



How Mobilized Small Businesses - Real and Disguised - Tilt the Partisan Playing Field on Tax Cuts

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Clashes over tax policy have been front and center in U.S. politics in recent times, but in these battles Republicans have been much more unified than Democrats. In 2001 and 2003, Congressional Republicans showed remarkable discipline in pushing through huge, upward-tilted federal tax cuts. By contrast, even after the election in 2008 of a Democratic president and Congress, Democrats still had a hard time raising much needed revenues or even structuring tax decisions to further their preference for adequately funded government. Why is this? Although a variety of factors contribute to this partisan imbalance in tax politics, our research shows that a key factor is the rising political clout of “small business,” including enterprises that do not fit traditional conceptions. Legally incorporated small firms, and actors claiming to speak on their behalf, have successfully pressured legislators, especially Democrats, to accept tax cuts favoring the very wealthiest Americans.

Why Have Small Firms Become More Involved in Tax Politics?

By many indicators, small businesses are more active in tax politics than they were decades ago. Stories about tax policy in major newspapers more frequently cite small businesses and their owners; political organizations claiming to speak for small business are more active in Congressional debates over taxes; and presidential candidates regularly mouth fealty to small businesses when taxes come up on the campaign trail. Increased public attention to small business is propelled by underlying shifts:

- Starting in the 1970s, corporate America as a whole mobilized to push back against waves of new environmental, health, workplace, and safety regulations. As part of this mobilization, a small business lobbying powerhouse, the National Federation of Independent Business, doubled its membership between 1970 and 1979.
- Changes in the federal tax code created new incentives for owners of both traditional and new forms of small business to support cuts in top federal income tax rates on individuals and households. By lowering personal income tax rates below the corporate income tax rates, Congress made it more appealing for firms and wealthy individuals to opt for taxation through the personal income tax code. To do so, many managers and wealthy people created newly restructured firms that are “small businesses” in name only. Both new and traditional small business owners became especially sensitive to changes in the top personal income tax rates and could be mobilized to support ever deeper cuts to those rates.
- As these shifts took hold, politicians could talk about cutting the top personal income tax rates to spur small business growth, even if most of the firms were legal entities set up by wealthy professionals or large companies hoping to dodge taxes. Tax relief for the very wealthy could be pushed by politicians feeding voters stories about family farms or mom and pop enterprises.

The Consequences for Democrats

The increasing mobilization of small businesses in tax politics has created new difficulties for legislators seeking to increase and even maintain federal revenues. Republicans are rarely cross-pressured because, in recent times, most want to cut back on the scope and services of government and many conservatives see cutting taxes as a good way to set the stage for subsequent cuts in social spending. By contrast, most Democrats do face dilemmas when they try to expand or sustain social and economic programs while at the same time dealing with strong pressures from small business advocates pressing for cuts in top income tax rates.

Pivotal Congressional battles over the U.S. tax code reveal what happens when small businesses and their political representatives push Democrats to support or sustain cuts in tax rates for top personal income earners:

- Top-heavy tax cuts championed by GOP President George W. Bush and Republican Congressional leaders reshaped the tax code in 2001 and 2003 to benefit the wealthiest Americans and set the stage for ballooning federal deficits. Debates at the time warned about such effects, and the two parties largely divided on the relevant votes. Perhaps surprisingly, however, a number of Congressional Democrats joined the GOP to support the Bush cuts. Testing various hypotheses about why this happened, our research finds that Democrats were more likely to support the cuts if they had disproportionately more people in their districts filing their taxes as small firms through the personal income tax code. This factor mattered even when we took into account past voting records and the popularity of GOP President George W. Bush in Democratic districts.
- After 2008, Democrats had the opportunity to reverse or greatly revise the Bush tax cuts, especially those tilted toward the wealthy. Key cuts were set to expire in 2010, requiring action by the Democratic president and Congress. Public opinion supported raising taxes on the rich; and economists argued that modest tax increases targeted on the rich could help to sustain federal spending to jump-start recovery from the Great Recession. But even though Democratic leaders had many opportunities in 2009 and 2010 to set up Congressional votes on their own terms, they repeatedly delayed and ultimately settled for a deal with Republicans that preserved most of the 2001 and 2003 cuts favorable to the wealthy. A minority of Democrats undercut their party's leaders in Congress – and our research shows that, once again, Congressional Democrats who had more small business tax filers in their districts were more likely to stall and support the preservation of the top-end tax cuts beyond 2010.

Small Business Pressures and the Future of U.S. Tax Politics

U.S. politics advantages well-organized actors who can marshal local and national pressures on politicians. “Small businesses” – whether truly small or not – have steadily honed such capacities to influence both political parties. If lawmakers are to maintain and raise public revenues to meet national needs, they must gain the political will to ignore or bypass appeals for ever-lower taxes. But this may not happen until ordinary citizens urge their elected representatives, including Democrats, to stop catering to privileged interests in “small business” disguise.

Read more in Alexander Hertel-Fernandez and Theda Skocpol, “Asymmetric Interest Group Mobilization and Party Coalitions in U.S. Tax Politics.” *Studies in American Political Development* (2015).