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Liberal Think Tank All Wet on Business Taxes

A recently released report from the Keystone Research Center asserts that Pennsylvania's business tax climate is more favorable than has been portrayed in previous studies. Keystone compares Pennsylvania's corporate tax rates to 10 other "competitor states" and reaches the conclusion that, taking all business taxes into account, Pennsylvania is, basically, no worse than anybody else. As we shall show, this is an unjustified and erroneous assertion.

Keystone proceeds to argue that, if anything, plans for further reductions in business taxes in Pennsylvania should be put on hold, with a clear implication that, given state budget deficits, taxes should be increased rather than cut state spending on "needed" social programs. And therein lies an insight into Keystone's agenda. Business taxes, like highways and infrastructure, education, and every other area in which state policy has effect, must be viewed in the larger social context of "equity, fairness and sustainability." Keystone is essentially lamenting that business does not contribute more to Pennsylvania's coffers, apparently oblivious to the reality that as more firms are driven away business tax revenues will continue to decline as a share of total state revenue.

Business taxation is very important; especially in light of the fact that data on employment from the US Department of Labor's Bureau of Labor Statistics show that Pennsylvania's performance between 1990 and 2000 was dismal. Total employment in the state grew only 4.13 percent for the period, ranking Pennsylvania 46th out of 50 states. Keystone acknowledges the state's woeful economic performance, and then contends that cutting business taxes has done nothing to improve it. But the fact is that Pennsylvania still has the second highest corporate income tax rate in the nation, at 10 percent, plus the infamous and onerous "stock and franchise" levy on top of that.

The average corporate income tax rate for the ten states that displayed the highest job growth rates between 1990 and 2000 is less than 5 percent, a full 50 percent lower than Pennsylvania's. Two of the top 10 states for job growth, number one Nevada with a 55 percent employment increase, and Texas, where nearly 2 million jobs were "created" in the decade, have no corporate income tax at all. To claim, as does Keystone, that there is "no evidence" that business tax rates are related to economic growth is simply incorrect.

The average job growth for the top ten states, again, those with an average corporate income tax rate of 5 percent, was 26.82 percent between 1990 and 2000. The bottom ten states, which include Pennsylvania, had an average corporate income tax rate of 7.93 percent. The average job growth for those ten states was a paltry 4.28 percent from 1990 to 2000. In other words, in the best performing states, the corporate income tax rate is an average 37 percent lower than in the worst ten states. And, job growth in the best ten states exceeded employment growth in the bottom ten by more than 5 million jobs or 360 percent.

Keystone's conclusion that Pennsylvania business taxes are not high compared to other states rests on the flawed argument that business tax revenues per state resident are in line with competitor states. Clearly, the ratio of revenue to residents is an inappropriate gauge of business tax burden. A more appropriate and meaningful measure of tax burden is the tax per dollar of income earned. No business makes an investment or location decision based on the taxes paid per resident. A high tax rate on income that deters business and income growth in the state could easily result in lower revenue per resident over time, a condition the Keystone Research Center would conclude was an indication that businesses are not burdened by taxes--the exact opposite of reality.

There is no question that factors other than tax rates affect a state's economic performance. We have frequently pointed out that Pennsylvania also ranks low on the "economic freedom" index--a key indicator of how a state is perceived by employers in terms of their ability to make strategic decisions free of undue governmental interference. Factors such as minimum and living wages, right to work, the excessive political power of unions and the over-politicization of economic development issues all serve to make Pennsylvania unattractive to business.

That said, however, tax rates do matter and are very important. The Keystone Research Center has chosen an inappropriate and erroneous gauge of the tax burden on business and finds that it gives the results they wanted to see. That is not serious research and should not be treated as such.

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