



## ECONOMIC DEVELOPMENT STRATEGIES, INFORMATION BRIEF 7

# How State Tax Commissions Approach Economic Development

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**Tax policy is a popular choice in the economic development toolkit for state policymakers. Typically, a targeted tax credit or exemption for a business or industry is proposed (Francis 2016a). But states also attempt overhauls of their tax structures (Francis 2016b). These major undertakings often start with the creation of a state tax commission, an independent group that studies and makes recommendations for improving a state's tax system.<sup>1</sup> Some commissions are tasked with finding new revenue during a fiscal crisis, others are asked to find ways to lower tax burdens during good times, and some update or simplify an outdated tax system in a revenue-neutral way.**

Over the past decade, 24 tax commissions have published findings in 19 states and the District of Columbia (DC). Additionally, tax commissions currently meet in Idaho, Missouri, North Dakota, and Ohio.<sup>2</sup> For more on the nuts and bolts of state tax commission, see our accompanying brief, "State Tax Commissions: 2006–2016" (Auxier 2016).

Nearly all tax commissions are tasked with improving economic development within the state. Their authorizing legislation and report introductions include phrases such as "growth-friendly," "unleash innovation," and "optimum competitor."<sup>3</sup> And many reports cite economic development to justify their concluding recommendations. But most reports ultimately contain little exploration or explanation on how taxes and economic development are (or are not) linked. This is a missed opportunity because most commissions thoroughly investigate their state's tax structure, often with the assistance of respected tax and budget experts.

Economic development encompasses far more than tax policy; any discussion of economic development should reach into policy debates outside the scope of a tax-focused commission, such as

infrastructure and workforce development. State tax commissions are also justifiably concerned with other tax priorities (e.g., fairness, simplicity, and modernization) that don't always align with economic development. But commissions would better understand the trade-offs and possibilities involved in any changes to tax policy if they looked more broadly at their state's cumulative efforts on economic development.

## How Commissions Understand Economic Development

State tax commissions typically mention economic development at the outset of their reports.<sup>4</sup> They defined it around competing with other states for jobs and economic growth. Here are some examples:<sup>5</sup>

- **DC:** “[The Commission] considered ways to...increase the District’s competitiveness, encourage business and employment growth.”
- **Georgia:** “Ultimately, the results of these recommendations are to ensure Georgia as a pro-growth, job-friendly state in line with the 21st century economy.”
- **Indiana:** “[Create] an environment in which individuals and businesses seek to locate and expand in the state.”
- **Kentucky:** “Any changes to the tax system should ensure that Kentucky continues to attract jobs and investment to the state, while keeping and protecting the jobs and business we already have.”
- **Maryland:** “Maryland has not nearly reached its potential in growing business and creating jobs.”
- **New York:** “Implementing the Commission’s recommendations would...enhance New York’s economic competitiveness.”
- **South Carolina:** “[E]nsure that our State remains an optimum competitor in its efforts to attract business and individuals to locate, live, work, and invest in South Carolina.”

But most reports stop there. Only seven of the 24 commissions—Georgia, Indiana (in 2014 and 2015), Kentucky, Maryland, Mississippi, and South Carolina—heard testimony or consulted reports from their state’s economic development office. Four commissions—Arizona, California (in 2009), Illinois, and Indiana (in 2014)—had a commission member from an economic development agency.

And few reports attempt to explain what drives business decisions and how state government can affect those decisions.<sup>6</sup> Bourdeaux (2010) summed up state tax commissions’ enthusiasm for economic development but lack of analysis: “States are almost uniformly concerned about their ability to compete for business with other states, although there is no consensus about what part of a tax structure, if any, might be shaping business decisions.”

Instead, most commissions used rankings as a bridge to pro-growth recommendations. As the Minnesota report asserted, “Business executives, entrepreneurs, and investors throughout the world rely on rankings that are often based on statutory tax rates when making decisions about where to locate new or expanded operations.” Some commissions used simplistic metrics, such as ranking of statutory tax rates or per capita tax revenue, to assess their tax systems but others used research reports that analyzed multiple taxes.

The most-cited report was the Tax Foundation’s annual “State Business Tax Climate Index,” which gave each state a score based on its individual income, sales, corporate, property, and unemployment taxes, using criteria that rewarded states that have simple and low (or nonexistent) taxes.<sup>7</sup> Commissions in Georgia, Indiana (2014), Kentucky, Maryland, Mississippi, Oklahoma, and South Carolina cited the Tax Foundation’s rankings. The Tax Foundation report and similar rankings were used to assess the perception of the state’s tax system (e.g., Was the state perceived as high or low tax? Was the state attractive to businesses?) and often contrasted that perception with that of neighboring states.

## What Tax Commissions Recommend for Economic Development

Given that most commissions singled out high taxes as an impediment to economic development, it’s not surprising that the most frequent recommendations were income tax cuts. The DC report summed up many pro-cut opinions: “This large tax cut would signal that the District is ‘open for business’ and, hopefully, boost the city’s tax reputation.”

Of the 24 commission reports analyzed, 16 recommended reducing (or eliminating) the state’s corporate income tax, and 13 recommended reducing individual income taxes (often with the goal of eventual elimination). The commissions that did not recommend cutting the corporate or individual income tax all had restricted objectives such as property tax relief (Illinois) or did not make policy recommendations (California, in 2016).

The other overtly pro-economic development recommendation proposed by multiple commissions was changing how the state taxes multistate corporate income. Traditionally, states have apportioned income using a three-part formula that accounts for a corporation’s payroll, property, and sales within the state. Many pro-business groups now advocate that states adopt a “single-sales-factor” formula based solely on sales to encourage corporations to bring jobs and buildings into the state (Francis 2013). Seven commissions recommended adopting a single-sales-factor formula. (Six other commissions were in states that already used single-sales factor.)

Two other common recommendations (using targeted business tax incentives and expanding the sales tax base) can also affect economic development—even if commissions sometimes ignored their economic impact. Tax incentives were a divisive issue.<sup>8</sup> Many elected officials champion tax abatements, credits, and other incentives as efficient policies for delivering tax relief to favored industries that (they hope) will diversify a state’s businesses and create jobs. However, that specificity is

an anathema to tax policy experts who favor simple and broad taxes with low rates. Seven commissions recommended reducing or eliminating business tax incentives. Georgia's report, which recommended eliminating all economic development tax credits, made the most common argument against tax incentives: "It would be preferable to lower the tax rate for all firms rather than allow tax credits for selective firms." But four commissions favored tax incentives. Minnesota's report admitted tax incentives "are not consistent with good tax policy" but in the next sentence argued the state cannot "unilaterally disarm without making the state fundamentally uncompetitive." Nearly all commissions recommended more rigorous analysis of whether tax incentives work—a policy recommendation that many governments are beginning to implement (Francis 2015).

For the sales tax base, 15 of the 24 commission reports recommended making more goods or services taxable. Having the broadest sales tax base possible is a bedrock of good tax policy, and a broader base generates additional tax revenue, which many commissions used to offset some of their recommended tax cuts. However, businesses newly subjected to taxation often object that new taxes will negatively affect their ability to attract customers. The Maryland commission, the only one to explicitly rule out expanding the sales tax base, argued as much in its report: "Taxes on services, if broadly applied, tend to be particularly harmful to smaller firms."<sup>9</sup>

## Why State Tax Commissions Should Ask More and Broader Questions about Economic Development

If commissions insist on using economic development to justify recommendations, commissions should dedicate more time and research to the issue. Alternatively, states focused on economic development and growth could charge commissions with studying those issues, with tax policy as part of the larger examination.

Every state has an economic development organization.<sup>10</sup> And there are many other public- and private-sector organizations involved in economic development strategy in each state. State tax commissions have typically met with members of this community. However, research and testimony have too often been limited to specific issues.

Kentucky is an illuminating example. The state's economic development agency, the Cabinet for Economic Development, offers numerous services to local businesses. Its website connects entrepreneurs to information about starting a business, workforce training, and finding capital.<sup>11</sup> But the agency's main public contribution to the commission was a letter asking for a tax credit targeted at the bourbon industry. (The commission recommended the tax credit.)

Georgia's report also shows the limits placed on state tax commissions. The commission's chair wrote at the outset of the report that "we know other factors [quality of life, a trainable workforce, infrastructure] have greater weight in [business location] decisions" than taxes, citing his commission's meetings with members of the economic development community. However, the commission recommended large personal and corporate income tax cuts because it was instructed to shift the

state's tax system from taxing income to taxing consumption. The Georgia report then argued (as several reports did) that income tax cuts would attract businesses to the state.

Evidence on the efficacy of tax cuts is mixed. Some research (e.g., Moretti and Wilson [2015]) shows states with low tax rates attract talented workers who can spur business and job growth in their field. Other research (e.g., Gale, Krupkin, and Rueben [2015]) shows cutting state tax rates, including income tax rates, does not lead to state economic growth, and Francis (2016b) shows the flaws of assuming one ideal tax structure for economic growth.

The crucial question is whether tax cuts are the best policy option for economic development or whether they are the best tax policy option when considered in isolation. It's difficult to imagine a business or person turning down a tax cut. But if the choice is a tax cut or investments in education, infrastructure, or job training, the answer might be different. Commissions focused solely on taxes should pose that question to businesses, experts, and government officials if the primary reason given for cutting taxes is economic growth.

Maryland's tax commission differed from all others because it was part of a larger project on economic development, and the results were telling. The commission recommended cutting taxes, arguing the state's existing system was a "detriment" to "attracting and retaining businesses" and creating jobs. But the report also noted that those taxes paid for services that give the state competitive advantages. The report concluded, "the commission believes investments in education at all levels, infrastructure, and public safety should not be compromised as the recommendations proposed here are implemented." The Maryland commission decided tax cuts were an important part of its economic development strategy, but other policies were equally or more important.

## Conclusion

Tax policy—specifically tax cuts—are often policymakers' favorite tool in the state's economic development toolbox but are not always the most effective. Before making recommendations for economic development and growth, state tax commissions should learn more from government, businesses, and residents about what drives development now and what will do so in the future. Commissions do a great job asking these interest groups how taxes affect economic development. But asking for the complete picture would serve everyone better. The independence and thoroughness of commissions could even lead to a new recommendation: the state needs to look beyond taxes to achieve its economic development goals.

TABLE 1

## State Tax Commissions Reports: 2006–2016

State	Year	Report
Arizona	2013	Joint Task Force on Income Tax Reform <a href="http://www.azleg.gov/itr/default.asp">http://www.azleg.gov/itr/default.asp</a>
California	2009	Commission on the 21st Century Economy Report <a href="http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf">http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf</a>
California	2016	Controller's Council of Economic Advisors for Comprehensive Tax Reform <a href="http://www.sco.ca.gov/eo_cea_contextual_framework.html">http://www.sco.ca.gov/eo_cea_contextual_framework.html</a>
Connecticut	2015	State Tax Panel Final Report <a href="https://www.cga.ct.gov/fin/tfs/20140929_State%20Tax%20Panel/CT%20State%20Tax%20Panel%20Final%20Report.pdf">https://www.cga.ct.gov/fin/tfs/20140929_State%20Tax%20Panel/CT%20State%20Tax%20Panel%20Final%20Report.pdf</a>
DC	2014	DC Tax Revision Commission Final Report <a href="http://www.dctaxrevisioncommission.org/">http://www.dctaxrevisioncommission.org/</a>
Georgia	2010	2010 Special Council on Tax Reform and Fairness for Georgians <a href="http://www.terry.uga.edu/media/documents/selig/georgia-tax-reform.pdf">http://www.terry.uga.edu/media/documents/selig/georgia-tax-reform.pdf</a>
Hawaii	2012	Report of the 2010–2013 Tax Review Commission <a href="http://files.hawaii.gov/tax/stats/trc/docs2012/trc_rpt_2012.pdf">http://files.hawaii.gov/tax/stats/trc/docs2012/trc_rpt_2012.pdf</a>
Illinois	2009	Property Tax reform and Relief Task Force <a href="http://tax.illinois.gov/localgovernment/Propertytax/TaskForceReport.pdf">http://tax.illinois.gov/localgovernment/Propertytax/TaskForceReport.pdf</a>
Indiana	2014	Tax Competitiveness and Simplification Report <a href="http://www.in.gov/dor/files/tax-conference-report-final.pdf">http://www.in.gov/dor/files/tax-conference-report-final.pdf</a>
Indiana	2015	Interim Study Committee on Fiscal Policy <a href="https://iga.in.gov/documents/606d992c">https://iga.in.gov/documents/606d992c</a>
Kentucky	2012	Blue Ribbon Commission on Tax Reform to Governor Steve Beshear Kentucky's report is no longer available online. A summary presentation on the report is available here: <a href="http://osbd.ky.gov/Publications/Documents/Presentations/130205_ARPresentation_BlueRibbonTaxCommission.pdf">http://osbd.ky.gov/Publications/Documents/Presentations/130205_ARPresentation_BlueRibbonTaxCommission.pdf</a> . A copy of Kentucky's report is available from the author on request.
Louisiana	2015	Louisiana Tax Study, 2015 <a href="http://murphy.tulane.edu/programs/public-policy/public-finance/louisiana-tax-study">http://murphy.tulane.edu/programs/public-policy/public-finance/louisiana-tax-study</a>
Maryland	2016	Report of the Maryland Economic Development and Business Climate Commission; Phase II: Taxes <a href="http://mgaleg.maryland.gov/Pubs/CommTFWorkgrp/2016-MEDBCC-Report-Phase-II.pdf">http://mgaleg.maryland.gov/Pubs/CommTFWorkgrp/2016-MEDBCC-Report-Phase-II.pdf</a>
Massachusetts	2007	Commonwealth of Massachusetts Study Commission on Corporate Taxation <a href="http://www.mass.gov/dor/docs/dor/publ/pdfs/study-commission-corp-taxation-final-report.pdf">http://www.mass.gov/dor/docs/dor/publ/pdfs/study-commission-corp-taxation-final-report.pdf</a>
Massachusetts	2014	Report of the Tax Fairness Commission <a href="https://malegislature.gov/Content/Documents/Events/TaxFairnessReport.pdf">https://malegislature.gov/Content/Documents/Events/TaxFairnessReport.pdf</a>
Minnesota	2009	Minnesota's Millennium: Launching a New Generation of Competitive Leadership and Economic Growth <a href="http://www.revenue.state.mn.us/research_stats/research_reports/2009/Govs_21_century_TRC_report.pdf">http://www.revenue.state.mn.us/research_stats/research_reports/2009/Govs_21_century_TRC_report.pdf</a>
Mississippi	2008	Mississippi Tax Study Commission Report <a href="http://www.sos.ms.gov/Policy-Research/Documents/6-2008MississippiTax.pdf">http://www.sos.ms.gov/Policy-Research/Documents/6-2008MississippiTax.pdf</a>
Nebraska	2013	Report to the Legislature: LR155–Nebraska's Tax Modernization Committee (2013) <a href="http://www.nebraskalegislature.gov/pdf/reports/committee/select_special/taxmod/lr155_taxmod2013.pdf">http://www.nebraskalegislature.gov/pdf/reports/committee/select_special/taxmod/lr155_taxmod2013.pdf</a>

State	Year	Report
New York	2013	New York State Tax Reform and Fairness Commission Final Report <a href="http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/greenislandandreportandappendicies.pdf">http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/greenislandandreportandappendicies.pdf</a>
New York	2013	New York State Tax Relief Commission Final Report <a href="http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/commission_report.pdf">http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/commission_report.pdf</a>
Oklahoma	2011	Task Force on Comprehensive Tax Reform <a href="http://digitalprairie.ok.gov/cdm/ref/collection/stgovpub/id/25495">http://digitalprairie.ok.gov/cdm/ref/collection/stgovpub/id/25495</a>
Oregon	2009	Task Force on Comprehensive Revenue Restructuring <a href="https://www.oregonlegislature.gov/lro/Documents/final_report_012109.pdf">https://www.oregonlegislature.gov/lro/Documents/final_report_012109.pdf</a>
South Carolina	2010	Final Report of the South Carolina Taxation Realignment Commission <a href="http://www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/FinalDocuments/TRACFinalReport.pdf">http://www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/FinalDocuments/TRACFinalReport.pdf</a>
Vermont	2011	Final Report: Blue Ribbon Tax Structure Commission <a href="http://www.leg.state.vt.us/jfo/reports/2011%20Blue%20Ribbon%20Tax%20Structure%20Commission%20FINAL%20REPORT.pdf">http://www.leg.state.vt.us/jfo/reports/2011%20Blue%20Ribbon%20Tax%20Structure%20Commission%20FINAL%20REPORT.pdf</a>
Idaho	2016	Ad Hoc Tax Working Group <a href="https://legislature.idaho.gov/sessioninfo/2015/interim/taxgrp.htm">https://legislature.idaho.gov/sessioninfo/2015/interim/taxgrp.htm</a>
Missouri	2016	Study Commission on State Tax Policy <a href="http://www.senate.mo.gov/cstp/">http://www.senate.mo.gov/cstp/</a>
North Dakota	2016	Political Subdivision Taxation Committee <a href="http://www.legis.nd.gov/assembly/64-2015/committees/interim/political-subdivision-taxation-committee">http://www.legis.nd.gov/assembly/64-2015/committees/interim/political-subdivision-taxation-committee</a>
Ohio	2016	Ohio 2020 Tax Policy Study Commission No official website

## Notes

1. *State tax commission* refers to a special group established outside the normal legislative process (even if that group is composed solely of elected officials) to make recommendations to improve the state's tax system. Some states have commissions that meet annually or biennially to discuss the state's tax issues. We omitted these commissions from this analysis. We also did not analyze reports focused solely on one aspect of a state's tax system (e.g., tax credits). Table 1 lists the commissions we analyzed.
2. See Liz Malm, "Which States Currently Have Tax Reform Commissions or Study Committees?" *MultiStateInsider*, February 8, 2016, <https://www.multistate.com/insider/2016/02/states-studying-their-tax-systems-can-mean-one-of-two-things-which-states-are-doing-it-now/>.
3. These phrases come from the Georgia, Minnesota, and South Carolina reports, respectively.
4. I was a research analyst for the DC Tax Revision Commission and helped author its final report. My Tax Policy Center colleagues Norton Francis, Tracy Gordon, Steve Rosenthal, and Kim Rueben also contributed to that commission and its final report.
5. Table 1 provides the titles of each state's report and links to an online version.
6. Maryland's report was a notable exception because its tax study was part of a larger study of the state's economic development strategy, The Maryland Economic Development and Business Climate Commission (see "Defunct Legislative Committees, Commissions, Task Forces, and Work Groups," Maryland.gov, last updated May 18, 2016, <http://msa.maryland.gov/msa/mdmanual/07leg/html/com/defunct/secon.html>).
7. Walczak, Drenkard, and Henschman (2015) authored the most recent report, but different commissions used earlier versions. All reports are available at <http://taxfoundation.org>. For a full explanation of the Tax Foundation's methodology, see Walczak, Drenkard, and Henschman (2015).

8. For further exploration of the ways state governments use targeted tax breaks to partner with the private sector, see Francis (2016a).
9. States tax most tangible goods but the taxation of services (e.g., dry cleaning, carpentry work, barbershops) is more complicated. See “How do state and local taxes work?” Urban-Brookings Tax Policy Center, accessed August 29, 2016, <http://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-sales-taxes-work>.
10. Find your state’s organization at <https://www.eda.gov/resources/>.
11. See <http://www.thinkkentucky.com/>.

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## About the Economic Development Strategies Project

The Economic Development Strategies project is a three-year project to assemble comprehensive research on state economic development strategies. The scope of the project goes beyond state tax commissions discussed here to include tax incentives, workforce development, and best practices. This is the seventh of a series of informational briefs that will frame the project.



## About the Author



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