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BTC Brief

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CORPORATE TAX CUTS OFFER ONLY FALSE HOPE: Evidence Favors Targeted Investments to Create Jobs and Spur Economic Growth

Timely, accessible, and credible analysis of state and local budget and tax issues

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KEY FINDINGS:

- **Cutting the state corporate income tax rate from its current 6.9 percent to 4.75 percent would cost the state $307 million in the next fiscal year, with the annual cost rising to $410 million after five years.**
- **Proponents claim that corporate tax cuts will create jobs, but economic analysts in other states have estimated the cost per new job of state corporate income tax cuts would be between $83,000 (California) and $97,000 (Oregon). Furthermore, economic research suggests that most of the new jobs are likely to be filled not by current state residents, but by in-migrants to the state.**
- **According to the most recent data, a mere 217 businesses paid three-fifths of all state corporate income taxes in North Carolina. Thus, approximately three-fifths of any corporate tax cut would flow to 0.12 percent of North Carolina's 175,000 private employers.**
- **North Carolina policymakers have better, more cost-effective alternatives for promoting economic growth and job creation in the state: customized job training, manufacturing extension services, temporary wage subsidies to create new jobs for those facing long-term unemployment, and expanded access to high-quality early childhood education and child care.**

SEVERAL STATE POLICYMAKERS from both political parties have proposed cutting North Carolina's corporate income tax rate—or even phasing out the corporate income tax altogether—in hopes that corporations will respond by investing in the state and creating much-needed jobs. While cutting corporate taxes might make for a good political sound bite, the available evidence demonstrates that the people of North Carolina would be better off if state policymakers opted for proven, pro-growth alternatives to boosting North Carolina's economy.

Evidence Suggests Corporate Tax Cut More Likely to Harm Economic Recovery than Help

Evidence from surveys of corporate CEOs, statistical analyses of state and local business taxes, and popular rankings of the "best states for business" all support the same conclusion: businesses care more about having a well-educated, highly productive workforce, access to markets and suppliers, sound infrastructure, and high quality of life for their employees than they do about taxes.

To the extent that business taxes do matter, North Carolina's low-tax status means that policymakers should be more concerned about under-investing in the public structures that businesses rely on than about cutting corporate taxes. North Carolina already has the lowest state and local business taxes as a share of the economy in the country,[1] and the corporate income tax accounts for less than one in thirteen dollars paid by North Carolina businesses in state and local taxes. In fact, as demonstrated in a previous BTC Brief, a 30-percent cut in the corporate income tax rate (as proposed by Governor Perdue) "would result in just a 2.2 percent reduction in business taxes and only a 0.04 percent reduction in total business costs."[2]

North Carolinians Would Pay Cost of Corporate Tax Cuts but Receive Few Benefits

The Fiscal Research Division of the General Assembly estimates that a recent proposal to cut the state corporate income tax rate from its current 6.9 percent to 4.75 percent would cost the state $307 million in the next fiscal year, with the annual cost rising to $410 million after five years.[3]

Legislative economic analysts in several other states have attempted to model the economic impact of corporate tax cut proposals in particular, and the results strongly suggest that any new jobs would come at too high a cost. In Oregon and California, legislative analysts predicted that cutting the state corporate income tax rate by 20 to 30 percent would increase personal income by 0.2 percent and employment by 0.06 to 0.1 percent after five years: This translates into an estimated $98,000 per job in Oregon and $83,000 per job in California.[4] Furthermore, economic research suggests that most of the new jobs are likely to be filled not by current state residents, but by in-migrants to the state.[5] And because nearly all states have a balanced budget requirement, current residents would pay the entire cost through higher personal taxes or cuts to public services.

Proponents argue corporate tax cuts will increase corporate profits and encourage investment in North Carolina. But corporate profits are currently at record highs,[6] and corporations are still not hiring new workers. Cutting the state corporate income tax rate will simply raise corporate profits even higher with no promise or evidence that these profitable corporations will create jobs. In fact, rising dividend payouts[7] and high executive bonuses suggest that much of the after-tax savings resulting from a corporate tax cut will flow straight to out-of-state investors and corporate managers headquartered in other states.

The other main beneficiary of proposed corporate tax cuts would be the federal government. Because profitable corporations deduct state income tax payments from federal corporate income tax returns, 35 cents of every dollar in corporate tax cuts will simply end up in the federal treasury.

Small- and medium-sized businesses are the engine of job growth in the state, and very few would benefit from reducing the state corporate income tax rate. As of 2005, only about 28,000[8] of North Carolina's more than 775,000 businesses (more than 175,000 of which were employers)[9] paid any corporate income tax. In the same year, 217 corporations accounted for nearly three of every five dollars in corporate income tax payments.[10] Thus, approximately three-fifths of any corporate tax cut would flow to 0.12 percent of North Carolina's private employers.

Because of loopholes and subsidies, North Carolina's biggest corporations typically pay less than the statutory 6.9% state corporate income tax rate. Of the 14 Fortune 500 companies headquartered in North Carolina, estimates show that none paid the statutory rate of 6.9 percent in state income taxes in 2010, and only three paid more than five percent.[11] In fact, three of these fourteen corporations—Nucor, Progress Energy and Goodrich—actually received net state corporate income tax subsidies despite earning substantial profits.[12]

Like the rest of the state's residents, small business owners would see little benefit from cutting the state's corporate income tax while bearing the cost of higher personal taxes and reduced public services.

Evidence Favors Targeted Investments to Boost North Carolina Economy

All types of businesses and all residents do benefit from having a skilled, educated workforce, sound infrastructure, and public investments to improve quality of life. Research from the Political Economy Research Institute at the University of Massachusetts has demonstrated a much stronger economic return on investments[13] in education and infrastructure than business tax incentives.

Other research by respected economist Timothy Bartik goes even further, suggesting specific public investments[14] that will do far more to build a state's economy than corporate tax cuts. Listed below are four alternatives, based on Bartik's research, that North Carolina policymakers could pursue as an alternative to corporate tax cuts:[15]

1. **Customized Job Training:** Expand job-training grants to individual firms, leveraging the resources through North Carolina's nationally recognized community college system. According to Bartik, "research suggests that customized job training programs are 10 to 16 times as cost-effective in creating jobs as business tax incentives."
2. **Manufacturing Extension Services:** Expand consulting services to small- and medium-sized manufacturers to help them become more competitive and successful, leveraging federal funds through the Manufacturing Extension Partnership program of the US Department of Commerce. "[A recent study] suggests that manufacturing extension, compared to business tax incentives, is about nine times more cost effective in creating jobs."[16]
3. **Subsidized Employment & Economic Development:** Temporarily subsidize part of the wages for new jobs filled by workers who endured long-term unemployment, with preferences for small- and medium-sized businesses. "Simulations [based on program data from several subsidized job programs] suggest that each dollar spent on a [subsidized job] program will increase the present value of state residents' earnings by $5.67."
4. **High-Quality Early Childhood Education:** Expand the income eligibility requirements for and increase the number of slots available in North Carolina's award-winning early childhood programs, Smart Start and More At Four, and eliminate the waiting list for child-care subsidies. Bartik recently estimated[17] that the present value of a dollar of state investment in Smart Start and More At Four equaled $8.79.

Conclusion

The people of North Carolina expect their elected representatives to be effective stewards of public resources. Each of the above options—as well as undoing many of the proposed budget cuts to education, health, and public safety—would, dollar-for-dollar, generate more economic benefits to the people of North Carolina than cutting the state's corporate income tax rate. Instead of joining the race to the bottom by cutting corporate taxes and the public investments those taxes make possible, state policymakers must demonstrate leadership and invest public resources in the programs most likely to pave the way to a brighter economic future for all North Carolinians.

1 Council on State Taxation. "Total state and local business taxes: State-by-state estimates for fiscal year 2009 (Table 6)." March 2010. Available at http://www.cost.org/Page.aspx?id=69654

2 Alexandra Forter-Sirota. "Cutting Corporate Tax Rate Unlikely to Boost Economy or Create Jobs." NC Budget and Tax Center. February 2011. Available at http://www.ncjustice.org/?q=node/721

3 North Carolina Fiscal Research Division. "Session 2011 Legislative Fiscal Note: House Bill 323 (First Edition)." March 22, 2011. Available at http://www.ncleg.net/Sessions/2011/FiscalNotes/House/PDF/HFN0323v1.pdf

4 Michael Mazerov. "Cutting State Corporate Income Taxes is Unlikely to Create Many Jobs." Center on Budget and Policy Priorities. September 2010. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3290#_ftnref25

5 Ibid.

6 Annie Lowrey. "More Profits, Fewer Jobs: Why record corporate profits aren't necessarily good for the economy." Slate.com. March 28, 2011. http://www.slate.com/id/2289619/

7 Whitney Kisling and Lynn Thomasson. "Profit Margins at 18-Year High Signal Bigger Dividends Coming for S&P 500." Bloomberg News. March 14, 2011. http://www.bloomberg.com/news/2011-03-14/profit-margins-at-18-year-high-signal-bigger-s-p-500-dividends.html

8 Barry Boardman. "Corporate Income and Franchise Tax Collections." NC Fiscal Research presentation to NC General Assembly on April 7, 2010.

9 US Small Business Administration, Office of Advocacy. "2008 Small Business Profile: North Carolina." Available at http://archive.sba.gov/advo/research/profiles/08nc.pdf

10 Barry Boardman. "Corporate Income and Franchise Tax Collections." NC Fiscal Research presentation to NC General Assembly on April 7, 2010.

11 Special data request. Institute on Taxation and Economic Policy, April 2011.

12 Ibid.

13 Jeffrey Thompson. "Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives." Political Economy Research Institute: University of Massachusetts – Amherst. August 2010. Available at http://www.peri.umass.edu/236/hash/3f1bd7d2221409d39332894e8e2e0c72/publication/422/

14 Timothy J. Bartik. "What Should Michigan Be Doing To Promote Long-Run Economic Development." W.E. Upjohn Instititute for Employment Research. November 2009. Available at http://www.upjohninst.org/publications/wp/09-160.pdf

15 Ibid.

16 Ibid.

17 Timothy Bartik. "New evidence for large state and local returns from investments in preschool and child care: Duke University study of North Carolina's programs," Investing in Kids. March 18, 2011. http://investinginkids.net/2011/03/18/new-evidence-for-large-state-and-local-returns-from-investments-in-preschool-and-child-care-duke-university-study-of-north-carolina%E2%80%99s-programs/

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