NC Justice Center

Opportunity and prosperity for all

BTC Brief

NC BUDGET & TAX CENTER

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TAXES AS JOB CREATORS:

Research shows investing in public structures creates jobs

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

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KEY FINDINGS:

- **A strong body of economic research has shown that tax-financed state and local public investments in education, transportation, public safety, and health care can create jobs and increase household incomes.**
- **Most independent econometric studies have shown only small positive economic effects from reducing state and local taxes on businesses. And unlike temporary federal tax cuts, state and local tax cuts must typically be paid for with cuts to public investments that support jobs and strengthen the state's economy.**
- **Most of the in-state benefits of increasing public investments also contribute to regional and national economic growth, but most of the in-state benefits of tax cuts result from shifting economic activity away from other states.**
- **Targeted, tax-financed investments in education, transportation, public safety, and health are likely to prove more cost-effective than tax cuts for creating jobs and increasing state residents' personal incomes.**

State and Local Taxes Support Job Creation

In survey after survey, North Carolinians have told pollsters that the number one priority of state and national policymakers should be creating jobs. Not surprisingly, virtually every candidate for public office, from city council to president, has campaigned on the promise of creating jobs. However, the strategies they champion frequently are at odds with what evidence shows will work to create jobs.

Because of balanced-budget requirements, state and local tax cuts almost always must be paid for with cuts to public investments that support jobs and strengthen the state's economy. Therefore, unlike temporary, deficit-financed federal tax cuts targeted at low-income and middle-class households – which evidence shows can be effective at creating jobs in times of high unemployment – tax cuts at the state and local levels do little to create jobs.[1]

A strong body of economic research demonstrates that using state and local tax dollars for public investments in education, transportation, public safety, and health does help to create jobs and increase household incomes in both the short and long terms.

Tax Cuts Have a Small Positive Impact Only when Public Investments Are Maintained

For more than 60 years, economists have attempted to use statistical tools to measure the impact of state and local taxes – particularly taxes on businesses – on local and regional economic outcomes like job creation, personal income growth, and total economic output.

Since the 1970s the majority of credible studies have found that reducing state and local taxes has, at most, a small positive impact on job creation and economic growth.[2] Recent surveys of credible research have generally concluded that reducing all state and local taxes on businesses by 10 percent leads to a 2-percent long-run growth in business activity *when the level of public services is held constant*.[3] Prior studies that had not attempted to hold the level of services constant often found no impact or even a positive impact of higher state and local taxes on economic growth.[4]

One reason the impact of cuts in state and local taxes is small is that these taxes typically make up less than 2 percent of total business costs.[5] That is why business taxes, as demonstrated in inter-state comparisons of similar businesses operating in different states, have little effect on the after-tax profitability of businesses even between relatively low- and high-tax states.[6] Another reason most studies find minimal impact of state and local taxes on growth is that taxes have little effect on individuals' work effort: raising someone's taxes will not cause him or her to choose to work fewer hours or produce fewer goods and services.[7]

Furthermore, econometric studies show that even the modest independent impact of state and local taxes on economic growth takes a long time to materialize and is mostly the result of large firms relocating from other states. Research by leading economic development expert Timothy Bartik indicates that more than three-fifths of the additional business activity generated by business tax cuts appears only after 10 years.[8] Bartik's research also indicates that the tax-cutting state's economic benefits comes mostly at the expense of other states, thereby contributing little to national economic growth.[9] And in the long run, in-migrants from other states, not original state residents, filled most of the additional jobs resulting from lower business taxes.[10]

At a time when the economy remains weak due to depressed demand for businesses' goods and services, providing businesses with a tax cut is particularly unlikely to create jobs.[11] Corporate profits are already at record highs,[12] and evidence from the most recent federal corporate tax cut in 2004 indicates that providing already-profitable corporations with more cash does little to encourage additional hiring.[13] The evidence from this last corporate tax cuts suggests that additional money corporations gain from tax cuts is likely to result in higher executive salaries and/or higher dividends to shareholders but not in additional workers.[14] Surveys of small-business owners indicate that low demand for their goods and services, not inadequate cash reserves or taxes, is their biggest problem and the most significant impediment to hiring in the foreseeable future.[15]

Public Investments & Services Play Vital Role in Economic Growth

Focusing solely on the independent effect of state and local taxes on growth ignores the economic impact of the public investments and services those taxes pay for. In a comprehensive survey of research on the economic impact of state and local services, economist Ronald Fisher concluded that most studies measured a positive impact from higher spending on some public investments and services.[16] More recent research by Timothy Bartik demonstrated that the cost effectiveness of several specific state and local investments – such as manufacturing extension services, pre-kindergarten for at-risk 4-year olds,[17] and customized job training – exceeded the economic return on investment of highly targeted tax incentives for businesses (which Bartik estimates are more cost-effective than broad-based tax cuts).[18]

An important caveat of the research demonstrating a positive effect of lower state and local taxes on economic growth is that such effects typically materialize only when the level of public investments and services is held constant. In practice, only in rare circumstances – such as financing a tax cut from a state's Rainy Day Fund – can policymakers cut state and local taxes without compromising the level and quality of public investments.

In the short term, especially in times when the economy is far below full employment, mainstream economic theory and industry-standard economic modeling indicate that tax-financed services and investments often create jobs and spur economic growth: raising additional tax revenue is likely to put more money to work in a state's economy.[19] Much of the additional tax revenue used to hire teachers, first responders, nurses, and construction workers, who will spend much of what they earn in the local economy, would otherwise have been saved or spent on imported goods and services that have little direct benefit for a local economy.[20]

In the long term, spending on upgrading and maintaining highways and railroads, educating children and training workers, and improving public health and safety makes the entire economy more productive. A recent survey of the literature by economist Jeffrey Thompson documented a considerable body of research showing that tax-financed investments in infrastructure, public education from preschool to higher education, and public health and safety can result in stronger local and regional economies.[21]

Some types of public investments and services, such as roads, water and sewer infrastructure, law enforcement, and fire protection, boost economic growth by directly reducing the cost of doing business.[22] Other types of tax-financed investments and services, like education, job training, and health, strengthen economic growth by improving the productivity of workers and expanding the pool of potential successful entrepreneurs.[23] Even public investments that might seem at first glance to have little impact on economic growth, such as on parks and the arts, often help businesses attract and keep high-skill workers at a lower cost.[24]

Examples of the critical role of public investments in driving economic growth abound in North Carolina and elsewhere:

- In August of last year, Caterpillar Inc. cited the high-quality training at Forsyth Technical Community College as a key factor in the company's decision to build a $426 million manufacturing plant in Forsyth County.[25]
- Continental Tire said a major factor in North Carolina losing out to Sumter County, SC in the recent fight over where to locate a plant was Sumter County's investment in transportation and water/sewer infrastructure.[26]
- Companies in Research Triangle Park consistently cite partnerships with local public universities as critical to their company's success.[27]
- The U.S. Chamber of Commerce recently highlighted the importance of early childhood education, including North Carolina's Smart Start and More at Four programs, in boosting the competitiveness and productivity of the U.S. workforce.[28]

Unlike Tax Cuts, Economic Benefits of Public Investments Improve National Economy

Another consistent finding in Thompson's survey of the research on the economic impacts of state and local taxes and public investments is that most of the in-state benefits of increasing public investments boost regional and national economic growth, but most of the in-state benefits of tax cuts result from shifting economic activity from one state to another.[29] Thus, while a particular state's economy may, in some cases, benefit from targeted state and local tax reductions, it is often at the expense of other states' economies.

One of the clearest examples of the national and regional benefits of state-level public investment is in the area of early childhood education. In his landmark study on the economic development potential of preschool education, economist Timothy Bartik found that, while from a single state's perspective, state-level universal preschool and traditional economic development subsidies have similar cost-effectiveness for increasing the earnings potential of state residents, "[f]rom a national perspective, the economic development benefits of universal preschool significantly exceed the economic development benefits from an unchecked economic development war among the states."[30]

Similarly, research on the economic gains from investment in higher education and physical infrastructure shows that the benefits from state-level investments reach beyond state borders and improve the vitality of an entire region's economy.[31] Insomuch as the economic future of individual states rests on the economic strength of the nation as a whole, state policymakers would be better advised to adopt an economic strategy focused on high-quality public investments rather than the "beggar thy neighbor" approach of state and local tax cuts.

Public Investments Offer Policymakers Cost-Effective Tools to Create Jobs

In times of scarce public resources and a weak national and global economy, making the most cost-effective use of public resources to achieve the public's top priorities is critical. The conclusion from credible research is that well-targeted public investments in education and training, transportation and water resources, public safety, and health are the most cost-effective strategies available to state and local policymakers for creating jobs in the months and years ahead.

Sound public investments in schools, hospitals, colleges and universities, and a modern transportation network were critical to propelling North Carolina from one of the most impoverished states in the country to become a leading economy by the end of the 20th century. Only by building on North Carolina's long history of investing in its people will the state emerge from the Great Recession in a position to thrive and compete in the global economy.

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