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

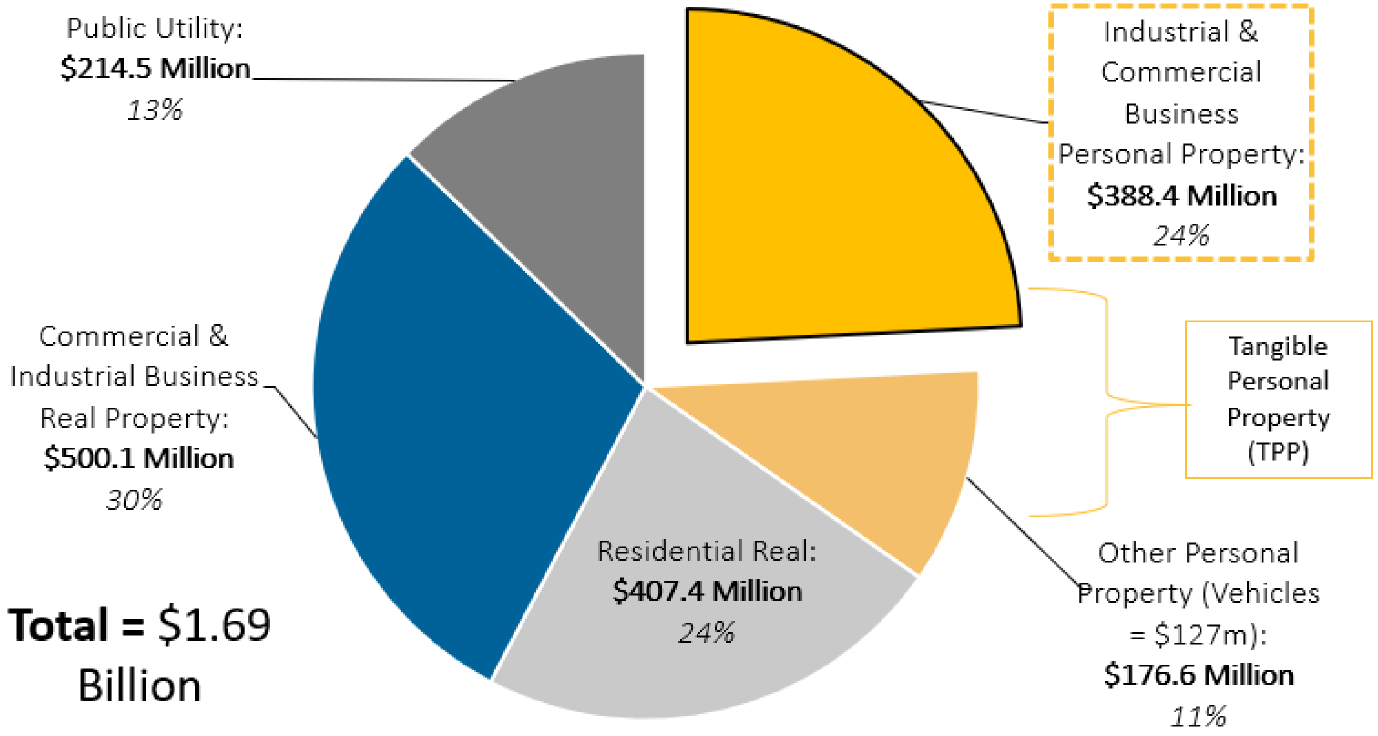
Dr. Siân Mughan

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

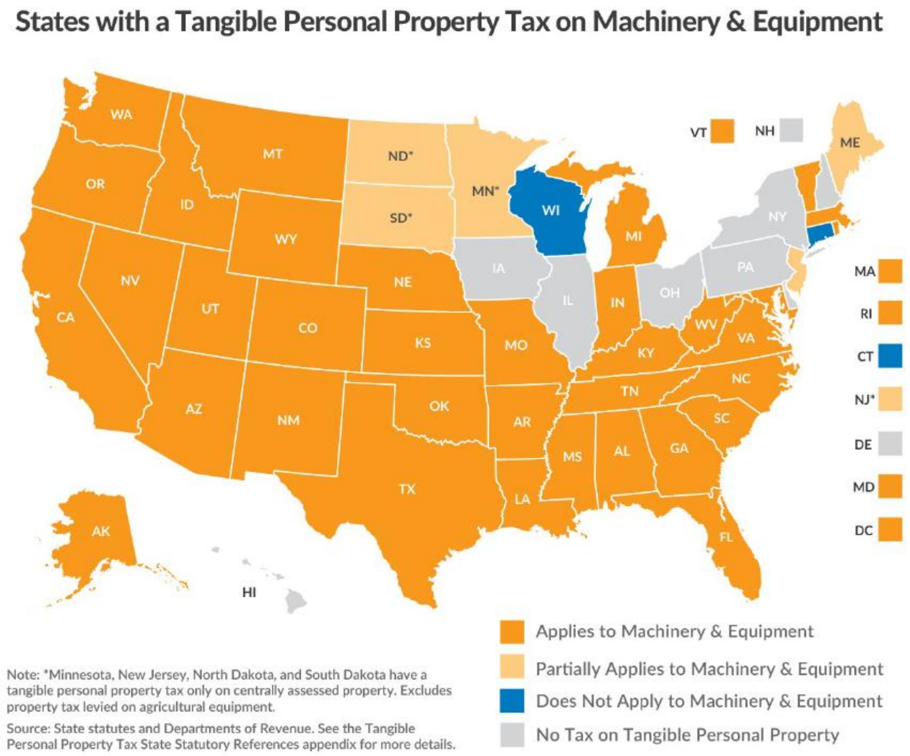
- What is tangible personal property? Property that can be touched or moved
- TPP on Business property applies to machinery & equipment and inventory (capital)
- Approximately two-thirds of property taxes fund schools



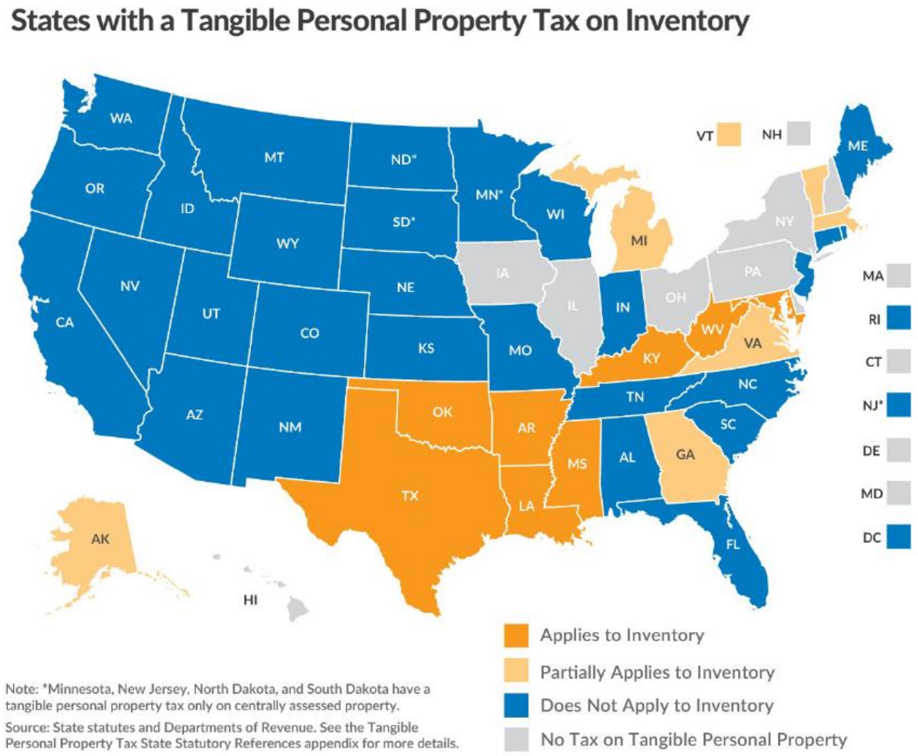
Source: West Virginia State Tax Department, FY 2016 **Note:** FY 2016 is the latest year in which data has been provided on property taxes by source

What Do Other States Do?

Machinery & Equipment



Inventory



Arguments For and Against Taxing Business Property

Against

- Reduces firm's competitiveness
- Reduces investment in production capacity
- Alter business's production, investment and location decisions
- Is administratively burdensome (high compliance costs)

For

- Tax policy has limited impact on:
  - Business activity
  - Hiring/location decisions
- Making capital cheaper relative to labor suggests negative employment effects
- Provides key revenues which fund key services
- Businesses benefit from services provided using local tax dollars

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). "

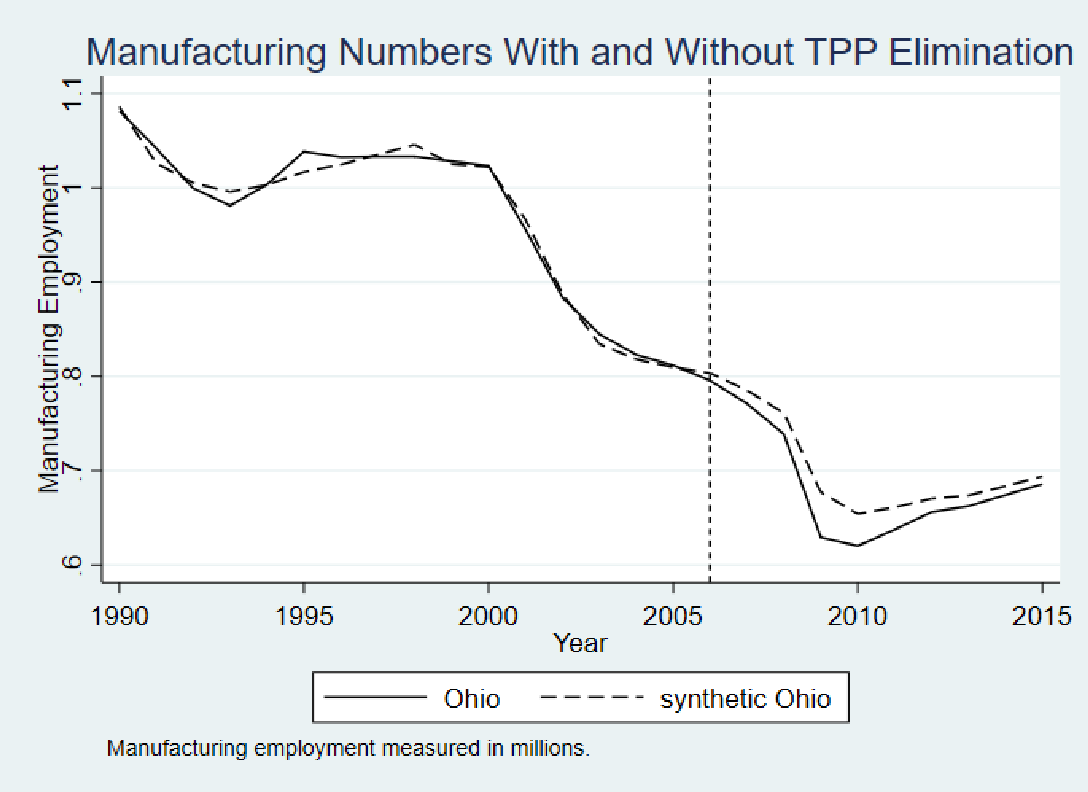
Opponents

- 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!