

Current Events



Shakedown

AS CASH RUNS LOW IN GOVERNMENT COFFERS AROUND THE COUNTRY, politicians are ratcheting up the intensity of their search for revenue and new areas to regulate. Small businesses are in their crosshairs in a mammoth, nationwide shakedown. They are the nation's critical engine for growth, innovation and job creation, yet they are being starved for credit and slammed with more taxes, government directives and litigation exposure. This spells weaker profits and fewer jobs, risking a fundamental deterioration in America's private sector.

The federal government's response to the crisis is to build up Washington's small-business dependency apparatus. Of the \$3.6 trillion in federal spending planned in 2010 (overruns likely), many crumbs will find their way to small businesses through government loan programs and complicated tax credits. Politicians are addicted to spending and can trumpet their ability to bring home the pork while ignoring the devastating net outflow from small businesses to Washington.

Washington's expansion does nothing to create a robust small-business environment. Businesses with fewer than 250 employees provided most of the net job growth in the 2002–07 expansion yet are still in the starting blocks in the current recovery. The 2,300-page health care bill will take months and years to decode and will weigh heavily on small-business decisions. New regulations are mushrooming from the constant string of thick "stimulus" bills, the coming law on new financial regulations and the sure-to-be-bad tax bill toward year's end.

The threat to profit is explicit in Washington's evolving "economic justice" platform. Small businesses already face a high top marginal tax rate, horrendous tax complexity and layers of new taxes, yet the revenue-extraction process is intensifying. The jump in tax rates planned for the end of the year, the expansion of the Medicare tax and the threat of a value-added tax are just the transparent side of the tax shakedown. Under the surface, intense job-killing fights are being waged over sales taxes (New York is sending auditors statewide to demand more tribute), the taxation of capital gains and dividends (rates will jump), private equity (the government is redefining long-term capital gains into ordinary income) and foreign profits. Hillary Clinton upped the ante with her May 27 speech broadly linking underemployment with undertaxation: "The rich are not paying their fair share in any nation that is facing the kind of employment issues [we face]."

Small businesses also suffer badly in times like these, when momentum trading takes over from value-based investing. Rather than supplying funds to small businesses, correctly self-interested investors are choosing to invest in gold to protect against inflation, in low-yielding government bonds as a hedge against deflation and in momentum-trading vehicles to tap into the market's wild gyrations.

This barbell trading strategy—investing to protect against bad government policies—leaves small businesses starved of credit. Normal business loans, the bread-and-butter staple of a healthy partnership between banks and small businesses, are down 8% from the already reduced levels of a year ago. Normal bank lending is further penalized in the coming 2,000-page financial services regulation bill and the latest antigrowth decisions by the Financial Accounting Standards Board in May. The FASB, an unelected new regulatory megapower, seems bent on outdoing Sarbanes-Oxley in transferring jobs to the accounting field—already one of the top growers—from innovation and growth elsewhere in the economy.

While Washington pays lip service to the challenges facing small businesses, it repeatedly chooses its own expansion over results. In effect, government has become a huge silent partner in all businesses, often taking a majority of the profits and forcing many unprofitable business decisions without the risk that it will be fired.

Clear Solutions Washington Won't Choose

- Stop the Jan. 1, 2011 tax hike (along with spending hikes). "What could a slight increase in taxes have to do with jobs?" asks Washington's tax-and-spend culture. Ronald Reagan cut through the economic mumbo jumbo: "You can't be for big government, big taxes and big bureaucracy and still be for the little guy."
- The Fed should make a clear commitment to stable money to reduce the swings in interest rates and inflation. Instead it champions and flaunts unstable money. This encourages momentum trading and the growth of derivatives. Meanwhile, layers of financial regulation make Washington bigger and more powerful but don't fix the underlying problems.
- Instruct bank regulators to use judgment in assessing capital adequacy for loans to governments and big businesses (now assumed to be ultrasafe) and small businesses (assumed unsafe). Regulators are hiding behind arbitrary trend-based pricing projections from accountants and oligopolistic bond raters instead of using experience or historical payment trends. The result: Banks lend riskily during booms and swing to excessive caution during downturns, making the swings worse. The financial system channels capital to larger businesses and the government at the expense of small-business lending.

Politicians are addicted to spending and revenue extraction. As with an addict, there's little pause for moral or legal contemplation. Contract law and private property are under increasing attack, with constitutional challenges escalating and providing a last bulwark against the morass of federal overreach. **F**



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