

## Self-Employed Boost The Economic Recovery

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Are start-up companies helping to drive the economic recovery?

For months, economists who pore over the Department of Labor's employment surveys have suspected as much. That is because for the past 18 months, more and more Americans have been going off to work on their own. Self-employment has increased by 400,000 in the past year alone, according to a monthly survey of American households conducted by the Labor Department. But it has been hard to tell whether these new self-employed workers were really profiting from their ventures, or whether they were just biding their time during a period of painful unemployment.

Now, investment strategist Kenneth Safian says he has found evidence that small enterprises really are playing an important role in the recovery. The evidence is buried in the government's monthly personal-income report, which was released last week. Proprietors' income, which is the income earned by individuals from running their own businesses and from partnerships, is surging. The Commerce Department reported Wednesday that proprietor's income, excluding the farm sector, was up 8.6% from a year earlier. By contrast, the wages and salaries of individuals on corporate payrolls were up just 2.3%.

Proprietor's income covers a broad swath of the economy -- everything from larger law firms to one-person construction companies or tech consultants operating out of a home office. Mr. Safian, who is president of Safian Investment Research Inc., based in White Plains, N.Y., says the upshot of the latest trend is that more workers are striking out on their own and earning money doing it. The economy, he says, "is becoming more entrepreneurial."

If that is the case, it would say a lot about the dynamism of an economy that has been through series of shocks in the past three years. It might also help explain why official payroll employment levels have been so depressed in recent months. If more people are striking out on their own, then their job status in some cases wouldn't show up in the government's measure of employment levels at established businesses, which is down 2.4 million since the recession started in March 2001.

Unfortunately, there are no official statistics for business formations across the \$10 trillion economy. And there are other explanations for the recent pop in proprietor's income. It might mean that existing small companies are simply enjoying an upturn in profits, just as larger corporations are. Nationwide, corporate profits were up 30% from a year earlier in the third quarter. It might also be related to corporate outsourcing -- more workers losing their jobs on corporate payrolls and then being hired back as independent, self-employed consultants, responsible for their own health benefits. Such a trend would shift their income from wages and salaries to proprietorship.

The personal-income report Wednesday showed that overall incomes were up 0.4% in October from the month before. Proprietor's income rose by 0.4% from September, while wages and salaries rose 0.2% from the month before. It was the 13th time in the past 14 months that proprietor's income has outpaced growth in wages and salaries. This type of trend has occurred in

previous recoveries. In 1992, for instance, nonfarm proprietor's income grew by more than 12% from a year earlier, and in 1984 it leapt by more than 20%.

Other glimmers of a pickup in new business formations lend some credence to Mr. Safian's suspicion. For example, the state of Delaware, a center for business incorporations, has seen a sharp pickup in business formations, notes Mark Zandi, chief economist with Economy.com, a West Chester, Pa., economic-research firm specializing in regional economies. In the fiscal year ended June 30, the state experienced a 14% increase in the fees it collects from individuals applying to register limited-liability companies. That trend appears to have accelerated since then, Mr. Zandi adds.

"This is a pretty good bellwether for what is happening around the nation," he says. "You can use Delaware as a window into whether the entrepreneurial spirit is being revived or not."

Delaware isn't the only state where this is occurring. Michael Bernick, the director of California's Employment Development Department, says. "Our data show that new businesses incorporations are running very high." The number of incorporations held up even during the tech downturn, which hit California especially hard, Mr. Bernick says. In 2003, he added, it accelerated.

While business-formation data is spotty, it is clear that individual business owners are seeing strong growth in their own income.

Today, proprietor's income is taking on a rising share of total national income. At \$822 billion, at an annual rate, it now accounts for more national income than the entire manufacturing sector's wages and salaries. It is just shy of the wages and salaries earned by government workers.

The Commerce Department's measure of proprietor's income is based on Internal Revenue Service tax returns from individuals and business partnerships. Since that data comes in with a lag, Commerce Department statisticians use a range of proxies to estimate it on a monthly basis, such as brokers' commissions, sales data and wages in certain industries. It is possible that the latest burst of income will be revised Dec. 10, when the government updates its estimates of national income and output using fuller data sets from the IRS.

That release in early December might also provide a glimpse of which industries account for the apparent rise in business formations. Right now, the government's data break down proprietor's income into only two sets -- farms and everything else.