The Small Business Administration and Policies for Entrepreneurship

Statement of

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before the

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Chairman Cardin, Ranking Member Paul, and members of the committee, thank you for inviting me to testify at today's hearing, "Review of SBA Entrepreneurial Development Programs and Initiatives."

The hearing comes in the midst of mixed economic news. Businesses and consumers are facing supply chain bottlenecks and high inflation, but the nation is enjoying solid economic growth. Another bright spot is entrepreneurship. Since the summer of 2020, the number of U.S. business startups has soared.

There is bipartisan support for many of the activities of the Small Business Administration. However, Congress should be looking for places to trim the budget given today's large deficits. Policymakers should consider handing over the SBA's entrepreneurial development programs to the states or the private sector. State governments are in better financial shape than the federal government, and many SBA activities appear to duplicate activities provided in markets and the nonprofit sector.

The SBA entrepreneurial development activities aim to generate broad-based opportunities and prosperity. This is a laudable goal, but a better approach would be for governments to repeal regulatory barriers to startups, some of which are identified in this testimony.

Good News About Entrepreneurship

Business startups plunged in early 2020, but then reversed course and have since risen to levels not seen in more than a decade. Census Bureau estimates show that the number of startups jumped 21 percent between December 2019 and December 2021.[1] The jump was 29 percent in the South, 20 percent in the Midwest, 16 percent in the Northeast, and 15 percent in the West.

There are probably numerous factors behind the increases. People laid-off during downturns may turn to entrepreneurship to earn income, and when downturns cause some businesses to close, it creates space for new businesses to fill the voids. Another factor is that fast-changing conditions create opportunities for startups to meet new demands. The pandemic created new needs in many industries. Economist John Haltiwanger notes that the startup spike has been strong in nonstore retail, personal and business services, trucking, and food services.[2]

How can we keep the startup boom going? Policymakers should avoid increases in taxes and regulations that may cause entrepreneurs to shelve their startup plans. And policymakers and the central bank should support price stability to enable entrepreneurs to better plan their operations and investments.

The SBA's Role in Entrepreneurship

Entrepreneurship is crucial to the American economy. Startups create most net new jobs and they revitalize cities by creating jobs for people displaced by older, shrinking businesses. Some startups grow to become large corporations that propel the overall U.S. economy. Also, startup activity fuels income growth because "newly established businesses are typically more productive than the firms that preceded them," noted the Congressional Budget Office.[3]

Startups are crucial for generating innovation and competition. Economist Clayton Christensen and others have observed that major innovations are usually pioneered by new companies, not established ones.[4] The personal computer industry, for example, was pioneered in the 1970s by startups such as Apple, not established firms such as IBM.

At first blush, it may seem useful for the government to fund activities that support startups. However, in an era of large budget deficits, Congress should be looking to restrain spending, and policymakers should explore whether SBA's functions could be handled by the states and private sector, including its entrepreneurial development programs.

The SBA's entrepreneurial development programs include Small Business Development Centers, SCORE, Women's Business Centers, entrepreneurial education, and other activities. Total spending on entrepreneurship programs was $461 million in 2020 and $369 million in 2021.[5] The SBA generally administers these programs through grants and cooperative agreements.[6] The largest spending activity is the SBDCs.

There are hundreds of SBDC locations across the nation, which are hosted by colleges and state development agencies. Let's consider Florida's SBDC network.[7] It had a budget of $20 million in 2020, funded 43 percent by the SBA and 57 percent by state-local agencies and local businesses.[8] The Florida SBDC network claims that every $1 it spends generates $60 in higher state taxes, and that its activities generate $3.9 billion in annual output.[9] Those figures are hard to believe, but if true, then the Florida government would have a huge incentive to fund these activities by itself.

SBDCs are located in colleges and state agencies and are aimed at benefiting state economies—so why don't we let the states fund them? The federal government is running huge deficits, but most state governments are running surpluses. State and local tax revenues are 14 percent higher today than before the pandemic began in early 2020.[10]

Federal audits have found substantial weaknesses in SBA's entrepreneurial development programs. A 2021 audit found that the "SBA did not provide effective oversight over the WBC program."[11] WBCs suffer from accounting deficiencies and improper payments that the SBA is not adequately policing. Other audits of entrepreneurial development programs have found "systemic issues with SBA's financial and performance oversight."[12] There are also concerns about duplication between the SBA's various entrepreneur programs.[13] These programs would likely enjoy better management and oversight if transferred to the states. State-funded programs tend to be less bureaucratic than federal ones and can be better tailored to meet local needs.

However, I am skeptical that governments need to fund entrepreneurial development at all. Angel investors, foundations, universities, free online media, and other private institutions provide education, training, and mentoring for entrepreneurs. The following paragraphs discuss some of these private-sector activities.

America has 335,000 "angel investors" who are wealthy people that invest equity in startups.[14] Angels are in every town and city in the nation and usually invest in startups close to home so that they can advise entrepreneurs.[15] Angels often have a strong desire to mentor young entrepreneurs, and they usually wait 5 to 10 years to see any return on their investments. Angels provide entrepreneurs not just with funding, but also with guidance and networking. One way for governments to generate more entrepreneurship is to pursue policies favorable to angel investment.

Private foundations are another source of guidance and education for new entrepreneurs. The Kauffman Foundation spends about $100 million a year on programs for entrepreneur-focused economic development.[16] The foundation aims at generating equitable and inclusive prosperity through entrepreneurship.

PNC Foundation recently announced a $16.8 million grant to create the National Center for Entrepreneurship at Howard University.[17] The center will support expanded opportunities for black entrepreneurship with education and access to capital in low-income communities nationwide.

The Blackstone Charitable Foundation runs numerous entrepreneur initiatives including Launchpad, which they say has participation of more than 10,000 students a year.[18] The program provides education, connections, and expertise for students interested in entrepreneurship, with numerous initiatives for underserved communities.

In Chicago, the Coleman Foundation has been investing millions of dollars in entrepreneurial education and training for years, with a focus on low-income neighborhoods.[19] Meanwhile, in Ohio, the Young Entrepreneurs Institute provides education and experience in entrepreneurship for thousands of students. It was founded by a serial entrepreneur and funded by corporations and private foundations.[20]

The National Foundation for Teaching Entrepreneurship says that it reaches 100,000 students a year with educational programs and interactions with business mentors.[21] One of the organization's slogans is, "Inclusive entrepreneurship education. Equitable access to economic opportunity."

Another development is the growing focus on entrepreneurship in America's colleges and universities. By one estimate, "formal programs (majors, minors and certificates) in entrepreneurship have more than quadrupled, from 104 in 1975 to more than 500 in 2006."[22]

In addition, there has been a proliferation of free courses on all aspects of entrepreneurship online, on YouTube and elsewhere. Many major universities appear to allow individuals to audit courses in entrepreneurship for free.[23]

All these private initiatives and free resources are fantastic, and there appears to be many others like them. The growing private efforts and resources for entrepreneurial development casts doubt on the need for federal involvement.

Regulations Impede Entrepreneurship

There is broad agreement that entrepreneurship is a great path to inclusive growth in the economy. But rather than spending programs, policymakers should boost entrepreneurship by reducing excessive federal, state, and local regulations on startups.

Surveys by the National Federation of Independent Business have long found that regulations are one of the "most important problems" faced by small businesses, although that concern is eclipsed today by inflation.[24] Similarly, a recent CNBC poll found that "60% of small business owners now expect government regulations to have a negative effect on their business in the next 12 months," although inflation is an even larger concern.[25]

The volume of federal regulations has increased over the decades. Regulations now span 186,000 pages, up from just 71,000 in 1975.[26] The federal government has about 260 agencies that impose regulations, with the burdens often landing on businesses.[27]

Regulatory burdens tend to fall more heavily on smaller firms than larger firms. In larger firms, the fixed costs of regulatory compliance can be spread over more revenues. Also, economist Steve Davis notes, "compared to smaller, newer and would-be competitors, larger and incumbent firms have greater capacity and incentive to lobby for legislative exemptions, administrative waivers, and favorable regulatory treatment."[28]

Congress has long recognized these problems, and the Regulatory Flexibility Act of 1980 and subsequent statutes and executive orders require federal agencies to assess the effects of proposed rules on small businesses. Entrepreneurs are in a struggle to survive since about half of all new businesses fail by the fifth year. So excessive regulations that divert their focus from the marketplace can have a high cost.

Today's hearing concerns federal policies, but federal policymakers should be aware that efforts to boost entrepreneurship can be undermined by state and local regulations, which I examined in a recent study.[29] The following are examples of how the states can create barriers to entrepreneurship, often for entrepreneurs from disadvantaged backgrounds.

Occupational Licensing

State governments define the education, training, and testing for entry into many occupations—not just for doctors, but in some states for travel agents, florists, makeup artists, tour guides, animal trainers, hair braiders, manicurists, bartenders, auctioneers, massage therapists, and others. Many licensed occupations are populated by small businesses, so licensing restrictions are restrictions on entrepreneurship.

The share of U.S. jobs requiring an occupational license increased from 5 percent in the 1950s to 22 percent in 2020.[30] The rationale for licensing is that it protects health and safety, but a report by the Obama administration found that "most research does not find that licensing improves quality or public health and safety."[31]

Many states have overly restrictive rules and substantial costs for gaining required qualifications for some occupations. Athletic trainers are not licensed in California, but in Nevada they must have a college degree, pass an exam, and pay $666 for a license and $150 for annual renewals.[32]

Excessive occupational licensing is a bipartisan concern. The Obama administration report concluded, "There is evidence licensing requirements raise the price of goods and services, restrict employment opportunities, and make it more difficult for workers to take their skills across state lines."[33] The Biden administration has taken steps to tackle excessive licensing.

Excessive occupational licensing can impose unfair costs on disadvantaged communities.[34] In one study, economist Stephen Slivinski found that those states that require licenses for a larger number of low-income occupations have lower rates of low-income entrepreneurship.[35]

Alcohol Licensing

The pandemic and related closures hit the restaurant industry hard with tens of thousands of eateries closing permanently. America will need entrepreneurs to launch new restaurants to fill the void, but restaurant entrepreneurs face many regulatory barriers.

One problem is alcohol licensing. I found 18 states that cap the number of licenses in cities and counties.[36] The caps can make restaurant launches very costly or block them entirely, particularly when businesses want to serve liquor in addition to beer and wine.

In the states with license caps, entrepreneurs can often only buy a liquor license when other restaurants close, and licenses can cost hundreds of thousands of dollars. These high costs favor corporate restaurant chains with deep pockets over independent and lower-income entrepreneurs. States and cities with tight alcohol license caps can strangle economic development in poorer neighborhoods because restaurant entrepreneurs in those neighborhoods cannot afford the high license costs.

Pre-pandemic, it cost about $400,000 for a liquor license in Boston and $150,000 for a beer-and-wine license. As a result, the *Boston Globe* reported that some poorer "neighborhoods have largely missed out on Boston's restaurant boom, as developers and restaurateurs in wealthier parts of the city pay top dollar to secure the available licenses."[37] One study found that the wealthiest one-quarter of census tracts in Boston hold more than half of the available licenses.[38]

Many news stories in the 18 states with these license caps highlight the unfairness. Repealing them would benefit entrepreneurs and economic growth particularly in lower-income neighborhoods.

Marijuana

There is a similar problem with regard to marijuana business licensing. While 18 states have legalized recreational pot, only some cities within states such as California allow it and they often cap the number of licenses tightly. This has undermined the efforts of entrepreneurs, including those wanting to move from the black market to the legal market. Unlike small businesses, large businesses can afford to wait months or years to get licenses, and they have greater political pull. In numerous cities, corruption scandals have stemmed from political leaders handing out marijuana licenses to favored insider companies.

A November article in *The Guardian* discussed how California's rigid marijuana license cap system is undermining opportunity for entrepreneurs:

> Half a million dollars and nearly four years into his Los Angeles-based cannabis venture, Donnie Anderson had no shop, no prospects and a mountain of debt. With financial help from family and friends, Anderson rented a $6,000-a-month space in January 2018 for his new cannabis retail shop. He kept paying the rent as the city's permitting process dragged on. He bought cabinets and other equipment as he waited. And waited. Sick of waiting, he's selling all that equipment and giving up his lease. Inaction by the city is forcing him to give up his dream, he says. "It's killing business owners," Anderson says. "All the air has been let out of me."[39]

California's strict marijuana rules are dashing the hopes of young black entrepreneurs such as Mr. Anderson. It is one thing to legalize the marijuana industry, but state and local governments should do a better job ensuring that the new opportunities are open to everybody.

Home-Based Businesses

A huge range of entrepreneurs run businesses out of their homes, including daycare providers, repair persons, music teachers, tutors, small-scale food producers, yoga teachers, contractors, caterers, and many others. Millions of American businesses are home-based, and in recent decades the internet has expanded the opportunities. Most artistic businesses in America are home-based, for example, with many artists selling their products online.

However, there is a big problem: many local governments impose zoning rules that ban, restrict, or raise costs for home-based businesses in residential neighborhoods. This is a particular problem for lower-income entrepreneurs because home businesses allow them to save costs from having to rent separate space and paying for childcare and commuting.

The cottage food industry illustrates the issue. Cottage food generally means home production and packaging of foods other than refrigerated items. When food production for sale is banned from homes, entrepreneurs need to rent expensive commercial kitchen space, thus undermining the financial viability of many startups.

Also, wealthier people can afford daycare and retirement home options for children or aging parents when they work. But for people with lower incomes, home-based businesses allow them to earn a living while caring for children or parents at home.

Reforming local zoning regulations to allow greater scope for home-based businesses would help to expand entrepreneurship. Home-based businesses are an inclusive way for cities to grow, and can provide opportunities open to everyone.

Entrepreneurship, Deregulation, and Craft Beer

Deregulation is sometimes thought of as a reform only conservatives and libertarians favor. But in the 1970s, federal deregulation of numerous industries had bipartisan support. It was designed to boost competition and tackle inflation. Industry deregulation can expand entrepreneurial opportunities to the broadest group of people.

One deregulation success story is the brewing industry. President Jimmy Carter signed legislation legalizing home brewing in 1978.[40] That was followed in state after state by partial deregulation of distribution rules to allow new breweries to sell their products in brewpubs and to allow limited self-distribution to retailers.[41]

These reforms led to an explosion of beer entrepreneurship.[42] The number of breweries in the United States has grown from less than 100 in 1980 to more than 8,300 today.[43] As craft beer production has grown, a diverse array of equipment makers has sprung up alongside to supply the industry.

Deregulating home brewing helped to launch the boom. A Smithsonian Institution article noted that "homebrewing is how over 95 percent of craft brewers learn their trade."[44] Craft brewing is a $22 billion industry today and thrives with entrepreneurship.[45] Distribution laws in some states still favor big brewers over small ones, but much progress has been made.

Conclusions

Congress should transfer SBA's entrepreneurial development activities to state governments. The activities are already located in colleges and state agencies and partly funded by the states. The states are generally running surpluses while the federal government has huge deficits. States could decide how to tailor the programs to meet local needs, or they could decide to leave entrepreneurial development to private-sector institutions.

Entrepreneurship can help lift all groups in society. But rather than federal programs, a better way to pursue the goal would be for governments to remove regulatory barriers to startups.

Thank you for holding this important hearing.

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