Reducing Taxes as a Path to Growth? A Look at the Evidence

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Key Points

• House Joint Resolution 17 (2019): A constitutional amendment to exempt business inventory, machinery, and equipment from property taxation
• Motivating idea: Reducing taxes on business stimulates economic growth
• Existing evidence provides mixed support
• Key Takeaway: Are tradeoffs involved in cutting taxes
  • Benefits of lowering tax burden on business are unclear
  • Tax cuts very rarely pay for themselves
  • How will tax cuts be paid for, much do we spend on public services and who should pay?
Tangible Personal Property (TPP) Tax

• What is tangible personal property? Property that can be touched or moved

• TPP on Business property applies to machinery & equipment and inventory (capital)

• Approximately two-thirds of property taxes fund schools

Source: West Virginia State Tax Department, FY 2016  Note: FY 2016 is the latest year in which data has been provided on property taxes by source.
What Do Other States Do?

Machinery & Equipment

States with a Tangible Personal Property Tax on Machinery & Equipment

- Applies to Machinery & Equipment
- Partially Applies to Machinery & Equipment
- Does Not Apply to Machinery & Equipment
- No Tax on Tangible Personal Property

Inventory

States with a Tangible Personal Property Tax on Inventory

- Applies to Inventory
- Partially Applies to Inventory
- Does Not Apply to Inventory
- No Tax on Tangible Personal Property

Note: Minnesota, New Jersey, North Dakota, and South Dakota have a tangible personal property tax only on centrally assessed property. For more information, see the Tangible Personal Property Tax State Statutory References appendix for more details.
## Arguments For and Against Taxing Business Property

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<th><strong>Against</strong></th>
<th><strong>For</strong></th>
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<td>• Reduces firm’s competitiveness</td>
<td>• Tax policy has limited impact on:</td>
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<td>• Reduces investment in production capacity</td>
<td>• Business activity</td>
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<td>• Alter business’s production, investment and location decisions</td>
<td>• Hiring/location decisions</td>
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<td>• Is administratively burdensome (high compliance costs)</td>
<td>• Making capital cheaper relative to labor suggests negative employment effects</td>
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<td>• Provides key revenues which fund key services</td>
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<td>• Businesses benefit from services provided using local tax dollars</td>
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Related Academic Literature

• State corporate individual/income taxes
• Evidence is mixed
  • Income tax reduction lead to tax avoidance and income shifting but little to no effect on economic activity (Debacker, Heim, Ramnath and Ross 2019)
  • “[T]he present study finds that a state’s personal tax rate has a negative effect on firm location but that a state’s corporate tax rate has no statistically significant effect on firm location (Gius and Frese 2002).”
  • We find the corporate income tax has a [statistically] significant negative impact on employment while the sales and individual income taxes do not (Harden and Hoyt 2003).”
• Matters how tax cuts are paid for
  • Tax increases may benefit economy when spending on public services boosts economic outcomes (Helms 1985; Gabe and Bell 2004)
Tangible Personal Property Tax in Ohio

- House Bill 66 (signed 2005) eliminates TPP tax
  - 3-year phase out beginning in 2006
- Prior to 2006 personal property assessed at 25% of its value
- Reliance on TPP declining from 12.6% to 6.4% over 1980-2005
- Collected an average of $2.1 billion per year (≈ 16.5% of all property tax revenue)
- ≈ 70% of revenues fund k-12 education
- Replaced TPP with a business gross receipts tax- Commercial Activity Tax
Projections

Proponents
• HB 66 projected to create 43,250 new jobs, increase economic output by $2.5 billion over 5 years (Honeck & Shiller 2005)
• HB 66 would “do more to protect job security in Ohio than any single public policy action in the last several decades (Ohio Manufacturing Association Executive quoted in Hershey, 2005). “

Opponents
• Decline in manufacturing driven by national and global forces, reducing business’s tax burden unlikely to have a major effect on employment
• Projected to result in a net reduction of more than $2.8 billion in Ohio tax revenue in 2010 (Honeck & Shiller 2005)
TPP Tax in Ohio (Mughan & Propheter (2017))

Find that in the short term TPP elimination *reduced* manufacturing employment below what it would have been if the TPP remained in place

- By approximately 19,300 jobs annually

Why?
Elimination of TPP Tax in Ohio

• 3 inputs into production process; land, labor and capital
• TPP tax elimination reduces the cost of capital (equipment and machinery) relative to labor and land
  • Also makes it cheaper to hold on to unproductive capital
• Short run: Lower employment growth as firms invest in capital rather than hire new workers
• Long run: More productive capital may improve a company’s competitiveness, boosting output which may then boost employment
• What happens depends on the substitutability between labor and capital
  • How capital intensive is the production process and how easily can machines/equipment replace human workers?
Takeaways

• Taxes place a burden on businesses (and individuals) and are one factor of many in firm production and location decisions

• Empirical evidence is mixed, suggesting that the relationship between taxes and economic growth is complicated; lower taxes do not necessarily result in economic growth

• Taxes also raise money communities rely on for vital public services

• All else equal, cutting taxes will mean less money for those services

• Tax cuts should be thought of as a tradeoff, they will obviously deliver benefits to business. The important questions are:
  • What will be the benefits to the wider community?
  • What costs will accrue to other tax-payers?
THANK YOU!