Introduction to Special Issue on "The Invisible Part of the Iceberg: Research Issues in Industrial Organization and Small Business"

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1. Origins

A standing-room-only crowd packed the House Small Business Committee's hearing room on January 21, 2000, for the Office of Advocacy's research conference on "The Invisible Part of the Iceberg: Research Issues in Industrial Organization and Small Business." The daylong meeting featured leading academics, senior policy makers and interest group representatives, all of who contributed valuable ideas on antitrust policy and research concerns affecting small business.

They played to a diverse and high-level audience that included a member-designate of the Council of Economic Advisers, officials from a score of federal agencies, the CEO of a high technology startup company who flew in from Silicon Valley, and a variety of researchers, lobbyists, and others.

In opening the program, I stressed that I had no preconceptions about the outcome. But I hoped to hear how views of industrial organization, traditionally seen as a large-firm research and policy matter, might have changed. Also, I wanted to come away with some useful suggestions for determining whether the ongoing changes in the economy warrant any changes in Advocacy's research agenda or in federal policies to foster competition. I got an earful. This volume summarizes what was said that day. Full copies of the papers are posted on the Office of Advocacy web site, *www.sba.gov/advo*, which also contains internal studies, data from other agencies, contractors' reports, testimony, and agency comment letters, on a variety of small business topics.

In closing, let me express my warm appreciation to those who worked so hard to make the conference the success that it was and to produce these proceedings: the speakers, conference organizer and summarizer Fred Tarpley, and from the Office of Advocacy, Chief Economist Robert E. Berney, Senior Economic Advisor Kenneth D. Simonson, Senior Editor Kathryn Tobias, and Administrative Support Staff Darlene A. Moye-Mahmoud.

As always, feedback on Office of Advocacy projects and publications is welcome. Contact me at (202) 205-6533, via fax at (202) 205-6928, or by writing to: Office of Advocacy, 409 Third Street, SW, Washington, DC 20416.

2. Contents

In the 1980s, policy makers were concerned that the U.S. economy was losing its competitive edge to the Asian "tigers" and some European economies. These countries seemed to know how to maximize efficiency through coordination of activity by government and large companies. What a difference a decade has made! By the late 1990s, the United States had re-emerged as the undisputed leader in producing new jobs and innovations, and rising productivity has kept inflation at bay.

What is less well known is that a considerable

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amount of "churning" – startup and closing of firms, large and small – has been responsible for this unprecedented reinvigoration of the U.S. economy. Economic growth has been led by innovation, particularly in high-technology firms that began as small enterprises.

The remarkable contribution of small, high-tech firms to U.S. economic growth suggests that it is time to re-examine laws and policies regarding industrial organization. Formerly, many economists believed it was healthy for the economy to enable firms to achieve a "minimum efficient scale," rather than permit a host of supposedly less efficient small firms to operate. But the emergence of many small, innovative competitors may suggest that policies should more actively encourage small firm formation.

These issues and others were explored in the Office of Advocacy's recent research conference on "The Invisible Part of the Iceberg: Research Issues in Industrial Organization and Small Business." Led by Chief Counsel for Advocacy Jere W. Glover, of the U.S. Small Business Administration, a spectrum of economists, lawyers and others from universities, government, and interest groups, reviewed the record and made recommendations for further research or for policy changes.

Three speakers highlighted the disproportionate contribution of small startup firms. Harvard Professor F. M. Scherer documented how even a tiny number of startup firms, particularly in certain high-tech fields, can keep competition vigorous. David Audretsch of Indiana University argued that small and new firms increase the economy's efficiency, contrary to the prevailing wisdom that larger firms are more efficient than small ones. New York University (NYU) Professor Boyan Jovanovic documented the increasing importance of small-firm initial public offerings, especially high-tech stocks, in advancing technological change and increasing economic efficiency. And conference organizer Fred Tarpley, Advocacy's former chief economist, pointed out that technological changes could alter minimum efficient scale in ways that favor either smaller or larger firms.

John Kwoka of George Washington University and Lawrence White of NYU presented data showing a slow but steady decline in the share of jobs accounted for by small employers and recommended research, by industry, into whether these changes resulted from natural consequences or deliberate strategies by large firms. Other speakers suggested that policies either are needed or are already in place to protect small firms. Specifically, Scherer warned that recent changes in patent and copyright laws might make it harder for some high technology startups to achieve this role. Albert A. Foer, president of the American Antitrust Institute, traced the history of antitrust law, threw his support behind recent initiatives by the Federal Trade Commission (FTC) that he deemed helpful to small firms, and made a case for why small business should support broad antitrust enforcement. He cited the FTC's successful opposition of the proposed merger of Staples and Office Depot as a step that had saved small businesses $200 million per year as office supply customers. Adam Golodner, chief of staff of the Justice Department's Antitrust Division, stressed the administration's commitment to keeping markets open for small businesses as both competitors and customers.

However, NFIB Education Foundation Senior Research Fellow William J. Dennis and Competitive Enterprise Institute President Fred L. Smith were less complimentary toward government's role. Dennis cited the support that state and local governments give large firms in the form of tax breaks and targeted spending as ways that they tilt the playing field against small business. Smith argued that antitrust policy, as well as international groupings of governments, such as the World Trade Organization, actually works against innovation and startups by defending the status quo.