Earnings Without a Salary: Trends in Proprietors' Income in the Washington Region

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This briefing is the second in a series addressing how technology advances and changes in the way we work affect the future of the Washington regional economy. The first briefing focused on individuals working in non-employer establishments as a proxy measure for the "gig economy." This paper turns to proprietors' income to understand how earnings outside of wage and salary employment contribute to the regional economy.

Executive Summary

People in the Washington region are working in increasingly diverse ways, but how do these new ways of working affect regional prosperity? Income data are a valuable complement to employment and establishment data to help answer this question. This briefing considers nonfarm proprietors' income to learn more about the dollar value of work in the Washington region that does not involve wage and salary employment. These data show that **nonfarm proprietors' income makes a substantial and growing contribution to the regional economy**.

- In 2016, nonfarm proprietors' income in the Washington region exceeded $33 billion – more than Department of Defense procurement or earnings from state and local government employment in our region.

- Nonfarm proprietors' income now accounts for 10% of all earnings by place of work in the Washington region.

- Proprietors' income is growing at a faster rate than wages and salaries in the Washington region. On an inflation-adjusted basis, total nonfarm proprietors' income increased 133% from 1997 to 2016, while wage and salary income in the region increased 62%.

- 75% of the Washington region's total nonfarm proprietors' income in 2016 was earned in DC, Montgomery County and Fairfax County, which have 47% of the region's population.

- Average nonfarm proprietors' income varies widely by county, exceeding $66,000 per proprietor in DC and Montgomery County but less than $15,000 in Stafford and Prince George's counties.

I. What Are Nonfarm Proprietors?

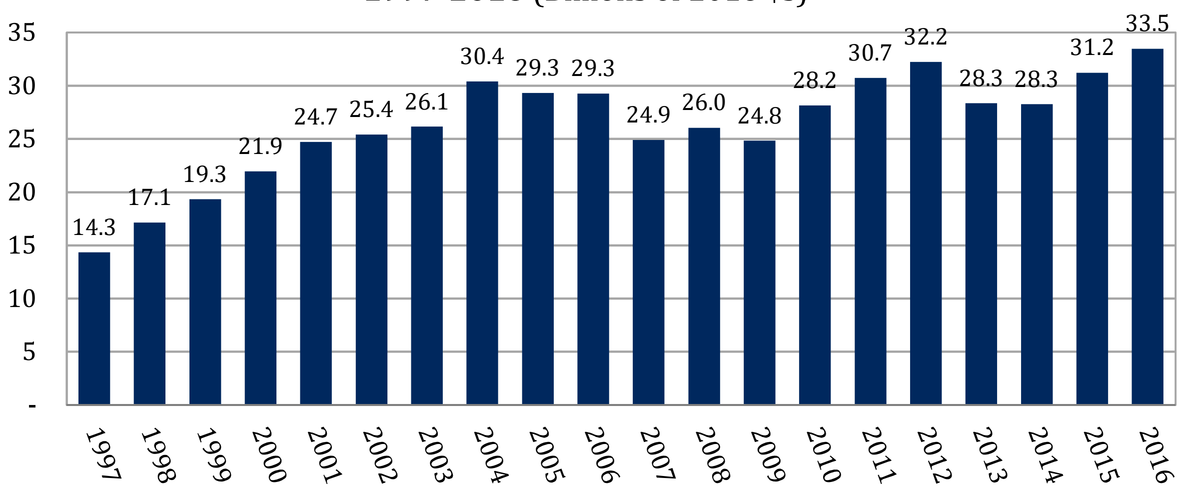
Proprietors are owners of unincorporated (noncorporate) businesses, which primarily consist of sole proprietorships and partnerships.[1] For unincorporated businesses, there is less separation between the individual owner(s) and the business, and earnings are typically reported on the owner's tax returns.[2] For the majority of these entities, the owner's residence is the same as, or recorded as, the business location or place of work. This report focuses solely upon nonfarm entities.

These unincorporated businesses are not defined by employment; in other words, they may or may not have employees. Nonfarm proprietors' income is based on receipts less expenses with some adjustments made for inventory, depreciation, and underreporting and nonreporting.[3] In these two ways nonfarm proprietors' income is different from total receipts per non-employer establishment, which were analyzed in our previous briefing, *Working Without a Job: Trends in Non-Employer Establishments.*

II. What's Happening in the Washington Region?

In 2016, nonfarm proprietors' income in the Washington region recorded a new high of $33 billion (Figure 1). As points of comparison, Department of Defense procurement in the region that year was $28.5 billion,[4] and earnings associated with employment in state and local government were $27.5 billion.[5]

Figure 1. Nonfarm Proprietors' Income in the Washington Region 1997-2016 (Billions of 2016 $s)



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

[1] U.S. Bureau of Economic Analysis. *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts* (December 2015). Chapter 11.

[2] *Id.,* p. 11-2.

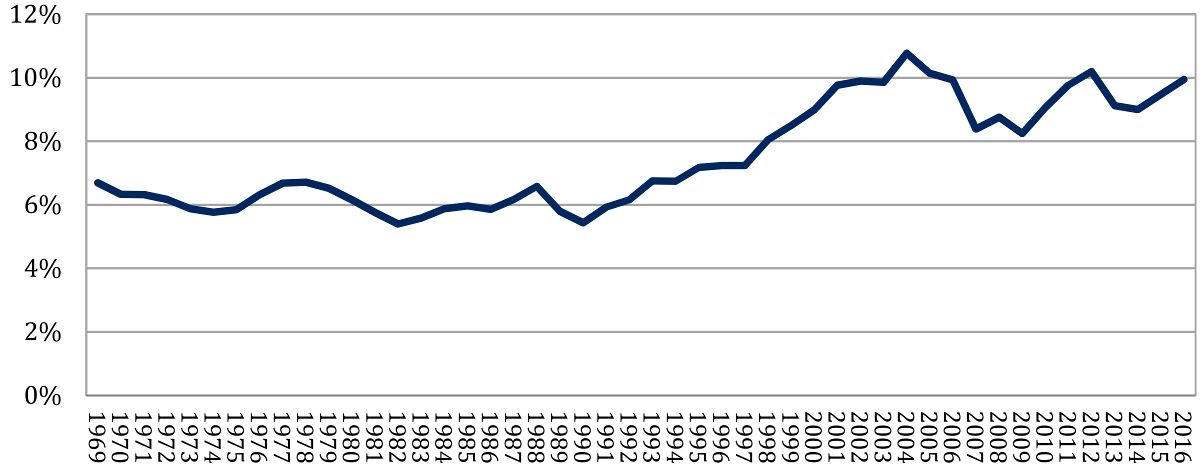
[3] *Id.,* p. 11-14 to 11-16

[4] http://sfullerinstitute.gmu.edu/2017/10/17/consequences-federal-reduction/

[5] Bureau of Economic Analysis, Personal income by major component

At $33 billion, nonfarm proprietors' income makes a substantial contribution to overall regional income. Nonfarm proprietors' income accounted for 10 percent of all earnings by place of work in the Washington region, up from 7.2 percent in 1997 and 6.9 percent in 1969 (Figure 2).

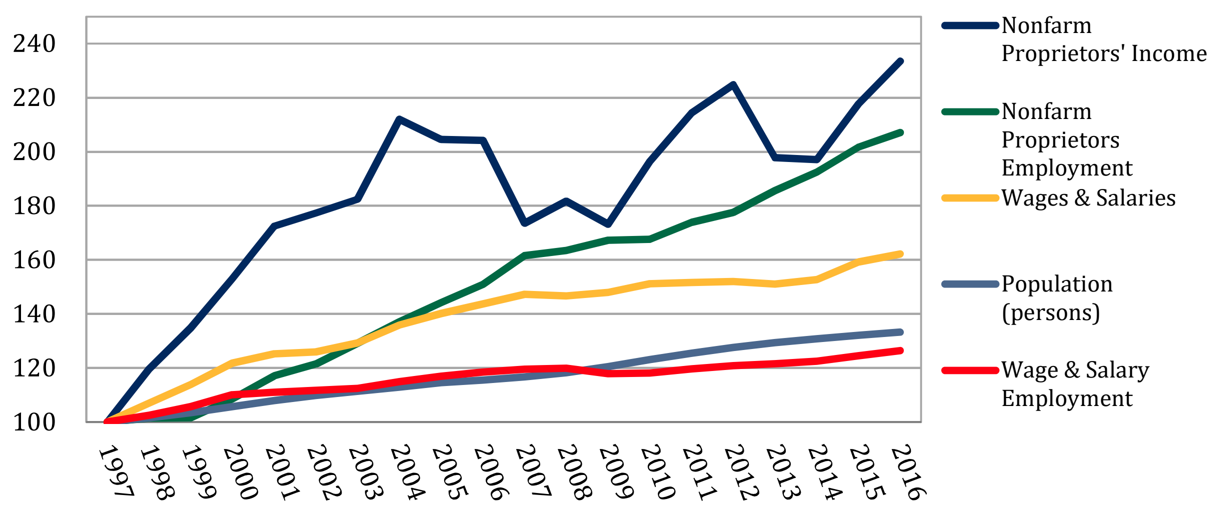
Figure 2. Nonfarm Proprietors' Income as a Percentage of All Earnings by Place of Work, Washington Region, 1969-2016



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

As we found with growth in non-employer establishments relative to employer establishments,[6] nonfarm proprietors' income is growing faster than wage and salary income. The number of proprietors is also increasing at a greater rate than wage and salary employment. (Figure 3)

Figure 3. Growth in Income, Employment and Population Washington Region 1997-2016
(1997 = 100, dollars adjusted for inflation)



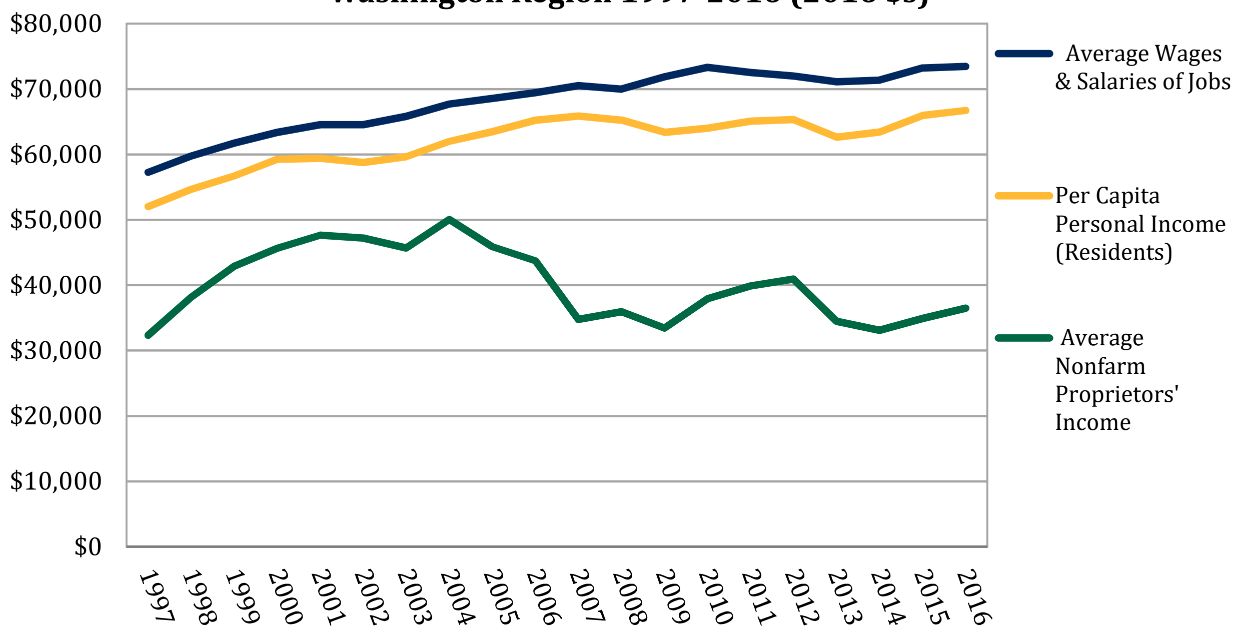
Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

[6] http://sfullerinstitute.gmu.edu/wp-content/uploads/2017/11/SFI_Non-Employer_Trends_111517.pdf

Nonfarm proprietors' employment in the Washington region more than doubled between 1997 and 2016. As the number of proprietors has grown, the ratio of wage and salary employment to nonfarm proprietor employment has fallen from 6:1 to 3.6:1 over that same period. In other words, there is now one proprietor for every 3.6 wage and salary workers in the Washington region.

On the other hand, average proprietors' income remains relatively low (Figure 4). Average nonfarm proprietors' income in 2016 was less than one-half of the average wage and salary level, and the gap has been widening. We identified a similar gap when comparing average non-employer receipts to average employer payroll, finding that the rise of the gig economy accelerated growth in non-employer establishments but lowered average receipts.

Figure 4. Average Nonfarm Proprietors' Income, Wages & Salaries, and Per Capita Personal Income Washington Region 1997-2016 (2016 $s)



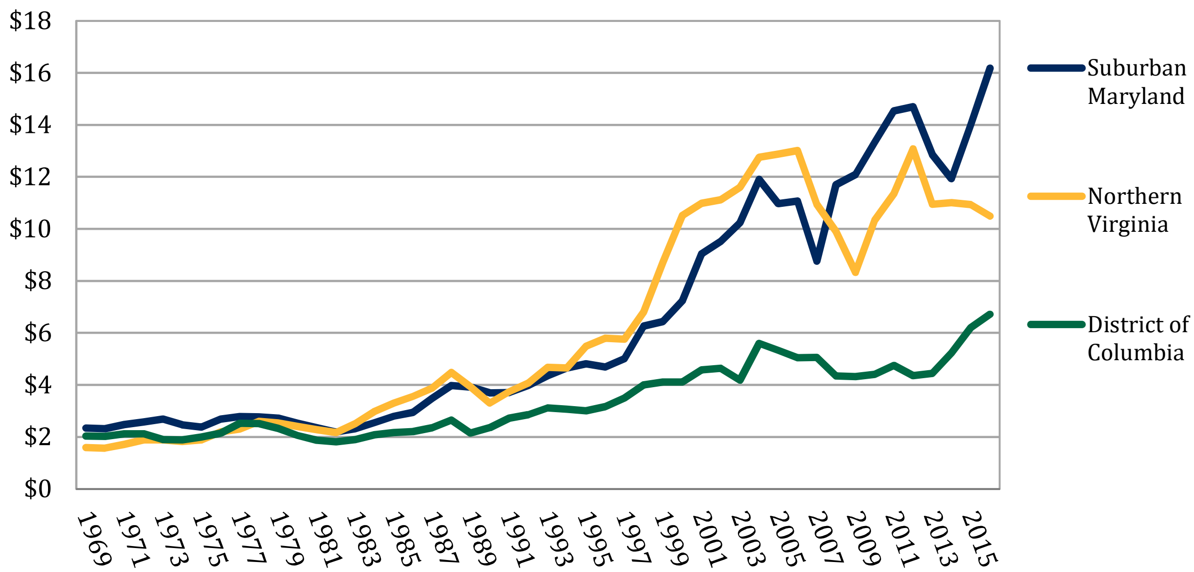
Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

Nonfarm proprietors' income offers further evidence of how the gig economy plays out in our region. Income volatility shown in Figures 1-3 and declining average nonfarm proprietors' income depicted in Figure 4 both suggest that the growing body of work conducted by nonfarm proprietors is supplemental or temporary in nature, rather than a source of ongoing, full-time employment for many individuals. This is consistent with our analysis of the work performed by non-employer establishments, which identified taxi and limousine services (reflecting services such as Lyft and Uber) as the fastest growing sub-sector. Professional services (such as consultants) and real estate professionals remain the foundation of alternative ways of working, but these sub-sectors have not grown as quickly as other types of gig work in recent years.

II. How Is Nonfarm Proprietors' Income Distributed In The Region?

Nonfarm proprietors' income is not evenly distributed across the Washington region. Data show that DC, Suburban Maryland, and Northern Virginia had similar levels of nonfarm proprietors' income until the mid-1980s, when this distribution began to change (Figure 5). As the suburban economies accelerated, fueled by population growth and federal contracting dollars, so did nonfarm proprietors' income. In the most recent years, proprietors' income in both Suburban Maryland and DC have continued to grow, while that in Northern Virginia has declined slightly.

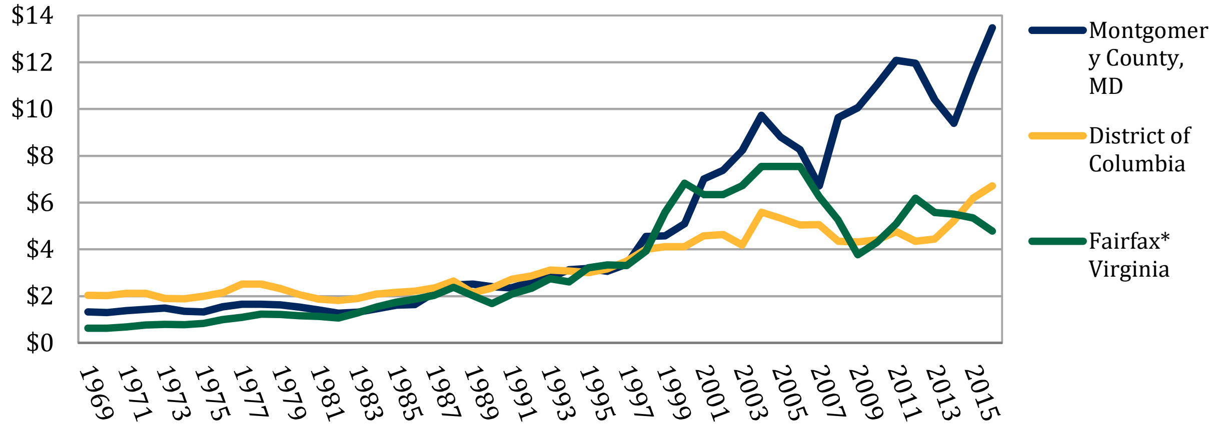
Figure 5. Nonfarm Proprietors' Income by Sub-State Area
Washington Region, 1969-2016 (Billions of 2016 $s)



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

The trend lines in Figure 5 also indicate that nonfarm proprietors' income may be playing different roles in each location's economy. DC, Montgomery County and Fairfax County (including Fairfax City and Falls Church) account for 75 percent of the region's total nonfarm proprietors' income, although they are responsible for just 67 percent of total earnings by place of work and 47 percent of the population. Figure 6 shows nonfarm proprietor's income in these three jurisdictions since 1997, when nonfarm proprietors' income began to expand rapidly in the region. The growth in Montgomery County since 2007 is striking.

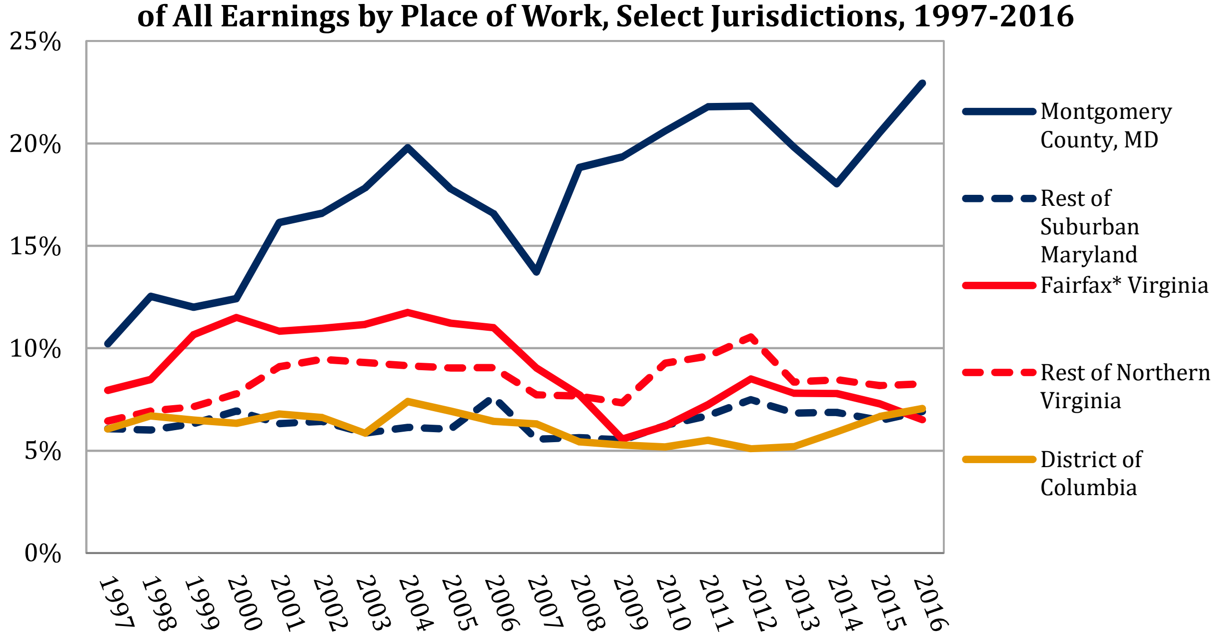
Figure 6. Nonfarm Proprietors' Income by Select Jurisdiction Washington Region, 1969-2016 (Billions of 2016 $s)



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU
*Includes Fairfax County, Fairfax City and Falls Church City

Across the Washington region, nonfarm proprietors' income accounts for 10 percent of all earnings by place of work. This, too, varies within the region (Figure 7). In most locations, nonfarm proprietors' income accounts for approximately 7 percent of earnings by place of work. In Montgomery County, 23 percent of earnings by place of work are associated with nonfarm proprietors' income.

Figure 7. Nonfarm Proprietors' Income as a Percentage of All Earnings by Place of Work, Select Jurisdictions, 1997-2016



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU
*Includes Fairfax County, Fairfax City and Falls Church City

What explains this income dynamic in Montgomery County? There were more than 202,000 nonfarm proprietors in Montgomery County compared to nearly 190,000 in Fairfax County in 2016, accounting for 29 percent of employment compared to 21 percent in Fairfax. BEA data do not break down earnings by industry into wage and salary and proprietor categories at the county level, so we have to turn to other sources for further explanation for the higher number of proprietors and their higher incomes in Montgomery County.

A key source of comparison, the non-employer statistics, do not reflect the significant increase shown by nonfarm proprietor's income. This suggests that the growth is the result of either unincorporated businesses with employees or estimated income and expenses that are not included in non-employer statistics. However, within the overall data set, non-employer establishment receipts for the Real Estate and Health Care and Social Assistance sectors are higher in Montgomery County than in Fairfax County or DC, providing a possible clue.

Occupational data from the American Community Survey[7] indicate that Montgomery County has nearly 7,000 more residents employed as healthcare practitioners and technicians and over 12,000 more employed in life, physical and social science occupations than Fairfax County. Therefore, one possible explanation is that some of these individuals – including doctors, scientists, health care and real estate professionals who are over-represented in Montgomery County – may be captured in the definition of nonfarm proprietors' income but might not stand out in the non-employer establishment data.

Altogether, the fast growth in nonfarm proprietors' income is likely due to a combination of factors, none of which can be fully detailed using available data. Montgomery may be home to a large and fast-growing number of unincorporated businesses with employees, or the BEA may be allocating a large and increasing amount of non-reported income to the County based on the industry mix of the unincorporated businesses. In either case, proprietors' income in Montgomery County appears to be playing a larger than average role in the County compared to other jurisdictions in the region. As a result of this large and increasing source of income, the more traditional economic data used to characterize the County's economy may disproportionately underestimate the activity that occurs in the County.

Table 1 summarizes nonfarm proprietors' income for all jurisdictions in the Washington region. Looking beyond DC, Montgomery County and Fairfax County, the other jurisdictions each reported nonfarm proprietors' income less than $2 billion in 2016. Among these remaining jurisdictions, Prince George's, Prince William, Loudoun, Arlington, Alexandria, and Frederick (MD) led the region. Nonfarm proprietors' income ranges from 5 percent of earnings by place of work in Arlington to 28 percent in Rappahannock County, VA.

[7] 2012-2016 American Community Survey 5-Year Estimates

Table 1. Nonfarm Proprietors' Income by Jurisdiction
(Ranked by Total Income in 2016)

	1997		2016	
	Billions 2016 $s	**% of Earnings** (Place of Work)	**Billions 2016 $s**	**% of Earnings** (Place of Work)
Montgomery County, MD	3.368	10.2%	13.475	22.9%
District of Columbia	3.496	6.1%	6.717	7.1%
Fairfax County, Fairfax City, & Falls Church City, VA	3.311	7.9%	4.780	6.5%
Prince George's County, MD	1.030	5.1%	1.450	5.5%
Prince William County, Manassas City, & Manassas Park City, VA	0.480	8.4%	1.300	10.7%
Loudoun County, VA	0.254	6.2%	1.274	8.9%
Arlington County, VA	0.666	4.1%	1.180	5.4%
Alexandria City, VA	0.369	5.6%	0.785	7.7%
Frederick County, MD	0.321	8.1%	0.756	9.8%
Spotsylvania County & Fredericksburg City, VA	0.222	11.1%	0.363	10.1%
Charles County, MD	0.172	9.2%	0.289	9.4%
Fauquier County, VA	0.137	15.7%	0.284	16.8%
Stafford County, VA	0.131	11.9%	0.213	6.6%
Calvert County, MD	0.122	12.5%	0.206	10.6%
Culpeper County, VA	0.071	10.9%	0.152	14.8%
Jefferson County, WV	0.063	11.8%	0.091	8.9%
Warren County, VA	0.067	16.6%	0.068	9.6%
Clarke County, VA	0.029	14.4%	0.049	17.9%
Rappahannock County, VA	0.023	28.2%	0.040	28.2%

Source: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute

Nonfarm proprietors' income per proprietor (average income) also varies by location (Figure 8). Montgomery County again stands out for its high average and rapid growth. DC's average nonfarm proprietors' income remains high but has declined slightly in real terms, while Fairfax County remains relatively low and declining. Across the region average income per proprietor increased only in seven jurisdictions over this time period and increased significantly only in Montgomery County.

Table 2. Average Nonfarm Proprietors' Income by Jurisdiction (Ranked by Average Income in 2016)

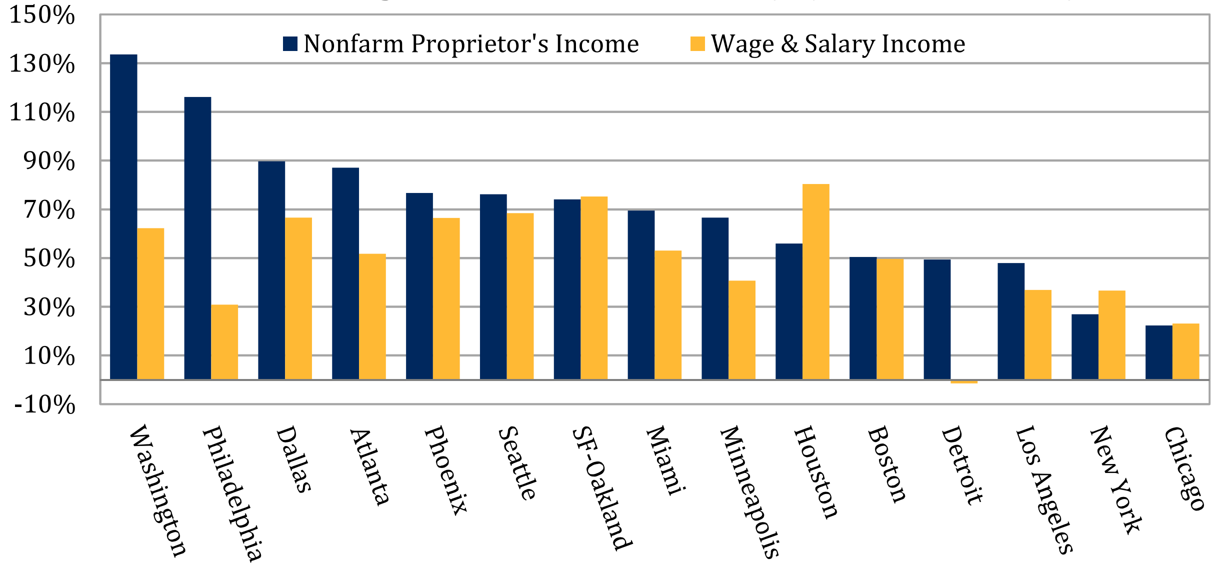
	2016 $s		% Increase
	1997	2016	
District of Columbia	72,413	66,970	-7.5%
Montgomery County, MD	34,464	66,660	93.4%
Arlington County, VA	36,557	34,803	-4.8%
Alexandria City, VA	24,567	31,348	27.6%
Rappahannock County, VA	18,100	28,162	55.6%
Fauquier County, VA	21,569	26,442	22.6%
Fairfax County, Fairfax City, & Falls Church City, VA	31,967	25,209	-21.1%
Frederick County, MD	18,417	24,421	32.6%
Loudoun County, VA	18,170	23,653	30.2%
Culpeper County, VA	25,768	23,376	-9.3%
Spotsylvania County & Fredericksburg City, VA	25,850	21,375	-17.3%
Prince William County, Manassas City, & Manassas Park City, VA	21,086	20,660	-2.0%
Calvert County, MD	17,233	18,849	9.4%
Clarke County, VA	24,499	18,426	-24.8%
Charles County, MD	17,810	16,329	-8.3%
Warren County, VA	28,126	16,167	-42.5%
Stafford County, VA	23,272	14,877	-36.1%
Jefferson County, WV	18,964	14,627	-22.9%
Prince George's County, MD	17,789	11,381	-36.0%

Source: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute

III. How does the Washington region compare?

The Washington region experienced the greatest level of growth in nonfarm proprietors' income among large metro areas from 1997 to 2016, with a 130 percent increase (Figure 8). As in Washington, nonfarm proprietors' income grew faster than wage and salary income in most metro areas. San Francisco/Oakland, Houston, New York and Chicago are the exceptions where wage and salary income grew faster over this period.

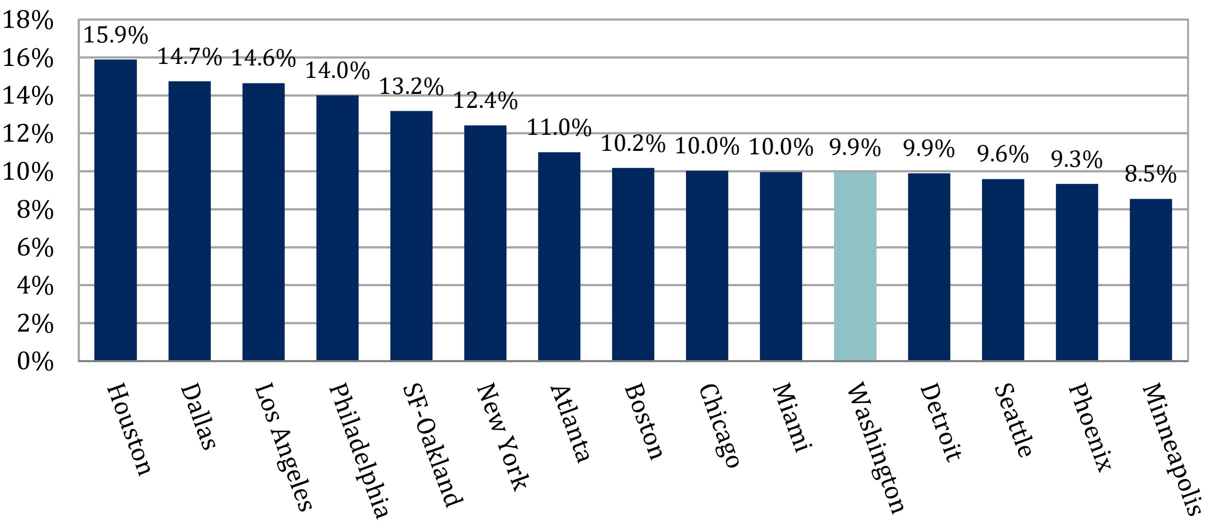
Figure 8. Change in Nonfarm Proprietors' Income and Wage & Salaries 15 Largest Metros, 1997 to 2016 (Adjusted for Inflation)



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

However, Washington's nonfarm proprietors' income as a percentage of all earnings by place of work is somewhat low relative to the other large metro areas (Figure 9). This is partly a reflection of the Washington region's high wages and salaries, but it also indicates relatively low average earnings among new proprietors in our region. Nonfarm proprietors' income is 10 percent of all earnings by place of work in Washington, but is nearly 16 percent in Houston. Minneapolis lags the group at 8.5 percent by this measure.

Figure 9. Nonfarm Proprietors' Income as a Share of All Earnings by Place of Work in the 15 Largest Metros, 2016



Sources: U.S. Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU

IV. Conclusion

Nonfarm proprietors' income provides a useful complement to employment and establishment data to inform the story of the evolving way in which work is conducted in our region. These data show that nonfarm proprietors' income is substantial, growing and becoming a more important part of the Washington regional economy.

Nonfarm proprietors' income is not evenly distributed across the region and growth patterns vary greatly. Montgomery County in particular stands out for its high total, growth rate and average income per proprietor. Our working hypothesis is that the figures are driven by a combination of unincorporated businesses with employees, occupational specialties (such as real estate and certain health care professions) that may be overly represented in unincorporated business data, and BEA-estimated income and expenses that are not included in non-employer statistics.

These findings demonstrate the complex nature of the evolving changes in the way the Washington region works. Nonfarm proprietors' income and non-employer establishment data provide evidence of the gig economy, exemplified by Uber drivers, with work that is supplemental and temporary in nature. These data also show a steady base in traditional forms of self-employment in fields like professional services (such as consultants and lawyers) and real estate.

Economic trends and technology advances are not the only factors driving change. Business entities also organize themselves in response to the tax and business climate. For example, the Maryland Comptroller expects the federal Tax Cuts and Jobs Act of 2017 to encourage some individuals to convert wages or compensation to qualified business income to claim a deduction and for some businesses to restructure as a C-corporation to take advantage of reduced corporate income tax rates.[8] Such changes would be reflected in establishment and income data going forward, and past tax code changes may have influenced the data cited in these reports.

The data in this briefing raise other interesting questions for the Washington region. Does volatility in nonfarm proprietors' income represent an opportunity or weakness for the overall regional economy? Is this extra income that workers can do without in bad times or a necessary supplement? Does the widening gap between average proprietors' income and the average wage contribute to income inequality – or does supplemental income ameliorate it? And if growth in wage and salary employment lags population growth (as in recent years), will nonfarm proprietors' income and associated avenues of work be a sufficient replacement? These are among the issues that we will consider in the course of this research series.

[8] *The 60-Day Report. Effects of Federal Tax Law Revisions on the State of Maryland*. Maryland Bureau of Revenue Estimates, January 2018.

About These Data

All data are from the U.S. Bureau of Economic Analysis's Local Area Personal Income and Employment tables last updated in November 16, 2017. The Washington region is the 2013 delineation of the metropolitan statistical area and all metro areas use the 2013 delineation.

BEA uses tax data from the Internal Revenue Service (IRS) and adjusts for inventory, capital consumption (depreciation)[9] and underreporting and nonreporting[10]. Nationally, the estimate of underreporting and nonreporting is the largest of these adjustments and accounted for 55 percent of the reported income in 2015.[11] As a result of these differences, the measure of income is more complete but reflects a larger degree of estimation compared to non-employer and other IRS-based datasets.

The estimation methodology changed starting with the 1998 data, suggesting that a methodological adjustment may drive a portion of the variation compared to prior years.[12] These adjustments are designed to reflect a more complete and accurate reflection of the work performed and income earned. Similar to the information on unincorporated employers, no data are available to quantify or describe these activities at the regional-level.

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[9] U.S. Bureau of Economic Analysis. *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts* (December 2015). Chapter 11. p. 11-3

[10] *Id.,* p. 11-14 to 11-16

[11] BEA Supplemental Table 7.14. Relation of Nonfarm Proprietors' Income in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service, as reported by the data released on August 3, 2017

[12] U.S. Bureau of Economic Analysis. *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts* (December 2015). Chapter 11.