Impact of Fiscal Policies on Small Business

Janemarie Mulvey, Ph.D.
Chief Economist
Office of Advocacy
U.S. Small Business Administration

INFORUM Annual Policy Meeting
December 12, 2013
Office of Advocacy

• Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government.

• Our mission is to serve as a voice for small businesses regarding:
  – Federal Regulation
  – Economic Research

• Regulation: Identify solutions or alternatives with the respective federal agency to minimize potential burden and unintended consequences on small businesses.
Office of Economic Research

- Examine the role of small business in the American economy;
- Analyze impact of tax policy on small businesses;
- Explore access to capital issues for small business;
- Identify characteristics and potential barriers for small business owners, including women, minorities and veteran owned entities; and
- Identify factors leading to small business successes and failures.
Overview of Fiscal Policy Impacts

• Small Business and the Economy
• Sequestration
  – Deficits vs. Debt
  – Discretionary vs. Mandatory Targets
  – Impact on Economic Activity on Small Businesses
• Tax Reform
  – Options and Obstacles
  – Small Business Tax Expenditures
Small Businesses in the US

- 99.7% of U.S. firms with <500 employees
- 64% of the net new jobs in the private sector
- 46% of private-sector output
- 98% of firms exporting goods
- 33% of exporting value
Employment Change by Firms Size As of 2013 Q1

Growth in Number of Small Firms Increasing as of 2013 Q1

Source: Bureau of Labor Statistics, Business Employment Dynamics
Challenges of Fiscal Policy

- Sequester/Shutdown(s)
- Potential Tax Reform
# Federal Budget in Perspective: Deficits vs. Debt

<table>
<thead>
<tr>
<th></th>
<th>Billions of Dollars</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenues</strong></td>
<td>2,105</td>
<td>2,813</td>
</tr>
<tr>
<td><strong>Total Outlays</strong></td>
<td>3,518</td>
<td>3,455</td>
</tr>
<tr>
<td><strong>Deficit</strong></td>
<td>-1,417</td>
<td>-642</td>
</tr>
<tr>
<td><strong>Debt</strong></td>
<td>7,545</td>
<td>12,036</td>
</tr>
</tbody>
</table>

## Sources of Outlays

<table>
<thead>
<tr>
<th>Source of Outlays</th>
<th>Actual 2009</th>
<th>Actual 2013</th>
<th>Projected 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discretionary</td>
<td>1,237</td>
<td>1,213</td>
<td>1,187</td>
</tr>
<tr>
<td>Mandatory</td>
<td>2,281</td>
<td>2,020</td>
<td>2,326</td>
</tr>
<tr>
<td>Net Interest</td>
<td>187</td>
<td>223</td>
<td>264</td>
</tr>
</tbody>
</table>

Source: Congressional Budget Office
Federal Debt Held by the Public Under CBO’s Extended Baseline

(Percentage of gross domestic product)
Sequestration: Across-the-Board and Only Affects Discretionary Spending

- Budget Control Act of 2011 implemented discretionary spending caps
- American Taxpayer Relief Act of 2012 modified caps
- About $1 trillion of across the board cuts to discretionary spending over 10 years ($100 billion a year)

Discretionary Spending Caps

Source: CBO, current law. Does not include Ryan-Murray Budget Proposal.
Discretionary Spending Not the Key Source of Future Debt
Economic Impact of Sequester: Dampen the Demand for SB Products

- Entrepreneurship
- Development of Product
- Supply
- Production of Goods or Services
- Demand
- Bring to Market
Growth in Economy Improving But....

Growth in Real GDP

Source: Bureau of Economic Analysis
Government Spending and Inventories Distorting Trend

Contributions to Percent Change in Real GDP

<table>
<thead>
<tr>
<th></th>
<th>2012 Q4</th>
<th>2013 Q1</th>
<th>2013 Q2</th>
<th>2013 Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;L</td>
<td>-0.12%</td>
<td>-0.14%</td>
<td>0.05%</td>
<td>0.19%</td>
</tr>
<tr>
<td>Federal</td>
<td>-1.19%</td>
<td>-0.58%</td>
<td>-0.12%</td>
<td>-0.10%</td>
</tr>
<tr>
<td>Net Exports</td>
<td>0.68%</td>
<td>-0.28%</td>
<td>-0.07%</td>
<td>0.07%</td>
</tr>
<tr>
<td>Chg. In Inventories</td>
<td>-2.00%</td>
<td>0.93%</td>
<td>0.41%</td>
<td>1.68%</td>
</tr>
<tr>
<td>Fixed Investment</td>
<td>1.63%</td>
<td>-0.23%</td>
<td>0.96%</td>
<td>0.81%</td>
</tr>
<tr>
<td>Consumption</td>
<td>1.13%</td>
<td>1.54%</td>
<td>1.24%</td>
<td>0.96%</td>
</tr>
</tbody>
</table>

Real GDP Growth Rate 0.1% 1.1% 2.5% 3.6%
Unemployment Rate is Declining But.. 

Source: Bureau of Labor Statistics
Share of Long-Term Unemployed Is Still High by Historical Standards


Note: Long-term unemployed defined as being unemployed 6 months or longer.
The Federal Reserve to the Rescue

• Quantitative Easing holding down interest rates to historical lows
  – Increasing demand in interest sensitive durables and housing which help small business
• But is it sustainable?
  – Fed purchased more than $4 trillion in government securities
  – When mature in 2016 and beyond, how will federal government pay back w/ budget targets still in effect.
    • $215 billion in 2016
    • $185 billion in 2017
    • $342 billion in 2018
Federal Reserve Holds Down Interest Rates to Historical Lows

10-Year Treasury Yield

- 1969
- 1971
- 1973
- 1975
- 1977
- 1979
- 1981
- 1983
- 1985
- 1987
- 1989
- 1991
- 1993
- 1995
- 1997
- 1999
- 2001
- 2003
- 2005
- 2007
- 2009
- 2011
- 2013
Jobs in Interest Sensitive Small Business Dominated Industries Grow

% Change in Employment Since Recovery Began

% Change Since Jan. 1, 2013 Interest Sensitive Industries
Tax Reform and Implications for Small Businesses

Options:
• Individual and/or Corporate Focus
• Budget neutral or raise revenues
• Targeted approach or comprehensive

Obstacles:
• Special interests
• Politics and 2014 elections
Individual Tax Expenditures Provide Larger Revenue Target

Selected Major Tax Expenditures in 2012, Compared with Other Categories of Revenues and Outlays

(Percentage of gross domestic product before BEA revisions)
Tax Expenditures by Small Business Entity Type, 2013

- **Sole Proprietorships (Non-Farm)**: 12%
- **Partnerships**: 36%
- **C Corporations**: 15%
- **S Corporations**: 37%

Health Premiums and Pensions
Largest Individual Tax Expenditure

Effect of Selected Major Tax Expenditures, 2013 to 2022

- Exclusion of Employers' Contributions for Health Care, Health Insurance Premiums, and Long-Term Care Insurance Premiums
- Net Exclusions of Pension Contributions and Earnings
- Exclusion of Capital Gains at Death
- Exclusion of Untaxed Social Security and Railroad Retirement Benefits
- Deduction for Mortgage Interest on Owner-Occupied Residences
- Deduction for State and Local Taxes
- Deduction for Charitable Contributions
- Reduced Tax Rates on Dividends and Long-Term Capital Gains
- Earned Income Tax Credit
- Child Tax Credit

Percentage of Gross Domestic Product
Pension and Health Also Largest Tax Expenditures For Small Business

Tax Expenditures by Share of Total, 2013

<table>
<thead>
<tr>
<th></th>
<th>Small Business</th>
<th>Large Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Plan (Keogh Plans)</td>
<td>26%</td>
<td>20%</td>
</tr>
<tr>
<td>Deduction for Health and LTC Insurance Premiums by the Self-Employed</td>
<td>13%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Other Tax Expenditures Important to Small Businesses

• Encourage U.S. domestic manufacturing and investment
  – IRC Sect. 199

• Promote investment by small businesses (expanded following great recession)
  – IRC Sect. 179

• **Not** important to small business
  – Deferral of active income of controlled foreign corporations

![Tax Expenditure Share of Total, 2013]

Conclusion

• Sequester doing more harm than good
  – Does not address real source of growing debt
  – Timing off and dampens economic activity

• Tax Reform may provide option for revenues
  – Must be targeted
  – Careful about unintended consequences
Questions

??????????

Janemarie.mulvey@sba.gov
(202) 205-7123