Institute on Taxation and Economic Policy
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To: The Governor's 21st Century Tax Reform Commission
From: The Institute on Taxation and Economic Policy
Date: September 15, 2008
Re: Public Comments - Economic Development and the Tax Code

The Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research and education organization that works on government taxation and spending policy issues. Our mission is to keep policymakers and the public informed of the effects of current and proposed tax polices on tax fairness.

We appreciate the opportunity to submit comments on ways to improve Minnesota's business climate. Historically, Minnesota has ranked above the national average in terms of many economic and social indicators. These public services are what foster economic development and what businesses look for when making location decisions. In fact, "research shows an emerging consensus that public investment in infrastructure either stimulates or supports economic growth and activity."[1]

The tax system used to fund these vital services deserves careful scrutiny. First and foremost a tax system must raise enough money to support and sustain the level of services demanded by citizens and policy makers. ITEP urges the Commission to adopt reforms that make the tax structure more sustainable instead of approving tax breaks or special incentives which erode Minnesota's ability to generate revenues. Policymakers must look past hollow arguments describing how taxes impact economic development and instead look to other more economically sound ways to spur economic development through investment.

The Important Role Taxes Play
While it may be politically popular to suggest cutting taxes, it's more responsible and better economic policy to acknowledge that taxes are useful and spur investment. No doubt, all things being equal, businesses and individual taxpayers would prefer lower taxes. But in fact, all things are not equal. Taxes are levied for a very important purpose: to help fund the public services that make Minnesota more attractive to businesses. Good roads and bridges, a well-educated workforce and other government services are essential to business productivity and profitability. And there is a clear linkage between taxes and a state's ability to provide these important public services.

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[1] [1] Lynch, Robert G., *Building a Strong Economy: The evidence on combined reporting, public investments, and economic growth,* Economic Policy Institute and Massachusetts Budget and Policy Center, June 2007.

Reducing or eliminating a tax altogether has consequences. Low taxes generally lead to low-quality public services. Providing businesses with a low-tax, low-service environment is not likely to be a winning strategy for attracting significant new investment over the long term.

Are Business Taxes Significant?

Yes, for the state budget. But for individual companies, business taxes are probably not significant. Some in the business community may argue that business taxes are too onerous and a burden. Yet, studies have found the opposite to be true. State and local taxes are a very small part of the cost of doing business. If you add up all state and local taxes paid by businesses, they account for only 0.8 percent of business costs.[2] So in the scheme of things, these taxes are relatively unimportant. While these taxes are largely insignificant for business they are a significant portion of Minnesota's general fund, the corporate income tax alone is expected to bring in nearly $1.9 billion or about 6 percent of state revenues in the next biennium.

In response to claims about "high" tax burdens or threats to leave, Minnesota policymakers may feel forced to enact special incentives or credits to entice businesses to stay or move into the state. In fact these decisions aren't necessary. As Paul O'Neill, a former executive at Alcoa and current Treasury Secretary put it, "I never made an investment decision based on the tax code…If you are giving money away I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements."[3]

Do Businesses Move Because of Taxes?

Policymakers often assume that low taxes and business tax incentives make the best bait to lure corporations. A study from economist Dr. Robert G. Lynch offers strong evidence that such policies are neither the best nor the most cost-effective strategies for attracting businesses and jobs.[4].

Reducing minor state and local taxes through rate cuts or more tax credits isn't likely to impact a corporation's decision to locate in a state. For example, long-time business leader and New York City Major Michael Bloomberg told the New York Times that "any company that makes a decision as to where they are going to be based on the tax rate is a company that won't be around very long. If you're down to that incremental margin you don't have a business."[5] Likewise, John Tyson, of Tyson Foods, noted that tax breaks had nothing to do with his company's decision to locate a plant in Pine Bluff, Arkansas, rather than out of state. "It [the location decision] was based purely on geography. Pine Bluff was in the right place. The tax credits didn't make any difference."[6]

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[2] Lynch, Robert G., *Rethinking Growth Strategies: How State and Local Taxes Affect Economic Development*, Economic Policy Institute, March 2004.

[3] Testimony before the United States Senate Finance Committee, January 18, 2001.

[4] Lynch, Robert G., *Rethinking Growth Strategies: How State and Local Taxes Affect Economic Development*, Economic Policy Institute, March 2004.

[5] *New York Times*, November 8, 2001.

[6] *Washington Post*, March 22, 1992.

Common sense tells us that businesses want to locate where people like to locate. In fact, cutting taxes can actually do harm. Dr. Lynch says, "what makes a community a good place to do business is the same things that make a community a good place to live in. That means good schools, good police and fire protection, a modern and well-maintained transportation infrastructure, and good all-around public services. Instead of creating jobs, tax-cutting strategies that undermine government's ability to provide quality services can end up destroying jobs."

On the other hand, companies that might actually be attracted by low taxes are likely to be low-paying, low-employment industries with little loyalty to the community and its long-term well being.

Lastly, it's important to remember that tax breaks don't buy loyalty from companies. Many states and communities have given huge tax breaks to large companies for years, only to have the company shut down the local plant for reasons unrelated to taxes. For example, despite receiving millions of dollars in tax breaks and incentives from federal, state, and local governments Northwest Airlines has repeatedly reduced employees and threatened to close local Minnesota facilities.

Do Tax Cuts Stimulate Jobs?

Given that taxes account for so little of the cost of doing business for a corporation and that businesses examine things other taxes, like the quality of public services, when deciding where to locate, there is actually very little evidence that cutting taxes and paying for these reductions through service cuts stimulates economic activity or create jobs. A study released by the Economic Policy Institute and the Massachusetts Budget and Policy Center found, "a growing body of research suggests that state and local tax cuts and incentives cannot create jobs in a cost-effective manner.[7]" Eliminating or lessening public services can actually make a state or locality less attractive to employers. States may find that they are offering unaffordable incentives to businesses that don't need them anyway with little job creation to show for their efforts.

Investment Before Tax Cuts

The policy response to times of economic downturn should not be to cut taxes or reduce spending. In fact, it's in hard times when working families may need to rely on government services more than ever before. If Minnesota is to adapt to the changing needs of the global economy, it must continue to invest in its workforce and other assets to improve their quality. This means that further attention must be paid to improvements in public investment instead of tax cuts like incentives or rate reductions which will do little over the long term to make Minnesota an attractive place for businesses.

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[7] Lynch, Robert G., *Building a Strong Economy: The evidence on combined reporting, public investments, and economic growth,* Economic Policy Institute and Massachusetts Budget and Policy Center, June 2007.