

# SMALL BUSINESS RESEARCH BULLETIN

## Rules Versus Discretion in Tax Policy

An Office of Economic Research Working Paper

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Small businesses bear a disproportionate share of the burden imposed by all federal regulations, including tax regulations (Hopkins, 1995; Crain and Hopkins, 2001). Small business trade associations consistently identify taxes as the single most important issue facing small businesses.

The current fiscal climate in the United States revolves around the notion that revisions to the tax code are forthcoming every four years, with each presidential election cycle. While the depth of the adjustments is usually unknown, the probability that adjustments will happen is very high.

In addition to the uncertainties inherent in operating a small business, employers must make allowances for unknown changes in the tax code while making plans that extend beyond the next presidential cycle. In this working paper, the author argues that a tax system based on predictability would benefit those who most need it: small businesses. The author developed a theoretical model which he supported empirically to show that rules with binding constraints were the preferred outcome.

### Highlights

The tax regime that prevailed in theory was not sustainable in reality. Upon introducing discount rates to the analysis, rules were not going to be observed “naturally” and lead to the preferred outcome. Constraints would be needed, should the optimal outcome be the goal. Evidence from the states strongly supports this conclusion.

- Added predictability in the tax system would be more beneficial to small businesses. Other means need to be investigated to ensure that fiscal policy is set in a stable and predictable environment.

- Binding constraints would be needed to steer policymakers to such an outcome with a discount rate greater than zero.

- A degree of rate stability is clearly needed, yet policymakers shy away from steps in this direction. The positive externality for small business is that such a system would allow them to figure out the tax structure, now and in the future, and make plans that are based on that knowledge.

### References

Thomas Hopkins, 1995. *A Survey of Regulatory Burdens*. Washington, D.C.: U.S. Small Business Administration, Office of Advocacy, [www.sba.gov/advo/research/rs1995hoptot.pdf](http://www.sba.gov/advo/research/rs1995hoptot.pdf).

Mark Crain and Thomas Hopkins, 2001. *The Impact of Regulatory Costs on Small Firms*. Washington, D.C.: U.S. Small Business Administration, Office of Advocacy, [www.sba.gov/advo/research/rs207tot.pdf](http://www.sba.gov/advo/research/rs207tot.pdf).

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