

Big is Beautiful: Debunking the Myth of Small Business, by Robert D. Atkinson and Michael Lind

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March 2019

It is a common sentiment: “Small businesses are the engine of job creation and innovation.” A host of policies have accordingly been designed to assist small firms, ranging from credit allocation efforts to size-based environmental regulations. But the sentiment is inaccurate; the job creation and innovation patterns of small businesses are, at best, more complicated than the conventional wisdom would suggest. Economists have articulated a more nuanced view in academic journals for years. In *Big is Beautiful*, Robert D. Atkinson and Michael Lind abandon academic nuances firmly to take the opposite position: *Big* business is the source of growth and innovation, and policy should be reformed accordingly.

The book’s timing is felicitous: Parts of the economics profession and its observers have recently become more intensely concerned about rising concentration of U.S. economic activity within just a few mega firms. In 2016, the White House Council of Economic Advisers (CEA) released a brief noting that the share of revenue accruing to the top 50 firms has risen since the late 1990s in almost every major sector (Council of Economic Advisers 2016). Related research, both before and since the CEA brief, has led to a widespread view that the U.S. faces a product market power problem—a monopolization of the economy as a few large firms extract increasing surplus from consumers. Amidst all this fretting about big business, Atkinson and Lind push back.

The book starts with a review of America’s obsession with small business. It then argues the evidence does not support common claims about small business’ job creation and innovation records. Rather, most small businesses are intended to provide jobs only for their founders and perhaps a handful of others, and they sell goods or services that already exist instead of developing innovative new products or processes (Hurst and Pugsley 2011). Further, Atkinson and Lind walk through a litany of complaints about small businesses: Compared with larger firms, small businesses may pay lower wages, are less productive, spend less on research and development, provide worse worker safety records and job security, enjoy weaker environmental regulation, and give less to charity.

Big firms, on the other hand, are big because they benefit society, argue the authors. Big firms acquired their dominant positions through superior productivity, and if they have market power they use it for the good of humanity. For example, high profits fund innovation, as in the famous corporate labs of past decades. Instead of policies to help small business, the authors want “size-neutral” policies, though when they describe their preferred policies in detail they amount to a decidedly pro-“big” agenda. Some of the policies the authors prescribe are explicitly *not* size neutral, such as providing subsidies to “help big corporations compete with the state-backed national champions of other countries” (page 251).² Other suggestions, such as ending size-based regulatory exemptions, implicitly favor large firms since they impose compliance

¹ The analysis and conclusions set forth here are those of the author and do not indicate concurrence by the Federal Reserve Board of Governors or its staff. A modified version of this review, omitting many references for brevity, was published in *Business Economics* (see Decker forthcoming).

² On page 251 the authors argue both the U.S. should subsidize its large firms and the U.S. should find ways to punish other countries that subsidize their own large firms.

hurdles that are disproportionately costly for smaller firms. True size neutrality is impossible in a world with fixed costs.

But the authors get much right. On average, larger firms are indeed more productive (Bartelsman et al. 2013) and see greater productivity growth (Decker et al. 2017). And the growing concern about concentration and rising market power is not yet conclusive. Perhaps the most commonly cited paper in this debate is by De Loecker, Eeckhout, and Unger (2018), who estimate that markups of price over marginal cost have tripled in recent decades; while others have also found an increase in markups, debate remains about the magnitude of the rise.³ Moreover, De Loecker, Eeckhout, and Unger (2018) find markups have risen most in sectors in which concentration has risen least (such as education and accommodation and food services), while markups have risen least in sectors in which concentration has risen most (such as transportation and warehousing and retail trade); any relationship between sector-level concentration and market power is not obvious (see also Shapiro forthcoming).⁴ The emerging consensus that the growing size and concentration of U.S. firms has resulted in consumer-harming market power appears weaker than it once did.⁵

The authors are also correct that small businesses do not, on average, live up to their reputation for job creation and innovation. Indeed, Haltiwanger et al. (2013) show that the job creation prowess commonly attributed to small businesses is misplaced: After accounting for firm age, firm size does not predict employment growth. But Haltiwanger et al. also show *young* firms—which tend to be small—do account for a disproportionate share of job creation in the U.S. Other research has shown business entry is an important source of aggregate productivity growth (Haltiwanger et al. 2017). Large firms account for a dominant share of employment and have certain advantages for innovation, but each year a handful of young firms play an important and lasting role in job creation and innovative activities; and since most firms start life small, policies that disadvantage small firms are likely to harm young firms.

Atkinson and Lind neglect an important literature—rooted in theories of the firm—that implicitly grants startups potential advantages for innovation. Employees of incumbent firms may have limited incentive to innovate if they are not residual claimants on firm value (Grossman and Hart 1986) or if the value of their innovative output is difficult for managers to measure (Holmstrom and Milgrom 1991). The financial structure of incumbent firms may limit their ability to exploit “growth options” (Myers 1977).⁶ Incumbent firms may fail to grasp or implement “disruptive” innovations—high-potential products that initially appear inferior to a firm’s existing products by the standards of current customers—leaving room for startups to

³ De Loecker, Eeckhout, and Unger (2018) is an expanded version of De Loecker and Eeckhout (2017), which received considerable attention in press and academia. Much of this literature relies on publicly traded firms, which account for less than half of U.S. economic activity and are not representative of broader patterns of firm dynamics (Davis et al. 2007). De Loecker, Eeckhout, and Unger (2018) focus mainly on publicly traded firms but, importantly, find some corroboration in economywide Census data. Smaller gains in markups have been found by Traina (2018), who limits to publicly traded firms (but uses different assumptions), and Edmond, Midrigan, and Xu (2018), who limit to publicly traded firms but argue for a different (cost-based) weighting scheme. The latter reference as well as De Loecker and Eeckhout (2018) provide extensive commentary on relevant assumptions and data.

⁴ A useful example of a case where rising concentration may have benefitted, rather than harmed, consumers is the consolidation of the retail trade sector in the 1980s and 1990s (Foster et al. 2006, Basker 2007, Matsa 2011).

⁵ Another commonly cited paper in this debate is Barkai (2017); for a discussion of its limitations see Karabarbounis and Neiman (2018). On the other hand, Blonigen and Pierce (2016) find mergers in manufacturing from 1997 to 2007 boosted prices without enhancing productivity.

⁶ Babina and Howell (2018) find bursts of research and development expenditures within large (publicly traded) firms prompt employees to depart and start new firms, consistent with the above theories.

enter markets and grow rapidly (Christensen 1997). Even Atkinson and Lind tell stories of big firms' own innovative ideas being commercialized by unrelated startups (e.g., Xerox versus Apple on page 96).

Those who study entrepreneurship therefore recognize a key dilemma. Most small and new firms will not innovate or create many jobs; indeed, many new firms and the jobs they create will not survive to age five (Decker et al. 2014). And large incumbent firms contribute substantially to overall prosperity through economies of scale, large research and development budgets, and ability to survive complicated regulatory and market environments. But a handful of new firms—which tend to start small—enter each year with the potential to create many jobs and contribute significantly to overall productivity. The plethora of non-innovating small businesses and failed innovative startups may be a reasonable price to pay for the next Microsoft or Google.

Indeed, Gort and Klepper (1982) developed a framework in which innovation spreads through a surge of business entry followed by a “shakeout” as failed experimenters are eliminated; this seemingly wasteful process is an important source of productivity gains (Foster et al. 2017).⁷ Since entrepreneurial potential is difficult to observe in advance,⁸ creating policy space for innovative successes without allowing space for failures and non-innovators may be infeasible. This is not an argument for subsidizing small or young firms, but it does suggest caution about raising entry and operating costs. Atkinson and Lind devote little more than a single paragraph to this critical policy question (page 265).

Favoring large firms, as most of the authors' policy prescriptions suggest, means favoring *incumbents*, at a time when potential entrepreneurs seem to be facing increasing difficulty entering and growing. Atkinson and Lind note firm entry has been declining in the United States for several decades (Haltiwanger et al. 2012), but they somewhat mischaracterize the related research, arguing the decline simply reflects less entry of non-innovating, non-growing small businesses. Since 2000, however, there has been a decline in entry of high-tech firms (Haltiwanger et al. 2014) and in the prevalence of high-growth young firms generally (Decker et al. 2016). Moreover, while Guzman and Stern (2017) argue just as many high-potential startups are being founded as before, these startups have become less likely to realize high-growth outcomes. Similarly, Decker et al. (2018) find high-productivity young firms have become less likely to grow and invest (relative to lower-productivity firms) than in decades past, particularly in the high-tech sector. Atkinson and Lind are sanguine about these patterns in the data, but the evidence does not warrant their confidence.

The key underlying limitation of the book is it does not take seriously firm *heterogeneity* and *dynamics*. The authors' recommended policies assume there is a single “national interest” coinciding with the fate of large incumbent firms and unifying workers and regions (page 246). They quote Charles Wilson, “what was good for the country was good for General Motors and vice versa” (page 10), but this has probably never been true. Even large firms have competitors and potential competitors, and they have customers and suppliers whose interests differ in some dimensions. Policies that support a handful of large firms and their workers unavoidably disadvantage other firms and workers, including firms that have yet to enter.

Big is Beautiful is a useful popular press corrective for the common view that small businesses generally are the engines of job growth and innovation. But much of the authors'

⁷ Further, Serrano and Ziedonis (2018) find most patents held by failed startups are purchased and redeployed by other firms.

⁸ One notable attempt to develop ex ante measures of entrepreneurial potential is Guzman and Stern (2017).

argumentation is one-sided and pushes the boundaries of consistency.⁹ And they avoid serious, empirically disciplined consideration of new businesses, a handful of which are critical to growth. In this respect, the authors may be lowering the status of small businesses at the risk of giving incumbents protection from high-quality entrant competitors. Atkinson and Lind will persuade readers small business subsidies require reevaluation—a valuable contribution to the “small versus large” policy debate—but I wish they had grappled with the more difficult policy dilemma: small versus large versus *young*.

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⁹ For example, on page 204 the authors insist rising concentration is not a problem because it is not resulting in higher profit rates for large firms, but much of the authors’ argument for large firms is that large firms use higher profit margins to fund innovation (page 210). Other arguments are simply one-sided, as when the authors argue many small firms are heavily dependent on being suppliers to, or partners with, large firms (pages 92 and 115), without considering whether the dependence might go in the opposite direction.

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