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EMBARGOED UNTIL: Tuesday, March 23, 2004, 12:01 a.m.
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STATE TAX BREAKS DON'T GROW JOBS, RESEARCH SHOWS

In the scramble to lure businesses and jobs to their state, policymakers have operated for many years on the assumption that low taxes and business tax incentives make the best bait. A new study published today by the Economic Policy Institute offers strong evidence that such policies are neither the best nor the most cost-effective strategies for attracting businesses and jobs. Conversely, raising taxes to support public services can promote economic and jobs growth.

In *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development* author Robert G. Lynch provides a comprehensive overview of the current research into the factors that influence business decisions about where to locate. The result is a powerful refutation of the idea that cutting taxes and shrinking government and services will attract new businesses and jobs.

Lynch analyzed hundreds of research studies that examined the effectiveness of state and local tax cuts, tax incentives, and public services in creating jobs and promoting economic development. That analysis led him to conclude that there is little evidence that state and local taxation figures prominently in business location decisions.

Factors that outweigh taxes in business decisions on where to locate are the availability of qualified workers, proximity to customers, and the quality of public services. Not only are tax cuts an unreliable way to attract businesses and promote economic development, according to Lynch, but they are also less effective than tax increases that are used to expand the quantity and quality of public services.

Lynch found little evidence that tax cuts stimulate economic activity or create jobs or that job transfers between states are a consequence of business tax incentives. On the other hand, reductions in public services due to state and local tax cuts can cause job loss and economic slowdown.

"The cuts in services that inevitably follow tax cuts can actually undermine economic development efforts," Lynch said. "A business needs a location where its operations are supported by good quality public services and infrastructure. Taxing decisions that eliminate or erode those services make that location less attractive to business than another one where there is a policy of investing in services and infrastructure that can support economic development."

Lynch's report takes a systematic look at arguments that are commonly used to justify state and local tax cuts and incentives and reveals the weaknesses in each of those arguments, as borne out by current research.

Those arguments are:

- **The tax burden argument:** Some argue that state and local taxes are significant burdens on the firms that pay them and that this burden markedly lowers their profitability. In fact, these taxes add up to only 0.8% of the cost of doing business. Cuts in taxes are likely to be offset by additional costs incurred by businesses forced to make up for the loss of public services. For example, a business may have to invest more in worker training, health care, workplace security, or other services formerly paid for with tax dollars.
- **The supply-side argument:** According to this theory, tax cuts give people an incentive to work harder and produce more and they also free more money for investment by letting individuals and firms keep more of their earnings. However, the evidence shows that tax cuts for individuals are just as likely to inspire less, not more work, since it takes less work to produce the same income. And for businesses, even if investment rose it would not necessarily be investment in the state or community that gave the tax breaks.
- **The demand-side argument:** This argument holds that tax cuts are a good way to stimulate the local economy because at least some of the increased after-tax income of individuals or businesses will be used to purchase more goods and services. Although this argument is widely accepted as true at the federal tax level, it doesn't hold true for state and local taxes. That's because the increase in private spending is typically more than offset by reductions in public spending at the state and local levels. With most states constitutionally required to balance their budgets, cuts in revenues almost always produce spending cuts that more than wash out any gains from private spending.
- **The business climate argument:** Some argue that lowering taxes makes an area more "friendly" and therefore attractive to businesses. However, the businesses that are the savviest – and therefore the most likely to make a lasting contribution to the economic health of the state or locality – aren't likely to be swayed by vaguely defined concepts of "friendliness." They want to know that they can rely on high quality public services – such as well maintained roads, bridges, ports, and airports; prompt snow removal; reliable fire and police protection; and a good education system. These high quality services will attract the high paying jobs. All these services require public investment and all are jeopardized by a tax-cutting strategy.
- **The competitiveness argument:** This argument, in essence, says that everybody is doing it and if we don't cut taxes and offer incentives, too, we won't be able to get and keep businesses here. Despite the seeming logic of this argument, researchers have not found evidence that states are losing any significant number of jobs to other states that offer tax cuts or incentives to businesses.

Lynch's study makes the case that tax cutting at the state and local level is not only ineffective at attracting businesses, it is also a very poor use of scarce state and local resources. For example, for every dollar cut in state and local taxes, a business realizes a revenue increase of only about 60 cents. The other 40 cents goes to the federal government and other jurisdictions because the firm's deduction for state taxes has fallen. In addition, for every private sector job created by state and local tax cuts, governments lose between $39,000 and $78,000 in annual tax revenues. This revenue loss forces lay-offs of more employees in the public sector than were gained in the private sector, producing a net loss of jobs from the tax cuts.

"The real lesson here for legislators and local policy makers," Lynch concluded, "is that what makes a community a good place to do business looks a lot like what makes a community a good place to live. 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."

Robert G. Lynch holds a Ph.D. in economics from the State University of New York at Stony Brook and chairs the Department of Economics at Washington College.

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RETHINKING GROWTH STRATEGIES by Robert Lynch
Published by the Economic Policy Institute (Under EMBARGO until 12:01 a.m. Tuesday, March 23, 2004)

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