Report by the House Small Business Committee
Democratic Staff
Nydia Velázquez, Ranking Member

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Small Business Index

-- 2005, First Quarter --

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Introduction

In recent months, the condition of the United States' economy has been mixed – with some positive news – a rising stock market and a strong housing sector – as well as some negative developments – high energy prices and a substantial trade deficit. To many observers, the recently revised annual GDP growth rate of 3.5 percent exemplifies the economy's performance – stronger than recent lows, but well below highs achieved just last year.

With such economic moderation comes concern that job growth may be sluggish. The May 2005 job report made these concerns a reality as only 78,000 new jobs were created. Looking within the labor market, the labor participation rate – the percentage of individuals with a job or actively searching for employment – is hovering near its ten-year low.

Adding to these concerns are reports that planned job cuts have risen significantly. Challenger, Gray, and Christmas – a leading employment consultancy – reported that employers announced 82,283 job cuts in May. The report also noted that for the year-to-date, 427,278 job cuts have been announced – 4.6 percent more than the five-month total of 2004. And earlier this month, General Motors announced layoffs of 25,000 U.S. employees.

Small business hiring, typically a bellwether of the economy's health, is also lackluster. According to SurePayroll's Small Business Scorecard, small firms' hiring has increased only 0.3 percent for the year to date, which projects forward to an annualized rate of 0.7 percent. This level of growth, which is well below the 2004 year-over-year growth of 4.4 percent, suggests that the economy will continue to struggle for 2005.

The combination of lackluster job growth and higher than expected layoffs creates significant economic risks for the economy. Such labor market characteristics raise the potential that economic growth for 2005 will be lower than projected – calling into question the economy's ability to maintain traction during a period of increased global competitiveness and rising worker productivity.

During previous periods following an economic downturn, the economy exhibited resilience and strength. Unfortunately, the current economy has not yet shown these signs of strong job creation. In May 2005, the economy finally returned to the level of private sector employment prior to the recessionary period of 2001 – a duration of 50 months, which is a record and well in excess of the 23 month average. After the prior episode of significant economic weakness – the recession that ended in 1991 – it took 33 months for the economy to regain the jobs lost during that period.

Essential to a stronger economy are the contributions of small businesses. Small businesses remain a critical component of the U.S. economy and continue to drive employment – generating 60 to 80 percent of net new jobs annually over the last decade. In 2000-2001 (the most recent data available), small businesses created all of the net new jobs in the U.S.[1] Firms with less than 500 employees saw a net increase in employment of 1,150,875, while large business employment decreased on net by 150,905 – demonstrating the job creation power of small businesses.

[1] "Frequently Asked Questions," Small Business Administration, Office of Advocacy, http://app1.sba.gov/faqs/faqindex.cfm?areaID=24.

Having small businesses account for all of the net new jobs is not unique to 2000-2001. After the recession of the early 1990s, small firms created approximately 3.8 million jobs, outpacing large firms by nearly 500,000 jobs. During that period it was often the downsized corporate executive or laid-off factory worker that were most likely to start a business, when nearly 25 percent of downsized managers over 40 started their own firms.

Today, this dynamic is less likely to have the positive effect on employment than it did in past periods. With skyrocketing health care and energy costs, tightening credit conditions, and increasing labor costs, small businesses are facing a challenging economic environment. In fact, according to the NFIB, small businesses are the least optimistic they have been in over two years, as the NFIB's Small Business Optimism Index dipped below 100 for the first time since March 2003.

In an effort to better track the economic conditions facing small businesses and to provide policymakers with a means to evaluate economic proposals, the Democratic staff of the House Small Business Committee developed the Small Business Index (SBI). The SBI documents how small businesses are progressing in this new economy.

Initially released in September 2003, the SBI reflects the current small business climate, while also providing insights into near-term performance of the small business sector. The SBI pools information from various sources and includes broad measures of the economy, such as the federal budget deficit, number of unemployed and the producer price index, as well as those reflecting the cost of business, including energy and health care. To compare and contrast the changing economic conditions facing small businesses, the SBI has been calculated for each year since 1998.

After reaching a high of 108.89 in 2000, the current 1Q 2005 SBI represents an eight-year low for the index, as conditions for small business creation and growth remain less than favorable. For the 1Q 2005, the SBI stands at 71.83, reflecting a downward slide since a brief period of increase in 4Q 2004. Contributing to the SBI's recent decline are increases in oil prices and the tightening of credit conditions, a rising trade deficit, declining small business confidence, and rising business inflation. Partially offsetting these decreases in the SBI are increases in net farm income, a lower projected federal deficit, as well as a rise in manufacturers' new orders.

The current downward trend in the SBI reveals that small businesses continue to meet barriers to their success. Current economic measures suggest that the economy is not strengthening, but – as labor market measures show – faltering. Until an environment exists where small businesses are able to make contributions to the economy, it is unlikely that the labor market situation will improve significantly.

The SBI assesses the factors that contribute to the small business economy and follows the trends that are representative of entrepreneurial success and economic development. As a result, policy decisions can be better analyzed and the need for future courses of action can be considered.

Analysis

Overview

The SBI provides insight into the economic environment facing small businesses, as well as an analysis of specific factors that impact entrepreneurial success. The SBI for 1Q 2005 is at an eight-year low of 71.83, nearly 35 percent below its high point reached in 2000. Small businesses face an economy marked by several challenges, including rising business costs, a decline in commercial lending, and increasing competition from abroad. The current SBI reflects economic conditions that remain unfavorable for small business growth and expansion.

In contrast to the current SBI, the 2000 SBI marked an all-time high of 108.89. Economic conditions in 2000 were favorable for small business growth as capital was more plentiful and operating costs were lower. The SBI declined precipitously in 2002 to 78.71, as gas and oil prices increased dramatically, commercial lending and venture capital activity declined, and the trade and budget deficits expanded.

3Q and 4Q 2004 and 1Q 2005

Since the previous release of the SBI in 2Q 2004, the SBI has trended downward, with the exception of a brief period of increase in 4Q 2004. During 4Q 2004, the SBI benefited from an increase in net farm income, an improving stock market, and rising commercial lending. However, late 2004 and early 2005 has been marked by a challenging small business economic environment – as health care, energy – notably record high oil prices, and pension costs have increased substantially, the trade deficit has risen to record levels, and interest rates have risen considerably.

Findings

The SBI for the 1Q 2005 shows a return to the downward trend of the middle two quarters of 2004. Many observers cite stable GDP growth and low interest rates as signs that the economy is on track, but many others are more cautious and point to weaknesses in several of the SBI's indicators as signs of economic trouble

As in previous quarters, the SBI continues to track labor market and GDP data, which suggest that there will not be a significant upswing in the near future. Termed a "Goldilocks" economy by some, this "not too hot, not too cold" economic environment has produced conditions that are far from comforting for entrepreneurs. Without a clear path to accomplish stronger economic growth, entrepreneurs are unable to estimate the costs and risks of starting a new business or making continued investments in an existing business.

To further analyze the SBI, its 17 economic indicators used are grouped below into four categories: costs factors, credit conditions, trade competitiveness, and industry metrics.

Cost Factors
Health Care, Oil, Natural Gas, Retirement and Savings, and Total Employee Compensation, Producer Price Index, Regulatory Costs

The cost factors are designed to reflect the input prices for small businesses, as opposed to the prices for the goods or services that are sold by them. The fluctuation in pricing or cost of these factors is mostly out of the control of the small business owner, but they have a significant impact on the firm.

The SBI data reveals that there continued to be a run-up on many cost factors in the third and fourth quarters of 2004 with moderation in the 1st Qtr 2005. The overall data shows that prices continue to be high. Many of these cost statistics reveal that small businesses are receiving the same amount of inputs to run their businesses, but at a higher cost. These increased costs limit the ability of employers to purchase new equipment, hire new employees, and expand their business.

Not surprisingly, the most significant increase in input cost has been the rising cost of oil. As major consumers of oil in various industries, these rising cost have had significant impact on small businesses. Oil prices have reached historic highs – expected to exceed $60 per barrel. This is reflected by a fifty percent increase since the 2nd Qtr 2004. The rising natural gas price rise over the last year has also started to have a significant impact.

As noted, the price of some input factors remained flat, but the relative nature of the Index means that the SBI remains the same, at a very low level. The Producer Price Index has had little movement in the past year. Additionally, overall compensation and employee retirement costs have seen modest increases. It is unclear if this is reflective of a weak labor market or increased productivity. Finally, the increase in regulations by the federal government has moderated over the last year.

However, one of the most important cost factors for small businesses, health care costs, has continued to rise. The consistent double-digit increase in health care costs, including in 2004 means that the SBI continues to drag. The 2005 health care data is not available, but early reports suggest little reason for optimism.

The overall impact of these high prices for small businesses has meant less capital for small firms. Oftentimes, plans for expansion involve an evaluation of cash flow. These high prices for inputs have made such growth much more difficult.

Credit Conditions and Access to Capital
Budget Deficit, Commercial and Industrial Loans, Interest Rates, Venture Capital

Business financing is a key ingredient to small businesses' success, providing the ability for entrepreneurs to either start a new firm or grow an existing business. Capital availability ebbs and flows as business cycles evolve – increasing during expansions and decreasing during recessions. The business cycles experienced since the downturn of 2001 have had a significant effect on small businesses' credit conditions and as a result, on the creation of new jobs.

Most credit extended to businesses, both in the form of credit cards and commercial loans, is tied to the prime lending rate, which is adjusted as the Federal Reserve raises or lowers the target overnight federal funds rate. Since June 30, 2004, the Federal Reserve has raised the target federal funds rate eight times, increasing this rate from 1 percent to 3 percent.

Rising interest rates increase the cost of capital for doing business, but also have a more severe impact on small businesses that place a greater reliance on debt financing. Often, small firms are unable to finance operations through alternative funding arrangements, such as through the issuance of stock or commercial paper, and are forced to pay higher interest costs to secure a loan.

With interest rates beginning to rise, but still near historic lows, commercial lending has increased slightly to $956.2 billion, remaining just below the $1 trillion level last reached in 2001. The recent small increase in bank lending can be attributed to a combination of looser lender requirements and small businesses' desire to lock in low interest rates before they begin to rise further. With interest rates likely to rise higher over the course of year and the economy on uncertain footing, small businesses may continue to face further difficulty in accessing affordable.

While last year's budget deficit was $412.1 billion, this year the projected deficit is $426.6 billion. This projection is nearly $100 billion less than the projected in 2Q 2004 of $520.7 billion. Consequently, interest rates continue to be pressured higher as private sources of capital compete with the public sector for investors. As a result of these higher borrowing costs, small businesses will continue to face challenges regardless of the economy's growth.

Another important indicator of small businesses access to affordable capital is the level of venture capital funding. Venture capital is a critical source of capital for many fast growing small firms. Through venture capital and equity investment, entrepreneurs are able to fulfill their business plans, expand rapidly, and bring their products to market faster than they would otherwise be able to do. A decrease in venture capital has contributed to the decline in the SBI during the early part of 2005. The current level of investment of $4.6 billion a quarter represents a significant decline in venture capital funding from the $6 billion level in 2Q 2004 and is well below the level of $27 billion a quarter in 2000.

Rising interest rates, considerable budget deficits, and declining venture capital investment challenge small business owners' ability to expand their operations, market new products, and hire new employees. Without favorable credit conditions, entrepreneurs will either pay higher prices for capital or forgo adequate capitalization all together. As a result, it is probable that sluggish job creation will persist in many sectors, particularly those dominated by small businesses.

Trade Competitiveness of Small Businesses
Trade Deficit, Manufacturers' New Orders

The increased globalization has provided U.S. business owners with the opportunity to market and sell their goods and services abroad. However, this opportunity has yet to be fully realized as small businesses are struggling to gain a foothold in foreign countries. This is represented by the sizable trade deficits, which have now exceeded $60 billion for the last month reported. This trade imbalance reflects the lackluster labor market conditions here in the U.S. – including the decline of domestic manufacturing, the offshoring of U.S. jobs, and the increased reliance on outsourcing.

The steady increase in the trade deficit has contributed to the decrease in the SBI from its transitory upsurge in 2Q and 3Q 2004. In 2003, the trade deficit averaged just less than $42 billion per month. In 2004, the trade deficit has risen sharply, averaging over $50 billion a month, with a then record deficit of over $59 billion for November 2004. Now, in 2005, the trade deficit is averaging nearly $60 billion per month.

The trade deficit is a double-edged sword for U.S. small businesses. On the one hand, they are unable to fully access and compete in foreign markets, yet on the other hand they face increased foreign competition at home. As foreign imports grow, domestic small businesses are faced with greater competitive pressures that ultimately reduce their profit margins. And, without access to foreign markets, businesses lose out on another attractive revenue stream. The recent emphasis on bilateral trade agreements may potentially exacerbate U.S. small businesses' global competitive disadvantage.

Even though the manufacturing sector lost 7,000 jobs in May, manufacturing activity continues to increase gradually – likely reflecting increases in productivity. Manufacturers' new orders, a benchmark measure of the domestic manufacturing industry, has increased recently from 360 billion to 380 billion new orders, showing signs of resurgence for the industrial sector. While this increase in activity is a positive development for small manufacturers, it is unclear if this trend will be sustained.

While many small firms export goods and services abroad, many more should be taking advantage of newly opened foreign markets. Poor trade policy and barriers to small business growth have made this difficult for U.S. entrepreneurs, and as a result, has significantly contributed to the SBI's further decline. Without public policies that level the playing field, small businesses will be unable to expand their operations, employ more workers, and contribute to our nation' economic growth.

Industry Metrics
NFIB Small Business Optimism Index, Net Farm Income, Russell 2000 Index, Total Unemployed

In order to provide a judge of the state of small business, the SBI includes a number of statistics that are reflective of small business investment and growth. The Industry Metrics reveal what entrepreneurs can expect if they choose to start or expand a business. These indicators are designed to show small businesses confidence in the economy and whether they are expanding or are planning to hire new employees. These figures include the NFIB's Small Business Optimism Index, a small company stock index (Russell Index), net farm income and the overall number of unemployment.

The Industry Metrics have been balanced by the fact that some indicators improved over the last quarter, while other business conditions and optimism declined. The net effect has been that the SBI remains at the same level, which is low by historic standards. The Net Farm Income saw significant increases in the last two quarters, but this appears to track seasonal results based on the last few years. Thus, it is difficult to determine whether these gains are part of a trend or a seasonal anomaly.

The cause for the greatest concern is the falling of the NFIB Optimism Index, which is at a two year low. In the first quarter of 2005, the NFIB Optimism Index has dropped over three percent, and reached a level that has not been seen in years. This index is designed to gauge business owner's opinions on the state of the economy and offers a good indication of their likelihood that businesses will pour more dollars into their business. When small businesses are more optimistic about the economy, they are more prone to expand and hire new employees.

A number of figures in this data category remain unchanged, but remain at levels suggesting there is little job creation and investment in small businesses. The number of unemployed, which is intended to show hiring patterns, has seen little fluctuation. Additionally, the Russell 2000, a small company stock index, has only seen modest gains since July 2004, and actually saw over a five percent decline in the 1st Qtr 2005.

These Industry Metrics tend to point to an economy that is drifting. The optimism of small firms is lagging and the investment flowing towards small firms seems to be flat. The only positive sign was an increase in net farm income, which may be more of a seasonal aspect than a positive sign. It appears that small firms are reluctant to do more hiring until entrepreneurs get a sense that the economic environment is ripe for growth.

Conclusion

This year's Small Business Index, which stands at an eight year low, reveals that the economy has failed to gain traction, falling short of economic expectations. While there have been areas of mixed and isolated improvement in the economy over the last four years, the job market has failed to see similar growth.

The economic conditions facing small businesses today determines the health and vitality of the nation's economy – influencing job growth and economic development. Corporate America, families, and communities throughout the United States feel the effects when there is a less than favorable economic environment for small business.

Over the past year, the unemployed have been forced to search for answers as to why the economy continues to struggle and job opportunities remain few and far between. According to recent data, the average duration of unemployment remains intractably high, nearly 20 weeks, well above the 13-week average duration experienced in the late 1990s.

For answers as to why the economy has not spurred labor market gains, one only has to look to the underlying indicators comprising the SBI. Rising operating costs, tightening credit conditions, a growing trade imbalance, and slumping business confidence point to the barriers that business owners face in gaining the financial strength to hire new employees.

As outlined in this report, small businesses are not only the primary job creator in the United States, but tend to play an even more important role in spurring employment growth during periods of economic sluggishness. However, as the SBI suggests, the current economic conditions are not sufficient to permit small businesses to create the new jobs that America's labor force so desperately needs.

In order to reverse the economy's trajectory and spur job creation, entrepreneurs must be better able to reinvest their profits back into their business and hire new employees. However, with today's rising energy, healthcare and regulatory costs – the opportunity for this reinvestment and expansion are being eroded by these higher costs. With oil prices at more than $60 per barrel, health care costs rising annually at double-digit rates, and the tide of regulatory red tape intensifying, business owners are compelled to direct additional cash flow to these operating costs.

Many entrepreneurs may seek financing as a means to stimulate new business growth. However, with the Federal Reserve poised to raise short-term interest rates for the ninth time since last year, business owners are now also facing higher costs for capital. As a result, many small businesses are either being forced to delay plans for expansion or scale back their operations altogether.

For business owners faced with higher costs and tighter credit conditions, many entrepreneurs can look to foreign markets for new business opportunities. Doing so enables businesses to sell their goods and services to more customers, thus providing a new source of revenue. A record level trade deficit demonstrates that small firms are not breaking into these new markets, and that they are finding themselves facing greater competition at home. The result is a trade environment that is less than conducive to domestic job growth.

Finally, small businesses confidence levels are at their lowest levels in two years. In addition, small businesses' outlook for expansion, according to the NFIB, is at an 18 month low. This lack of stability and predictability of the economy has hurt job growth and expansion in the small business sector. In much the same way, investors in the stock market tend to "keep their money on the sidelines" during times of uncertainty, entrepreneurs appear reluctant to move their venture forward whether as a start up or possible expansion.

At a time when the economy is slowly recovering and investor appetite for risk remains modest, policies must address the needs of small businesses. The lack of a sound energy policy and the inability to lower the cost of health insurance for small business has greatly hindered their ability to create new jobs. In addition, America's entrepreneurs continue to need access to affordable capital, and an open and fair international marketplace in which they can compete.

Economic policies must also incorporate programs and incentives that encourage innovation and the development of new ideas. Lawmakers should pursue policies that encourage entrepreneurship across our country's diverse population, provide seed capital for those with new ideas, and retrain those workers whose employment opportunities have waned. It would be appropriate to direct these policies to geographic areas hardest hit by the slowdown in the economy, such as manufacturing centers and textile producers.

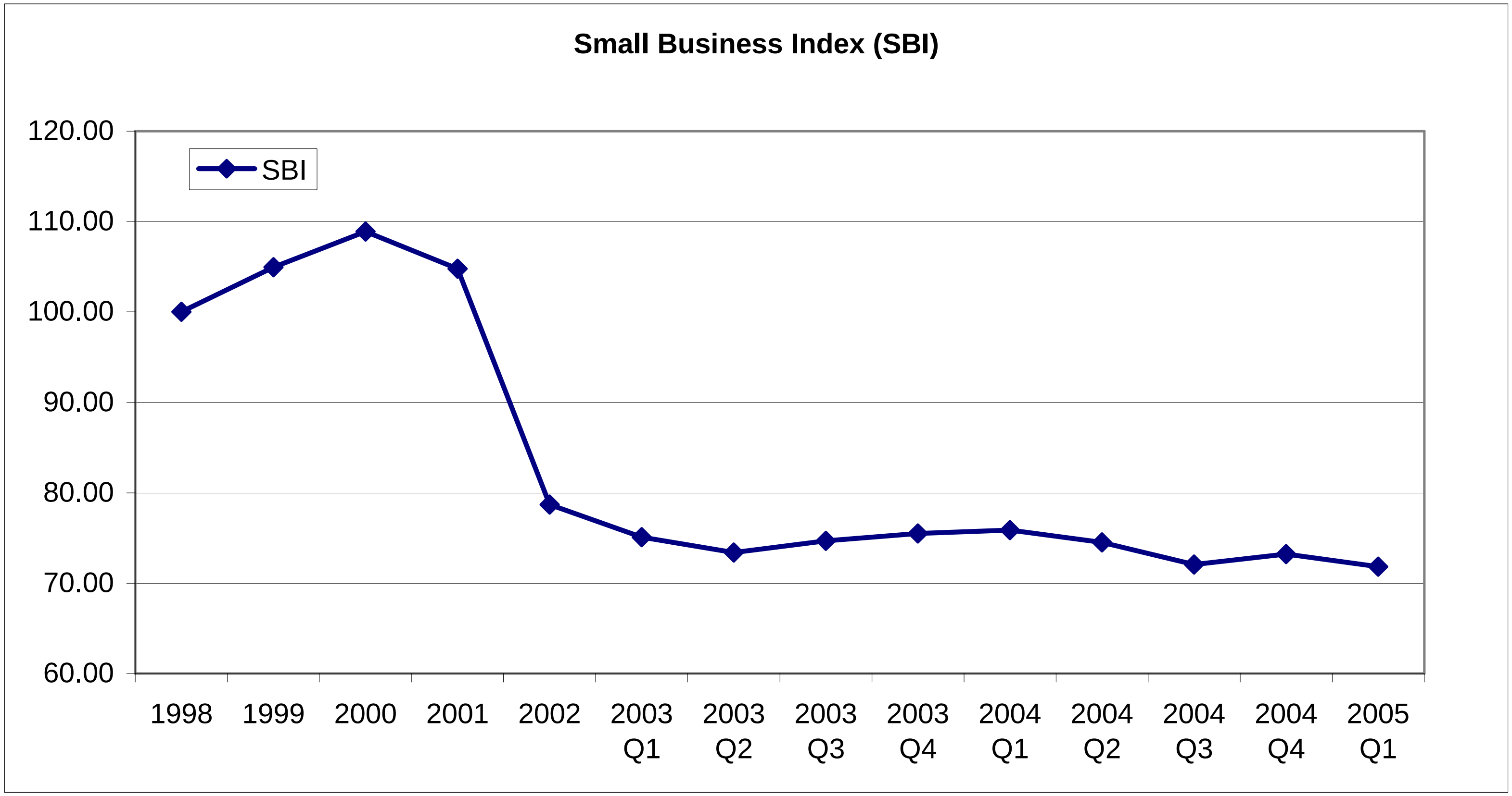
Historically, the SBI has demonstrated that when economic fundamentals are positively aligned, job creation will occur. During the 1990s and early 2000s, these economic fundamentals were favorable – lower operating costs, ready access to capital, a lower trade deficit, and strong business optimism – and helped spawn the creation of thousands of new businesses.

In turn, this wave of entrepreneurial development spurred substantial employment growth, which led to decade high levels of payroll growth. As evidence, in March of 2000, the SBI reached nearly 110, and 476,000 jobs were created that month alone. Compare this to today's SBI that is at 70, when only 78,000 jobs were created last month.

The U.S. economy is blessed with strong fundamentals – a flexible workforce, deep capital markets, accessible raw materials, and a high quality infrastructure. While this foundation has served the country ably, it is simply not enough. As the four main basket indicators that comprise the SBI demonstrate, in order for small businesses to take advantage of this nation's strong base and to serve their historic roles as the catalyst for job creation, they must have a positive economic environment.

Small businesses need to have the necessary tools to remain competitive in today's global marketplace. Entrepreneurs must also have the confidence and ability to invest in this economy and create jobs. While not all economic indicators need to be buoyant to enable small businesses to take the reins, stimulate economic growth, create jobs and turn this economy around – there does need to be some positives. If not, the current state of the economy will only continue to be mixed and job creation will remain stagnant.

Data



Period		**98-99**	**99-00**	**00-01**	**01-02**	**02-031Q**	**031Q-032Q**	**032Q-033Q**	**033Q-034Q**	**034Q-041Q**	**041Q-042Q**	**042Q-043Q**	**043Q-044Q**	**044Q-051Q**
% Change		4.9%	3.8%	-3.8%	-24.9%	-4.6%	-2.3%	1.8%	1.1%	0.5%	-1.8%	-3.3%	1.6%	-1.9%
	1998	**1999**	**2000**	**2001**	**2002**	**2003 Q1**	**2003 Q2**	**2003 Q3**	**2003 Q4**	**2004 Q1**	**2004 Q2**	**2004 Q3**	**2004 Q4**	**2005 Q1**
SBI	100.00	104.95	108.89	104.78	78.71	75.09	73.39	74.69	75.50	75.86	74.51	72.07	73.21	71.83

Methodology

The SBI is comprised of a basket of economic indicators. These indicators provide a broad measure of the degree of small business creation and viability by representing the characteristics necessary for a healthy domestic small business sector. An increasing SBI is indicative of an improving small business sector. The data is gathered and compiled quarterly from various sources, including government agencies, congressional sources, and private institutions. The report is generally released annually.

The SBI is what is generally known as a coincident index in that it reflects the current economic conditions facing small businesses. In order to expand the scope of the economic environment measured by the SBI, both leading and lagging indicators are included. Leading indicators are commonly used to predict changes in economic activity, whereas lagging indicators typically confirm previous changes in the economy. By using both types of data, the SBI demonstrates not only the current state of small businesses, but also how strong the environment is for starting new ventures.

The SBI is calculated using both broad economic measures as well as more specific indicators showing the health of the small business sector. Broad economic measures incorporate the effect of changes in aggregate economic conditions, such as inflation, employment, and trade balances. The sector, specific indicators track changes in the costs associated with operating a small business, such as health care and energy costs. Together, this combination of indicators provides an expansive measure of the small business economic environment.

Since the initial SBI was released in 2003, the index's indicators have been reviewed and updated to ensure that the SBI remains the most accurate measure of the small business economy. Revisions to data series maintained by federal agencies used in the SBI are commonplace; as a result of these changes, the current SBI's comparability to previously released SBIs is limited.

Business starts and failures, which were originally used as a broad measure of small businesses' confidence in the economy, were removed in 2004 from the index due to the substantial lag in the issuance of the data series. In place of these variables, NFIB's benchmark Index of Small Business Optimism was incorporated into the SBI to measure small business owners' views of and confidence in the economy. Also in 2004, the SBI's energy indicators were refined to more accurately capture the costs of the energy resources most relied on by small businesses – oil and natural gas.

For each economic indicator, data is used to calculate a percent change. This change is calculated quarterly beginning in 2003. For the five-year period between 1998 and 2002, the SBI was calculated annually. The change in each indicator is used as the basis for computing the SBI.

Understanding that not every indicator positively affects the economic conditions facing small businesses, each indicator is assigned a positive or negative correlation. Positive indicators contribute to more favorable economic conditions for small businesses, whereas negative indicators weaken their economic environment. The correlation determines whether the SBI will increase or decrease given a change in the value of each economic indicator.

The average percent change of the basket of economic indicators is then calculated. For this calculation, each economic indicator has an equal statistical weight. This average percent change is used to increase or decrease the SBI.

Indicators

Balance of Trade represents the net amount of domestic international trade, as the combination of the number of imports and exports. A trade deficit occurs when foreign imports exceed domestic exports. Conversely, a trade surplus occurs when domestic exports exceed foreign imports.

While trade deficits have helped contain inflation during periods of economic growth, they produce many challenges to domestic manufacturers and exporters, the majority of which are small businesses. For these domestic small businesses, trade deficits often signal a lack of global competitiveness and a loss of market share. Larger corporations are better able to move their operations abroad, reducing their exposure to the factors that cause trade imbalances. Small businesses, however, are unable to easily relocate overseas and must reduce their operating costs or change their business model.

Commercial and Industrial Loans and Leases reflect the amount of business lending by commercial banks. Small businesses, including small manufacturers, rely on commercial and industrial loans to expand their operations and to modernize their facilities. These loans are used to purchase real estate and equipment, as well as for working capital purposes.

The measure of commercial and industrial lending and leasing activity provides a good gauge of the credit conditions facing small businesses. An increase in lending and leasing indicates that banks are willing to extend more credit, while a decrease represents a tightening, or rationing, of credit. Because bank lending patterns also reflect the financial conditions of their borrowers, a change in this measure is often correlated with the underlying economic fundamentals of the business sector.

Federal Budget Surplus or Deficit represents the net amount of federal government outlays and receipts. A budget deficit may negatively affect small businesses for two reasons. First, it may be indicative of a decrease in federal government domestic discretionary spending, including reductions in programs targeted to assisting small businesses and entrepreneurs. For instance, budget deficits are likely representative of reductions in many of the Small Business Administration's (SBA) programs, as well as programs that provide vocational training to adults, energy and technological support to companies, assistance to small manufacturers, and mentoring opportunities to minority-owned businesses.

Second, budget deficits contribute to higher credit costs. As the supply of government debt is increased, the price (interest rate) on the debt must also be increased in order to attract investors. To remain competitive, private sector debt issuers often raise the interest rates on their instruments as well. The result is higher interest rates for all borrowers. Borrowers who rely on commercial loans, such as small business owners, are most likely to be hurt by these interest rate increases.

Health Care accounts for the cost of health care insurance premiums. The indicator represents the price companies pay for providing health care to their employees. It is a combination of the cost of health care supplied by all providers (HMO, PPO, and point of service). While small businesses are not required to provide health care to their employees, most do so in order to retain qualified workers. As with any workforce benefit, changes in the price of health care have a direct impact on the company's bottom line. For small businesses, increases in these costs can lead to either a reduction in coverage offered or other forms of compensation, and can have a detrimental affect on the stability of the company.

Manufacturers' New Orders represent the amount of orders for durable and non-durable goods placed with domestic manufacturers, the majority of which are small businesses. Manufacturers' new orders are a benchmark for economic activity, often signaling a near-term economic recovery or downturn.

A rise in manufacturers' new orders reflects an upturn in economic activity and is a likely indicator of a rise in near term profitability. A decrease in manufacturers' new orders is indicative of a decline in business, which will result in lower profits for manufacturing businesses.

Natural Gas Costs are the average monthly price of natural gas sold to consumers in the United States. These figures are taken from the U.S. Energy Information Association. The amounts are measured in dollar amounts per cubic foot.

For many small businesses, the costs of energy, including natural gas, make up a significant percent of their daily operating costs. Spikes in natural gas prices can be devastating to certain sectors of the economy. These price increases are particularly tough on gas-intensive businesses like small restaurants and dry cleaners. Federal Reserve Chairman Alan Greenspan and other economists have cited the rising costs of natural gas as an impediment to economic growth.

NFIB Small Business Optimism Index is a composite measure of ten qualitative small business survey indicators and generally reflects small businesses' views of the economy. The index is based on monthly surveys of NFIB members.

Net Farm Income is a measure of the financial condition of the farm industry. It reflects the farm income received from the sale of livestock and crops, as well as payments from the government less the production expenses. Farms often drive rural economies, providing jobs to local residents and generating wealth in these communities. As a result, the economic well-being of rural small businesses is frequently tied to local farms.

An increase in net farm income is indicative of an improving rural economy. Growth in net farm income often translates into higher profitability for rural small businesses. Alternatively, a decline in net farm income often signals tougher times for small firms, as farms purchase less goods and services from local rural small businesses.

Number of Unemployed represents the number of individuals without jobs, indicating the level of small business economic activity. A decline in the number of unemployed reflects an improving economy, in which more consumers have the means to purchase goods and services. An increase in the number of unemployed indicates a slowing economy, in which consumers are less able to spend freely on goods and services.

Oil Costs pertain to the sweet crude oil costs in U.S. dollars per barrel. Such figures are compiled by the New York Mercantile Exchange Index and are posted by the U.S. Department of Energy. As many small companies are dependent on transportation costs, changes in gasoline prices can severely affect the cost of doing business. In addition, price volatility of oil can make it difficult for small businesses to decide on future investments due to cash flow issues related to these rising costs.

Prime Rate is the interest rate charged by banks to their most creditworthy customers. Interest rates on small business loans are generally tied to the prime rate. The prime rate is included as a measure of the credit terms available to small businesses. While the prime rate is directly charged to the most creditworthy small businesses, the interest rates charged to less creditworthy small businesses are increased and decreased according to this rate. This demonstrates how the prime rate affects the lending conditions of nearly every company.

The prime rate fluctuates based on the federal funds rate and other factors. The prime rate provides the lender with sufficient revenue to cover the costs associated with loans to borrowers determined to have a low risk of default. The rate is adjusted in increments, called the margin, to compensate for greater credit risk or other factors that affect the cost of lending.

Producer Price Index (PPI) measures the average change over time in the selling prices received by domestic producers for their output. The PPI represents the prices that small manufacturers and producers will receive for their products. In addition, the PPI also measures the prices charged to small businesses for purchases of their retail inventory.

Rising resource and labor costs often cause the PPI to increase and may result in a reduction in the demand for small businesses products, dampening economic activity. A decrease in the PPI reflects declining costs of production and may cause small businesses to lower their prices or increase their profit margins.

Regulatory Costs represent the total number of final regulations issued each year. This measure is used as a general indicator for small business regulatory burden. Regulatory compliance and paperwork consistently rank as one of the top ten costs facing small businesses in America today. Costs to small firms for regulatory compliance are generally 60 percent higher than they are for large firms.

Retirement and Savings represent the costs for small businesses to provide employee pension benefits per working hour. These costs are associated with the amount spent in offering retirement coverage, a critical tool in attracting and retaining employees.

Russell 2000 Index represents the 2,000 smallest companies in the Russell 3000, a broad based index that represents approximately 98% of the value of what is invested within the U.S. equity market. The Russell 2000 makes up only about 8% of the total market capitalization of the Russell 3000. This is the most quoted index that focuses on the smaller company portion of the economy.

While most small businesses are not publicly traded, the Russell 2000 Index is a benchmark measure of the economic performance of smaller companies. An increase in the Russell 2000 reflects rising investor confidence in the smaller company sector and heightened expectations for future profitability. A decline in the Russell 2000 is generally driven by decreased investor confidence and lower profit expectations for the Index's companies.

Total Employee Compensation accounts for what small businesses spend on employees for each hour worked. This number represents the compensation for companies that have 99 employees or less, and is a combination of salary, benefits, and government paycheck requirements. This measure does not account for employee retirement costs.

Cost increases for small businesses can have a detrimental affect on them, since many operate on very thin profit margins. An increase in the cost of each employee hour worked can force small firms to make cuts or raise their product's price. When the cost of each hour worked decreases, small businesses have more flexibility in running their companies, as they are able to provide more benefits, hire additional workers, or save money for a later date.

Venture Capital reflects the amount of equity investment in private companies, the majority of which are small businesses. Equity capital is an important financing element for entrepreneurs seeking to improve their business model, expand their operations, and reach new customers.

Venture capital activity is beneficial to small enterprise because it provides a source of long-term capital investment. Any increase in venture capital investment is beneficial to small businesses, as it provides another source of financing. A rise in venture capital financing is also symbolic of increased innovation and entrepreneurship. On the other hand, a decline in venture capital financing increases the likelihood that small businesses will have to rely on more costly financing arrangements, such as high interest credit cards.