

**ALASKA LEGISLATURE COMMITTEE FILES 1991-1992 8672**  
**7218 HOUSE RULES**

|   | Exemption |                            |                | Treatment of Balance |           | State(s)  |
|---|-----------|----------------------------|----------------|----------------------|-----------|---|
|   | Exempt    | Conditional                | Partial        | Allocate             | Apportion |   |
| RHODE ISLAND<br>SOUTH CAROLINA<br>2)                    |           | If 80% ownership of payor. |                | X                    | X         | §§44-11-11, 44-11-12<br>§12-7-700(15), repealed L. 1935, S351,<br>eff. for tax years beginning after<br>12-31-84; §12-7-1120(2)<br>§12-7-415, 12-7-430 and L. 1935,<br>S351, eff. for tax years beginning<br>after 12-31-84; §12-7-1120(2)                                  |
| TENNESSEE<br>UTAH                                       |           | If 80% ownership of payor. | 50% exclusion. |                      | X         | §67-2708(b)(2)(A)<br>§69-11-6(2)(d), L. 1973, c. 62<br>(R 178), eff. for tax years<br>beginning on/after 1-1-85   |
| VERMONT<br>VIRGINIA<br>WEST VIRGINIA 1) X<br>2)<br>3) X |           | If 50% ownership of payor. |                | X                    |           | §5011(10)<br>§153-181.002(1), 1976-1-1-87<br>§11-54-d(c)(3), L. 1935, S120,<br>716 has to include years beginning<br>before 7-2-87<br>§11-24-6, 11-24-7(a)(3)<br>§11-24-6(c)(10), L. 1953, S 4475, eff.<br>for taxable years ending after 7-1-88<br>§71.04(4)<br>§47-1810.1 |
| WISCONSIN<br>DISTRICT OF COLUMBIA                       |           | If 80% ownership of payor. |                |                      | X         | §47-1810.1  |
| <b>Worldwide Combination States*</b>                    |           |                            |                |                      |           |   |
| ALASKA  |           |                            |                |                      |           | §47-20.03   |

\*Dividends between combined corporations are eliminated from income, thus the indicated treatment of dividends is limited to dividends received by members of the combined group from corporations not included in the combination.

ATTACHMENT B

Larry Ledebur and William W. Hamilton, "The Failure  
of Tax Concessions as Economic Development Incentives," in  
*Reforming State Tax Systems*, ed., Steve Gold, NCSL, December 1986

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# The Failure of Tax Concessions as Economic Development Incentives

by

Larry C. Ledebur

William W. Hamilton

On October 7, 1985, the *Washington Post* reported:

**Chrysler, Mitsubishi Set Joint U.S. Venture**  
Chrysler Corp. and Mitsubishi Motors Corp. last night signed a \$500 million agreement to build 180,000 subcompact cars a year in the United States, beginning in 1989, according to industry sources. . . .

The plant is to be built in the Bloomington-Normal, Ill. area, according to the Associated Press. . . . To attract the plant, the AP reported, the state of Illinois and Bloomington-Normal offered the automakers about \$10 million worth of land, \$20 million in local real estate tax breaks over 10 years and various other incentives valued conservatively at more than \$100 million.

The joint venture between Chrysler and Mitsubishi is expected to yield 2,500 production jobs and 9,000 jobs in related industries when the plant is operating on two shifts, the sources said.

Announcements such as that of the Chrysler-Mitsubishi joint U.S. venture have ripple effects throughout state legislatures and other state bodies involved in economic development policy and programs. The clear implication of the article is that the new facility was "attracted" to the Bloomington-Normal area because of the package of incentives offered by the state and locality. As a consequence of this type of information, misinformation, states and local governments have joined the race to provide broad and expensive packages of industrial assistance.

Since 1975, state subsidies/incentives to business have proliferated. States now offer a broad array of incentives to firms locating, expanding, or agreeing to remain in their jurisdictions. These include loans, loan guarantees, direct interest subsidies, land write-downs, tax-exempt financing, and equity and near-equity investments, and in a few cases, outright grants (Table 1).<sup>1</sup> The centerpiece of most state industrial finance programs, however, is tax concessions in the form of exemptions, deductions, credits, and abatements.<sup>2</sup> This array of state and local subsidies to industry has been described as a "well-stocked candy store."<sup>3</sup>

This rapid proliferation of state and local programs testifies to the widespread belief among policymakers and practitioners that an arsenal of development incentives is considered critical to inter-jurisdictional, interstate, and regional competition for industry

and jobs. Despite the creativity demonstrated by state and local governments in providing sophisticated financial assistance packages to firms involving both public and private funds, subsidization of private enterprise to achieve public objectives remains a malnourished art form. The effectiveness of interstate business incentives in exerting any significant influence on firm location decisions, however, is undemonstrated.

Table 1.  
State Industrial Incentives

| Incentive  | Number of States |
|--|------------------|
| Grants   | 4                |
| Debt Instruments   |                  |
| Direct Interest Subsidies                                  | 3                |
| Loans  |                  |
| Direct State Loans   | 21               |
| Private Development Credit Corporation                     | 17               |
| Industrial Revenue Bonds                                   |                  |
| State-Issued   | 22               |
| Locally Issued   | 45               |
| General Revenue Bonds                                      | 4                |
| Umbrella Bonds   | 10               |
| Loan Guarantees  | 11               |
| Industrial Revenue Bond Guarantees                         | 11               |
| Equity and Near-Equity Financing                           |                  |
| State-Chartered Equity/Venture Capital Corporations        | 8                |
| Tax Exemptions, Credits, Deductions, and Special Treatment |                  |
| Job Creation Tax Credits                                   | 19               |
| Investment Tax Credits                                     | 23               |
| Property Tax Abatements                                    | 31               |
| Business Inventory   | 35               |
| Goods in Transit   | 43               |
| Research and Development                                   | 43               |
| Pollution Control Equipment                                | 37               |
| Industrial Fuels and Raw Materials                         | 45               |
| Energy and Fuel Conservation Measures                      | 41               |

Source: William Hamilton, Larry Leshchur, and Deborah Metz, *Industrial Incentives: Public Promotion of Private Enterprise* (Washington, DC: Ashin Press, 1985), pp. 4-5.

musts" center on proximity to markets and supplies, labor conditions and costs, and amenities. "Ease in obtaining environmental permits" is the only "must" directly amenable to government action in the short term.

A survey of influences on plant location decisions in Michigan produced similar results (Table 3). Among the most important factors are access to markets and suppliers, local cost considerations, and labor supply and quality. Local property taxes are important, ranking fifth. Tax concessions, on the other hand, ranked 16th among the 23 most important influences.

Finally, a 1981 survey of 500 of the 1,000 largest U.S. industrial corporations assessed the importance of factors in locating plants in the continental United States (Table 4). In this study, "state and local attitude toward taxes and business and industry" (i.e., tax structures and rates) ranked fourth in order of importance. "Financing inducements" ranked 15th, with 77 percent of the responding firms indicating that these inducements were "fairly" (29 percent), "quite" (32 percent), or "extremely" (16 percent) important. It appears, therefore, that some forms of financial incentives, although not necessarily tax concessions, are important in the site location decisions of a majority of large corporations in the United States.

Table 2.  
Influences on Plant Location Decisions-National  
Plant Openings in All Industries

| Factors Viewed as "Musts"                            | Percent of Plants Citing Factor |
|--|---------------------------------|
| Favorable labor climate                              | 76%                             |
| Proximity to market                                  | 55                              |
| Attractive place for engineers/managers to live      | 35                              |
| Proximity to supplies, resources (including energy)  | 31                              |
| Low labor rates                                      | 30                              |
| Proximity to existing facilities or division/company | 25                              |
| Ease in obtaining environmental permits              | 17                              |

Source: Roger Schmenner, "Location Decisions of Large Firms: Implications for Public Policy," *Commentary*, January 1981.

Table 3.  
Influences on Plant Location Decisions Michigan  
(Establishment Weighted)

| Criterion                           | Total Sample |
|-------------------------------------|--------------|
| Access to markets                   | 1            |
| Land, building, rent cost           | 2            |
| Labor cost                          | 3            |
| Skilled labor pool                  | 4            |
| Local property taxes                | 5            |
| Transportation                      | 6            |
| Specialized suppliers               | 7            |
| Quality of living                   | 8            |
| Raw materials                       | 9            |
| Energy                              | 10           |
| Qualified professionals             | 11           |
| State taxes on business             | 12           |
| Financing and capital               | 13           |
| Labor/management relations          | 14           |
| Unemployment compensation cost      | 15           |
| Tax incentives                      | 16           |
| Attitude of state government        | 17           |
| Crime rates                         | 18           |
| Workers compensation cost           | 19           |
| Licensing and state regulations     | 20           |
| Water                               | 21           |
| State and local government services | 22           |
| Access to universities              | 23           |

Source: Patricia A. Braden and Susan R. Rideout, "Location Decision-Making in Export-Oriented Business and Industry" (Ann Arbor: Division of Research, Graduate School of Business Administration, University of Michigan, 1978), p. 111-13.

### Recent Experience

Three examples of site selection decisions of major corporations that received national attention, Microelectronics and Computer Technology Corporation (MCC), General Motors' Saturn Plant, and Volkswagen, provide additional evidence on the possible role of tax concessions.

Both MCC and General Motors were vigorously courted by states and cities, many of which offered extremely generous packages of financial incentives to attract the new facilities. After

Pennsylvania and Ohio off against one another to obtain the best possible deal from Pennsylvania. The state responded by offering increasing costly tax concessions to lock up the decision. The characterization of this spectacle as "the Rabbit that ate Pennsylvania" is descriptive.

### *Summary of Existing Evidence*

There appears to be little or no evidence that tax concessions play a major or even significant role in the site selection processes of firms. The business facility location decision-making process is complex and driven primarily by economic considerations beyond the capacity of state and/or local governments to affect, particularly in the short term.

This dichotomy between the belief of many policymakers and practitioners in the efficacy and need for tax concessions and the findings of existing research literature is paradoxical. It appears that what are "good business practices" for state and local governments and sound public policy are in conflict with what is viewed as "good" or "expedient" politics.

Tax structures and rates and forms of financial incentives, other than tax concessions, however, do appear to be important considerations in the site selection process of corporations. This suggests that states (and localities) (a) should be concerned about the effects of taxes on the competitiveness of businesses in their jurisdictions, and (b) should consider more cost-effective industrial incentives if seeking to offer firms financial assistance to influence their behavior to achieve some specified public purpose.

### **Cost-Effectiveness of Industrial Incentives**

Cost-effectiveness, for present purposes, is defined as the ratio of actual benefits received by the assisted firm to the real cost of the assistance to the administering government. Use of this measure would permit state and local governments to identify the benefit derived by the firm per dollar of public expenditure and to allocate scarce development resources to their most cost-effective uses.

Actual benefit to the firm of any form of public assistance is the difference between operating costs in the absence of the government and the operating costs in the presence of this assistance. The

The major offsetting cost is the loss of tax benefits for which the firm would have been eligible in the absence of the development incentive or tax-offsets. Firms pay both state and federal corporate income taxes on net revenues, the effective rate of tax ratio varying with the level of profitability and the tax policies of the state. An incentive treated as revenue for tax purposes is directly taxed, reducing the benefits to the firm of the assistance. For example, if a firm's marginal tax rate under current federal rates is 46 percent, the actual value of a dollar of public assistance to a firm making a profit is 54 cents. Incentives that reduce operating costs of firms that otherwise would be tax deductible if incurred by the firm from its own resources decrease the value of assistance in the same manner. For example, forms of assistance that subsidize depreciable assets such as a plant and its equipment reduce the amount of depreciation deductible from the firm's income.

Costs to government of development incentives include direct outlays and revenues foregone. When the subsidy involves a flow of government commitments over time, as in the case of tax abatements, the present value of the cost is determined by discounting the time stream of direct costs. The net cost to government, however, may be less than the gross outlay because subsidies increasing firm revenues or reducing operating costs also raise the tax liability of the firm.

*A minimum condition of sound state and/or local government business practice in providing incentives to business is that the ratio of benefits received by the firm from the assistance exceed the cost to the administering government.* There appears to be no justification for providing assistance to private firms from public coffers where government costs are greater than private benefits.

Some will argue that measuring only direct benefits to firms in terms of effects of assistance understates the real value of the incentive. This line of argumentation takes two tacks. First, there are benefits to a community or state of the location or expansion of economic activity that are not readily quantifiable (such as the image of the business climate, importance of the facility as a turnkey or catalyst in the economic development process, contributions to the community, and so on). Second, the baseline measurement ignores secondary benefits generated through the employment and income multiplier processes as new incomes are spent and respent in the economy.

The logic of these arguments cannot be denied. The first category of benefits, however, is essentially intangible and, in the absence of quantification, can be used to justify almost any undertaking. While these intangible benefits should be recognized, past

high-technology manufacturing, (3) wholesale supply, and (4) a business supply service industry. Two primary findings emerged:

- Although numerators and denominators of the cost-effectiveness ratios varied widely across type of tax concession, firm size, and industry, none of the ratios exceeded one; i.e., *in no case were the tax concessions cost-effective.*
- In every case, even where tax concession ratios approached unity, there is always some more cost-effective instrument for pursuing the public purpose.

The importance of tax incentives lies primarily in psychological effects on businesses. They often are viewed as measures of a jurisdiction's business climate and willingness to work with business to improve their operating environment. This viewpoint argues that state and local governments should offer a small set of tax concessions that are relatively inexpensive in terms of tax revenues forgone.

Cost-effective industrial incentives are those that leverage investment from commercial lending and investing institutions. Among these are loan guarantees, direct interest subsidies, and incentives targeted to nondepreciable assets.

Loan guarantees to small businesses are the most cost-effective of all industrial incentives evaluated. At a default rate of 22 percent, the cost-effectiveness ratio of this form of assistance to small firms is 0.79. This ratio is highly sensitive to the ex-post default discount rate. Estimates indicate that default rates can be as high as 40 percent before loan guarantees are no longer a cost-effective instrument of industrial finance.

## Conclusion

State and local governments' rush to provide tax concessions to business is paradoxical in the absence of any substantive evidence that these incentives influence firm decisions and behavior in ways that contribute to the public purpose. Proliferation of tax incentives occurs, in part, because of the failure of researchers to effectively communicate the inadequacies of concessions as tools of public policy and the penchant of policymakers to dismiss research as being "academic" and not an accurate representation of the

against business tax concessions risk being labeled "antibusiness," a pejorative reference, presumably entailing political risk. But it also occurs because business has learned to play the game, and to play it well. Site location decisions are made primarily on the basis of considerations that lie beyond the capacity of state and local governments to influence. Once the decision is made, however, many businesses appear quite willing to pressure state and local governments for tax breaks and to play governments off against one another to increase their leverage in obtaining reductions in their tax liabilities. Where these tax concessions are granted, businesses are subsidized for undertaking actions that are in their own financial self-interest and that would have been undertaken in the absence of public assistance.

Throughout the United States, state and local governments are being subjected to pressures to provide special tax concessions in the name of "economic development." Subnational governments must become increasingly sophisticated in dealing with these issues and develop the capacity to sit at the bargaining table with industry as informed, equal partners. Two initial steps are necessary. First, state and local governments should understand the cost-effectiveness of various tools of government for assisting business enterprise. Second, they should establish a consistent decision-making framework and guidelines for evaluating the desirability of awarding incentives to firms and avoid the trap of making these decisions on an ad hoc case-by-case basis.

Nine basic guidelines are recommended to the state and local governments as central pillars in a decision-making framework:

- (1) The primary responsibility of local government is to provide the level and quality of public services and public infrastructure consistent with the preferences and requirements for basic welfare of its citizens, and to ensure the revenue base necessary to this end
- (2) The appropriate concern of local government is the overall tax structure, its capacity to generate necessary revenues, equity in the distribution of tax burdens between citizens and businesses, and the effect of business taxes on the competitiveness of the local business environment.
- (3) Subsidization of business enterprise lies beyond the conventional scope of responsibilities of local government and should be considered only in exceptional circumstances in which the essential welfare of the jurisdiction is at issue.

- (4) Revenues forgone through tax concession should be regarded as costs to the local government no less real than direct expenditures.
- (5) Industrial subsidies should not be awarded to businesses for actions undertaken in pursuit of their own financial self-interests.
- (6) Local government should establish overall policies on industrial subsidies and avoid operating on an ad hoc or case-by-case basis. These policy guidelines should be overridden only in exceptional circumstances.
- (7) Industrial incentive programs should operate within carefully specified budget constraints. All too often incentive programs are administered with no clear account of their costs, especially those resulting from off-budget programs and tax expenditures. Adherence to budget constraints encourages the careful targeting of resources and the use of the most cost-effective instruments to achieve public development objectives.
- (8) Jurisdictions should use the most cost-effective instrument for accomplishing their purposes. In most cases, there will be little justification for using less effective incentives. Two possible exceptions to this general rule can be identified. First, the use of limited tax concessions with firms considering relocation from other jurisdictions or relocation to another jurisdiction may be justified because of the psychological dimensions of concessions to businesses. Even in these cases, jurisdictions will want to ensure that they are not being "blackmailed" by the possibility or threat of relocations simply to "sweeten" a move that the firm would undertake in any case. Second, in some cases, jurisdictions might be justified in using an incentive of lesser cost-effectiveness that delivers a higher effective value to the firm in order to achieve the necessary leverage with the firm.
- (9) Cost-effectiveness ratios should be used to rank applicant firms and determine priorities for allocating limited state and local industrial development resources. These ratios measure the efficiency of state expenditures in providing financial assistance to firms. They are, therefore, the appropriate reference for guiding decisions on allocating industrial development resources.

## Notes

1. For information on state industrial incentives and recent innovations, see William Hamilton, Larry Ledebur, and Deborah Matz, *Industrial Incentives: Public Promotion of Private Enterprise* (Washington, D.C.: Aslan Press, 1985), and Deborah Matz, *An Analysis of Innovative State Economic Development Financing Programs* (Washington, D.C.: National Association of State Development Agencies, 1985).
2. Exemptions exclude particular items or actions from taxation. Deductions reduce the base upon which a tax is computed. Credits are subtracted from the tax due, thereby reducing the actual tax payment. Abatements are reductions in, or forgiveness from, taxes (usually property taxes) provided for a specified period of time. For a more detailed discussion of forms of tax concessions, see *Industrial Incentives: Public Promotion of Private Enterprise*.
3. John Gray and Dean Spina, "State and Local Industrial Location Incentives—A Well Stocked Candy Store," *Journal of Corporation Law*, Spring 1980, pp. 517-687.
4. U.S. Office of Management and Budget, *Managing Federal Assistance in the 1980s* (Washington, D.C.: Office of Management and Budget, 1980).
5. Lester Salamon, "Rethinking Public Management: Third Party Government and Changing Forms of Government Action," *Public Policy*, Summer 1981, pp. 255-275.
6. For reviews of these studies, see Larry C. Ledebur and David W. Rasmussen, "State Development Incentives" (Urban Institute Report, May 10, 1983), and George A. Reigeluth and Harold Wolman, "The Determinants and Implications of Communities Changing Competitive Advantages: A Review of Literature" (Urban Institute Report, January 9, 1979).
7. Michael Kieschnick, *Taxes and Growth: Business Incentives and Economic Development* (Washington, D.C.: Council of State Planning Agencies, 1981).
8. Roger Vaughan, *The Urban Impacts of Federal Policies: Vol. 2, Economic Development* (Santa Monica: The Rand Corporation, June 1977).
9. Roger Schmenner, "The Location Decisions of Large, Multi-Plant Companies," mimeographed, 1980.
10. Conclusions of Harry M. Rubin and C. Kurt Zorn, "Sensible State and Local Economic Development," *Public Administration Review*, March/April 1985, pp. 333-339. As sources supporting these conclusions, the authors cite Michael Wasylenko, "The Location of Firms: The Role of Taxes and Fiscal Incentives," in *Urban Government Finance*, ed. Roy Bahl (Beverly Hills, California: Sage Publications, 1981), pp. 155-190.
11. Jerry Jacobs, *Bidding for Business* (Washington, D.C.: Public Interest Research Group, 1979).
12. Roger W. Schmenner, *Making Business Location Decisions* (Englewood Cliffs, N.J.: Prentice-Hall Inc., 1982).
13. Calculation of the value of benefits to firms requires identification of the flow of gross benefits from the incentive, the appropriate discount rate to compute present values of flows accruing over time, and any offsetting costs of accepting the assistance.

public expenditures argues for extreme caution in weighing these factors.

Secondary income and employment benefits can be quantified. The cost-effectiveness model can build in income and employment multipliers. Application of the expanded model, however, has demonstrated that projects that are not cost-effective in terms of direct benefits to the recipient firm seldom become cost-effective even when secondary benefits are included. Further, multipliers used by state and local governments are, at times, somewhat unrealistic. Absurdly large multipliers have been used to justify projects that otherwise would not meet a reasonable test of benefits to costs. Therefore, one should be cautious in the application of secondary benefit tests of cost-effectiveness.

Calculating the cost of development incentives is complicated by the multilevel structure of the U.S. federal system. Changes in tax revenues resulting from incentives—both positive and negative—may accrue to both state and federal governments, and the full public sector cost of a development subsidy is the combined federal and state cost. For example, the most cost-effective instrument of industrial finance available to state and local governments, by far, is industrial development bonds. Costs of IDBs are borne by the federal government in the form of tax expenditures resulting from the tax-exempt nature of these bonds. The cost to the state is a relatively modest tax expenditure, while the benefits to the firm may be great. This situation results in a low (that is favorable) cost-to-government/benefit-to-firm ratio from the state and local government perspective. Consequently, use of IDBs has proliferated. Inclusion of federal tax expenditures in the IDB cost-effectiveness calculations, however, reduces the effectiveness of this instrument below several other tools of industrial finance.

Cost-effectiveness ratios for selected interest subsidies, subsidies for production inputs, and state and local tax abatement are presented in Table 5. Cost-effective incentives will have ratios of less than one. Negative ratios indicate the most cost-effective incentives. A general principle emerging from this table is that the federal system diminishes the cost-effectiveness of many forms of development incentives. Whenever a form of assistance raises profits or lowers costs, the aided firm faces an increased income tax liability. Since the federal government receives most income tax revenues, the states, in effect, subsidize the federal government when they assist business firms.

Tax concessions are not cost-effective. State and local government revenues forgone through tax expenditures are greater than

tax concession can be cost-effective. One application of the cost-effectiveness methodology examined the benefits to firms and cost to governments of business income taxes, property taxes, and employment tax credits in one state. The cost-effectiveness of these tax concessions was examined for large and small firms in four industries: (1) capital-intensive manufacturing, (2) labor-intensive,

Table 5.

Cost-Effectiveness Ratios for Selected Development Incentives

| Incentive                             | Cost to Government/Benefit to Firm |       |          |
|---------------------------------------|------------------------------------|-------|----------|
|                                       | Federal                            | State | Combined |
| <b>Low-Profit Firms<sup>a</sup></b>   |                                    |       |          |
| Interest Subsidies                    |                                    |       |          |
| Industrial revenue bonds <sup>b</sup> | 2.01                               | 0.18  | 2.19     |
| Subsidized direct loan                | -0.33                              | 1.47  | 1.14     |
| Loan guarantee <sup>c</sup>           |                                    | 0.79  | .079     |
| Subsidized Production Inputs          |                                    |       |          |
| Equipment                             | -1.11                              | 2.36  | 1.25     |
| Land                                  | -0.58                              | 1.58  | 1.00     |
| Plant                                 | -1.40                              | 2.40  | 1.00     |
| Tax Abatement                         | -0.42                              | 1.42  | 1.00     |
| <b>High-Profit Firms<sup>d</sup></b>  |                                    |       |          |
| Interest Subsidies                    |                                    |       |          |
| Industrial revenue bonds <sup>b</sup> | 2.24                               | 0.25  | 2.49     |
| Subsidized direct loan                | -0.84                              | 1.82  | 0.98     |
| Subsidized Production Inputs          |                                    |       |          |
| Equipment                             | -0.53                              | 1.71  | 1.18     |
| Land                                  | -0.58                              | 1.58  | 1.00     |
| Plant                                 | -1.40                              | 2.40  | 1.00     |
| Tax Abatement                         | -0.85                              | 1.85  | 1.00     |

- Notes: a. Low-profit firms face a federal corporate income tax rate of 20 percent and an average state corporate income tax of 5 percent. The combined tax rate is 24 percent under the assumption that states do not allow the deduction of federal income taxes.  
 b. Industrial revenue bonds are federally funded via tax expenditures.  
 c. Assumes a default rate of 22 percent.  
 d. High-profit firms face the maximum federal corporate tax rate and an average state corporate income tax of 5 percent. The combined tax rate is 48.7 percent under the assumption that states do not allow the deduction of federal income taxes.

Source: David Rasmussen, Marc Bendick, and Larry Ledebur, "A Methodology for Selecting Economic Development Incentives," *Growth and Change*, Vol. 15, January 1984, pp. 1-15.

Table 4.

## Fortune Survey

Comparative Importance of Factors in Locating Next Mainland  
U.S. Plant

| (1981 Rank Order)<br>1981<br>Rank | Factor   | Weighted Score* |      |                    |
|-----------------------------------|--|-----------------|------|--------------------|
|                                   |  | 1981            | 1976 | Notable<br>Changes |
| Figures in ( ) are 1976 ranks     |  |                 |      |                    |
| 1.                                | Productivity of workers (1)  | 82              | 82   |                    |
| 2.                                | Efficient transportation facilities for materials and products (1)                                   | 79              | 82   |                    |
| 2.                                | Community receptivity to business and industry (3)   | 79              | 80   |                    |
| 4.                                | State and/or local attitude toward taxes on business and industry (5)                                | 77              | 79   |                    |
| 5.                                | Availability of energy supplies (3)  | 75              | 80   | -5                 |
| 6.                                | Ample area for future expansion (8)  | 71              | 70   |                    |
| 7.                                | Costs of property and construction (6)   | 70              | 71   |                    |
| 7.                                | Availability of skilled workers (11)   | 70              | 65   | +5                 |
| 7.                                | Quality of life for employees (n/a)  | 70              | n/a  |                    |
| 10.                               | State and local posture on environmental controls and processing of environmental impact reports (6) | 69              | 71   |                    |
| 11.                               | Water supply (9)   | 66              | 68   |                    |
| 11.                               | Calm and stable social climate (14)  | 66              | 62   | +4                 |
| 13.                               | Adequate civic waste treatment facilities (14)   | 63              | 62   |                    |
| 14.                               | Availability of technical or professional workers (22)   | 62              | 53   | +9                 |
| 15.                               | Financing inducements (23)   | 61              | 51   | +10                |
| 15.                               | Fiscal health of state and/or city (12)  | 61              | 63   |                    |
| 15.                               | Proximity to customers (12)  | 61              | 63   |                    |
| 15.                               | Availability of unskilled or semi-skilled workers (10)   | 61              | 66   | -5                 |
| 19.                               | State and/or local personal income tax structure (17)  | 60              | 60   |                    |
| 20.                               | Proximity to raw materials, components, or supplies (16)   | 59              | 61   |                    |
| 20.                               | Proximity to services (17)   | 59              | 60   |                    |
| 20.                               | Efficient transportation facilities for people (20)  | 59              | 55   | +4                 |

| (1981 Rank Order)<br>1981<br>Rank | Factor  | Weighted Score* |      |                    |
|-----------------------------------|---|-----------------|------|--------------------|
|                                   |   | 1981            | 1976 | Notable<br>Changes |
| Figures in ( ) are 1976 ranks     |   |                 |      |                    |
| 23.                               | A growing regional market (20)                  | 57              | 55   |                    |
| 24.                               | Availability of clerical workers (24)           | 49              | 47   |                    |
| 25.                               | Personal preferences of company executives (26) | 42              | 36   | +6                 |
| 26.                               | Proximity to other company facilities (25)      | 37              | 37   |                    |

n/a: not asked.

\*Weighted Score: Respondents were asked to rate each of 26 possible factors as to their importance in locating the company's probable next new plant. The rating scale had five points, ranging from "extremely important" to "not at all important." For ease of interpretation, the answers were presented in the form of "weighted scores" so that if every respondent had said "extremely important," the weighted score would be 100, and if every respondent had said "not at all important," the weighted score would be 0.

Source: Fortune Market Research Survey, *Why Corporate America Moves Where* (New York, N.Y.: Time, Inc., 1982), p. 9.

national site selection processes, MCC chose Austin, Texas, and General Motors announced its intention to locate in Springhill, Tennessee. In neither case did tax concessions play a role in the site selection process. The state of Texas and city of Austin made a commitment to provide ongoing support to the state's education system, a commitment benefiting all firms and residents, and to assist employees in locating satisfactory housing. The Saturn decision was made on the basis of traditional location factors, primarily access to market, labor quality and costs, and local amenities.

The Volkswagen case provides an unfortunate example of corporate behavior in the site selection process. Most knowledgeable observers agree that Volkswagen made its decision primarily on the basis of access to market, access to resources and supplies, and labor considerations. Having made, but not announced, the decision to locate in Pennsylvania, the corporation proceeded to play

The United States Office of Management and Budget, after a two-year study, concluded:

The relative effectiveness of different forms of assistance such as grants, loans, and risk assumption for meeting different types of program objectives has not been systematically reviewed, in public literature. In the light of the scope, magnitude and importance of assistance as a tool of national leadership, much more needs to be known.<sup>4</sup>

The significance of this deficiency in the literature has been emphasized by Lester Salamon:

The widespread use of tools like loans, loan guarantees, social regulation, insurance, government corporations, tax incentives, various types of grants and others—many of which involve the pervasive sharing of governmental authority with a host of "third parties" . . . has significantly altered the practice of public management. . . . To come to terms with the new reality, it will be necessary to change the unit of analysis in public management and implementation research from the individual programs or agencies to the generic tools of government action and to develop a systematic body of knowledge about the dynamics and characters, the distinctive "political economies," and resulting advantages and disadvantages of different tools through which the public sector now acts.<sup>5</sup>

### Existing Evidence

Variations in business tax liabilities among states and municipalities are unlikely to play a major role in business site selection, location, or relocation decisions. Existing studies, with a striking degree of consistency, have failed to demonstrate a significant relationship between taxes and location decisions of business firms.<sup>6</sup>

#### Studies

No empirical analysis has been able to find a significant relationship between local taxes and economic development.<sup>7</sup>

Only 3.3 percent of the new firms [in a survey], none of the expansions, and 6.3 percent of the new branch plants indicated they would have located in another state in the absence of tax incentives.<sup>8</sup>

Tax levels are either not applicable or of low concern to the typical relocating plant. . . . [O]nly about a quarter to a third of the relocating plants actually move to new locations with lower property tax rates. The bulk, 40 to 50 percent, move within the same taxing jurisdiction or to locations in towns with similar tax rates. Another quarter move to jurisdictions with higher property tax rates.<sup>9</sup>

Despite the perception among policy makers that taxes matter and, therefore, a good incentive package should contain tax concessions, the overriding conclusion from previous research is that taxes do not play a significant role in a firm's choice of location among regions. Research also has shown that the other nontax controllables contained in state and local industrial incentive packages play little or no role in a firm's interregional choice of location. But as the geographical area diminishes, the importance of taxes and fiscal incentives increases. Transportation, energy, labor cost and market differentials tend to decrease as the area under consideration diminishes, making taxes a more significant locational determinant.<sup>10</sup>

Further, it has been argued that the availability of special subsidies for business has increased to the point that most states now offer standard types of business location incentives. "To the extent that this is the case, the usefulness of these subsidies in affecting interstate cost differentials is "washed out."

#### Surveys

Corporations do not identify tax concessions as significant factors in location, relocation, or expansion decisions. Roger Schmenner, in a far-reaching examination of determinants of behavior of large firms, identified the most important influences in national . . . "The seven cor . . . ons viewed as

|  | Exemption |                            |  | Treatment of Balance |           | Statute(s)  |
|--|-----------|----------------------------|--|----------------------|-----------|---|
|  | Exempt    | Conditional                | Partial  | Allocate             | Apportion |   |
| MAINE. 1)<br>2)  |           |                            | 1989: 10% exclusion.<br>1990: 20% exclusion.<br>1991: 30% exclusion.<br>1992: 40% exclusion.<br>1993: 50% exclusion.                         | X                    | X         | §5102.8<br>§5200-A, Subd. 2. G; §5244, L. 1988, c. 841, eff. for taxable years beginning in 1989  |
| MARYLAND<br>MASSACHUSETTS 1) X<br>(Unless less than<br>15% ownership of<br>payor.)<br>2) |           | If 50% ownership of payor. |  | X                    |           | §280A(c)(5)<br>§30(a)(1)  |
| MINNESOTA 1) X<br>2)<br>3)   | X         |                            | 95% exclusion.<br><br>80% exclusion.<br><br>80% exclusion if<br>20% ownership of<br>payor, otherwise<br>70% exclusion.                       | X                    | X         | §30(a)(1), L. 1988, ch. 202, eff. for<br>tax years ending on/after 12-31-88<br>§290.21 Subd. 4(e), L. 1984, c. 502,<br>eff. for taxable years beginning<br>after 6-30-85<br>§290.21 Subd. 4(a), L. 1987, c. 268,<br>eff. for tax years beginning on/<br>after 1-1-87<br>§290.21 Subd. 4, L. 1988, c. 719,<br>eff. for taxable years beginning<br>after 12-31-87 |
| MISSISSIPPI  |           |                            |  | X                    |           | §§27-7-15(1), 27-7-15(4)(1),<br>27-7-23(c)(2)(B)  |
| MISSOURI X   |           |                            |  |                      |           | §143.431, <u>Union Electric Co. v. Coale</u> ,<br>347 Mo. 175 (1910)  |
| MONTANA 1)<br>2)   |           |                            | 80% exclusion.   | X                    | X         | §15-31-113(1)<br>§15-31-3, L. 1987, c. 616, eff. for<br>tax years beginning after 12-31-87  |
| NEBRASKA X   |           |                            |  |                      |           | §77-2716(7), L. 1984, LB 1124, eff.<br>for taxable years beginning on/after<br>1-1-84   |
| NEW HAMPSHIRE 1)<br>2)   |           |                            | Amount of exclusion<br>determined by formula<br>modified to include<br>payor's foreign divi-<br>dend-related property,<br>payroll and sales. | X                    | X         | §§77-A:1.111(a), 77-A:1.VI<br>§77-A:3.11(b), L. 1986, c. 153, eff.<br>for tax years beginning after<br>6-30-86  |
| NEW JERSEY   |           | If 80% ownership of payor. | Otherwise, 50% exclusion.  | X                    |           | §54:10A-4(k)(1)   |
| NEW MEXICO   |           |                            |  | X                    |           | §17-2A-2.M & N  |
| NEW YORK   |           | If 50% ownership of payor. | Otherwise, 50% exclusion.  | X                    | X         | §§208.9(a)(1) & (2) and (b)(2)  |
| NORTH CAROLINA   |           |                            |  | X                    |           | §§105-130.7, 105-130.4(f)   |
| NORTH DAKOTA 1)<br>2)  |           |                            | 1989-1994: 50% exclusion<br>or, if at least 25%<br>increase in "threshold<br>activity", 70% exclu-<br>sion.<br>1995: 70% exclusion.          | X                    | X         | §57-38-01.8<br>L. 1987, H.B. 1064, effective for<br>tax years beginning after<br>12-31-88   |
| OHIO X   |           |                            |  |                      |           | §5733.04(1)(2)  |
| OKLAHOMA   |           |                            |  | X                    |           | §2358.A.4.b   |
| OREGON   |           |                            | 85% exclusion.   |                      | X         | §117.267(2), c. 1, Oregon Laws 1984,<br>eff. for tax years beginning on/after<br>1-1-86   |
| PENNSYLVANIA X   |           |                            |  |                      |           | §§401(3)1.(A) & (n)   |

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# Reforming State Tax Systems

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## NOTES

*... The states should stress the uniform, equal, predictable and certain application of taxes to all businesses.*

generous tax deal, and because the evidence suggests pretty clearly that these offers are not major determinants of the location decision, that the state that dares to turn its back on this game is likely to attract favorable attention.

I commend this to you as food for thought.

1. Gray C. Cornia, William A. Testa, and Frederick D. Stocker, *State-Local Fiscal Incentives and Economic Development* (Urban and Regional Development Series No. 4), Academy for Contemporary Problems, Columbus, June 1978.

2. George W. Morse and Michael C. Farmer, *Tax Abatement Location Investment Effects: Does the Ohio Reinvestment Area Tax Exemption Really Work?* (Report ESS 605), Department of Agricultural Economics and Rural Sociology, The Ohio State University, Columbus, November 1983.

Frederick D. Stocker is a Professor of Economics and Public Administration at Ohio State University. This paper was originally presented at the Western States Association of Tax Administrators meeting in Boise, Idaho, on September 17, 1984.

## The State 'Unitary Tax' Dispute by Congressman Byron Dorgan

Most of the major newspapers in the United States have printed stories and editorials in the past year on the subject of a "unitary tax" dispute, an issue that has divided the U.S. and some of its allies and has reached all the way to the Oval Office in the White House.

The controversy is shrouded in the language of tax lawyers and corporate attorneys, but the dispute is really simple.

Some state governments, including the state that I'm from (North Dakota), require a corporation doing business in that state to report for income-tax purposes on a unitary worldwide combination basis.

Simply put, that means a corporation doing business all around the globe, and also in North Dakota, is asked to report to North Dakota a portion of its total income for the purpose of allowing North Dakota to compute the income-tax liability it owes the state.

That portion of income attributable to North Dakota is computed by requiring the corporation to report its payroll, property and sales in North Dakota and compare that to its payroll, property and sales everywhere else. These three fractions then are applied to the total income of that corporation, and that is the piece of the income pie attributable to North Dakota as a tax base.

Some Corporations have become very upset with that approach. They believe states are attempting to tax foreign income. That, of course, is not the case. The states are only attempting to tax a fair percentage of the total corporation's income as measured by the corporation's activity in that state.

The corporations say the state should use something called the "arm's-length method" of computing a corporation's state income tax. This method is similar to the old shell game at the carnival. You only get to look at one portion of the corporation's financial picture. The result is corporations price-transfer their profits around and play the shell game to avoid paying their state-tax liability. That's why they like this method.

Some corporations headquartered in Great Britain have been especially active in trying to convince the British government that they are being mistreated when they do business here.

All of that is pure nonsense. There is not a shred of evidence anywhere that the state governments, using the unitary worldwide combination approach, have overreached and are attempting to require more than an appropriate share of a corporation's tax base to be reported to the states for income-tax purposes.

Let me repeat—there's not a single credible instance that I know of in which injury to those corporations has been demonstrated, and I don't believe it ever will be, because the issue is pure myth.

When I was tax commissioner for the state of North Dakota, I learned very quickly that the problem is not that the states are overreaching to try to tax income that does not belong to them. The problem is that too many of the multinational corporations are underreporting their income and avoiding scandalous amounts of state income taxes.

Byron L. Dorgan, a Democrat from Bismarck, is North Dakota's U.S. representative. This article was originally published in *The Denver Post*, Oct. 13, 1984.





# Multistate Tax Commission

## REVIEW

### A New York Perspective on Tax Incentives The Role of State Tax Incentives in Attracting and Retaining Business by Richard D. Pomp\*

Chief Justice Marshall once wrote that the power to tax involves the power to destroy. This essay examines the 1985 version of that statement: whether the power not to tax involves the power to create. More specifically, are state tax incentives an efficient strategy for attracting and retaining businesses and their employees?

States, municipalities, and big businesses are currently playing a high stakes game. The premise of this game is that a healthy state economy can be created (or maintained) by providing tax incentives that affect a business's locational decision.<sup>1</sup> If a state does not meet the going ante in terms of incentives, it runs the risk that a business will locate in areas offering greater inducements. It is a high stakes game that pits neighbor against neighbor, North against South. If tax incentives are the new ammunition in the latest war between the states, as some commentators have claimed, then the courtship of General Motors for its Saturn plant must be the most recent battle.<sup>2</sup>

The use of tax incentives is not new. Tax policymakers and theorists have concerned themselves with the impact of taxes on business activity and employment since governments began levying taxes. From the

early years of the Union, state governments have sought to influence the character and pace of economic activity with tax policy, direct expenditures, public relations, and regulations.<sup>3</sup> During years of slow growth, states have increased their efforts to attract industry and to stimulate employment and income.

New York has actively used its tax laws in an attempt to attract and maintain businesses and their employees by adopting tax credits and other special provisions. Although these provisions may be cost-effective, the State has never demanded a rigorous or systematic evaluation either prior to or after their adoption. This failure is perhaps understandable because it is during periods of slow growth that the temptation and pressure to adopt these provisions without adequate research is greatest.<sup>4</sup>

In order to provide for an informed debate over the use of such provisions, and more generally to analyze the effect of New York's overall business tax structure, the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law (Tax Study Commission) undertook a comprehensive study of these issues.<sup>5</sup> The Staff first reviewed over 30 years of research on the factors that influence where a business locates.<sup>6</sup> This body of learning suggests that locational decisions are extremely complex and that state business taxes are just one of innumerable factors that vary among jurisdictions. The majority of studies conclude that state and local business taxes do not significantly influence most business locational decisions.<sup>7</sup>

The Staff then attempted to determine whether this conclusion was valid regarding New York taxes. Are the State's business taxes out-of-line with those of other states so that studies on locational decisionmaking are not valid for New York? To answer this question, the impact of the corporate, sales, and property taxes on the after-tax rates of return of representative manufacturing firms was evaluated.<sup>8</sup> A computer model was used to simulate a representative manufacturing firm's

*Continued on page 2*

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profits over a period of time both in New York and in a variety of other locations in the United States. Simulations were made under existing law and under a number of possible changes. These simulations provided a basis for evaluating the impact of the State's overall tax structure on the after-tax rates of return of various manufacturing firms and the impact of the State's investment tax credit, the employment incentive credit, the recently repealed job incentive credit, and the double-weighted receipts factor, as well as changes in the corporate tax rate, the adoption of the federal rules on depreciation (ACRS), and the adoption of a so-called throwback rule.<sup>7</sup> Comparisons were made between New York and seven other states. The results of these simulations were consistent with the conclusions drawn from the literature review.

The combination of three decades of research and analysis and the microsimulations conducted specifically for New York suggest that changes in business taxes cannot be viewed as an effective means of influencing business locational decisions.<sup>10</sup> Interstate differences in corporate, sales, and property taxes among the states do not seem to have a large impact on after-tax rates of return. The reason why changes in the State's business taxes are unlikely to be a successful policy can be summarized as follows.

First, innumerable factors are important to a business in its decision about where to locate. Depending on the type of business at issue, the locational decision can be influenced by plant or site availability,<sup>11</sup> access to financing, access to and cost of transportation,<sup>12</sup> quality<sup>13</sup> and cost of labor,<sup>14</sup> proximity to markets,<sup>15</sup> the cost of utilities,<sup>16</sup> proximity to supplies,<sup>17</sup> proximity to other company facilities,<sup>18</sup> the regulatory environment, the quality of a state's schools, colleges and universities,<sup>19</sup> the cost of housing,<sup>20</sup> the level and quality of public services,<sup>21</sup> and the range of other amenities that enter into the general quality of life offered.<sup>22</sup>

Second, taxes are one of the many costs of doing business and the magnitude of these other costs may easily swamp the amount of state taxes involved. For example, a Staff analysis of those corporations which allocate their income for purposes of the State franchise tax—a group that pays approximately 70% of the corporate tax revenues—indicated that their labor costs in New York are 53 times as large as their State corporate tax payments. A 2% wage differential is equivalent in its effect on profits to a 106% corporate tax differential. For a labor-intensive corporation, a few pennies difference in the hourly wages paid to employees might reduce its costs by more than any conceivable tax savings that would result from locating in one state rather than another.<sup>23</sup>

Third, state and local tax payments are deductible for purposes of the federal corporate income tax. The effect of this deduction, the so-called federal offset, is to reduce both the absolute burden of state and local taxes and differences in burdens among the states. For example, consider a corporation subject to 46% fed-

eral corporate marginal tax rate. Assume that this corporation is deciding whether to move from State A to State B. Taxes would be \$200 in State A but would only be \$100 in State B—a \$100 difference. After taking into account the federal offset, however, the out-of-pocket cost of state taxes is \$108 in State A and \$54 in State B. The net difference in taxes between A and B is reduced to \$54 (\$108-\$54), from \$100 (\$200-\$100).<sup>24</sup>

Fourth, differences in state and local taxes may reflect differences in the level and quality of state and local public goods and services, and these goods and services also affect business locational decisions. Low taxes are not necessarily attractive to businesses if they mean that the firm will have to supply, at its own expense, what is supplied through the public sector in other states or other jurisdictions. Furthermore, if low taxes mean inferior schools, a state may lack the educated and literate labor force that is essential to certain types of businesses.<sup>25</sup> Of course, not all public goods and services are equally important to businesses.

Fifth, to the extent that tax rate differentials are capitalized, their impact will be reduced. For example, low property taxes in one jurisdiction might mean that land sells there for a higher price than it would sell for in another jurisdiction having higher property taxes. In other words, land located in a high-property tax jurisdiction may sell for less than an equivalent parcel of land in a low-tax jurisdiction, assuming that differences in taxation are not reflected in differences in public services, which might also be capitalized.<sup>26</sup>

Sixth, most relocating companies plan to stay at their new site years longer than any group of elected officials is likely to be in office. Consequently, current tax levels, special concessions, or special features of the tax law may not be a reliable basis upon which to make a multi-million dollar investment. What one group of legislators might grant today by way of concession another might eliminate tomorrow, especially if financial conditions change significantly. Fiscal stability and predictability may be more important than special concessions.<sup>27</sup>

Seventh, a state tax incentive that is granted by way of incorporating a similar federal provision may have no impact on a firm's decisionmaking if the future of the federal provision itself is in jeopardy. For example, states have been urged to adopt the federal provisions on depreciation (ACRS) in order to provide a tax incentive to businesses. Because the U.S. Treasury has proposed eliminating ACRS, it is highly unlikely that any business would make a major investment decision on the basis of whether a state had adopted ACRS.<sup>28</sup>

Eighth, state tax incentives may contain their own seeds of destruction. If incentives are effective at all, a state will gain only a short-lived advantage over other states because the latter can be expected to adopt similar ones.<sup>29</sup> A tax incentive that is adopted by all states is equivalent to no incentive at all, except that tax revenue is needlessly lost. In reality, however, states

are afraid of letting any other state obtain an advantage, and thus tax incentives are often adopted without evaluating the results that occurred elsewhere.

Ninth, some executives charged with the locational decision may be uninformed about the existence of tax incentives. For example, one researcher found that most firms were unaware of whether tax incentives even existed when making their locational decisions. In the case of those firms which were aware, only a small portion claimed that they would have located in another state in the absence of the incentives. Further, most firms making new investments did not even consider locating in any state other than their final choice.<sup>30</sup>

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***... the weight of the evidence indicates that business tax incentives cannot play a significant role in attracting or maintaining firms.***

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Finally, there are relatively few footloose firms that can be affected by tax incentives.<sup>31</sup>

Because the weight of the evidence indicates that business tax incentives cannot play a significant role in attracting or maintaining firms, their use probably results in a needless loss of State revenue. Unfortunately, the New York Legislature, like most legislatures, is unaware of the ongoing cost of various special provisions in the tax law. Aside from an initial revenue estimate that is sometimes made when a tax incentive is proposed the Legislature has not requested an annual accounting. Yet such costs can increase dramatically.

As an illustration, consider that no revenue estimate accompanied either the adoption of the New York investment tax credit (ITC) in 1969 or the related employment incentive tax credit (EIC) in 1975.<sup>32</sup> By 1982, however—the most recent year for which data is available—\$136 million of ITCs were claimed, with \$133 million of unused investment and employment tax credits carried forward into 1983. Indeed, the amount of unused credits carried forward into 1983 exceeded the total amount of credits claimed in 1980. Moreover, in 1982 two corporations used nearly 40 percent (\$57 million) of the total amount of ITCs and EICs used. Overall, from 1970 to 1982 more than two-thirds of a billion dollars of ITCs and EICs have been claimed. This rapid escalation in cost and the marked concentration of these credits have occurred without a full accounting to the Legislature.

In effect, tax incentives are tantamount to a spending program that is implemented through the tax system. For example, in lieu of enacting the ITC the State could have adopted an explicit spending program. Rather than filing a form claiming an investment tax credit with the Tax Department, the taxpayer could have filed the same form with a different agency, perhaps the Commerce Department. The Commerce Department would then have issued a check to the taxpayer, instead of the current approach in which the

corporation receives an implicit check through a reduction in its tax liability.

By choosing a tax incentive over an explicit spending program, the State surrenders control over the amount it expends each year on the ITC and the EIC and abdicates its responsibility for financial accountability. In a conventional direct spending program, the State appropriates a specific amount of funding. The appropriated amount represents the State's maximum revenue exposure and presumably reflects a Legislative judgment about the costs and benefits of that program relative to other programs competing for funding. Tax incentives, however, are more like an entitlement program, in which any taxpayer that meets the stated criteria qualifies for the benefit. The State cannot control the total expenditure in advance and the program has unpredictable financial consequences for the budget.

The lack of control over the cost of tax incentives is exacerbated by the Legislature's failure to review these credits in the same manner it reviews other spending programs. Direct subsidy programs are reviewed annually through the Legislative appropriation process. Using the tax system to implement a program to encourage capital investment avoids this process. Indeed, no published information is even available to facilitate periodic review. For example, until a report by the Staff of the Tax Study Commission, there was no publicly available document indicating the annual amount and distribution of ITCs or EICs claimed by corporations.<sup>33</sup> But the need for this evaluation may be greater in the case of a spending program that is implemented through the tax system than in the case of an explicit spending program. In the former case, the details are often buried in the technical and abstruse language that exemplifies the tax law. Furthermore, in periods when the budget is scrutinized in order to ferret out any possible waste, and painful decisions are confronted regarding the provision of services, the tax system escapes this same degree of fiscal vigilance. Tax incentives thus avoid the traditional cost-benefit analysis that is applied to other governmental programs.

In addition to the explicit loss in revenue, tax incentives impose inevitable administrative costs and result in "leakage" as taxpayers pursue aggressive tax planning techniques to qualify for the special benefits. These problems are not unique to the State. A recent example of possible abuse of the federal investment tax credit involves a major accounting firm. In a civil complaint, the Justice Department alleged that this firm engaged in a pattern and practice of misclassifying property that was clearly unqualified for the investment tax credit. For example, it was alleged that the firm encouraged its clients to classify concrete block walls as portable plug-in panels and to classify immovable industrial heating units as unit heaters so that they would not appear as buildings or structural components of buildings, which are ineligible for the federal ITC.<sup>34</sup>

*Continued on page 4*

indications exist suggesting that taxpayers are abusing the State ITC and EIC. For example, when the amount of EIC claimed by a corporation in 1980 was matched by a computer against the maximum amount of EIC that could have been claimed legitimately, it appeared that nearly one-half of the corporations claimed an EIC that was too high. These apparent errors involved about three-fourths of the value of the total EICs claimed in 1980, over \$30 million.<sup>35</sup>

Tax incentives also raise serious questions of equity. The State's investment and employment tax credits, for example, raise four different sets of equity considerations. First, over 97 percent of all corporate filers do not benefit from the ITC and over 99 percent do not benefit from the EIC, yet they indirectly bear the costs of these credits through higher rates. By contrast, these credits have allowed nearly 4,000 corporations, including some of the largest corporations in the State, to pay the \$250 minimum tax.

Second, even though the ITC and EIC are claimed primarily by manufacturers, the benefits are highly skewed. In 1982, less than 16 percent of all manufacturers claimed an ITC and less than six percent claimed an EIC. Two corporations received 40 percent of all the credits used in 1982 and ten corporations received 50 percent.

Third, corporations receiving an ITC pay lower taxes than do equivalent firms that are not investing in assets qualifying for the credit. If such corporations are competitors, the State has provided one group of firms with an "edge" over another. To take just one example, a corporation manufacturing or processing frozen gourmet dinners receives an ITC on its qualifying assets, whereas a fast foods restaurant is ineligible for the credit. If the credit is reflected in the price of the final product, frozen gourmet dinners have received a subsidy from the State while corporations producing a competing product have not. These haphazard effects are inevitable whenever the tax system is used to subsidize certain activities or investments over others. Since such effects are neither obvious nor easily traceable, they are unlikely to represent a conscious industrial policy by the State.

Fourth, most tax incentives favor capital rather than labor. Consequently, their effect might be to lower employment. An investment tax credit, for example, lowers the cost of capital relative to labor, which encourages businesses to shift from the use of labor to the use of capital, and can result in a decline in employment. In addition, much new equipment tends to be labor saving (e.g., robotics). Indeed, the more successful the ITC might be at inducing investment the less successful it might be at creating jobs. The New York data is consistent with this supposition.<sup>36</sup>

In addition to these problems, state tax incentives are inherently wasteful. Because of the federal offset, a state may forgo \$2 in revenue yet a corporation may, after taking into account the increase in its federal corporate income tax, receive barely more than \$1. The difference between what a state forgoes and what the

corporation receives inures to the benefit of the federal government—revenue sharing in reverse.<sup>37</sup>

Most tax incentives are also wasteful because their benefits are available to corporations whether they alter their behavior or not. To illustrate, a corporation receives the State investment tax credit for all of its qualifying purchases, including those which it would have made anyway. No attempt is made to limit the credit to investments in excess of those which would have occurred in any event.<sup>38</sup>

In addition, New York, like all other states, does not require that any tax savings from the use of an incentive be invested within the State. For example, not only does a corporation receive the ITC for investment that it would have made anyway, but it is then free to use such savings to finance activities in other states or to increase its dividends. Indeed, a recent study of the U.S. corporate income tax indicates that corporations receiving the largest amount of tax incentives actually reduced their investment and increased their dividends.<sup>39</sup>

Why, despite the evidence to the contrary, has it become an article of faith in some quarters that a state can affect locational decisions through changes in its business taxes? One common explanation is that business taxes are one of the few aspects of the economic milieu that a legislature can directly control. Transportation costs, the cost of labor, the price and availability of real estate, climatic conditions, and so forth are less susceptible to state intervention. A business seeking a reduction in its costs is likely to focus its political activities on tax relief—an area in which the legislature at least has the power to act.<sup>40</sup> Indeed, some corporate officials view themselves as having an obligation to the shareholders to pursue all possible tax incentives.<sup>41</sup>

From a legislature's viewpoint, taxes are one of the few costs of doing business that can be reduced and no doubt for this reason the temptation to do so is great. And, because legislatures may never demand an annual accounting of the cost of the various special provisions they have enacted, tax incentives may appear to be less costly than direct spending programs aimed at economic development. Moreover, legislators do not wish to be perceived as being opposed to jobs or economic development or as having the blood of a runaway plant on their hands. In addition, no state desires other states to get a jump on it. It is not surprising, therefore, that tax incentives are easy to legislate if only because they give lawmakers a feeling of having done something constructive.

A more cynical view is that tax incentives may allow some legislators to accomplish indirectly what they cannot do directly—lower taxes on business. Indeed, from a business lobbyist's perspective, the combination of high nominal rates and a narrow tax base may be preferable to low nominal rates and a broad base. A high nominal rate provides an effective club that can be waved in order to persuade a legislator to support some arcane change in the tax law. One of a lobbyist's

standard tools—the incantation of “business climate” and “economic development”—depends on high nominal rates for maximum impact.

Many New York legislators are aware of the substantial body of research indicating the ineffectiveness of tax incentives but nonetheless view such measures as symbolic of a favorable business climate. No easy way exists of evaluating this position because there is no acceptable definition or measurement of “business climate.” Many considerations affect a corporation’s view of New York’s business climate, and the issues important to one corporation—energy costs or transportation facilities—may be unimportant to another.<sup>42</sup> There is little doubt, however, that the level of taxes compared with the level and quality of public services is one factor that shapes a business’s perception. Firms that avail themselves of various tax incentives and receive the level of public services that they desire probably have a favorable view of the State’s business climate and of its tax law. For other corporations, the level of taxes rather than the level and quality of public services may shape their perceptions. Whether this view is shared by all corporations, however, is problematic. For the 91.3 percent (379,000) of all corporate taxpayers in 1982 that did not utilize the double-weighted receipts factor, or did not benefit from the lack of a throwback rule, or did not benefit from any of New York’s special credits, but bore the burden of the forgone tax revenue through higher rates,<sup>43</sup> the tax law may simply be viewed as a complicated morass of special provisions benefiting their competitors.<sup>44</sup> Such corporations may feel that the State’s business climate would be improved if these various provisions were eliminated with a correlative reduction in tax rates. As economists remind us, no “free lunch” exists. Revenue that is lost through wasteful tax provisions results in a combination of lowered services and higher taxes than would otherwise result and these effects must be considered by policymakers when evaluating tax incentives.

Commentators caution that the role that taxes play in a particular firm’s perception of a state’s business climate must be placed in perspective. Zoning regulations, construction permits, the attitude of those public officials with whom a firm most often deals, the speed with which telephone calls are returned from the public sector, the degree of government regulations and restrictions, the way businesses are treated by a tax department’s auditors, the level of civility that characterizes interaction with government personnel, the amount of “red tape” that exists, the number of forms and permits that must be filled out, and the governmental assistance offered to a new firm and its employees in relocating all contribute to perceptions of business climate. Perceptions of business climate are also based on intangibles and imponderables that defy analysis or quantification (e.g., personal reasons of executives).

In this vein, a leading researcher suggests that:  
... states and localities should concentrate

on helping their manufacturers with the physical items which go into selecting a plant’s location, constructing it, and starting it up. States and localities should stand ready to offer the interested manufacturer (i) speedy and accurate information about potential sites, (ii) help in securing necessary environmental or zoning permits, and (iii) timely help with the roads, sewerage, water, waste treatment, and labor training which can make a real difference to the smooth start-up of a new manufacturing facility. I remain convinced that the industrial growth of the South has had more to do with Southern hospitality than with Southern tax rates. The regional differences in the use of such assistance as labor training suggests that supply does seem to create at least some of its own demand in these matters.

Recently there has been a rise in expediting mechanisms to counter the stifling effect that large bureaucracies have on industrial decision-making. Some cities and states have sponsored ombudsmen to guide businesses through the red-tape mazes. Such programs have received uniformly positive reactions. Such expediting is highly valued by many large companies, and explains, in part, the favorable opinions they have of the industrial development programs of North Carolina, South Carolina, Nebraska, and elsewhere. It is difficult for the average businessperson to know how to secure quick rulings on zoning variances, building permits, environmental standards and regulations, parking regulations, and tax assessments and abatements. The more government can cut the red tape, the more industry it can expect to retain. This exceedingly useful function could be promoted even more than it has been.<sup>45</sup>

To the extent that business taxes contribute to perceptions of business climate, some researchers argue that a state is better off with a broad tax base and low nominal rates than with a high nominal rate coupled with numerous special provisions. On the one hand, such differences should not matter. The sophisticated tax manager of a corporation is likely to be more interested in the “bottom line” liability and less concerned with what the nominal rates might be. On the other hand, the tax manager of a corporation that is considering a number of expansion sites, including New York, may not be involved in compiling the initial list identifying which of the 50 states merit further consideration. Such a list may be compiled by persons such as the division general manager who might not be involved in preparing the state tax returns for the corporation. A state with a high nominal tax rate but having favorable allocation formulae, tax credits, or

*Continued on page 6*

favorable rules on defining taxable income may be eliminated from consideration as an expansion site in favor of a state having a lower nominal rate but a less desirable tax law. Whether a state obtains the same advantages when it indirectly lowers business taxes by adopting special provisions rather than when it directly lowers visible tax rates is a fundamental and critical question.<sup>46</sup> In terms of improving its business climate, a state may be better off eliminating most or all of its special provisions and using the increased revenue to lower rates.<sup>47</sup>

One commentator has concluded that:

State tax policy should be designed so as to emphasize stability, predictability, and uniformity in state business taxation. The business tax climate is impaired more than anything else by tax policies that seem to single out particular industries or activities for special treatment, either favorable or punitive, creating a situation in which everything seems to be up for grabs. Tax concessions to specific firms or industries are to be avoided. On the contrary, state policy should emphasize the evenhanded application of the tax structure to businesses of all kinds.<sup>48</sup>

Whatever the perceptions are of New York's business climate, work by the Staff of the Tax Study Commission indicates that the State's business tax structure is generally in line with that of other states. Moreover, the effects of a range of policy options that were simulated, which included rather dramatic changes in the State's franchise tax, did not alter New York's ranking among the sites studied and were probably too insignificant to alter New York's attractiveness.<sup>49</sup>

Perhaps in recognition of the competitiveness of the State's business tax structure, attention has recently turned to the role played by New York's personal income tax. The effects of a state's personal income tax on the location of a business has not yet been studied with any rigor, primarily because the issue is not as susceptible to the kind of analytical tools that are applied to business taxes. The research discussed above covered only the corporate, sales, and property taxes and therefore its findings cannot be extrapolated to the State's personal income tax.

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***This essay . . . concludes that using business taxes as a significant part of an economic development strategy is virtually certain not to have the impact that proponents expect.***

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The conclusions and findings of the Tax Commission's research on New York, which are consistent with a substantial body of economic analysis, seriously question the emphasis the State has previously placed on the relationship between business taxes and economic development. In the past, it has been assumed

that a change in the business allocation formula, the introduction of an investment tax credit, the adoption of ACRS, the ability to allocate income to other states even if such income is not taxed by these other states, and similar special tax provisions, would significantly affect a business's locational decision. Like many issues that state policymakers confront, the question of the influence of taxes on the business locational decision cannot be definitively and conclusively answered. Knowledge in this area is and will remain imperfect, which, unfortunately, describes many of the other areas that policymakers are asked to address. Confronted with the lack of perfect information, policymakers should respond by determining the direction in which the bulk of the evidence points.

Clearly, a substantial body of evidence suggests that state business taxes are unlikely to affect significantly the locational decisions of firms. Businesses are not flocking to Mississippi, Louisiana, or Arkansas—low tax states. Conversely, Route 128 developed at a time when Massachusetts's unofficial sobriquet was "Taxachusetts." Apparently, low taxes do not inevitably attract firms any more than high taxes necessarily repel them. Of course, in some cases state and local taxes may be the determinative factor in a locational decision. It is also possible that taxes matter more for some types of firms than for others, and that the mix of taxes might also be important. For some businesses, an adverse tax picture reinforces other disadvantages that a state has. What the research suggests, however, is that these situations are infrequent and should not be the "tail that wags the dog."<sup>50</sup> This finding should not be misinterpreted, however, as an invitation for a state to increase cavalierly its taxes on business—at some point, deleterious effects can be expected.

The policy implications seem clear. Those who advocate using the tax system to influence business locational decisions, a position that is seemingly inconsistent with over 30 years of research, should have to support their case with a rigorous and periodic cost-benefit analysis. Because of the revenue and inequities at stake, the burden of proof should be on such advocates. Ironically, programs costing a few million dollars receive more scrutiny than tax incentives like the ITC and EIC, which cost more than the budgets of most State agencies.

De-emphasizing the use of business tax incentives as a tool for attracting and maintaining businesses should be viewed as a way of eliminating waste, inefficiency, and inequity in the tax system and is not tantamount to abandoning any meaningful program of economic development or to damaging the State's business climate. To the contrary, the money that would be raised from eliminating ineffective and inequitable provisions in the tax code could be used to finance rate reductions in the corporate and personal income taxes, to supplement existing State programs, or to fund new ones. Money raised from eliminating provisions that cannot survive a cost-benefit analysis could be used for human resource development, job

training, research and technological development, providing capital to finance growth and development, improving the State's infrastructure, and energy and natural resources management. To encourage economic growth, money is probably best spent on programs that increase the birth rate of local companies and the encourage the expansion of small, local companies. This essay does not address the specific merits of these programs, but only concludes that using business taxes as a significant part of an economic development strategy is virtually certain not to have the impact that proponents expect.

## NOTES

\* Director, Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, and Visiting Scholar, Harvard Law School. The views expressed do not necessarily represent those of any group with which the author is associated.

1. See *State Taxation Policy* (ed. M. Barker 1983), p. xiii-xv.

2. See note 27 *infra*.

3. See M. Kieschnick, "Taxes and Growth: Business Incentives and Economic Development," p. 155, in *State Taxation Policy* *supra* note 1 at 155; S. Kanter, "A History of State Business Subsidies," *Proceedings of the National Tax Association—Tax Institute of America*, (1977) p. 148. Massachusetts granted the first tax incentive in the country in the 17th century. See R. Pomp, S. Kanter, K. Simonson, and R. Vaughan, "Can Tax Policy Be Used to Stimulate Economic Development," 29 *Amer. L.R.* 207, 222 (1980). New Jersey granted a tax exemption to a manufacturing company established by Alexander Hamilton in 1791. See *Fortune*, March 5, 1984, p. 112.

4. A survey by the Advisory Commission on Intergovernmental Relations found that support for business tax incentives is strongest when economic growth has been slowest. See "State Tax Incentives: How Effective Are They?" *CUED Commentary*, Jan. 1980, p. 3.

5. The Staff's work is summarized in a Report by the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, *Interstate Business Locational Decisions and the Effect of the State's Tax Structure on After Tax Rates of Return of Manufacturing Firms* (December 31, 1984).

6. Nearly all of the research was conducted on the locational decisions made by existing firms that were expanding, establishing branch operations, or moving from one site to another. Little research has been conducted on the effect of state taxation on new business formation, although intuitively it would seem that state taxes would be less important than other factors, such as school and family ties and availability of financing.

7. Kieschnick, *supra* note 3 at 187 discusses numerous weaknesses in some of the existing empirical literature. His more carefully conducted research is consistent, however, with much of existing literature.

8. The Staff did not address the effect of local taxes on the location of businesses within the State—for example, whether a property tax abatement offered by Jurisdiction A is likely to be cost effective. Any impact the personal income tax or payroll taxes might have on business locational decisions was also not addressed.

9. By using after tax rates of return of representative manufacturing firms in selected industries a number of problems that mark other studies of comparative tax burdens were avoided. See Report of the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, *Interstate Tax Comparisons: Introduction and Overview* (1985). Kieschnick, *supra* note 3 at 190-198. Staff Report, *supra* note 5 at 31-36.

10. State tax incentives typically favor capital investment (e.g., the investment tax credit or the adoption of a depreciation regime like ACRS). These incentives can increase the level of investment in a state in two independent ways, by encouraging existing firms to invest more than they otherwise would or by encouraging firms to locate (or remain) in a state. Such incentives, however, are rarely defended as tools for increasing the level of investment in a state except through their impact on attracting new businesses. The simulations described in the text which included doubling the rate of the State's ITC, as well as eliminating it entirely, suggest that tax incentives cannot be seriously defended as a cost effective means of increasing the level of investment by existing firms. For a further discussion, see Staff Report, *infra* note 28 and Staff Report, *infra* note 32.

11. The red tape involved in site assembly may be a much greater investment barrier than the price of land. See R. Vaughan, *State Taxation and Economic Development* (1979) p. 25.

12. Transportation costs affect both the revenue a firm receives from its sales and the prices it pays for its inputs. Availability of transportation linkages, such as the ease with which trucks can make deliveries and collections, or the proximity of a railroad spur, shipping pier, or major airport, can also be critical for some activities. Cities like New York, which have traditionally housed a large number of small firms whose products are fairly transportation intensive, suffer from inadequate access to rail transportation and inconvenient access to truck routes. See *id.* 24.

13. Because training labor is expensive, businesses are attracted to areas that have a ready supply of skilled labor. Labor that is priced low relative to its skill was a major factor in the development of manufacturing in the South. See *id.* 24. Skilled labor also appears critical to attracting technology-

oriented firms. See note 19 *infra*.

14. The cost of labor may be a major consideration in competitive labor intensive industries, for example, apparel, leather, furniture, and consumer electronics. Another labor consideration is whether the workforce is likely to be unionized. See R. Schmenner, *Making Business Location Decisions* (1982), p. 37. A company with seasonal needs for labor has to be located in an area with a large labor pool. See Vaughan, *supra* note 11 at 24.

15. A site near established markets may be essential for industries such as printing, plastics fabrication, paper conversion, and can manufacturing, which involve commodities that have a low value-to-weight ratio and thus have transportation costs that are a high percentage of the selling price of the goods. See Schmenner, *supra* note 14 at 37.

16. One of the factors cited by Bankers Trust for transferring part of its operations from New York to New Jersey was the lower cost of utilities, an important consideration presumably because of the large amount of electricity needed to run the company's computers. See *New York Times*, April 29, 1983, p. B3. Energy costs are commonly mentioned as one of the reasons why the banking and insurance industries are relocating part of their operations outside of New York City. See *New York Times*, March 2, 1982, p. D23; December 23, 1981, p. D14. State and local taxes, of course contribute to the cost of energy. The price and availability of office space is another factor contributing to the movement of firms from New York City to less dense regions, both within and without the State.

17. For example, paper mills typically locate near a supply of trees and water; fruit and vegetable processors are usually located near farms; and petrochemical complexes must be close to pipelines. See Schmenner, *supra* note 14 at 37.

18. Some manufacturing plants operate as satellites to a base or main plant and cannot be located too far from the main plant without stretching the lines of support too taut. Schmenner, *supra* note 14 at 37. Savin Corporation decided to build a plant in Union, New York because four of its feeder plants were already in the area. According to the corporation's senior vice president, "the choice wasn't made because of tax considerations." *Wall Street Journal*, July 1, 1980. Nonetheless, the State's Commerce Commissioner chose to describe Savin's decision as "a splendid example" of the drawing power of tax incentives. *id.*

State officials responsible for economic development have an institutional interest in exaggerating the impact of tax incentives. When Church and Dwight built a new plant in Ohio, one economic development official claimed: "The tax incentive was the keystone of the deal." The corporate comptroller, however, stated that: "The tax abatement was a nice kicker at the end, but we chose Ohio mainly because of its strategic location for distribution and market growth." *Wall Street Journal*, June 30, 1978, p. 1.

19. High-tech companies, which are being wooed by many states today, are especially sensitive to the existence of prominent universities having graduate-level technical programs that produce a pool of potential employees. A recent example involves Microelectronics and Computer Technology Co., a joint venture of 12 major companies, including Control Data, Digital Equipment, Honeywell, RCA, and Sperry, which was courted by fifty-seven cities. According to the president of Microelectronics in selecting Austin, Texas for its site the corporation emphasized "the output of technical people in the area," particularly electrical engineers and computer scientists with advanced degrees—and "not who's holding a gold watch to get you to come." *Wall Street Journal*, May 12, 1983. See also note 20 *infra*. The existence of high quality graduate programs no doubt explains the presence of high-tech firms along Route 128 in Massachusetts and in the "Silicon Valley" in California. But see *infra*.

According to recent reports, sweeping changes in educational policies are being pursued throughout the South by a growing number of persons who assert that the ability of their states to attract growth industries increasingly hinges on the educational depth of the work force. Many of these changes are being financed by increased taxes. *New York Times*, March 20, 1982, p. 26.

The Alabama Governor's Task Force on Economic Recovery expressed a similar concern: "Alabama's traditional combination of low taxes and minimum services no longer constitutes a sound basis for progress. . . . Today the premium is on the elements which support technology—the educational system, engineering resources, communications research." *New York Times*, June 14, 1983, p. A19.

Florida recently increased its budget for education by \$227.8 million through a variety of tax increases. The Florida Governor supported the tax increases with the slogan, "Education Means Business." *New York Times*, January 11, 1984.

This phenomenon is not limited only to the South. When voters approved the first Dayton, Ohio public school tax in twelve years, they were described as acting in part from a concern for jobs. *New York Times*, June 14, 1983, p. A18. Business executives in California have also called for tax increases to finance educational reforms. Business leaders fear that the poor quality of public education in California is undermining the ability of their companies to compete with foreign countries, especially Japan, which are perceived to have better education systems. *New York Times*, April 23, 1983, p. 7.

20. The high cost of housing in the Silicon Valley is apparently making it increasingly difficult for companies to attract employees and is causing some corporations to move to lower cost areas. *Wall Street Journal*, May 11, 1983, p. 37. The cost of housing played a role in the selection of Austin, Texas by Microelectronics and Computer Technology Co., *supra* note 19. The biggest economic factor was the cost of private housing. Taxes didn't play a significant role in our decision. . . . The governor of Texas put together a statewide task force of bankers, industrialists, educators and political figures. . . and they did some clever things to reduce the hassles of relocating—such as getting bank commitments for mortgage money below FHA rates, and starting a job placement center for spouses." *USA Today*, August 24, 1983, p. A8.

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21. Improvements in the level and quality of public services, such as a state's infrastructure, will benefit many firms, both large and small. By comparison, tax incentives tend to accrue to a small percentage of large firms.

22. According to one of the leading researchers on locational decision-making, corporations visit a potential site in order to gather information about the community—its attractiveness as a place to live and raise a family, its housing, schools, medical facilities, cultural and recreational activities, and its civic pride. Schmenner, *supra* note 14 at 20.

23. Many studies have concluded that regional differences in labor costs, construction costs, and energy costs are generally too large to be offset by differences in tax levels. See, e.g., Cornia, Testa, and Stocker, *State Local Fiscal Incentives and Economic Development, Urban and Regional Development Series No. 4, Academy for Contemporary Problems* (1978).

24. To the extent that other costs of a business are also deductible, the relative differentials between such costs and taxes would be unchanged.

25. See *supra* note 19; C. Tiebout, "A Pure Theory of Local Expenditures," 54 *J. Political Economy* (1956), p. 416.

26. See W. Oates, "The Effects of Property Taxes and Local Public Services of Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis," 77 *J. of Political Economy* (1969), p. 957.

27. Roger Smith, Chairman of General Motors, whose Saturn plant has been sought after by nearly every governor, stressed that "tax breaks can't make a silk purse out of a sow's ear." According to Smith, "we're going to be in business for the long term... you've got to look at more than just what the great big cookie is that's coming in on the plate." *Detroit Free Press*, March 18, 1985, p. 1A. Consistent with this philosophy, the first state GM eliminated as a site for the Saturn plant was Florida, a state that is perceived as having an extremely favorable tax climate (e.g., no personal income tax, no estate tax, a double-weighted receipts factor, as well as its recent elimination of worldwide combined reporting). See also text accompanying *infra* note 48.

28. For a fuller discussion, see Report by the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, The Article 9-A Franchise Tax: Should New York Adopt ACRS? (December 31, 1984). The issue of whether a state should adopt the federal rules on ACRS also illustrates a significant difference in perspective between federal and state tax law. When the Congress enacts special tax provisions designed to encourage investment, it is indifferent to where within the United States such activity occurs. A particular state does not share this perspective, however. If state law mirrors federal measures designed to encourage investment regardless of where it occurs, a state may lose revenue to support investment occurring beyond its borders, the benefits of which may not sufficiently rebound to that state. If the policy question is phrased as whether a state should adopt a tax incentive that results in a loss in revenue for investments made in other states, most officials would answer with a resounding "No." Yet, if New York were simply to adopt the federal rules on ACRS, as has been vigorously proposed by many persons, a corporation would receive the benefits of the faster depreciation for investment occurring both within and without the State. If, indeed, most of the revenue loss that New York would experience from adopting ACRS would actually be attributable to investments made in other states. See *id.* In order to minimize this revenue loss, a state that wished to adopt ACRS should limit it only to in-state investment, which is the approach New York recently adopted. Even this approach, however, does not ensure that the resulting loss in revenue will be cost effective. See *id.*

29. For example, shortly after New York adopted its double-weighted receipts factor, Massachusetts and Connecticut adopted similar provisions. See Report by the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, The Article 9-A Franchise Tax: The Double-Weighted Receipts Factor (May 1985).

30. Kieschnick, *supra* note 3 at 325. Moreover, some economists argue that business accounting and organizational structures can reduce the effectiveness of a tax incentive. Tax incentives operate at the overall company level by reducing the final tax. But the problem that generated the need for a tax incentive is often focused at the plant level, where the plant manager is faced with the decision to purchase equipment that would otherwise be unprofitable without the tax incentive. Consider, for example, the investment tax credit (ITC). Unless the tax savings at the overall level are allocated within the company to the particular plant, that plant manager might be saddled in the company's books with a high pre-ITC cost for the equipment. See Surrey, Warren, McDaniel & Ault, *Federal Income Taxation* (1972), Vol. 1, p. 271 at n. 21. Further, the plant manager or other persons in charge of purchasing equipment may be unaware of the credit. A staff member of Minnesota's Taxation Committee expressed a similar sentiment: "We've learned that accountants are better at discovering tax breaks than managers." See D. Frey, *Economic Development Tax Incentives, A Staff Perspective, Paper Presented at the National Conference of State Legislatures*, July 22, 1984.

31. *State Taxation Policy*, *supra* note 1 at 89.

32. The EIC can only be claimed by those firms which have claimed ITC. For a complete discussion, see Report by the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, The New York State Investment and Employment Tax Credits (March 11, 1985).

33. See *id.* The federal government annually publishes a supplement to the budget which estimates the cost of various tax incentives. See Budget of the United States Government, Special Analysis G. A few states publish a similar analysis.

34. See Ernst & Whinney Faces Civil Charges for Deceptive ITC Studies, *Tax Notes*, March 22, 1982, p. 770.

35. See Staff Report, *supra* note 32 at 56.

36. See *id.* at 30-33, 35-36.

37. A reduction in the rate of the franchise tax would also have the effect described in the text. A state program that was structured to provide a tax-free benefit to a corporation would not have such an effect, provided that

the program did not reduce a cost that a business would have otherwise incurred.

38. See Staff Report, *supra* note 32 at 36-37.

39. The study compared the investment patterns of 238 profitable non-financial corporations with the federal taxes they paid in 1981, 1982, and 1983 and concluded that "evidence that the billions of dollars the federal government spends each year on tax incentives to encourage investment have failed to achieve their purpose is overwhelming." See *The Failure of Corporate Tax Incentives: A Study of Three Years of Growing Loopholes and Lagging Investment, Citizens for Tax Justice* (1985), p. 4. The study found that the 50 lowest-taxed corporations had an average tax rate of minus 8.4 percent (i.e., they received tax refunds or sold their excess tax benefits) but reduced their investment by 21.6 percent. By contrast, the 50 corporations with the highest tax rates increased their investment over the same period by 4.3 percent while paying 33.1 percent of their profits in federal income taxes. Moreover, although the low-tax companies cut back on their new investment, they increased their dividends at a pace more than 30 percent greater than the high-tax companies.

40. The pressure exerted on some states to repeal worldwide combined reporting provides a recent illustration. See also note 41 *infra*.

41. A spokesman for General Motors, for example, stated that the reason the corporation asked Baltimore for a tax abatement (in addition to non-tax benefits that were already granted) was that "we'd be very irresponsible to our shareholders not to request it." See New York State Comptroller, *Fiscal Research Report, Tax Concessions for Business Development* (January 1981), p. 3.

Michael Barker's description of the role of business is more cynical: In virtually every state, businesses and their trade associations make an annual pilgrimage to the state capital, pleading for additional tax reductions or the creation of special investment incentives. Armed with studies and charts, they attempt to show why the state is suddenly in danger of losing jobs to other, more attractive areas. Usually, they stress that the tax reductions being advocated pose no long term threat to the state's treasury and that prompt action on tax reductions will provide such a stimulus to private taxable activities that the changes will pay for themselves, producing no net loss in state or local revenues. But the alternative is always clear. Without action, disaster looms. The state's business climate will be severely damaged. Investment capital will flow elsewhere. Existing businesses will wither and die. Workers will go jobless. Tax revenues will fall as industry stagnates. Business interests will support other, more responsive candidates. A blight will move across the face of the land.

That such efforts continue to prove successful in the complete absence of any empirical evidence that state or local taxes play an important role in guiding business investment decisions is not surprising. Business lobbies are powerful in state capitals. What very few numbers do exist concerning the impact of taxes on business investment decisions have usually been furnished by the very people seeking tax relief. *State Taxation Policy supra* note 1 at xliii-xiv.

42. Various groups attempt to measure a state's "business climate." One well-known attempt by Alexander Grant has been described as lacking rigor and scientific methodology. See Wheeler, *Interstate Differences in Tax Costs to Corporations: A Look at Some Accounting Studies, in Michigan's Fiscal and Economic Structure* (Brazer & Laren eds., 1982). Professor Wheeler notes that the Alexander Grant study "does not claim to be, nor should it be construed to be, using scientific methodology in that a whole host of internal and external validity problems exist." *Id.* 252. The Grant study has been criticized for counting the same variable twice, relying on poor data sources, and improperly measuring the factors used. See Biermann, "The Validity of Business Climate Rankings: A Test," *Industrial Development*, March/April 1984), p. 17.

Attempts to measure a state's business climate often suffer from the problems encountered in measuring a state's tax burden: most business climate studies are not industry specific and are thus too general to be very useful. Disparate industries are likely to have very different impressions of a state's business climate and a general study that ranks various aspects of doing business in a state cannot reflect the priorities of every sector of the economy.

Fantus Corporation contends that business climate studies are inappropriate and unusable in the site selection process. See Biermann, *supra*. Fantus described the Grant study, *supra*, as "a tremendous disservice for states and industries because it is so misleading... the ranking is subjective and uses general data that are misleading because they don't come to grips with the specific needs of companies in specific locations." *Id.* 23.

43. The North Carolina director of industrial development stated: "Existing industries in most cases pay for incentives, and we don't burden our industries with that. We treat everybody equally." *Wall Street Journal*, June 30, 1978, p. 17.

44. "Tax subsidies tend to provide windfalls to large, well-established companies and have little meaning for new small companies that offer the greatest potential for local economic development." Jack Faucett Associates, *Effectiveness of Financial Incentives on Investment in the Economic Development Administration's Designated Areas*, Economic Development Administration, U.S. Department of Commerce (June 1976), p. iii.

45. Schmenner, *supra* note 14 at 58. Some persons have argued that tax concessions should be viewed in terms of their announcement effect—that the businessman is a hero who is admired and loved by the citizenry. Southern policymakers are often described as accomplished practitioners of this stroking policy. See Shannon, "State Income Taxes—Living with Complexity," *National Tax Journal* (1977), p. 339-340. Schmenner's recommendations would seem to serve this purpose.

In discussing the psychological effects of investment incentives on business climate, one economist concluded, "Unfortunately, about all one

can do about such matters is to note their existence and our inability to say anything definite about them." *Bird, Tax Incentives for Investment: The State of the Art* (1980), p. 49 n. 10.

46. A 1979 survey conducted for the Chemical Bank asked the question: "If you had to choose between general tax relief and State assistance and incentives for business, which should be emphasized to improve the State's business climate?" Of the 898 businessmen questioned, 76% chose general tax relief. See New York State Comptroller, Fiscal Research Report, Tax Concessions for Business Development (January 1981), p. 4.

47. One representative of a prominent Massachusetts lobbying group was reported as stating that he would prefer an outright cut in the state's corporate income tax rate, but since that was hard to obtain, "tax incentives will have to do." Another lobbyist who was instrumental in the adoption of the Massachusetts job creation tax credit stated that his organization fully intended the credit to be a "gift" to companies to "compensate" them for the State's high tax rates. See Harrison and Kanter, *The Great State Robbery* (Working Papers for a New Society, Spring 1976), p. 57.

As this essay goes to press, Stanley Fink, Speaker of the New York State Assembly, is planning to introduce a bill that would eliminate many of the special provisions in the New York corporate tax, coupled with a dramatic reduction in the rates. His bill would reduce (or leave unaffected) the taxes paid by 99 percent of the corporations in the state. Speaker Fink's proposals are philosophically similar to those being proposed by the U.S. Treasury Department for reforming the federal corporate income tax.

48. Stocker, "A Fiscal Strategy of Ohio Economic Development," *Lil Bulletin of Business Research* (May 1977).

49. The simulations conducted actually understate New York's attractiveness for four reasons. First, the State's tax law has extremely favorable rules on the taxation of dividends, interest, and capital gains. These rules were not simulated because only income from manufacturing activities was modeled.

Second, the manufacturing firms that were simulated were assumed to have a pattern of sales that would magnify and exaggerate the impact of adopting more stringent changes in the taxation of corporations. For example, the firms modeled were those which would experience nearly the greatest decline in after-tax rates of return if a throwback rule were introduced, or if a single weighted receipts factor were adopted. The overall decline in after-tax rates of return which would actually accompany these changes, even though modest, were nonetheless overstated.

Third, the computer model assumes that an out-of-state firm would ex-

pand in New York through a branch rather than through a new subsidiary. If a combined report is filed, the tax consequences will be identical regardless of whether the out-of-state firm expands through a branch or through a subsidiary. If a combined report is not filed, however, very different tax consequences can result. By creating a subsidiary for its New York operations, an out-of-state corporation can achieve even more favorable tax results than those indicated in the Staff Report, *supra* note 5. (Using orthodox tax planning techniques, the subsidiary can reduce its New York taxable income through payments to its parent (or other related corporations) for goods or services, such as legal fees, accounting fees, advertising expenses, stewardship costs, and interest. These expenses would be deductible as costs of doing business and thus reduce the corporation's New York taxable income. If the payee is subject to a lower tax rate than the payor, a net savings results. The creation of a branch in New York would not allow this same flexibility and thus the simulations understate the competitiveness of the New York tax structure.)

Fourth, all other states were assumed to have adopted the federal ACRS rules on depreciation. To the extent that some of these states have decoupled, the simulations make New York appear less attractive than it is.

50. Theoretically, if only a few firms were influenced by a tax incentive to locate (or remain) in New York, the resulting benefits might still outweigh the various costs and inequities that are identified in the text. Evaluating the benefits generated when a firm is induced to locate in New York involves a complex set of issues: Are the kinds of firms or investments attracted by tax incentives consistent with the long term interests of the State? Will the new corporation's employment, investment, and environmental policies comport with the needs of the local community? Will the new firm bring its own work force or absorb local unemployed persons? Will profits by the firm be invested locally or outside the State? Will raw materials and other inputs be purchased from local firms or from out-of-state firms? What services, such as water, transportation, and waste disposal will be required by the new firm and how will these be financed?

Once the benefits have been quantified, they can be compared to the costs of the tax incentive to see whether the incentive was a sound policy or whether there were more cost-efficient means of achieving the same goals. Although quantifying the benefits generated by a new firm is exceedingly complex, some commentators have concluded that the types of businesses most likely to be attracted by tax incentives pay low wages, offer poor working conditions, and provide unstable employment. See R. Vaughan, *supra* note 11 at 94 (citing Harrison and Kanter).

## MTC Annual Meeting Covered Wide Range of Tax Subjects

Representatives of twenty-eight states and of many businesses attended the Commission's Eighteenth Annual Meeting. This year's meeting consisted of programs on Sales and Use Taxes, Enforcement Efforts, Property Taxes, Corporate Income Taxes, and National Taxes.

### SALES AND USE TAXES

#### Untaxed Mail Order Sales from Out-of-State

##### *Plight of the In-State Retailer*

The first program addressed the burgeoning mail-order problem which faces the states. Arthur Wheeler, Executive Director of the North Dakota Retailers' Association, lamented the fact that so many sales are made into his state by out-of-state mail order sellers whom his State cannot require to collect and remit applicable use tax. Since the State cannot effectively enforce the payment of the tax by each individual buyer (it does not even receive any information with respect to such sales from the sellers), the result is, according to Wheeler, "an unrecognized form of tax relief for out-of-state direct marketers." In-state sellers must, he pointed out, collect and remit sales tax with respect to each sale of the same items as those which such out-of-state sellers market tax-free. He said that the

same situation prevails across the country. Many mail order sellers can be required to collect and remit the tax by virtue of the fact that they have a jurisdictional nexus in a state, i.e. they have sufficient contacts with the state to allow the State to impose the collection and remittance requirement on them. Thus, Sears Roebuck is subject to that requirement in all states because of the fact that it has at least one store in each state. However, under a 1967 U.S. Supreme Court decision in *National Bellas Hess v. Illinois Department of Revenue*, sellers who operate solely through the mails or have similarly minimal contacts with a state cannot be subjected to that State's tax collection jurisdiction.

Wheeler referred to proposed federal legislation which has been drafted by state tax administration officials for the purpose of extending the jurisdictional reach of the states to enable them to impose the collection requirement upon such out-of-state direct marketers. That proposal would cause the requirement to trigger when the seller exceeded a certain threshold level of sales into a state. Wheeler objected to the exemption of such sales below the threshold level, saying that that would still be unfair to in-state sellers and to buyers from in-state sellers. (It appears likely, however, that the tax collection requirement could apply to all sales, including those below the threshold, but

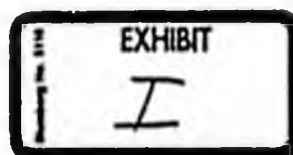
*Continued on page 10*

THE ROLE OF TAXATION  
IN STATE BUSINESS CLIMATE

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## Introduction

Tax policy is one of the most difficult and publicly scrutinized issues that state policymakers encounter. Legislators must balance many concerns when deciding upon tax questions. Undoubtedly, they seek to keep the level of taxation reasonable while also addressing demands and needs for public spending. The fairness and efficiency of taxation are other important considerations in tax policy. Lawmakers pursue tax fairness by attempting to tailor tax burdens to the taxpayer's ability to pay and by taxing individuals and businesses in similar circumstances under the same rules. Furthermore, since taxes can distort economic decision-making and lead to a less efficient allocation of resources, this consequence of tax policy must also be weighed.

In recent years, another issue has come to dominate tax debates in state capitols. Legislators and public officials have been warned that their tax system is the key to their economic fortunes – if their tax system is not competitive with those of other states, then businesses will chose to invest and create jobs in those states where taxes are lower and tax incentives for business investment are greater. Since private business investment generates most employment and income growth, the competitiveness of state tax systems is largely a question of how differences in state and local taxes effect business investment and location decisions . Consequently, the effect of taxes on business location and investment decisions is the primary subject of this paper. Since it dominates tax policy debate in many states, policymakers need to understand how taxes may shape economic development and the results of empirical research on this question. Special attention to this issues is not meant to imply that competitiveness should be the major consideration in making tax policy. Tax competitiveness is only one characteristic that legislators need to consider alongside traditional concerns of adequate and stable revenue sources, tax fairness and economic efficiency.

This paper is divided into five sections. The first section discusses the potential effect of taxes on business investment and job growth. In the second section, the specific effects of different types of taxes are outlined. The next two sections summarize and critique empirical studies of taxes and economic development, first focusing on the cost impact of taxes and then looking at the indirect effects of taxation on population. Finally, the conclusions of the paper are presented.

## 1.0 Taxes and Economic Growth: The Major Issues

### 1.10 The Role of Different Business Investment Decisions in Job Creation

Business investment decisions are the motor behind state job and income growth. Different regions and states experience varying economic conditions, largely based upon their particular pattern of business investments.<sup>1</sup> One recent study suggests that plant closing rates vary far less than job replacement rates by region and therefore, the rate of new job creation is a more significant factor in economic growth.<sup>2</sup> Since job creation results from several kinds of business investment, the importance of taxes and other factors will vary with the type of investment involved.<sup>3</sup> Thus, state policy-makers need to know which investment decisions are the largest contributors to economic growth and which are most sensitive to tax considerations. Current research suggests that investments which are the largest sources of new jobs are the least likely to be affected by tax considerations while the investment type that is most sensitive to taxes is a relatively insignificant source of job growth.

Job generating investment decisions can be grouped into four categories:

- (1) starting a new business;
- (2) expansion at an existing site (with or without adding new facilities);
- (3) opening a new branch plant; and
- (4) relocating a plant or business.

Several studies indicate that on-site expansion is the most important source of new jobs while business relocations are relatively unimportant. Roger Schmenner's census of employment and investments at 410 of the nation's largest corporations during the 1970s uncovered that 60% of national job growth at these firms resulted from on-site expansions, net of contractions. Another 36% of employment gains were from new branch plant employment in excess of job loss from plant closings. Employment growth at relocating plants accounts for only 4% of the national job creation by these large companies. Results for the Sunbelt were different, with new plant employment being the largest source of new jobs. Since these findings apply only to large firms, they do not measure employment from

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<sup>1</sup>See Roger W. Schmenner, Making Business Location Decisions (Englewood Cliffs, New Jersey:Prentice-Hall, Inc., 1982), pp. 164-199; and Candee S. Harns, "The Magnitude of Job Loss from Plant Closings and the Generation of Replacement Jobs: Some Recent Evidence," The Annals of the American Academy of Political and Social Science 475 (September 1984), pp. 15-27 for a detailed analysis of this issue.

<sup>2</sup>See Harns, pp. 23-25.

<sup>3</sup>See Harold Wolman, Components of Employment Change in Local Economies: A Review and Critique of the Literature (Washington, D.C.: The Urban Institute, 1979), pp. 22-29, which discusses how the causes behind different sources of job creation are likely to vary by investment type.

two of the three most important job generating business investment decisions – the start-up of a new business and on site expansion – typically do not involve this type of site selection and, therefore, taxes are unlikely to be a location factor. Entrepreneurs typically start their business where they work and live; they do not search out the optimal location.<sup>7</sup> This location may be necessary for access to expertise at a university or to be close to a major customer. Alternatively, the entrepreneur may simply be choosing to stay in an area that is known and liked. Furthermore, corporate profit and property taxes are a minor concern for new firms since they usually are not profitable in the initial years and do not have substantial assets. Consequently, tax costs are likely to be quite small.

Expansion at an existing site is also insensitive to taxes. In many cases, expansion at an existing site may simply involve adding employees, a shift and some equipment, rather than new construction. Since, in this case, expansion does not require a new site, alternative sites, including their tax consequences, are unlikely to be considered and evaluated. When on site expansion does involve new construction and additional facilities, it is likely that the advantages of remaining at the same site (lower land costs and economies of scale) and the problems of dividing up operations will either preclude a search for an alternative site or outweigh cost savings at other sites. Detailed studies of business location decisions indicate that on site expansion is the most frequent expansion route chosen by companies.<sup>8</sup>

Relocation of an existing business or facility and establishing a branch plant are the two situations where tax considerations will matter most. These decisions are likely to involve information gathering and comparison of alternative sites, especially when the firm is large. When different sites are compared, the tax costs at each site may be estimated and considered in evaluating the costs and benefits of different locations.

Interstate tax differences, however, are irrelevant for most relocations since most firms relocate over a small distance. One study estimated that 80-90% of all relocations are short distance moves and are primarily motivated by space considerations.<sup>9</sup> Even among large Fortune 500 companies most plant relocations are short-distance. Since "the interstate, inter-regional relocation is a rare event,"<sup>10</sup> differentials in tax rates among states are unlikely to influence most business

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<sup>7</sup>This point is made by Eva Mueller and James M. Morgan, "Location Decisions of Manufacturers," American Economic Review 52 (March 1962), pp. 204-217; and by Wolman pp. 23-25.

<sup>8</sup>See Roger W. Schmenner, Summary of Findings: The Manufacturing Location Decision: Evidence from Cincinnati and New England (Cambridge, Massachusetts: Harvard Business School, March 1978), p. 2.

<sup>9</sup>See Schmenner (1978), p. 9.

<sup>10</sup>Schmenner (1982), p. 179.

is perhaps the most important determinant of business location and employment growth.<sup>13</sup> Thus trends in population growth and migration partly influence business location since they determine the distribution of consumer demand. Access to markets is likely to be most important for industries that produce goods with low value to weight ratios and where transportation costs are large.<sup>14</sup> A location close to customers can also be important for firms that supply intermediate products to other industries. When supplier firms need to regularly share information with customers, observe and understand their operations and meet tight scheduling requirements, proximity may be a determining factor in location.

Supply of production factors. Labor, materials, land and energy are necessary inputs for production. Any plant must have an adequate supply of these resources to be profitable. Labor is generally the most important factor, representing the largest single cost and value component for most industries. Consequently, a plant must be located in an area where there is a sufficient supply of workers and where the required mix of skills is available. For firms that require highly skilled labor such as engineers, computer programmers, or scientists, the supply of skilled labor can be a major location factor. Similarly, technology-based operations may need a location that provides access to research, training and expertise at a university. While raw material supplies are not generally a major location factor, they are important for resource based industries such as paper, food processing and oil.<sup>15</sup> Energy and land availability are less important issues since they are generally available nationwide. However, land and space considerations can influence the choice of suburbs over central cities for manufacturing plants.

Production and Distribution Costs. Labor and transportation costs are generally the most important location cost factors. Several studies indicate that a large share of manufacturers is sensitive to transportation costs.<sup>16</sup> A study that simulated labor, transportation, tax and energy costs for manufacturing industries across the continental United States found that labor and transportation costs greatly exceed tax and energy costs for virtually all industries at the 2 digit SIC code.<sup>17</sup> The location of facilities that serve a national or large regional market will be affected by the cost of transporting goods to consumers, and will thus be influenced by the distribution of population. Labor costs are a consideration for

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<sup>13</sup>See Vaughan (1977), pp. 49-53 and (1982), pp. 21-23.

<sup>14</sup>Schmenner (1982), p. 37.

<sup>15</sup>Schmenner (1982), p. 37.

<sup>16</sup>See Vaughan (1982), p. 23.

<sup>17</sup>See Barry M. Rubin and C. Kurt Zorn, "A Comparative Analysis of Interstate Variation in Manufacturing Industry Business Costs" Center for Urban and Regional Analysis, School of Public and Environmental Affairs, Indiana University, 1983.

of industrial concentration.<sup>23</sup> Location in a industrially developed and diversified economy may also benefit firms that rely on specialized business services and a range of labor force needs.

Relationship to Other Plants and Operations. When a firm establishes a new branch plant, it must consider how this plant fits into its existing operations. The relationship of a new branch plant to other plants will depend on a firm's organization and multiplant manufacturing strategy. Schmenner outlines four possible strategies:

- (1) a product plant strategy where a plant or a few plants produce a product for the entire domestic market;
- (2) a market area plant strategy where a plant produces a product or product line for an entire regional market;
- (3) process plant strategy where a plant is assigned a specialized stage in the production process for a more complex product; and
- (4) general purpose plant strategy where a plant can take on a broad range of responsibilities with an assignment to a product, market area or process for a set period of time depending on changing conditions.<sup>24</sup>

Process plant strategies are most likely to require plant locations that are close to and closely related to other plants, while each market area plant will be placed in a separate region. The direct and logistical costs of moving people and materials between plants can be significant and may lead firms to cluster plants within one area, especially for firms following a process plant strategy.<sup>25</sup>

Local Characteristics. A number of local conditions, some of which are not directly related to demand, cost or supply issues, are important in business location decisions.<sup>26</sup> The quality of life in an area can influence the decision of where to site a plant or corporate headquarters. Firms are likely to prefer an area with good recreational and cultural amenities, good schools and less congestion and pollution. Quality of life consideration may be weighed heavily for plants that must attract and retain a more mobile, professional workforce.<sup>27</sup> Several factors that shape the local quality of life depend on public goods and services, e.g., recreation facilities and education. Local attitudes and leadership may also be considered.

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<sup>23</sup>ACIR, p. 37.

<sup>24</sup>See Schmenner (1982), p. 11-12 for a discussion of the classification.

<sup>25</sup>Schmenner (1982), p. 39.

<sup>26</sup>See Vaughan (1977), pp. 77-79 on these location factors.

<sup>27</sup>Schmenner (1982), p. 38.

Two important economic trends provide a compelling explanation for why the Sunbelt grew faster than the Frostbelt since World War II. The first trend is the substantial shift in population from the Northeast and Midwest to the South and Southwest. This pattern of population shapes business locations in many ways. It has greatly increased consumer demand in these regions and shifted the locus of plants that serve national markets southward. It has also increased the labor supply for businesses in these regions. Secondly, U.S. industry has undergone a process of decentralization that has been reinforced by the shifts of population southward and the development of a large interstate highway system. With industry highly concentrated in the Northeast and Midwest at the end of World War II, the greater growth in the Sunbelt is understandable as part of a decentralization process. As industry expanded during this period, it spread plant locations throughout the nation partly in response to a more decentralized population, partly to take advantage of better access to markets and materials provided by a national highway system, and partly to reduce vulnerability to disruptions from labor stoppages, weather and natural disasters that were greater when production was centralized in one or two regions.<sup>29</sup>

### 1.30 The Potential Effect of Taxes on Business Investment

Direct Effect on Business Costs. State and local taxes may affect businesses in several ways and these effects can vary with the scope of the geographic region considered. Taxes may directly affect businesses by increasing their costs. If all other costs are the same, then a higher tax bill will reduce profits and lower a firm's rate of return. Since state and local taxes differ across jurisdictions, businesses will face lower tax bills in some states than in others. A business could increase its profit rate by making its plant investments in the lower tax state, assuming revenues and all other costs are not affected. Theoretically, this potential consequence of taxes could, over time, result in greater levels of investment and employment in states with lower taxes than in states with higher taxes.

The investment impact of tax differentials is far more complicated than this simple hypothesis for several reasons. First, the crucial "ceteris paribus" assumption (everything else being equal) is not true. Non-tax costs vary considerably across states and are generally more significant than taxes. Second, a tax collected from a business is not necessarily paid by the business's owners. A firm may be able to shift taxes, such as sales and property taxes, forward to consumers or backward to factor suppliers. If the cost of taxes is not ultimately paid by the firm, then profits will not be affected. While the ultimate tax incidence question has been well researched, no clear conclusions have been reached.<sup>30</sup> Third, differences in property tax rates may be offset by their capitalization in land value, thus

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<sup>29</sup>The role of decentralization in the post war pattern of business investment and employment growth is discussed by several authors. See Mueller and Morgan, p. 14; and Schmenner (1982), pp. 167-172.

<sup>30</sup>For discussions of tax incidence see Kieschnick, p. 5; and Lester Thurow, The Impact of Taxes on the American Economy (New York: Praeger Publishers, 1971), chapter 4.

certain population groups. These incentives attempt to use taxes to make the desired action economically advantageous through the value of tax savings. To be effective, a tax incentive must actually cause a firm to take a desired action it would not otherwise take rather than provide a windfall benefit to firms that would have acted the same way without the incentive. To be an efficient expenditure of public dollars, the public benefits generated by those firms which acted due to the incentive must exceed the foregone tax revenues from all business who use the incentive.

Interregional and Intraregional Effects. As mentioned earlier, the influence of tax costs on business investments may vary depending on the geographic area. Since access to markets and resources, the nature of the labor force, labor costs, transportation costs, energy costs and other business location considerations vary enormously between major regions of the United States, we would expect the impact of different tax bills to be less significant across regions. However, within the same state, among bordering states and within metropolitan areas, where major business factors are fairly similar, the variation in taxes may take on more significance. Similarly, people may be more likely to locate based on tax considerations when the underlying climate, economic conditions and quality of life is similar within an area. Therefore, we might expect the potential influence of taxes, both directly and indirectly, to be greater within regions than across regions. This evaluation of the evidence on the effect of taxes on economic growth, therefore, will consider separately the impact between regions and the impact within a state or metropolitan area.

The Importance of Federal Taxes. State and local taxes interact with federal taxes as they influence economic decisions. Since federal taxes are significantly greater than state and local taxes, federal tax policy is an important constraint and influence on the potential effect of state and local taxes on business investment. The ability of businesses to deduct state and local taxes from their income for federal purposes reduces the actual cost of these taxes and the magnitude of differentials between jurisdictions.<sup>33</sup> With most corporations now paying a federal marginal tax rate of 46%, each \$100 of state and local taxes paid reduces federal tax liability by \$46 and thus is actually an effective tax of only \$54. Thus, federal deductibility will reduce a \$100 tax differential between two states to a \$54 differential. Although federal deductibility does not change the relative difference between taxes across states, it does alter the size of the state and local tax bill and thus the importance of taxes in comparison to other location costs. Federal deductibility also significantly reduces disparities in personal income taxes among states and thus mitigates the potential impact of these taxes on population migration.<sup>34</sup>

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<sup>33</sup>See Herman B. Leonard, Unchecked Balances: The Quiet Side of Public Spending (New York: Basic Books, 1986), p. 134.

<sup>34</sup>See ACTR, pp. 19 and 22.

## 2.0 The Potential Effects of Major State and Local Taxes

It is the variation in state and local taxes across jurisdictions that potentially affects business and individual location decisions, altering the distribution of economic growth. States and localities, however, vary not only in their level of taxes but in the tax mix they employ. Two states with similar overall tax burdens may have very different tax structures; one state may rely heavily on sales and property taxes while the other largely depends on corporate and personal income taxes. Since the myriad studies on taxes and economic growth use a variety of tax burden measures, it is important to consider how particular taxes may influence economic growth before evaluating their results. This section discusses the relevance of overall tax burden, and the four major state and local taxes—property, sales, personal income and corporation income — to the debate.

### 2.10 Overall Tax Burden

The most common way to compare taxes across states is to use an aggregate measure of total tax burden. Per capita tax revenues and tax revenues as a share of personal income are the two most common measures of total tax burden. Since fees are also used to finance government services, it is appropriate to include both tax and fee revenue (usually called own source revenue) in these figures. Many studies rely on these indicators. The Grant Thornton state business climate ranking uses state and local taxes per \$1000 of personal income as its tax burden measure. Two recent studies of interstate effects of taxes on business investment and employment growth also use overall tax burden.<sup>35</sup>

Aggregate tax measures, however, do not accurately reflect the tax burdens that matter to businesses and individuals. Firms should be interested in taxes that are direct costs to them. A high tax burden due to a large sales tax for which goods and equipment used in manufacturing are exempt (a fairly common exemption) should not matter to a manufacturing business. Similarly, we would not expect high taxes to discourage individuals from moving to or remaining in a state if the major tax was an oil severance tax and energy costs were a small share of income. Alaska is a good example of this problem. Alaska has the highest overall tax burden per \$1000 of personal income. However, since most of its revenues come from oil severance taxes, the taxes paid by a married couple in Alaska are the lowest in the nation.<sup>36</sup>

Different taxes, tax bases, and rates across states, as well as the complication of tax incidence and capitalization, make it difficult to get accurate data on the actual tax burdens for corporations and individuals. Therefore, overall tax burden

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<sup>35</sup>See B. Benson and R. Johnson, "Capital Formation and Interstate Tax Competition;" and Michael Wasylenko, "The Effect of Business Climate on Employment Growth: A Report to The Minnesota Tax Study Commission," 23 June 1984, cited in Netzer, p. 25.

<sup>36</sup>See ACTR, Significant Features of Fiscal Federalism, 1985-86 Edition (Washington, D.C.: ACTR, 1986), pp. 52 and 123.

## 2.30 Corporate Income Taxes

In 1984, forty-five states collected \$15.5 billion in corporate income taxes, representing only 3.1% of state and local revenues nationwide. Corporate tax rates and tax bases, like the personal income tax, vary to a large extent across states. Top rates range from 23.5% in Michigan to 11.5 % in Connecticut. There are also differences in depreciation schedules, investment tax credits and the allocation of income for multistate firms.<sup>41</sup>

Since corporate income taxes are a cost to businesses that directly reduce their profits and rate of return, variation in this tax is expected to influence business investment and location. Firms in states with high corporate income taxes might invest less, while those in low tax states might have a higher rate of investment. Similarly, firms considering new plant investments or relocations would favor states with lower corporate income taxes. This effect will differ by type of firm since the effective tax is lessened by depreciation write-offs, investment credits and the like. Furthermore, new firms and firms with unstable profits should be less influenced by corporate tax rate differences since their tax liabilities will be less and can be offset with loss carry-forwards. The potential economic impact of the corporate income tax also may be overshadowed by property tax rate differentials. A study by the Federal Reserve Bank of Boston found that, on average, corporate income taxes accounted for 20% of the state and local taxes paid by a firm while property taxes were 43% of the total. Therefore, differing property tax burdens, which are large both within and across regions, may have a more significant effect than interstate variation in corporate income taxes.<sup>42</sup>

## 2.40 Sales Taxes

Forty-five states had general sales taxes in 1984 that generated \$62.6 billion in revenue. The sales tax is the most important single tax for state governments, accounting for 18.9% of revenues in 1984. For combined state and local revenues, sales taxes represent 13.9% of revenues. While the variation in state sales taxes is limited, ranging from 3 to 7.5%, the sales tax base varies enormously. States differ in exemptions for consumer goods (clothes, food, etc.), consumer services, business services, and materials and equipment used in manufacturing. In addition to these variations, local sales tax add-ons are very common. Over six thousand local government units in twenty-nine states collect sales taxes.<sup>43</sup> Consequently, the sales tax burden can vary a lot both between and within states.

Sales taxes can impose a cost on businesses. However, the sales tax's burden on business, and thus its effect on investment, is reduced due to widespread

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<sup>41</sup>See ACTR (1986), pp. 40, 48 and 103 for data on state corporate income taxes.

<sup>42</sup>See Vaughan (1982), pp. 73 and 76.

<sup>43</sup>Data on sales taxes is from ACTR (1986), pp. 48, 49, 92 and 94.

property wealth per capita. Consequently, cities may have higher property tax rates while appearing to have a lower level of services valued by businesses. In this manner, variation in tax rates and services within a region can have a reinforcing effect. This situation can be ameliorated through state aid that helps equalize localities' ability to provide services or their property tax rates, or by metropolitan tax base sharing.<sup>47</sup>

Property tax differentials are likely to affect business and residential location only to the extent that they are not capitalized in land values. While research on this issue is not conclusive, there is some evidence that capitalization of tax differentials does occur.<sup>48</sup> To the extent that property tax rates are not capitalized, businesses investments and individual residency would be expected to shift toward low property tax jurisdictions. This effect should be greater for more capital intensive firms. Property taxes, by raising the cost of investments in plant and equipment, may also reduce these investments and lower the capital to labor ratio. Since property taxes generally support services valued by businesses, the impact of property tax differentials may well be offset by differences in the benefits firms receive from these services. Areas with lower property tax burdens may also impose more user fees, further reducing the actual variation in business costs.

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<sup>47</sup>See Vaughan (1982), chapter 4 on this issue.

<sup>48</sup>Vaughan (1977), p. 73; Leonard, p. 135; and Nerzer, p. 27.

### 3.0 The Direct Impact of Taxes as a Business Cost

#### 3.10 The Relative Size and Variation of State and Local Tax Burdens

The direct impact of state and local taxes on business location decisions depends both on the variation in effective tax (and fee) costs across jurisdictions and the size of tax cost differentials in comparison to variations in other costs and location factors. While the theoretical effect of each tax may differ, it is not the variations in these particular taxes that matter, but rather the variation in the sum total of taxes incurred by businesses. A review of data and studies indicates that there is substantial variation in business tax bills across states. However, these measures often do not accurately reflect tax costs and overstate the extent of variation in the net tax costs since they do account for the benefits received from government services, tax incidence and tax capitalization.<sup>49</sup>

Measures of overall tax burden provide a rough indication of the extent of tax variation. In 1984, the per capita state and local tax burdens ranged from \$866 in Arkansas to \$4704 in Alaska. If we exclude Alaska because of its high costs and unique tax structure, the range is \$866 to \$2504, almost three to one, with 47 states within a range of 2 to 1. Measuring tax burden as a share of personal income, the variation in overall tax burdens was similar. The range from the state with the highest to the lowest burden was three to one, with 48 states within a range of 1.8 to 1.

Since businesses face a specific set of taxes and do not pay the average tax burden, several studies have looked at interstate differences in the particular taxes paid by firms. Three approaches have been taken. Some studies estimate the total amount of taxes initially paid by businesses in a state and then compare it to total business income, profits or capital stock in that state. While this approach is informative about the taxes paid by business as a whole, it does not reveal actual differences in taxes for specific firms or classes of firms due to the highly aggregated data employed. This measure is also very sensitive to the year chosen for comparison since business income fluctuates from year to year with the business cycle. Other studies construct a typical manufacturing firm or typical firms in several industries and then estimate the taxes collected from these typical firms in each state. Both approaches, however, ignore the interaction of federal tax deductibility and do not measure the marginal cost of taxes for new investments. Despite these problems, both kinds of analysis are better indicators of the variation in state and local taxes paid by businesses than overall tax burden.

These studies, while somewhat mixed in their results, do indicate that a large degree of variation in business taxes exists and that the variation appears greater for manufacturing firms than for all business. Wheaton's analysis of tax burdens for all business and manufacturing firms in the continental U. S. in 1977 found

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<sup>49</sup>For a good discussion of the problems with various measures of tax burdens as indicators of business tax costs, see Stephen Brooks, Robert Tannenwald, Hillary Sale and Sandeep Puri, The Competitiveness of the Massachusetts Tax System (Boston: Massachusetts Special Commission on Tax Reform, 1986), pp. 4-27.

relatively small increase in wage costs can have a large impact on profitability. For example, a 5% increase in wages for a firm with moderate wage costs can reduce profits by over 16%.<sup>56</sup> Legislative staff in New York estimated that a 2% wage differential is equivalent in its effect on profits to a 106% differential in corporate taxes.<sup>57</sup> Thus, a 20% difference in wage costs among states would overwhelm even a 500% difference in tax bills.

Rubin and Zorn's study of interstate cost difference for 20 manufacturing industries shows that absolute tax differences are far less than those for labor and transportation costs. While estimated tax costs might vary by 6 to 1, the actual cost difference was usually a matter of a few thousand dollars.<sup>58</sup> Labor costs, on the other hand, generally varied by less than 2:1, but these variations represented tens of thousands if not hundreds of thousands of dollars in annual costs.<sup>59</sup> Similarly, in most industries the transportation cost differentials across states were at least tens of thousands of dollars.<sup>60</sup> In each manufacturing sector, transportation and labor costs were far greater than tax costs, by multiples ranging from 5 to 50.

### 3.20 Survey Studies

One way of studying the role of taxes in business location decisions is to survey the corporate executives who make these decisions. Most of the early studies of this issue were done through mail and personal interview surveys of business executives. A number of states have also commissioned such studies to

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<sup>55</sup>(-continued)

Michigan. See also Leonard, p. 136 for data on the greater size and variation of business costs other than taxes.

<sup>56</sup>Assume initial annual sales of \$1 million, wages of \$333,000, 10% profit margin and total taxes equal to 60% of profits. Before tax profits are \$100,000 and after tax profits are \$40,000. A 5% increase in wages raised the wage bill to \$349,650 and reduced gross profits to \$83,350. After tax profits are \$33,340 ( $83,350 \times .40$ ). The change in profits is \$6,660 or 16.6%.

<sup>57</sup>See State of New York Legislative Commission on the Modernization and Simplification of Tax Administration and the Law, "Interstate Business Locational Decisions and the Effect of the State's Tax Structure on After-Tax Rates-of-Return of Manufacturing Firms," Staff Working Paper, 1983, p. 76.

<sup>58</sup>See Rubin and Zorn, Table 2A, pp. 30-31.

<sup>59</sup>Rubin and Zorn, Table 4A, pp. 49-50.

<sup>60</sup>Rubin and Zorn, Table 1A, pp. 16-17.

factor was personal reasons or chance.<sup>62</sup>

Roger Schmenner's research included interviews with executives at dozens of the nation's largest U.S. firms. He concluded that:

In none of the more than 80 interviews I have had with key location decision makers in, mainly, large companies have I heard that state or local levels of taxation have been the most significant determinant of a plant's location. Almost every company takes a look at taxes; indeed, tax costs are one of the costs of a new site which can be quantified and presented in the documentation that supports the project's formal capital appropriation request. Nevertheless, taxes themselves are merely a minor consideration, capable of altering the decision in favor of a particular site only if almost all other factors are equal.

Taxes, according to Schmenner's interviews, are more likely to be a consideration when a high rate for a very visible tax "pushes" a firm away from a potential site.<sup>63</sup>

In another analysis, Schmenner looked at how the tax bill changed for relocating firms. If lower taxes were an important factor in firm location, then taxes at a new site should be lower than taxes at the old site. Overall, Schmenner found that the likelihood of moving to either a lower tax or higher tax site was about equal. For plant relocations studied in New England and Cincinnati, slightly more than one quarter moved to a site with lower property taxes, almost half found a new site with the same property taxes and one-quarter located at a new site with higher taxes. Furthermore, firms with higher capital to labor ratios, which would be expected to be more sensitive to property tax rates, were not more likely to settle in low tax jurisdictions.<sup>64</sup> Schmenner did find that multiplant firms in Cincinnati and long distance movers from New England were likely to choose new sites with lower taxes. However, this pattern did not hold true for long distance moves by Fortune 500 firms.<sup>65</sup>

Michael Kieschnick conducted a mail survey of firms concerning investments they made in 1979 in 11 states offering employment or investment incentives through their tax codes. Investments in creating a new firm, expansion of an existing plant and establishment of a new branch plant were analyzed separately. Business and personal taxes were rated as an insignificant or moderate factor by

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<sup>62</sup>See Mueller and Morgan, pp. 207-210.

<sup>63</sup>Schmenner (1982), p. 46.

<sup>64</sup>Roger W. Schmenner, "Industrial Location and Urban Public Management," in Arthur P. Solomon, Editor, The Prospective City (Cambridge: The MIT Press, 1980), pp. 460-461.

<sup>65</sup>Schmenner (1982), pp. 47-51.

mixed, a few studies suggest that tax considerations may be weighed more heavily by larger firms and firms locating new branch plants. The few studies that look at the tax impact of actual location decisions also support the view that reducing tax costs is not a motivating factor in location choices.

### 3.30 Evidence from Interregional Econometric Studies

A second, increasingly common way to analyze the relationship between taxes and economic growth is through econometric studies that use a statistical method known as multiple regression. These studies attempt to statistically explain the relationship between business investment (or other measures of state economic growth) and various causal factors using historical data. Econometric studies have several advantages over survey studies. First, econometric analysis is based on the actual behavior and experience of firms and states rather than the subjective opinions of surveyed executives. Second, these studies can provide a more precise measure of the role of taxes in states' economic performance by controlling for the contribution of non-tax differences between states. With the inclusion of non-tax factors in econometric models, the variation in these factors is used to explain differences in economic growth and a better estimate of the separate effect of taxes can be obtained. Thus, econometric studies hold the promise of using empirical evidence to elucidate the importance of tax factors in business investment.

There are, however, potential problems with econometric studies, which warrant caution in their interpretation. First, a study must include all the factors that determine business investment or economic growth to successfully control for the influence of non-tax factors. This task is difficult since so many state characteristics shape economic growth and some factors – for example, the talent of a state's population – are very hard to measure. When an important controlling factor is inappropriately omitted, the impact of this omitted factor may be partially attributed to factors included in the study, overstating or understating their effect. Second, when a statistical relationship is uncovered, the underlying causality between a factor and economic growth may not exist or may be in the opposite direction than presumed. In the first case, the revealed correlation is spurious—a result of a chance relationship in the data or a unique historical situation rather than underlying causality. In the second case, causality exists but it runs in the opposite direction than assumed in the study. For example, a statistical relationship between lower tax rates and greater economic growth may mean faster growth increases tax revenues, leading to lower tax rates – rather than lower tax rates leading to more growth.

### 3.31 Study Summaries

In the past several years, several studies have been conducted to relate differences in economic growth among states to differences in tax levels and other factors. These studies employ a number of economic growth measures including new firm formations, branch plant locations, employment growth, personal income growth and business investment. Most often, the study focus is on the manufacturing sector of the economy, although a few studies look at broader

Workers' compensation and unemployment insurance rates variables often indicated a positive effect. Bartik concludes that his estimated effect of taxes on location is small.<sup>74</sup>

The remaining studies have involved much more aggregate measure of economic growth based on employment, business investment and personal income. Since these studies are not based on actual business location decisions and use aggregate data, they are less precise and may hide the effects that appear with micro level data. Three studies have analyzed the impact of state and local taxation on employment growth. Plaut and Pluta studied how manufacturing growth from 1967-1972 and 1972-1977 was related to four location factors - access to markets, cost and availability of production factors, climate and environment and business climate and taxes. Three growth measures were used: employment, value added and capital stock. Their results did not demonstrate any strong or consistent negative affect from the taxation factors. While adding the tax variables as a group improved the model's ability to predict employment growth and capital stock growth, no such result occurred for value added. Corporate tax, personal income tax and sales tax variables were all statistically insignificant. A state's overall tax effort was found to have a negative and statistically significant effect while the property tax variable and education expenditures were significant with a positive effect on growth. The authors concluded that "differences in overall industrial expansion can still be best explained largely by traditional market factors."<sup>75</sup>

Neuman's study was based on relative employment growth for 13 separate manufacturing industries during 1957-1965 and 1965-1973. This model used just three factors to explain growth - corporate tax rates, unionization rates and the presence of a right to work law. Furthermore, the corporate tax data was based on the ten years prior to the period of employment growth, since Neuman argued that the tax effect was a lagged one, i.e., businesses are slow to see tax differentials and respond to them. The corporate income tax variable had a negative effect and was statistically significant for 5 of the 13 industries. Neuman also found that the tax effect was greater for more capital intensive and faster growing industries. Neuman concluded that his results were consistent with Carlton because the impact of taxes may vary by industry.<sup>76</sup> However, Neuman's results seem problematic due to his failure to control for most non-tax factors that affect state employment growth. His use of a lagged tax variable is also questionable since it assumes that businesses are more concerned with the past level of taxation than with present or future taxes when making investment decisions.

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<sup>74</sup>See Timothy J. Bartik, "Business Location Decisions in the United States: Estimates of the Effects of Unionization, Taxes and Other Characteristics of States," Journal of Business and Economic Statistics, 3, No. 1 (January 1985), pp. 14-22.

<sup>75</sup>See Thomas R. Plaut and Joseph E. Pluta, "Business Climate, Taxes and Expenditures, and State Industrial Growth in the United States," Southern Economic Journal July 1983, pp. 99-119.

<sup>76</sup>See Robert J. Neuman, "Industry Migration and Growth in the South," The Review of Economics and Statistics 65, No. 1 (February 1983), pp. 76-85.

effect. Since their study is based on relative tax levels, it is difficult to translate actual tax changes into changes in relative position, especially since states may respond to tax reductions in other states.<sup>79</sup>

Kieschnick used 1977 data to analyze the impact of taxes on a state's share of gross national investment for 13 manufacturing industries. Two tax variables were used - an estimate of the actual taxes paid by a hypothetical firm for each industry and a state's rank in an ordering of tax burdens for each industry. Other factors in the model included average wage levels, labor productivity, energy costs, unionization rates, population growth and density, income levels, industry concentration, climate and welfare expenditures. Kieschnick's results did not show any strong impact of taxes on investment. The variable for taxes paid was significant for 2 of the 13 industries, but the estimated effect was positive in one case. The tax rank variable was significant for five industries, with a positive effect estimated for one industry. However, when the tax effect was statistically significant, its size was very small.<sup>80</sup>

The final study of taxes and capital investment was done by Papke using data from 20 states and 20 industries. New capital investment per production worker in a year was related to taxes and several variables that controlled for energy costs, wage costs, industry concentration, and labor productivity. Tax differentials were measured as the after-tax rate of return on investment for each industry and state, derived by a computer simulation model. Thus taxes are not included directly, but rather through their estimated effects on investment profit rates. The estimated effect of the after-tax rate of return variable was positive and statistically significant. This variable also had the greatest impact on investment among factors in the study.<sup>81</sup>

### 3.32 Analysis and Conclusions from These Studies

Econometric studies of interregional growth fail to provide conclusive evidence concerning the impact of taxes on economic development. Although several studies conclude that higher state and local taxes do deter growth, the case for this conclusion is not strong. The inconsistent pattern of results, several methodological questions and the small impact of most estimated tax effects together mitigate the evidence that taxes are an important factor in business location and growth.

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<sup>79</sup>See Bruce L. Benson and Ronald N. Johnson, "The Lagged Impact of State and Local Taxes on Economic Activity and Political Behavior," Economic Inquiry, pp. 389-401.

<sup>80</sup>See Kieschnick, pp. 74-78.

<sup>81</sup> See Leslie E. Papke, "The Influence of Taxes on the Location of Manufacturing Activity: New Evidence," in James A. Papke, Ed., "Indiana's Revenue Structure: Major Components and Issues, Part II," Center for Tax Policy Studies, Purdue University March 1984.

econometric evidence on taxes and interregional growth supports the conclusions of survey research that tax effects are not a major influence on business location and economic growth.

### 3.40 Evidence From Intraregional Econometric Studies

Within a state or metropolitan area, taxes may affect business location differently. Since many important location factors, such as wages, availability of labor, market access and energy costs will be similar within a small geographic area, the impact of tax differentials between communities may be amplified. Several studies over the past two decades have employed multiple regression analysis to estimate how taxes influence firm location within a region. Most of these studies analyze business location or investment within metropolitan areas. Intraurban studies have two advantages over the interregional studies. First, since tax differentials across communities in the same metropolitan area are primarily due to property tax rates, there is consistency in the tax variable used. Second, since many location factors are the same within an urban area, studies have had to control for fewer non-tax related influences. In addition to property taxes, studies have typically included measures of distance from the central city, transportation access, labor supply, agglomeration, land availability and public services as controlling factors.<sup>83</sup> While no consensus has emerged from these studies, some do conclude that property taxes influence some types of business location within metropolitan areas.

The first study of intraurban business location did not directly measure tax impacts. Moses and Williamson studied expansions and relocations by 2000 firms in the Chicago area between 1950 and 1959. While no tax variable was used, a "dummy" variable indicated whether a location zone was predominantly inside or outside Chicago and served as a proxy for differences in tax rates, zoning policy and other factors between Chicago and its suburbs. Distance from the central city and an agglomeration measure were found to have statistically significant effects, but the tax proxy variable was not statistically significant.<sup>84</sup>

Schmenner used econometric models to predict three measures of business location - the existing pattern of firm density, changes in firm density and relocations - in four metropolitan areas during two time periods. In all, sixty regressions were conducted. Two tax variables were used - effective property tax and income tax rates. The income tax rate was never statistically significant. The property tax variable was significant in only five regressions but with no consistent pattern. Consequently, Schmenner concluded that taxes were an unimportant factor in firm location. He also observed that causation may run two ways. While lower taxes may induce firms to locate in a community, low taxes may

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<sup>83</sup>See Wasylenko (1985), pp. 19-20 for a brief discussion of factors in intraurban firm location.

<sup>84</sup>See Leon Moses and H. Williamson, Jr., "The Location of Economic Activity in Cities," American Economic Review 57 (1967), pp. 211-222.

negative and statistically significant effect for property tax rates.<sup>90</sup> Charney studied the density of manufacturing firms that relocated to communities within the Detroit metropolitan area between 1970 and 1975. Both local property taxes and local income taxes were included as location factors in his model. His results indicated that property tax rates had a large negative and statistically significant effect on relocation destination. The effect was strongest for large firms and nondurable goods producers. No consistent, statistically significant effect was found for income tax rates.<sup>91</sup> In a third study, McGuire explained the building permit value for both new and existing firms over six years in 119 Minneapolis-St. Paul area communities using the property tax rate and four other variables. While the property tax rate had a negative and statistically significant effect in two cases, her results were not consistent. The property tax rate was not significant when building value per land area was used as the dependent variable, and when data for 1976 alone were used. McGuire concluded that there was only qualified support for the hypothesis that taxes matter in firm location and that the extent to which taxes matter is unclear.<sup>92</sup>

No apparent conclusions emerge from studies of intraregional firm location. While four studies concluded that taxes do not matter, three other studies found a strong relationship between property tax rates and firm location or investment within a metropolitan area. One study uncovered qualified evidence that taxes affected commercial and industrial building activity. It is possible, as Fox and Wasylenko argue,<sup>93</sup> that the studies where taxes do not matter are flawed because they do not account for the supply of industrial space. Studies that control for communities where zoning prohibits industry, therefore, are better designed and provide corroborating evidence that taxes matter.

While this point has some validity, there are important problems that question the conclusions of these studies as well. First, studies that omit communities that zone out industrial land use an imperfect measure of site supply. The actual size and number of available business sites is not included in the model. Thus, densely developed urban communities with existing industrial use, but a shortage of land for expansion or new firms, are inaccurately measured as suppliers of industrial sites. Consequently, the paucity of new business location or investment may be attributed to higher tax rates, when in fact it results from supply shortage. Second, the dependent variables used in several studies raise questions about the

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<sup>90</sup>Cited in Wasylenko (1985), p. 31.

<sup>91</sup>See Albert H. Charney, "Intraurban Manufacturing Location Decisions and Local Tax Differentials," Journal of Urban Economics 14 (1983), pp. 184-205.

<sup>92</sup>See T. McGuire, "Are Local Property Taxes Important in the Intrametropolitan Location Decision of Firms? An Empirical Analysis of the Minneapolis-St. Paul Area," Journal of Urban Economics 18 (1985), pp. 226-234.

<sup>93</sup>See especially Wasylenko (1980), pp. 339-340 and Wasylenko (1985), pp. 29-31.

Several states have used simulation studies to evaluate the competitiveness of their tax system. The advantages of tax simulations and their flexibility in estimating the impact of specific tax law changes make them useful tools in policy analysis. Tax commissions in Hawaii, Indiana, Massachusetts and New York have all used a simulation model to evaluate the competitiveness of their tax system for business investment. With the exception of Massachusetts, the same simulation model - AFTAX - has been used by each state.

AFTAX is a simulation model developed by James and Leslie Papke to estimate how taxes affect the after tax rate of return on investments at alternative sites.<sup>95</sup> This model assumes that the pre-tax rate of return is identical at all sites, i.e., all non-tax costs are identical across sites, and then applies federal, state and local tax laws to calculate the after-tax rate of return. Consequently, the results measure how taxes alone affect profitability at varying locations. Federal corporate income taxes, state corporate income taxes, state business franchise fees, state and local sales taxes, and state and local income taxes are all included in the AFTAX model. Representative firms are defined for several manufacturing industries and size classes, and assumptions are made about the location of a firm's sales and plants. The after tax rate of return is then calculated for a variety of situations. First, a baseline estimate of how profit rates vary by site can be calculated. Second, the tax impact of a new investment made at different locations can be simulated. This latter simulation is often run both for "home state" firms and firms based in other states. AFTAX simulations are also used to estimate the impact of particular tax changes and tax incentives on profit rates.

An early application of the AFTAX model compared Hartford, Connecticut to ten sites in nine other states for investments by representative firms in ten industries. When the firm was based in Hartford, the after tax rate of return for a new investment at alternative sites fell within a range of 2-3 percentage points. For some industries, investing in the site with the highest return could boost the return by close to 30% over the site with the lowest return. A simulation to measure the after tax return for home site investment for firms based in each state showed a slightly narrower range of variation.<sup>96</sup>

AFTAX simulations were also used to evaluate the competitiveness of Indiana's tax code. For Indiana based firms, expansion investments in eleven out-of-state sites generally had higher returns than in-state expansion. Across 13 industries, the average out-of-state return is ranged from 7-12% higher than in-state investment. However, in some cases particular sites outside Indiana provided a greater advantage. For example, an electronic components manufacturer which expanded in Cameron, Texas was estimated to earn a return almost 25% higher than

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<sup>95</sup>See Leslie E. Papke and James A. Papke, "Microanalytic Simulation For Analyses of Interstate Business Tax Differentials," National Tax Journal (September 1981), pp. 76-85 for a more detailed description of the AFTAX model.

<sup>96</sup>Papke and Papke, pp. 73-83.

making expansion investments at five sites in Massachusetts and ten sites in ten other states.<sup>103</sup>

The Massachusetts study found that state and local tax differentials resulted in minimal variation in after tax-rates of return. For a hypothetical firm where all sales occurred in its home state, the after-tax rate of return on an expansion investment in all five industries differed by less than 1 percentage point between the site with the highest return (El Paso, Texas) and the one with the lowest return (Bala Cynwyd, Pennsylvania). When the highest and lowest sites are ignored, the after-tax rate of return is virtually the same for all sites.<sup>104</sup> When the hypothetical firm was assumed to have ten percent of sales in its home state and the remaining 90% in states where the firm had no investment, there is a greater spread of returns on the new investment. The largest difference between sites is 2 percentage points, but on average the highest and lowest sites differ by 1.5 percentage points which represents about a 10% difference in after tax returns. Moreover, when the lowest and highest states are omitted, the difference in returns drops to 1 point.<sup>105</sup> Much of the increased variation in returns for this second simulation resulted from a tax law provision relating to the treatment of sales in states where the firm has no income tax liability. However, in practice, this rule is easy to avoid and is rarely applied.

Brooks also simulated the effect of eliminating all state and local taxes. His study included an "empty site" where only federal taxes existed. The after tax rate of return at this empty site, on average, ranged from 10% to 16% higher than the return at the site with the lowest return. Therefore, the maximum impact state and local taxes would have on profit rates was found to be fairly moderate.<sup>106</sup>

While simulation studies found differences in profitability due to state and local taxes, these more precise estimates show far less variation than most other estimates of overall business tax burdens. These four simulation studies all estimate that tax-related differences in profitability from new investments can vary across states by as much as 10 to 30%. Other gross measures of business tax burdens have estimated differences of 100% and upward. Thus, simulation model results indicate that variation in profit rates due to state and local taxes are much less than the variation in state and local business taxes themselves. Furthermore, the tax-induced differences in profitability appear modest in comparison with the effect of differences in other factors such as market access, availability of skilled labor, wage levels, transportation costs, and energy costs across states. Thus, evidence from simulations supports other evidence that state and local tax differences are unlikely to exert a major influence on business location decisions.

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<sup>103</sup>See Brooks, et.al., pp. 28-33 and Appendix B for an explanation of the model and his analysis.

<sup>104</sup>Brooks, pp. 39-42.

<sup>105</sup>Brooks, et.al. p.43.

<sup>106</sup>See Brooks, et. al., Tables 2 and 3, pp. 41 and 44.

#### 4.0 The Indirect Effect of Taxes on Population Movement

While the evidence on the direct impact of tax costs generally supports the view that taxes are not a major influence on business location, it is also possible that taxes may indirectly affect economic growth through their influence on population movement. According to this hypothesis, people may choose their residential location in part by the level of taxation, and jobs then follow people to areas with greater population. This theory has been proposed by Wasylenko who argues in two recent papers that personal income taxes affect economic growth by influencing personal location and the availability of labor.<sup>107</sup>

An indirect tax-induced influence on business location is based on two causal relationships. First, population location must shape business location, i.e., jobs must follow people. Second, population location choices must be effected by tax levels. Evidence on these two relationships is reviewed in this section. While empirical studies support the theory that jobs follow people, the limited research on the effect of taxation of residential location is inconclusive.

#### 4.10 Population and Employment Location

The relationship of population and employment location is likely to be a mutually dependent one. Movement of population to an area should attract firms that seek access to consumer markets and a labor force. On the other hand, people are likely to locate where there are greater employment opportunities. However, there is much debate on which effect is larger. Is the tendency of jobs to follow people stronger than the tendency of people to follow jobs? The answer to this question may well depend on the geographic area studied. Within a metropolitan area, where people have relatively good access to jobs throughout the area, the choice of residency may be less dependent on employment locations. However, businesses in the retail, transportation, and service sectors that directly serve consumers, might then follow the pattern of population location. Across regions, individual migration is more likely to be affected by employment opportunities and the tendency of people to follow jobs may be greater.

Several studies of suburbanization indicate that, within a metropolitan area, jobs follow people to a greater extent than people follow jobs. These studies, for the most part, rely on separate econometric models to simultaneously explain population movement with employment shifts and changes in employment location with population movement. The results of the two separate models are then compared to identify which effect is stronger. A 1974 study by Steinnes and Fisher concluded that the location of employment did not have a significant effect on

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<sup>107</sup>See Wasylenko (1985), pp. 19 and 33; and Wasylenko and McGuire (1985).

location.<sup>114</sup> On the other hand, Olvey found that in-migration responded to employment growth, but the effect was twice as high for noncontiguous states than for contiguous states.<sup>115</sup> This latter result suggests that the tendency of people to follow jobs is stronger across regions than within regions.

Despite the difficulty of econometric models to completely control for the many factors that shape population and employment location, the consistency of results in numerous studies over several time periods provides strong evidence that jobs do follow people, both within and across states. With this relationship fairly well established, it is necessary to consider the effect of taxes on population location.

#### 4.20 Taxes and Population Location

Unfortunately, the literature on how taxes affect residential location is fairly limited and has produced mixed results. There is no strong evidence that taxes effect migration across regions and studies of tax-induced intraurban population movement have yielded some conflicting results. The difficulty in obtaining consistent results undoubtedly reflects the complexity of influences on population movement and residential location.<sup>116</sup> Another problem results from the interaction between taxes and population. On the one hand, population growth increases public service needs such as schools, sewers, and police and fire protection which in turn require more taxes. This situation suggests population growth is associated with higher taxes. On the other hand, population growth and associated development of an area may increase the tax base and reduce tax rates and average tax burdens, suggesting a negative relationship between taxes and population growth. In either case, since population growth can affect taxes as well as taxes affecting population location, it is difficult to interpret the meaning of study conclusions. This is particularly problematic since these studies have not used the type of simultaneous models applied to study the interaction of population and employment growth. There have also been no studies that test Wasylenko's hypothesis on the negative effect of personal income taxes on population location.

Carlino and Mills found a negative and statistically significant effect of per capita taxes on county population growth. However, the effect was small and the authors conclude that "public policies, such as taxes, crime rates and Industrial Development Bonds (IDBs) exert little impact on either county population or total

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<sup>114</sup>Cited in Michael J. Greenwood. "Research on Internal Migration in the United States: A Survey," Journal of Economic Literature 13, pp. 397-433; and in Vaughan and Vogel, p. 30.

<sup>115</sup>Cited in Greenwood, p. 420.

<sup>116</sup>For a detailed discussion of factors in population migration, see Vaughan and Vogel, pp. 21-34; and Greenwood, Vaughan and Vogel also discuss what influences residential location choice and suburbanization on pp. 52-84.

decentralization of population in urban areas.<sup>124</sup>

In conclusion, the impact of taxes on population location is unclear. There are too few studies on taxes and interregional population migration to justify any conclusions. For intrametropolitan areas, several studies have found that higher taxes are associated with slower population growth or out-migration. However, other studies do not support these findings. Moreover, these studies do not account for the potential effect of population changes on taxes and do not control for many non-tax factors affecting residential location. Consequently, both the meaning of these results and the relative effect of taxes on population location are unresolved. Thus, there is currently no strong evidence that taxes are an important influence on population location choices either across or within regions, but it is also not possible to conclude that no such effect exists.

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<sup>124</sup>Vaughan and Vogel, p. 34.

## 5.0 Conclusions

Given the large amount of taxpayers' money at stake in tax incentive programs and general tax deductions aimed at stimulating economic growth, the burden of proof for using tax incentives and reductions to stimulate growth should rest with the advocates of tax concessions. However, the wealth of research summarized in this paper fails to support the position that state and local taxes are an important factor in business location decisions or overall economic development. On the contrary, the weight of evidence lends support to the conclusion that taxes are not a major influence on state economic growth. While studies do not rule out the possibility that taxes influence growth in some circumstances or for some economic sectors, several types of research provide strong evidence that taxes are a minor factor in firm location while other research is inconclusive. Therefore, state policymakers would be wise to ignore the pleas for lower taxes or tax incentives and concentrate instead on other policies with greater promise in fostering economic development.

The following lessons that emerge from this analysis and literature review lend support to a economic development policy that rejects the use of state tax expenditures to stimulate job creation.

- o State and local taxes are only one factor among many in complex plant location decisions. Firms consider access to markets, availability of labor and materials, costs, local amenities and integration with other facilities when choosing a plant site. Taxes enter the equation as one part of the cost factor.
- o As a direct cost to business, state and local taxes are small and the variation in other costs, such as labor and transportation, overwhelm interregional differences in taxes. When the impact of taxes on profit rates for new investment is measured, fairly modest differences in rates of return are attributable to state and local taxes.
- o Business executives themselves, in numerous surveys conducted over three decades, consistently point to factors other than taxes as the major items that they consider when making location decisions.
- o The interstate impact of taxes on economic development is further mitigated by the limited type of business investment decisions where taxes are considered. New business start-ups and on-site expansion, which account for a large share of job growth, are insensitive to tax considerations. Firm or plant relocations are most likely to be influenced by tax costs but account for a very small share of job growth. New branch plant locations are one important source of job creation where taxes are a location factor, although a secondary one. Consequently, interstate tax differentials are irrelevant for investment decisions responsible for a majority of state job creation.



**HOUSE BILL NO. 12**  
**IN THE LEGISLATURE OF THE STATE OF ALASKA**  
**SEVENTEENTH LEGISLATURE - FIRST SESSION**

**BY REPRESENTATIVES MOYER, Brown, Koponen, Ellis**

**Introduced: 1/21/91**

**Referred: International Trade and Tourism, Labor and Commerce, Finance**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to the water's edge method of calculating income taxes for certain  
 2 corporations other than corporations engaged in the production of oil or gas from a lease  
 3 or property in the state or in the transportation of oil or gas by regulated pipeline in  
 4 the state; and providing for an effective date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 \* Section 1. It is the purpose of this Act to promote investment and trade opportunities in the state.

7 \* Sec. 2. AS 43.20 is amended by adding a new section to read:

8           Sec. 43.20.073. **AFFILIATED GROUPS.** (a) A corporation that is a member of an  
 9 affiliated group shall file a return using the water's edge combined reporting method. A return  
 10 under this section must include the following corporations if the corporations are part of a unitary  
 11 business with the filing corporation:

12                   (1) an affiliated corporation that is eligible to be included in a federal consolidated  
 13 return under 26 U.S.C. 1501 - 1505 (Internal Revenue Code) if the corporation's property,

1 payroll, and sales factors in the United States average

2 (A) 20 percent or more; or

3 (B) under 20 percent, if the corporation does not meet the requirements  
4 of 26 U.S.C. 861(c);

5 (2) a domestic international sales corporation; in this paragraph, "domestic  
6 international sales corporation" has the meaning given in 26 U.S.C. 992(a);

7 (3) a foreign sales corporation; in this paragraph, "foreign sales corporation" has  
8 the meaning given to the term "FSC" in 26 U.S.C. 922(a);

9 (4) a corporation, regardless of the place where the corporation was incorporated,  
10 if the corporation's property, payroll, and sales factors in the United States average 20 percent  
11 or more;

12 (5) a corporation that is incorporated in or does business in a country that does  
13 not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the  
14 United States income tax rate on the income tax base of the corporation in the United States, if

15 (A) 50 percent or more of the sales, purchases, or payments of income or  
16 expenses, exclusive of payments for intangible property, of the corporation are made  
17 directly or indirectly to one or more members of a group of corporations filing under the  
18 water's edge combined reporting method;

19 (B) the corporation does not conduct significant economic activity.

20 (b) When computing taxable income for a corporation under (a) of this section, the  
21 following amounts shall be excluded:

22 (1) 80 percent of dividend income received from foreign corporations;

23 (2) an amount treated as a dividend under 26 U.S.C. 78;

24 (3) 80 percent of the royalties accrued or received from a foreign corporation.

25 (c) In (b)(1) and (3) of this section, a payment is considered to be received from a  
26 corporation that is part of the unitary business if the payment is received

27 (1) by a member of an affiliated group included in a water's edge combined  
28 report filed under this section; and

29 (2) from a corporation in which the recipient owns 50 percent or more of the  
30 stock of the corporation.

31 (d) Dividends and royalties taxable to a corporation using the water's edge combined

requirements

reporting method are in lieu of an expense attribution for income excluded under (b) of this section.

(c) The department may require a corporation that files under (a) of this section to file a worldwide combined report instead, if the corporation or an affiliated corporation

(1) fails to comply with regulations adopted under this chapter, including domestic disclosure spread sheet filing requirements; or

(2) does not provide information that is requested by the department that is necessary for the department to audit the taxpayer's corporate return in a reasonable period of time.

(f) This section does not apply to taxpayers subject to AS 43.20.072 engaged in

(1) the production of oil or gas from a lease or property in the state; or

(2) the transportation of oil or gas by regulated pipeline in the state.

(g) In this section,

(1) "affiliated corporation" means a member of an affiliated group to which the taxpayer filing a return under (a) of this section belongs;

(2) "affiliated group" means a group of two or more corporations in which 50 percent or more of the voting stock of each member of the group is directly or indirectly owned by one or more corporate or noncorporate common owners, or by one or more of the members of the group;

(3) "foreign corporation" means a corporation created or organized outside of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of the United States;

(4) "water's edge combined reporting method" means a reporting method in which the only corporations besides the taxpayer that may be included in the return are the corporations listed in (a) of this section.

\* Sec. 3. This Act applies to tax years beginning after December 31, 1991.

\* Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

1-23-92

HB 31

HB 247



Official Business

# Alaska State Legislature

House of Representatives

Committee on Rules

P. O. Box V  
Juneau, Alaska 99811

Phone:  
(907) 465-3764  
465-3765

## MEMBERS:

REP. ELLIS, CHAIR  
REP. DAVIDSON, VICE-CHAIR  
REP. DONLEY  
REP. GRUSSENDORF  
REP. GRUENBERG  
REP. MARTIN  
REP. TAYLOR

HOUSE RULES COMMITTEE MEETING  
THURSDAY, JANUARY 23, 1992  
CAPITOL ROOM 208  
8:00 A.M.

## AGENDA:

HB 31      APPLICANTS FOR PHARMACIST LICENSING  
HB 247     LICENSURE OF DENTISTS



# HOUSE RULES COMMITTEE

## JOHNNY ELLIS, CHAIR

465-3765

DATE: January 23, 1992

PLACE: Speaker's Chambers

**SUBJECT OF MEETING:**  
 HB 31 Applicants for Pharmacists Licenses  
 HB 247 Licensure of Dentists

| NAME              | REPRESENTING         | BUSINESS/PERSONAL MAILING ADDRESS | ZIP | (H) PHONE       | (W) PHONE    | DO YOU WANT TO TESTIFY?                                      | WHAT SUBJECT/ WHICH BILL? |
|-------------------|----------------------|-----------------------------------|-----|-----------------|--------------|--|---------------------------|
| Nancy BENNETT     | Rep Mackie           | State Capitol                     |     | <del>3882</del> | 3882         | Y <input checked="" type="radio"/> N                         | HB 247                    |
| Rep Niilo Koponen | self                 | Capitol 503                       |     |                 | 4992         | Y <sup>if necessary</sup> <input checked="" type="radio"/> N | HB 31                     |
| STAN ROSS         | GRUENBERG            | " 214                             |     |                 | 3718         | Y <input checked="" type="radio"/> N                         |                           |
| Ashley Reed       | Dental<br>Magistrate | 3201 C St #300<br>Anch 99503      |     |                 | 562-<br>2560 | Y <input checked="" type="radio"/> N                         | HB 247                    |
| Rep. Mackie       |                      |                                   |     |                 |              | <input checked="" type="radio"/> Y N                         |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |
|                   |                      |                                   |     |                 |              | Y N  |                           |

STATE OF ALASKA  
THE LEGISLATURE

POUCH V - STATE CAPITOL  
JUNEAU, ALASKA 99811  
907-463-2800

LEGISLATIVE AFFAIRS AGENCY  
LEGISLATIVE REFERENCE LIBRARY

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS database CMPR. In order to save space copies of minutes have not been left in the files.

Mary Van Nimwegen

*House Rules 1-23-92 8:00 am*

B  
(7)

**HOUSE COMMITTEE REPORT**

Date Referred: 5/13/91

FURTHER REFERRALS:

Date of Committee Action: 1-23-92

1-24-92  
HB 31

The Rules Committee considered:

HOUSE BILL NO. 31

"An Act relating to applicants for pharmacist licenses."

RECOMMENDATIONS:

be replaced with CSHB 31 (Rules)  the same title  
 a new title

have attached amendments(s)

do pass

do not pass

no recommendations

individual recommendations

additional referral to the \_\_\_\_\_ Committee

ADOPTS: \_\_\_\_\_ letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept)

APPROVES PREVIOUS: (Dept/Date)

fiscal impact \_\_\_\_\_

fiscal note(s) \_\_\_\_\_

zero fiscal note DCED (Fy92 report)

zero fiscal note(s) \_\_\_\_\_

| SIGNING DO PASS | DP | OTHER RECOMMENDATIONS | DNP | NR | AM |
|-----------------|----|-----------------------|-----|----|----|
| <i>Ph Ellis</i> | ✓  |                       |     |    |    |
| <i>Ben ...</i>  | ✓  |                       |     |    |    |
| <i>...</i>      | ✓  |                       |     |    |    |
| <i>...</i>      | ✓  |                       |     |    |    |
| <i>...</i>      | ✓  |                       |     |    |    |
| <i>...</i>      | ✓  |                       |     |    |    |
| <i>...</i>      | ✓  |                       |     |    |    |
|                 |    |                       |     |    |    |
|                 |    |                       |     |    |    |
|                 |    |                       |     |    |    |

*Ph Ellis*  
CHAIRMAN'S SIGNATURE



Official Business

# Alaska State Legislature

House of Representatives

Committee on Rules

P. O. Box V  
Juneau, Alaska 99811

Phone:  
(907) 465-3764  
465-3765

## HB 31: APPLICANTS FOR PHARMACIST LICENSING

### I N D E X

- I. RULES COMMITTEE DRAFT CS
- II. ORIGINAL VERSION
- III. SPONSOR STATEMENT
- IV. DCED POSITION PAPER
- V. PHARMACIST LICENSING FACTS
- VI. FISCAL NOTE

I

7-LS0294G  
Luckhaupt  
1/22/92

CS FOR HOUSE BILL NO. 31 (RULES)  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
SEVENTEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE RULES COMMITTEE

Offered:  
Referred:

Sponsor(s): Representative Koponen

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to applicants for pharmacist licenses; and providing for an effective  
2 date."

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 \* Section 1. AS 08.80.110 is amended to read:

5 Sec. 08.80.110. QUALIFICATIONS FOR REGISTRATION. An applicant for  
6 registration as a pharmacist shall

7 (1) be fluent in the reading, writing, and speaking of the English language;

8 (2) furnish the board with at least two affidavits from reputable citizens, that the  
9 applicant has known for at least one year, attesting to the applicant's good moral character and  
10 freedom from addiction to the use of drugs or alcoholic liquors;

11 (3) be a graduate of a college of pharmacy recognized by the American Council  
12 on Pharmaceutical Education or, if the applicant has received a bachelor of science degree  
13 in pharmacy or an equivalent degree from an institution located outside of the United States  
14 and its territories, possess the Foreign Pharmacy Graduate Equivalency Committee

1 certificate issued by the Foreign Pharmacy Graduate Equivalency Committee of the  
2 National Association of Boards of Pharmacy Foundation [AMERICAN ASSOCIATION OF  
3 COLLEGES OF PHARMACY];

4 (4) pass an examination by a board of pharmacy which has been approved by the  
5 National Association of Boards of Pharmacy;

6 (5) have completed at least 1,500 hours of internship training under the direct  
7 supervision of a licensed pharmacist in a licensed pharmacy, 160 hours of which must have been  
8 completed after graduation.

9 \* Sec. 2. AS 08.80.110 is amended to read:

10 Sec. 08.80.110. QUALIFICATIONS FOR REGISTRATION. An applicant for  
11 registration as a pharmacist shall

12 (1) be fluent in the reading, writing, and speaking of the English language;

13 (2) furnish the board with at least two affidavits from reputable citizens, that the  
14 applicant has known for at least one year, attesting to the applicant's good moral character and  
15 freedom from addiction to the use of drugs or alcoholic liquors;

16 (3) be a graduate of a college of pharmacy recognized by the American Council  
17 on Pharmaceutical Education [OR, IF THE APPLICANT HAS RECEIVED A BACHELOR OF  
18 SCIENCE DEGREE IN PHARMACY OR AN EQUIVALENT DEGREE FROM AN INSTITU-  
19 TION LOCATED OUTSIDE OF THE UNITED STATES AND ITS TERRITORIES, POSSESS  
20 THE FOREIGN PHARMACY GRADUATE EQUIVALENCY COMMITTEE CERTIFICATE  
21 ISSUED BY THE FOREIGN PHARMACY GRADUATE EQUIVALENCY COMMITTEE OF  
22 THE NATIONAL ASSOCIATION OF BOARDS OF PHARMACY FOUNDATION];

23 (4) pass an examination by a board of pharmacy which has been approved by the  
24 National Association of Boards of Pharmacy;

25 (5) have completed at least 1,500 hours of internship training under the direct  
26 supervision of a licensed pharmacist in a licensed pharmacy, 160 hours of which must have been  
27 completed after graduation.

28 \* Sec. 3. AS 08.80.116(b) is amended to read:

29 (b) An applicant for license as a pregraduate pharmacist must meet the requirements of  
30 AS 08.80.110(1) and (2) and must be enrolled in a pharmacy school recognized by the American  
31 Council on Pharmaceutical Education [AMERICAN ASSOCIATION OF COLLEGES OF

1 PHARMACY] as a junior. An applicant may be on recognized vacation from the pharmacy  
2 school. However, the vacation may not exceed one quarter or one semester. The pregraduate  
3 internship pharmacist shall pay the required fee.

4 \* Sec. 4. AS 08.80.480(13) is repealed.

5 \* Sec. 5. Section 2 of this Act takes effect July 1, 1994.

HOUSE BILL NO. 31

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE KOPONEN

Introduced: 1/21/91

Referred: Labor and Commerce, Health, Education and Social Services

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to applicants for pharmacist licenses."

2 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

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9 freedom from addiction to the use of drugs or alcoholic liquors;

10 (3) be a graduate of a college of pharmacy recognized by the American Council  
11 on Pharmaceutical Education or, if the applicant has received a bachelor of science degree  
12 in pharmacy or an equivalent degree from an institution located outside of the United States  
13 and its territories, possess the Foreign Pharmacy Graduate Equivalency Committee  
14 certificate issued by the Foreign Pharmacy Graduate Equivalency Committee of the

Alaska State Capitol  
Juneau, AK 99801-1182  
XXXXXXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXXXX  
Juneau, Alaska 99801  
(907) 465-4992

Alaska State Legislature  
Representative Niilo Koponen  
House District 21

119 N. Cushman, Suite 207  
Fairbanks, Alaska 99701  
(907) 456-8172

SPONSOR STATEMENT

House Bill 31  
"An Act relating to applicants for pharmacist licenses"

Foreign-educated doctors, nurses, chiropractors, physical therapists, optometrists and veterinarians may practice in Alaska, provided they successfully complete Alaskan licensing examinations and fulfill all pertinent qualifications. Standard equivalency examinations insure that credentials earned outside of the United States meet American standards of academic and clinical competence.

HB 31 extends the same opportunity to pharmacists trained at non-U.S. institutions. The state would benefit from expanding the universe of trained professionals available to serve the public. At present, Alaskans may qualify for state loans to study pharmacy at non-U.S. institutions, but they may not be licensed when they return to the state. Continued exclusion of these Alaskans from practice is inconsistent with treatment of other health professionals and extends no apparent advantage to other state residents.

Section 2 of the bill is essentially a sunset. Changes made by Section 1 allow licensure of foreign-educated pharmacists. When it takes effect in July 1994, Section 2 returns the statute's licensing requirements to the qualifications presently in place.

The greater principle of licensing competent professionals in Alaska is made clear -- and urgent -- in one specific case. A constituent of mine, educated at the Sorbonne in Paris, cannot work as a pharmacist in Alaska. She and her husband, a highly-valued member of the UAF mathematics faculty, may leave the state if she is unable to secure a professional pharmacist position in Alaska. It would be an unnecessary loss to our citizens if we lost these Alaskans to the Lower 48.

I urge your affirmative vote on HB 31.

# **CORRECTION**

**THIS DOCUMENT  
HAS BEEN REPHOTOGRAPHED  
TO ASSURE LEGIBILITY**

HOUSE BILL NO. 31

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE KOPONEN

Introduced: 1/21/91

Referred: Labor and Commerce, Health, Education and Social Services

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12 in pharmacy or an equivalent degree from an institution located outside of the United States  
13 and its territories, possess the Foreign Pharmacy Graduate Equivalency Committee  
14 certificate issued by the Foreign Pharmacy Graduate Equivalency Committee of the

1 National Association of Boards of Pharmacy Foundation [AMERICAN ASSOCIATION OF  
2 COLLEGES OF PHARMACY];

3 (4) pass an examination by a board of pharmacy which has been approved by the  
4 National Association of Boards of Pharmacy;

5 (5) have completed at least 1,500 hours of internship training under the direct  
6 supervision of a licensed pharmacist in a licensed pharmacy, 160 hours of which must have been  
7 completed after graduation.

8 \* Sec. 2. AS 08.80.116(b) is amended to read:

9 (b) An applicant for license as a pregraduate pharmacist must meet the requirements of  
10 AS 08.80.110(1) and (2) and must be enrolled in a pharmacy school recognized by the American  
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Alaska State Legislature

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Representative Niilo Koponen  
House District 21

119 N. Cushman, Suite 207  
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SPONSOR STATEMENT

House Bill 31  
"An Act relating to applicants for pharmacist licenses"

Foreign-educated doctors, nurses, chiropractors, physical therapists, optometrists and veterinarians may practice in Alaska, provided they successfully complete Alaskan licensing examinations and fulfill all pertinent qualifications. Standard equivalency examinations insure that credentials earned outside of the United States meet American standards of academic and clinical competence.

HB 31 extends the same opportunity to pharmacists trained at non-U.S. institutions. The state would benefit from expanding the universe of trained professionals available to serve the public. At present, Alaskans may qualify for state loans to study pharmacy at non-U.S. institutions, but they may not be licensed when they return to the state. Continued exclusion of these Alaskans from practice is inconsistent with treatment of other health professionals and extends no apparent advantage to other state residents.

Section 2 of the bill is essentially a sunset. Changes made by Section 1 allow licensure of foreign-educated pharmacists. When it takes effect in July 1994, Section 2 returns the statute's licensing requirements to the qualifications presently in place.

The greater principle of licensing competent professionals in Alaska is made clear -- and urgent -- in one specific case. A constituent of mine, educated at the Sorbonne in Paris, cannot work as a pharmacist in Alaska. She and her husband, a highly-valued member of the UAF mathematics faculty, may leave the state if she is unable to secure a professional pharmacist position in Alaska. It would be an unnecessary loss to our citizens if we lost these Alaskans to the Lower 48.

I urge your affirmative vote on HB 31.

HB 31: An Act relating to applicants for pharmacist licenses.

The Department of Commerce and Economic Development supports passage of HB 31.

The proposed legislation will address a problem of longstanding for the Board of Pharmacy (hereinafter "board") within the Division of Occupational Licensing (hereinafter "division"). Presently, the board has no provision for licensure of pharmacy graduates educated in institutions not recognized by the American Council on Pharmaceutical Education (ACPE) and located outside the United States and its territories (hereinafter "foreign graduates").

The bill amends the qualifications for pharmacy registration to recognize applicants who have received their bachelor of science degree in pharmacy or an equivalent degree from outside of the United States and its territories. Currently, when foreign graduates apply for licensure, regardless of their qualifications, the board must deny licensure.

Nationally, the National Association of Boards of Pharmacy (NABP) Foundation has responded to this problem by developing course review procedures geared towards determining whether the bachelor of science degree in pharmacy attained by a foreign graduate is substantially equivalent to the degree and learning attained by a graduate of an ACPE accredited school in the United States.

The foreign graduate who possesses an NABP Foreign Pharmacy Graduate Equivalency Committee certificate is considered equivalently educated and is, therefore, eligible for licensure (assuming compliance with other admission criteria) in any state throughout the country. HB 31 will allow foreign-trained pharmacy graduates who possess an NABP Foreign Pharmacy Graduate Equivalency Committee certificate the opportunity to become licensed in Alaska.

There exists nationwide a significant shortage of pharmacists and an acute shortage in Alaska. This legislation will enable the state to admit qualified foreign graduates and, potentially improve our ability to meet our employment needs in this area.

Therefore, the department urges passage of HB 31.



Glenn A. Olds, Commissioner

Date: February 1, 1991

GAO/JS/dgl8849D  
020191b

V

## PHARMACIST LICENSING FACTS

The American Council on Pharmaceutical Education (ACPE, established 1932) is the national agency for accreditation of professional degree programs in pharmacy and for approval of providers of continuing pharmaceutical education.

The ACPE presently recognizes 74 accredited professional programs in 43 states, plus the District of Columbia and Puerto Rico.

30 other states, the District of Columbia and Puerto Rico allow foreign-educated pharmacists to sit for state licensing exams if they pass the Foreign Pharmacy Graduate Equivalency Examination administered by the Foreign Pharmacy Graduate Examination Committee (FPGEC).

The FPGEC certificate is awarded only to four-year graduates with Bachelor of Science degrees scoring 550 or higher on the Test of English as a Foreign Language.

Some foreign graduates are allowed to enter accredited U.S. schools of pharmacy as advanced students. After graduation, they qualify to take state examinations.

New York and California allow some candidates to take the state examination after their credentials have been evaluated and approved by the state licensing board.

### ALASKA FACTS

All pharmacists must be licensed in Alaska. Operators of pharmacy businesses must also have a license to dispense drugs and controlled substances. Applicants must be graduates of a college of pharmacy and complete at least 1,500 hours as an intern.

Application fee: \$30.00  
Examination fee: \$150.00  
License fee: \$180.00  
Biennial renewal: \$180.00

### ALASKA EMPLOYMENT

(Statistics from the Alaska Department of Labor)

Employment in 1989: 188; in 1990: 193; in 1994: 209 (predicted)

Average Annual Job Openings, 1989-1994

Due to Growth: 4; Due to Separations: 5; Total: 9

Current license holders: 489

*misc. facts*

HB31 Miscellaneous Notes

Alaska licenses the following professionals who were educated at non-U.S. institutions:

Physicians  
Nurses  
Optometrists  
Chiropractors  
Physical Therapists  
Veterinarians

On 4/25/91, the chairman of the Board of Pharmacy told me (RGC) that he had five vacancies for pharmacists in his company (Carr's) alone.

This is not a one-constituent bill. One constituent brought to light the broader issue -- a statewide shortage of pharmacists, and an inability for Alaskans educated at non-U.S. institutions to work in Alaska.

FISCAL NOTE

**VI**

STATE OF ALASKA  
1991 LEGISLATIVE SESSION

BILL NO. HB 31

Revision Date: \_\_\_\_\_ Department Affected: Commerce & Economic Dev.  
 Title: An Act relating to applicants for pharmacist licenses. BRU: Occupational Licensing  
 Component: Administration  
 Sponsor: Rep. Koponen  
 Requestor: Rep. Koponen COMPONENT SERIAL NO. 

|   |   |   |   |
|---|---|---|---|
| 0 | 3 | 5 | 6 |
|---|---|---|---|

Expenditures/Revenues: (Thousands of Dollars)

| OPERATING         | FY 92 | FY 93 | FY 94 | FY 95 | FY 96 | FY 97 |
|-------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES |       |       |       |       |       |       |
| TRAVEL            |       |       |       |       |       |       |
| CONTRACTUAL       |       |       |       |       |       |       |
| SUPPLIES          |       |       |       |       |       |       |
| EQUIPMENT         |       |       |       |       |       |       |
| LAND & STRUCTURES |       |       |       |       |       |       |
| GRANTS, CLAIMS    |       |       |       |       |       |       |
| MISCELLANEOUS     |       |       |       |       |       |       |
| TOTAL OPERATING   | 0     | 0     | 0     | 0     | 0     | 0     |

|         |   |   |   |   |   |   |
|---------|---|---|---|---|---|---|
| CAPITAL | 0 | 0 | 0 | 0 | 0 | 0 |
|---------|---|---|---|---|---|---|

|         |   |   |   |   |   |   |
|---------|---|---|---|---|---|---|
| REVENUE | 0 | 0 | 0 | 0 | 0 | 0 |
|---------|---|---|---|---|---|---|

FUNDING: (Thousands of Dollars)

|               |   |   |   |   |   |   |
|---------------|---|---|---|---|---|---|
| GENERAL FUND  |   |   |   |   |   |   |
| FEDERAL FUNDS |   |   |   |   |   |   |
| OTHER         |   |   |   |   |   |   |
| TOTAL         | 0 | 0 | 0 | 0 | 0 | 0 |

POSITIONS:

|           |   |   |   |   |   |   |
|-----------|---|---|---|---|---|---|
| FULL-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| PART-TIME |   |   |   |   |   |   |
| TEMPORARY |   |   |   |   |   |   |

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

HB 31 amends pharmacy education requirements for licensure to allow foreign pharmacy graduates an opportunity to become licensed. New funds are not required to implement this bill.

Prepared By: Jennifer Strickler, Administrative Officer Phone: 465-2144

Division: Occupational Licensing Date: February 1, 1991

Approved by Commissioner: Glenn A. Olds

Agency: Department of Commerce & Economic Development Date: February 1, 1991

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies)

STATE OF ALASKA

FISCAL NOTE

No. 2

Bill Version: CSHB 31(RLS)

(H) Publish Date: 1/24/92

1992 LEGISLATIVE SESSION

Revision Date: 01/22/92 Department Affected: Commerce & Economic Development

Title: An Act relating to applicants for pharmacist licenses. BRU: Occupational Licensing

Component: Administration

Sponsor: Rep. Koponen

Requestor: House Rules COMPONENT SERIAL NO. 

|   |   |   |   |
|---|---|---|---|
| 0 | 3 | 5 | 6 |
|---|---|---|---|

Expenditures/Revenues: (Thousands of Dollars)

| OPERATING         | FY 93 | FY 94 | FY 95 | FY 96 | FY 97 | FY 98 |
|-------------------|-------|-------|-------|-------|-------|-------|
| PERSONAL SERVICES | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| TRAVEL            | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| CONTRACTUAL       | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| SUPPLIES          | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| EQUIPMENT         | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| LAND & STRUCTURES | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| GRANTS, CLAIMS    | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| MISCELLANEOUS     | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| TOTAL OPERATING   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |

|         |     |     |     |     |     |     |
|---------|-----|-----|-----|-----|-----|-----|
| CAPITAL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
|---------|-----|-----|-----|-----|-----|-----|

|         |     |     |     |     |     |     |
|---------|-----|-----|-----|-----|-----|-----|
| REVENUE | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
|---------|-----|-----|-----|-----|-----|-----|

FUNDING: (Thousands of Dollars)

|               |     |     |     |     |     |     |
|---------------|-----|-----|-----|-----|-----|-----|
| GENERAL FUND  | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| FEDERAL FUNDS | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| OTHER         | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| TOTAL         | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

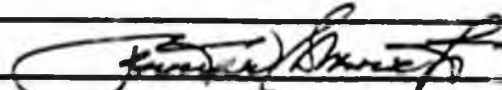
POSITIONS:

|           |     |     |     |     |     |     |
|-----------|-----|-----|-----|-----|-----|-----|
| FULL-TIME | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| PART-TIME | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| TEMPORARY | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary)

HB 31 amends pharmacy education requirements for licensure to allow foreign pharmacy graduates an opportunity to become licensed. New funds are not required to implement this bill.

Prepared By: Jennifer Strickler  Phone: 465-2144

Division: Occupational Licensing Date: 01/22/92

Approved by Commissioner: Glen A. Oida  for the Willard Act - Comm.

Agency: Department of Commerce & Economic Development Date: 1.22.92

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Alaska State Capitol  
Juneau, AK 99801-1182

# Alaska State Legislature

Representative Niilo Koponen

House District 21

119 N. Cushman, Suite 207  
Fairbanks, Alaska 99701  
(907) 456-8172

(907) 465-4992

## SECTIONAL ANALYSIS

### CS FOR HOUSE BILL NO. 31 (RULES)

"An Act relating to applicants for pharmacist licenses;  
and providing for an effective date."

Section 1. Replaces the American Association of Colleges of Pharmacy (AAP), a service organization for U.S. pharmacy schools, with the American Council on Pharmaceutical Education (ACPE), which accredits all U.S. schools of pharmacy, as the agency responsible for recognizing institutions from which Alaska-licensed pharmacists graduate. Allows Alaska licensing of graduates of non-U.S. institutions after applicants pass the Foreign Pharmacy Graduate Equivalency Examination, a standard test employed by a majority of other states.

Section 2. Effectively sunsets licensing of foreign-educated pharmacists; replaces Section 1 with the previous statutory language after July 1, 1994.

Section 3. Changes accreditation authority for Alaskan pregraduate intern pharmacists from AAP to ACPE.

Section 4. Repeals obsolete definition of "recognized college of pharmacy," since it is redefined in Section 1.

Section 5. Provides an effective date for the Section 2 sunset.

Alaska State Capitol  
Juneau, AK 99801-1182

Alaska State Legislature  
Representative Niilo Koponen

House District 21

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SPONSOR STATEMENT

House Bill 31

"An Act relating to applicants for pharmacist licenses"

Foreign-educated doctors, nurses, chiropractors, physical therapists, optometrists and veterinarians may practice in Alaska, provided they successfully complete Alaskan licensing examinations and fulfill all pertinent qualifications. Standard equivalency examinations insure that credentials earned outside of the United States meet American standards of academic and clinical competence.

HB 31 extends the same opportunity to pharmacists trained at non-U.S. institutions. The state would benefit from expanding the universe of trained professionals available to serve the public. At present, Alaskans may qualify for state loans to study pharmacy at non-U.S. institutions, but they may not be licensed when they return to the state. Continued exclusion of these Alaskans from practice is inconsistent with treatment of other health professionals and extends no apparent advantage to other state residents.

Section 2 of the bill is essentially a sunset. Changes made by Section 1 allow licensure of foreign-educated pharmacists. When it takes effect in July 1994, Section 2 returns the statute's licensing requirements to the qualifications presently in place.

The greater principle of licensing competent professionals in Alaska is made clear -- and urgent -- in one specific case. A constituent of mine, educated at the Sorbonne in Paris, cannot work as a pharmacist in Alaska. She and her husband, a highly-valued member of the UAF mathematics faculty, may leave the state if she is unable to secure a professional pharmacist position in Alaska. It would be an unnecessary loss to our citizens if we lost these Alaskans to the Lower 48.

I urge your affirmative vote on HB 31.

### HB31 Miscellaneous Notes

Alaska licenses the following professionals who were educated at non-U.S. institutions:

- Physicians
- Nurses
- Optometrists
- Chiropractors
- Physical Therapists
- Veterinarians

On 4/25/91, the chairman of the Board of Pharmacy told me (RGC) that he had five vacancies for pharmacists in his company (Carr's) alone.

This is not a one-constituent bill. One constituent brought to light the broader issue -- a statewide shortage of pharmacists, and an inability for Alaskans educated at non-U.S. institutions to work in Alaska.

4ES

(7)

Date Referred: January 21, 1991

FURTHER REFERRALS: Health, Education & Social Services

Date of Committee Action: 4-30-91

The LABOR AND COMMERCE Committee considered:

HB 31

HOUSE BILL NO. 31

APPLICANTS FOR PHARMACIST LICENSING

"An Act relating to applicants for pharmacist licenses."

RECOMMENDATIONS:

be replaced with \_\_\_\_\_ [ ] the same title [ ] a new title

[ ] have attached amendments(s)

[ ] do pass

[ ] do not pass

no recommendations

[ ] individual recommendations

[ ] additional referral to the \_\_\_\_\_ Committee

ADOPTS: \_\_\_\_\_ letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept) \_\_\_\_\_

APPROVES PREVIOUS: (Dept/Date) \_\_\_\_\_

[ ] fiscal impact \_\_\_\_\_

[ ] fiscal note(s) \_\_\_\_\_

zero fiscal note Commerce & Econ. Dev.

[ ] zero fiscal note(s) \_\_\_\_\_

SIGNING DO PASS:

SIGNING OTHER RECOMMENDATIONS:

| Finkelstein | Check appropriate column: | Do Not Pass | No Rec                              | Amend |
|-------------|---------------------------|-------------|-------------------------------------|-------|
|             | John Taylor TAYLOR        |             | <input checked="" type="checkbox"/> |       |
|             | Bruce KMAN                |             | <input type="checkbox"/>            |       |
|             | Evan                      |             | <input checked="" type="checkbox"/> |       |
|             | Kevin Parnell PARNELL     |             | <input checked="" type="checkbox"/> |       |
|             |                           |             |                                     |       |
|             |                           |             |                                     |       |
|             |                           |             |                                     |       |
|             |                           |             |                                     |       |
|             |                           |             |                                     |       |
|             |                           |             |                                     |       |

Chairman's Signature

Alaska State Legislature  
Representative Niilo Koponen

Pouch V  
Juneau, Alaska 99811  
(907) 465-4992

House District 21

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Fairbanks, Alaska 99701  
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SPONSOR STATEMENT

House Bill 31

"An Act relating to applicants for pharmacist licenses"

By Representative Niilo Koponen

Foreign-educated doctors, nurses, chiropractors, physical therapists, optometrists and veterinarians may practice in Alaska, provided they successfully complete Alaskan licensing examinations and fulfill all pertinent qualifications. Standard equivalency examinations insure that credentials earned outside of the United States meet American standards of academic and clinical competence.

HB 31 extends the same opportunity to pharmacists trained at non-U.S. institutions. The state would benefit from expanding the universe of trained professionals available to serve the public. Continued exclusion of these Alaskans from practice is inconsistent with treatment of other health professionals and extends no apparent advantage to other state residents.


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M E M O R A N D U M

TO: House Labor and Commerce Committee Members  
FROM: Representative Niilo Koponen   
DATE: April 30, 1991  
RE: House Bill 31, "An Act relating to applicants for pharmacist licenses"

At the first committee hearing of the HB 31, confusion arose as to the appropriate body to recognize an Alaskan pharmacist's credentials. Here's a quick summary of the players:

- American Council on Pharmaceutical Education (ACPE): accredits all U.S. schools of pharmacy.

- National Association of Boards of Pharmacy Foundation (NABPF): examines and certifies foreign-educated pharmacists, through administration of the Foreign Pharmacy Graduate Equivalency Examination (FPGEE). Successful applicants receive a certificate from the Foreign Pharmacy Graduate Equivalency Committee (FPGEC).

- American Association of Colleges of Pharmacy (AACP): service organization for U.S. schools of pharmacy; publishes regular newsletter, etc.

Today, my staff spoke with Ms. Susan Meyer, Academic Affairs Director for the AACP. She stated unequivocally that the ACPE, not the AACP, was the appropriate body to recognize, certify or accredit U.S.-trained pharmacists, and that the NABPF/FPGEC was the appropriate body to perform the same function for foreign-educated pharmacists. She said the AACP was mostly a fraternal, "industry"-oriented group, not one concerned with professional licensing.

Therefore, the bill should stand as written, with the ACPE listed as the accrediting body.

Finally, the addition of the word "intern" to Sec. 2, Line 1, AS 08.80.116(b) is reasonable. I would accept this change in a CS for this bill.

FEB 07 1991

February 4, 1991

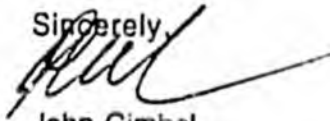
Representative Niilo Koponen  
PO Box V  
Juneau, AK 99811

Dear Representative Koponen:

Greetings. I am writing today in support of HB31, "An Act Relating to Applicants for Pharmacist Licensing." This is, in my opinion, an excellent piece of legislation and certainly deserves passage by this legislature.

Thank you. Warm, kind and friendly regards.

Sincerely,



John Gimbel  
Box 84885  
Fairbanks, AK 99775

cc: Rep. Finkelstein

February 5, 1991

Representative Niilo Koponen  
P.O. Box V  
Juneau, Ak 99811

FEB 07 1991

Dear Representative Koponen: \*

I appreciate your introducing HB31 -- "An Act Relating to Applicants for Pharmacist Licensing." The present regulation that prohibits qualified persons, who have earned a degree outside the United States, from receiving a license is unjust.

Thank you.

Sincerely,



Robert A. Sullivan  
P.O. Box 802224  
College, Ak 99708

copy to Rep. Finkelstein

3501 College Road - #2  
Fairbanks, AK 99709  
1 February 1991

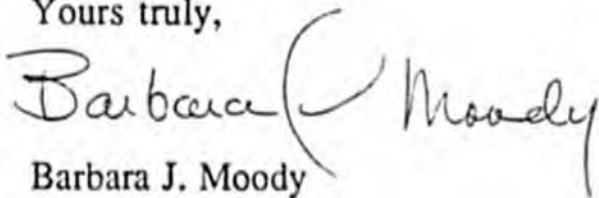
Representative Niilo Koponen  
P. O. Box V  
Juneau, AK 99811

Dear Representative Koponen:

I firmly support House Bill 31, "An Act Relating to Applicants for Pharmacist Licensing", and urge you to vote in favor of its passage.

Thank you.

Yours truly,

A handwritten signature in cursive script that reads "Barbara J. Moody". The signature is written in dark ink and is positioned to the right of the typed name.

Barbara J. Moody

copy: Representative Finkelstein, Chair  
Labor and Commerce Committee