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Has American Business Lost Its Mojo?

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Over the past three decades, the American economy has become less vigorous. An extensive body of evidence shows that the public focus on the success of high-tech companies like Apple and Google masks an overall downward trend in key measures of business vitality.

“Business deaths now exceed business births for the first time in the thirty-plus year history of our data,” note Ian Hathaway and Robert E. Litan, economists at the Brookings Institution, in a May 2014 essay, “Declining Business Dynamism in the United States.”

There is widespread support for their assertion. Jim Clifton, chairman and C.E.O. of Gallup, wrote in a January 2015 essay, “American Entrepreneurship: Dead or Alive?”:

> Until 2008, start-ups outpaced business failures by about 100,000 a year. But in the past six years, that number has suddenly turned upside down. There has been an underground earthquake.

The forces driving this trend include the increasing regulation of small businesses, corporate consolidation, more occupational licensing requirements and too few immigrants with high-tech skills. Ultimately, however, the political system itself appears to be making a significant contribution to the problem.

Federal and state officials, often under pressure from major corporations seeking to stifle competition, have adopted a regulatory regime that makes the creation of new businesses more difficult.

Many, if not most, of the reforms proposed by economists and other analysts require political action. At the federal level, this would require bipartisan support, an achievement often out of reach in a polarized system.

Contemporary American politics have become an economic hindrance. Daron Acemoglu, an economist at M.I.T., put it this way in an email to me:

> It’s becoming more and more difficult to run a successful business in the United States without doing lobbying, campaign contributions and other deals with politicians. This I think is the most dangerous, I would even say nefarious, trend for the creativity of American business in general, and young and new businesses which we badly need in particular.

The drop in new business start-ups should be seen in the context of other key indicators — for example, a lack of labor liquidity, which is a measure of "the rate at which workers leave one firm to go to another," according to Acemoglu.

"The reason why it's so central is that this is the method via which the economy puts more of its resources into more productive areas," Acemoglu wrote.

> New firm creation feeds into this big time. If you don't create new firms, then workers are likely to remain locked up in their previous jobs or just go to unemployment because there aren't new, higher productivity jobs to which they can be reallocated.

In a widely cited September 2014 paper, "Labor Market Fluidity and Economic Performance," Steven J. Davis and John Haltiwanger, professors of economics at the University of Chicago and the University of Maryland, respectively, wrote:

> The U.S. economy experienced large, broad-based declines in labor market fluidity in recent decades. Long-term declines in job and worker reallocation rates hold across states, industries, and demographic groups defined by gender, education and age. Fluidity declines are large for most groups, and they are enormous for younger and less educated workers.

The authors conclude:

> If our assessment is correct, the United States is unlikely to return to sustained high employment rates without restoring labor market fluidity.

There are disputes over both the causes of and the possible remedies for the decline in business creation and labor fluidity. Politically, proposed reforms run the ideological gamut, from making it easier to fire workers to limiting the political power of big business.

The consequences of the decline are enormous. Litan points out that:

> Business dynamism is really not a choice. If other economies exhibit more dynamic firm structures and thus faster innovation than we do, our firms will either gradually lose out or move their facilities abroad. Either outcome would augur poorly for mobility at home.

Clinton, the Gallup C.E.O., is more dramatic:

> I don't want to sound like a doomsayer, but when small and medium-size businesses are dying faster than they're being born, so is free enterprise. And when free enterprise dies, America dies with it.

In December, Haltiwanger told a conference on The Future of U.S. Economic Growth at the libertarian Cato Institute that the United States appeared to be suffering "death by 1,000 cuts."

Many of the economists I contacted support liberalized immigration policies, especially for immigrants with high-tech skills, but the issue remains divisive in Congress.

Litan and Acemoglu both stress the potential advantages of allowing many more immigrants to enter the country, ideally with a chance of getting a green card that can lead to citizenship. In the January/February 2015 issue of Foreign Affairs, Litan argues that “immigrants, who tend to be less risk averse than the general population, have historically proved twice as likely to launch businesses as native-born Americans.” He cites research showing that in 2005, “companies led by immigrant entrepreneurs employed 450,000 workers and generated $52 billion in sales.”

Davis, of the University of Chicago, has more controversial reforms in mind. In an email, he suggested these two:

First, “allowing employers to hire workers for extended probationary periods, during which they could be fired at will without running afoul of litigation risks related to anti-discrimination laws and exemptions.” And second, “eliminating federal minimum wage requirements, or at least allowing states and municipalities to opt out of federal minimum wage requirements.”

Many liberal economists are critical of these proposals.

Alan Krueger of Princeton, who was chairman of the Council of Economic Advisers under President Obama, wrote in an email responding to my inquiry that “firing restrictions in the U.S. are very modest. Most employment relationships are ‘at-will.’ ”

In addition, Krueger said that he was “skeptical of the argument that the minimum wage is a reason why business formation has slowed in the U.S.” because “the value of the minimum wage after inflation is currently very low.The real value of the minimum wage was higher in the 1960s, when business formation was much higher.”

Acemoglu dismisses the role of the minimum wage: “It’s so low in the United States, that’s not going to be a factor.”

One area of modest agreement among analysts of business development is what they see as the detrimental consequences of the growing practice by state governments of requiring licenses for a host of previously unlicensed occupations.

Morris Kleiner, a professor at the University of Minnesota’s Humphrey School of Public Affairs, finds that the share of workers in this country who must have licenses to do their jobs has grown sixfold over the past half-century.

“In the early 1950s, less than 5 percent of U.S. workers were required to have a license from a state government in order to perform their jobs legally,” Kleiner writes in a January 2015 paper, “Reforming Occupational Licensing Policies.” By 2008, that share had grown to 29 percent of all workers.

Jobs requiring a license run the gamut from “from scrap metal recyclers in Louisiana to body artists in the District of Columbia,” and include pest control applicators, emergency medical technicians, cosmetologists, athletic trainers, massage therapists and auctioneers, Kleiner writes.

State licensing requirements make both job entry and job relocation across state borders more difficult, effectively restraining the movement of workers to more productive employment —

discouraging labor liquidity. While some form of regulation of these jobs may be necessary to protect consumers and the public generally, Kleiner and others argue that in those cases, a system of certification transferable from state to state would help free up the job market.

The importance of politics in the slowdown in business creation and labor fluidity is perhaps most interesting and most salient.

James Bessen, a lecturer at the Boston University School of Law and former C.E.O. of the software company Bestinfo, argues that companies and lobbyists protecting their own self-interest have become a major force undermining business creativity and growth.

In a January 2015 Foreign Affairs article, "The Anti-Innovators: How Special Interests Undermine Entrepreneurship," Bessen writes that the Department of Defense, which in the past had fostered innovation, has more recently adopted procurement policies "that benefit traditional defense contractors while shutting out start-ups."

The reason "for the shift is simple: large defense contractors have the money and influence to secure lucrative government contracts," according to Bessen. In fact, "the pure quantity of cash has skyrocketed. Since 1990, the defense industry has contributed more than $200 million to political campaigns, and in 2012 alone, it spent roughly $132 million on more than 900 lobbyists." Over the past 10 years, from 2005 to 2015, the defense industry spent $1.319 billion on lobbying.

At the state level, Bessen notes, corporations are suppressing competition by successfully lobbying for legislation to make "it easy for employers to enforce non-compete agreements, which prohibit employees from leaving one company to join or start another in the same industry."

Perhaps the most intriguing argument about economic stagnation is that political polarization itself is a significant factor.

Davis, of the University of Chicago, writing with Scott Baker, a professor of finance at Northwestern, and three colleagues, argues that polarization escalates uncertainty over future government policy, inhibiting investors who cannot accurately estimate future gains and losses.

Rising policy uncertainty results from "the potential for political polarization to produce more extreme policies, less policy stability, and less capacity of policy makers to address pressing problems," the five authors write in a paper published in the May 2014 American Economic Review, "Why Has U.S. Policy Uncertainty Risen Since 1960?"

Polarization results in legislative gridlock, according to Davis et al. at a time when the status quo poses dangers: "The status quo is unattractive when the debt ceiling must be raised to avoid default, or fiscal adjustment is required for a sustainable debt path." In addition, polarization has resulted in the politicization of the regulatory system so that "the policy environment is now more prone to rapid swings between an aggressive regulatory stance and a more hands-off approach."

Insofar as polarization is a significant factor in the decline of business dynamism, prospects for improvement are not good.

In a comparison of voters from 2004 and 2014, the Pew Research Center found that ideological consistency – a measure of polarization – has increased remarkably:

> The share who are ideologically consistent has doubled: 21 percent express either consistently liberal or conservative opinions across a range of issues – the size and scope of government, the environment, foreign policy and many others.

At the same time, according to Pew, the ideological left and right have gained leverage in the political process, and are more likely than moderates "to vote regularly, and far more likely to donate to political campaigns." In addition, these influential partisans are far less willing to compromise than centrist voters, making polarization ever more intractable.

In theory, elections are designed to put in office politicians skilled at winning enactment of legislation. At the moment, however, polarization is resulting in the election of men and women who are opposed to governing, if governing requires them to compromise.

In these circumstances, the economy will be held hostage in the battle for supremacy between two ideological poles, with no relief in sight.