroad for graduate study. I had put great effort into studying English, especially in conversational English. I spent 300 yen of my monthly



take-home pay of 540 Taiwanese yen (about \$15 or \$20 at the time) to pay for private lessons with an English tutor!

**Q: Was it difficult to immigrate at that time?**

A: Yes and no. It was easy as long as you could pass the government exams to study abroad and the American Embassy's English exam. Financially, it was very hard, even for my father with his grocery store. I had to have \$2,000 in American dollars to cover the first year expenses! I was the third of nine children and the first to come to America. My parents did not have any formal education—my father started working as a breakfast vendor at the age of 10 to help support the family. He wanted us to have the best education; he ended up sending six of us to the United States: four Ph.Ds and two MAs.

At UNC in Chapel Hill, I met and married Charlotte, a Taiwanese student in library science. After Charlotte received her master's of library science and I completed my studies, we had our first daughter in Chapel Hill in 1967. I got a teach-

ing job at Wake Forest. A year later, I went to teach at the University of Dayton (1969-1973), then to Queens College in Charlotte, North Carolina (1973-1977), before joining the SBA's Office of Research and Statistics in 1977.

**Q: That was before there was an Office of Advocacy, right?**

A: Yes, that came in 1978. Advocacy absorbed the office and grew.

**Q: Do you have any particular memories of those early years?**

A: Congress gave us so much money! We tried to use money to break new ground in data and research grants. But we had limited success because of limited data.

**Q: What about your field of small business finance?**

A: At that time, all we had was the Federal Reserve Board's 1956 study on small business financing. We tried to provide a current study on the issues with a project in collaboration with the Federal Reserve. The result was a small lender survey and a compendium of papers on small business financing topics.

**Q: Did you contribute to the first report on The State of Small Business in 1982?**

A: Yes. It was not easy because there was not much data. I squeezed as much as I could from the IRS Statistics of Income corporate tax return data on the assets and liabilities of small corporations.

**Q: So you didn't have to start in the Office of Advocacy with a completely blank slate.**

A: Not quite. But collecting small business financial information is

and will continue to be a challenge. We are losing one of the most important databases for small business financial research—the Federal Reserve Board’s Survey of Small Business Finances (SSBF).

***Q: You’re the only current Advocacy staff member who has experienced all of Advocacy history and all of the chief counsels. Any reflections?***

A: We had four chief counsels who served long enough to influence the character of this office—Milt Stewart, as the entrepreneur of the venture; Frank Swain, who created a strong research capacity; Jere Glover, extending our research output to policymakers; and Tom Sullivan, who emphasized small business regulatory flexibility at all federal agencies and the states.

Advocacy has a very devoted staff. They helped me a great deal—especially the Office of Information. Without their assistance and hard work my research output would have been much less.

One thing I hope is that the Office of Economic Research receives more support in terms of funding and staff. Our knowledge of small business economic issues is still pretty rudimentary; there are still so many data gaps: small business innovation, small investment and productivity, financing types, and so forth.

***Q: What’s new on the data scene?***

A: The biggest promise in the database scene is the Kauffman Foundation’s recent projects. They are supporting database projects on business dynamics, entrepreneurship, innovation, and other areas. In the financial area, we now have a very exciting database on business startup and startup financing, the Kauffman Firm Survey.

***Q: And the survey asks financial questions?***

A: Oh yes. The database will be a gold mine for researchers in small business financing.

***Q: What do you see as the most significant research or initiative you were a part of in your time with Advocacy?***

A: My small part in helping the Federal Reserve Board start the National Survey of Small Business Finances in 1987, and our continuing role until the 2003 SSBF.

***Q: Why was that important?***

A: This is the only national survey creating a database that provides a *comprehensive* profile of alternative sources and the uses of financing by small firms in the United States. It has provided the basis for hundreds of research works on small



business finance beginning with the 1987 survey. It is sad that this survey will not be continued.

***Q: What piece of data would add the most useful information about small business financing?***

A: For now, I would say better small business loan data from financial institutions, specifically quarterly or bi-annual data on the number and volume of loans and

loans outstanding for three major types of small business loans: business credit cards, credit lines, and commercial mortgages by these lenders to small businesses in the United States. Recent events since the credit freeze of last winter have shown us how much information we lack about what has been going in small business loan markets.

***Q: Any thoughts about the outlook for small business financing?***

A: The market is getting better, but credit is still very tight because of the uncertainty about the economy. Since business failures are continuing and banks are still reluctant to lend, loans will continue to be down over previous years for a while.

***Q: What was the most memorable day you spent in Advocacy?***

A: The invitation to the White House for the release of *The State of Small Business*.

***Q: What are you looking forward to doing in retirement?***

A: For the immediate future, I will spend more time practicing using my voice. My wife and I are in a Taiwanese choral group that will be performing at Lincoln Center along with other Taiwanese-American choral groups on July 11. I’ll have more time to do other things, like spending time with my three children and four grandchildren (in Chicago, Seattle, and Claremont, California). I hope to keep reading about small business financing issues—to develop a routine of mental exercise—and to have the discipline to write.

***Q: What would you like to leave as a legacy here?***

A: I don’t know that I leave a legacy—in my position, you don’t leave a footprint. I will say I really enjoyed this place, the bosses and people I worked with, and the work I did. That’s why I stayed!



## Advocacy Officials Get a High Tech Education

One of the most technically complex issue-areas in the Office of Advocacy's workload is telecommunications. Advocacy is in constant communication with different telecom industry representatives and the Federal Communications Commission to analyze how specific regulations affect their business models.

To expand Advocacy's "cable education" a bit further, Acting Chief Counsel for Advocacy Shawne McGibbon and members of Advocacy's legal team paid a site visit to MetroCast cable system in St. Mary's County, Maryland, in May. In addition to witnessing a small cable company in action, the group discussed the operations of independent cable operators and their leading role in deploying and operating advanced voice, video, and broadband networks throughout rural America.

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