State Board of Equalization
Economic Perspective
Summary of Recent Economic Developments February 2007

❖ How Big is "Small" Business?

There is nothing small about small business. Small businesses are very important to the economy in terms of innovation of goods and services, job growth, and economic growth.[1] They are also important to state and local sales and use tax revenues, since small businesses can be both buyers and sellers of taxable goods.

SBA Releases Small Business Report

Small businesses are often hidden from view, both in reality and statistically. While finding data on small businesses can be challenging, the U.S. Small Business Administration (SBA) publishes a wealth of statistics. In December the SBA published *The Small Business Economy: a Report to the President.*[2] In this article we'll review some highlights from this report, particularly the "Small Business Data" appendix. While many of the statistics in the report are national, as with most economic indicators, it is very likely that California closely follows national patterns.[3]

Small Businesses Defined

First of all, what is a small business? There is no commonly accepted definition, even within the SBA. Descriptions vary, and are commonly based on whether the firm has employees or not, number of employees if it does, or size of receipts, size of assets, or type of business entity (corporate or noncorporate). The SBA is the source of most definitions, and classification by number of employees is commonly used as a measure. For research purposes, the SBA defines small businesses as firms that are independently owned and operated with fewer than 500 employees. "Very small" businesses generally refer to firms with fewer than 20 employees, and "microenterprises" are businesses with fewer than five.

Very Small Businesses Contribute Greatly to GDP and Job Growth

The transmittal letter to the SBA report notes " . . . of the nearly 26 million firms in the United States, nearly all are very small—97.5 percent of them have fewer than 20 employees. Yet cumulatively, these firms account for over half of our nonfarm real gross domestic product, and they have generated 60 to 80 percent of the net new jobs over the past decade."

Nonemployer Firms Outnumber Employer Firms Three to One

The first appendix table in the SBA report has data on numbers of all sizes of firms. There were an estimated 6 million U.S. employer firms and 19.9 million nonemployer firms. A total of 671,800 new employer firms came into existence in 2005, while 544,800 employer firms terminated operations.

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[1] Small business information cited in this issue is found in "Small Business Development: An Overview," Naomi Cytron, *Community Investments,* Spring 2006, Federal Reserve Bank of San Francisco. Website: *www.sf.frb.org/publications/community/investments/06spring/cytron.pdf.*

[2] See *www.sba.gov/advo/research/sb_econ2006.pdf.*

[3] In a separate report the SBA provides more detailed and current state profiles. For the California, go to: *www.sba.gov/advo/research/profiles/o6ca.pdf.*

Other tables in the report show that 51 percent of U.S. employees worked at firms with fewer than 500 employees in 2003, and 18 percent worked at firms with fewer than 20 employees. The average small employer (less than 500 employees) operated in one location and had 10 employees.

Very Small Service Firms Employ Nearly Half of the Workforce

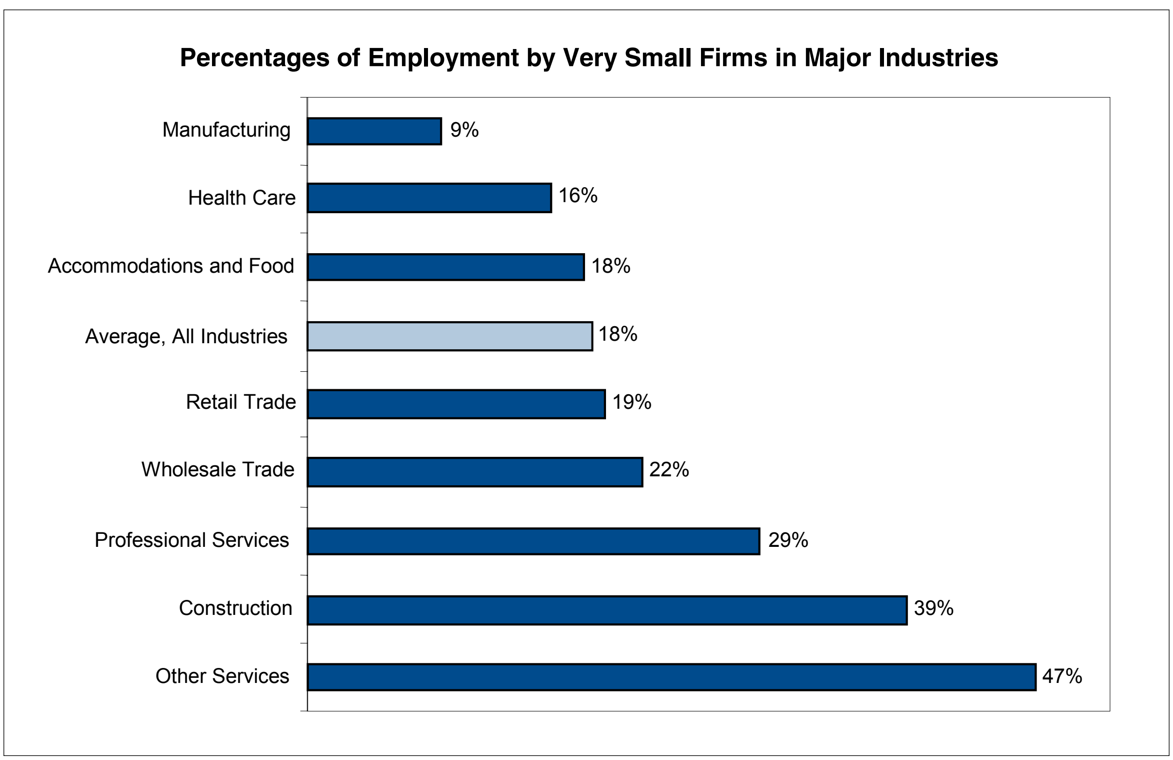
The SBA report also breaks these figures out by industry. For the rest of this section we'll focus on the "very small" employers, those with fewer than 20 employees.

The chart below is created from data found in the SBA report by selecting the top eight industries of very small firms as ranked by employment. (These major industries combined account for more than three quarters of all employment by very small firms.) They are ranked by the percentage of employees employed by very small firms in each industry. *Other Services* has 47 percent of all employees working in very small firms, a higher percentage than any other industry. (Examples of other services include auto repair shops, barber shops, beauty salons, nail salons, and dry cleaners.) *Construction* is next, with 39 percent of its employment in very small firms, followed by *Professional, Scientific and Technical Services* with 29 percent.

In the chart *Manufacturing* has the smallest percentage of its employment in very small firms, just 9.0 percent. However, since manufacturing is a relatively large employment category it is one of the industries selected. Employment by very small manufacturing firms accounts for about 6.0 percent of all employment by very small firms.

Demographics of Self-Employed

The SBA report also includes demographic characteristics of self-employed people. In 2004, 10.2 percent of the labor force was



self-employed. Self-employment rates tend to increase with both age and educational attainment. For those individuals having attained at least a master's degree, the self-employment rate was higher, 13.9 percent in 2004.

Small Business Capital Goods Spending

An entire chapter of the SBA report is devoted to small business financing. One of the major uses of funds for businesses is to purchase structures, equipment, or software. U.S. noncorporate nonfarm firms spent $232.9 billion on such capital goods in 2005. This capital goods spending by noncorporate firms accounted for 20 percent of such capital goods spending by all nonfarm nonfinancial firms. In California most of the capital goods spending is subject to the sales and use tax.

In summary, by many measures small businesses are very big components of the U.S. and California economies. Though often hidden from view, they contribute significantly to economic growth, employment, and tax revenues.

❖ U.S. Economic Developments

Real GDP by Industry in 2005

In December the U.S. Bureau of Economic Analysis (BEA) released estimates of 2005 real gross domestic product (GDP) by industry. Real growth in goods-producing industries was slower than that for the economy as a whole, a reversal of the situation evident in 2004. In 2005, goods-producing industries increased their real output by 2.1 percent and services-producing industries grew by 3.7 percent as overall real GDP rose 3.2 percent. Information services grew faster than any other industry, with real output increasing 9.0 percent. Retail trade was a very healthy industry in 2005, as its real value added increased by 5.0 percent.

Slower Growth Expected in 2007

Real GDP increased 3.4 percent in 2006, close to the ten-year norm of about 3.3 percent. Quarterly growth was uneven in 2006, slowing in the second and third quarters, but improving in the fourth quarter. However, many economists expect growth to be below the ten-year average this year. A survey of 51 professional forecasters polled by the Federal Reserve Bank of Philadelphia in November calls for real GDP to increase 2.6 percent in 2007. The California Department of Finance is expecting similar growth as an underlying assumption of the Governor's Budget for 2007-08 released in early January.

Retail Sales Strong Excluding Autos

Based on preliminary data, U.S. retail sales rose 6.0 percent in 2006. Excluding autos, U.S. retail sales increased a much stronger 7.3 percent. Motor vehicle sales were the weakest major sector, inching up just 1.6 percent and holding down the overall retail sales growth rate. At the other end of the spectrum, U.S. sales from nonstore retailers (most of which is from electronic shopping and mail order houses) increased 11.3 percent. The strong growth for nonstore retailers is similar to its increases of recent years. Other U.S. retail categories posting solid growth in 2006 include gasoline stations (up 9.5 percent), building materials stores (up 8.6 percent), restaurants (up 8.1 percent) and furniture and home furnishings stores (up 8.0 percent).

Moderate Payroll Employment Gains, Declining Unemployment Rate

Preliminary data indicate that U.S. nonagricultural employment rose 1.4 percent in 2006, down slightly from 1.5 percent in

2005. The U.S. unemployment rate declined from 5.1 percent in 2005 to 4.6 percent in 2006. This is the lowest annual unemployment rate since 2000.

❖ California Economic Developments

California Employment Growth Nearly Matches U.S.

One of the most comprehensive indicators of economic well being available for states on a timely basis is nonagricultural payroll employment. Preliminary data for 2006 show that California payroll employment nearly matched U.S. payroll employment, increasing 1.5 percent. The California unemployment rate averaged 4.8 percent in 2006, very close to the national average rate of 4.6 percent, and the lowest in 37 years.

Personal Income Faster Growth So Far In 2006

In late December the U.S. Bureau of Economic Analysis released preliminary figures for third quarter U.S. and California personal incomes for 2006. The data show that U.S. and California personal incomes each increased 6.6 percent over the first three quarters of 2006 compared to the first three quarters of 2005. Both figures are also more than one percent greater than their respective average growth rates for 2005.

Contact Us

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www.boe.ca.gov/news/epcont.htm

Taxpayers' Rights Advocate:
888-324-2798

To contact your Board Member, see
www.boe.ca.gov/members/board.htm

Online Resources

For more information about topics covered in this issue, please visit any of the websites listed below.

California Department of Finance
www.dof.ca.gov

California Employment Development Department (EDD), Labor Market Conditions in California
www.labormarketinfo.edd.ca.gov

Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters
www.phil.frb.org/econ/spf/index.html

National Association for Business Economists
http://www.nabe.com

U.S. Bureau of Economic Analysis
www.bea.doc.gov

U.S. Bureau of Labor Statistics
www.bls.gov

U.S. Census Bureau
www.census.gov