December 17, 2012 Policy Brief: Volume 12, Number 62

Rebutting Business Owner's Support of Higher Taxes

In a recent editorial in a Pittsburgh newspaper, a small business owner argued that if the Bush tax cuts for the richest two percent of taxpayers are not extended, small businesses like hers will not get hurt. But worse, the editorial goes on to argue the Bush tax rates should not be extended. The business owner justifies support for President Obama's plan with a set of deeply flawed arguments and assertions of purported facts that are either incorrect or misleading.

The writer of the op-ed disagrees with the claim that taxes affect the economy or job creation. The argument is that when demand for a firm's product increases the business will hire more people to meet the demand. By this reasoning the only real creator of jobs is the growth of demand for products. While this might sounds reasonable to some, it is not the whole story by a long stretch. But it is the prevailing view of those who believe that government stimulus is net new real demand and consequently a job creator.

How about firms that hire people and spend large amounts of money developing new and/or improved products? What was the demand for the personal computer, the automobile, or hula hoop before they were invented and marketed? The magic of the free market, entrepreneurial economy is that growth stems largely from the pursuit of profit that in turn encourages innovation and invention—the very lifeblood of sustained prosperity. It also rewards the firms that keep costs down compared to competitors, domestic and foreign.

Government can stymie the market based economy with burdensome regulations and misguided, counterproductive policies such as those that spawned the runaway housing bubble in the last decade. Creating artificial incentives or disincentives leads to over and under allocation of resources that end up damaging the economy. The President's current policy of wanting to raise taxes on high income earners will be a disincentive to invest at a time when weak investment is the biggest drag on the economy's ability to grow.

On the other hand, the op-ed writer is partially correct when she says the vast majority of small business will not be affected if the tax rates go up on the top earners. And that is because the vast majority of small businesses (small businesses are defined as businesses with fewer than 500 employees) are very small, have only a handful of employees and pay only a fraction of the payroll paid by the relatively tiny number of "small" businesses with 50 or more employees. According to government data for 2010, there were 5,160,404 businesses with fewer than 20 employees and 3,575, 340 with four or fewer employees (63 percent of all small businesses.) The firms with four or fewer employees had 5,826,452 workers and payrolls totaling $226.5 billion, just 10.8 percent of all small business payrolls and only 4.5 percent of total business payrolls.

These data presumably do not include the self-employed which are not captured under the government's industry classification system (NAICS).

Meanwhile, there were only 193,922 small businesses with 50 or more workers, a mere 3.4 percent of all 5.72 million businesses with fewer than 500 employees. These firms are critical because they are subject to and likely to be negatively impacted by the Affordable Care Act provisions regarding mandatory minimum health insurance coverage. However, those 193,922 companies hired 23,524,000 workers and had payrolls totaling $973 billion, 46 percent of all small business payrolls. That is to say, the 193,922 small businesses with over 50 employees hire four times more workers than the 3.6 million four or fewer employee firms and have well over four times the payroll. This is not to disparage the very small businesses. Many will grow to be very successful firms and hire lots of workers. It's the American way.

The point at hand however is that larger firms will typically earn higher profits and have much greater capital investment than the 4.2 million firms with 10 or fewer employees that make up the overwhelming majority of all small businesses. Therefore, imposing higher tax rates on business owners who have to be concerned about the effect on large capital investments —they are already paying a 35 percent marginal income tax rate and will be less inclined (all other things equal) to increase investment or hire as many employees.

In short, the argument that the vast majority of small businesses will not be directly affected by tax hikes on the highest two percent of earners might well be true for most low value added firms that do not generate high levels of income. But that is not the basis on which policy should be made considering that it is a comparatively small number of firms with employment between 50 and 499 workers that account for nearly half of small business employment and payrolls. These are the small businesses that will be hit hardest by the tax hike.

While the smaller firms might escape the initial direct effects of higher taxes, they will surely be impacted by any economic slowdown that occurs when the small businesses that account for a quarter of all private sector employees begin to cut investment and hiring. And that does not take into account the impacts higher taxes could have on the firms that are over 500 employees. In sum, the argument that the vast majority of small firms won't be affected by the raising of the tax rate on the upper two percent of income earners is shortsighted and not a position business owners who hope to see a strong economy that boosts everyone's opportunities should ever make.

To top off the liberal talking points editorial, the writer declares confidently that Bush tax cuts led to the serious recession of 2008. Never a word about the colossal housing bubble that burst and collapsed the financial house of cards underpinning the bubble. The housing market calamity was fostered by policies created primarily by Democrats with some Republican assistance. If Bush gets any blame, it is because his administration did not work hard enough to curtail the outrageous expansion of mortgage credit by Fannie Mae, Freddie Mac and the FHA that aided and abetted the corruption of prudent lending practices. Then with the aid of failures of credit rating agencies to appropriately assess loan quality, the bad loans were packaged into mortgage backed securities by the hundreds of billions and sold to investors who believed the high bond rating they came with.

Inevitably, this scheme had to blow up. And it did in 2008 with the attendant massive decline in asset value producing an entirely predictable impact on the economy. The truth? The Bush tax cuts were not the cause of the housing and financial bubbles no many how many times the administration's spokespersons claim otherwise. Here is the relevant question for those making the preposterous claim that Bush tax cuts caused the deep recession. If tax rates on the richest two percent had been at the 2001 pre-tax cut level in 2007 and 2008 would that have prevented the runaway housing bubble from collapsing? The answer is absolutely not. Case closed.

Sadly, the inability or refusal to understand correctly what has happened in the past leads to prescriptions about future policies that are as nonsensical as the ones that produced the previous debacle.

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