

Since this report's release on August 21, a number of questions have been raised about the report. This memo briefly answers some of these questions. We want to clarify what the report does and does not say about Michigan's economy and public policy. We also want to clarify the report's relationship to other research and information about Michigan's economy and public policy.

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Frequently asked questions

- Are the conclusions of the Competitiveness Report contradicted by the recent report by the Anderson Economic Group (the "Anderson Report")?
- Are the Competitiveness Report's conclusions contradicted by the recent report on the "Best States for Business" by Forbes magazine, which ranks Michigan as forty-fifth?
- Are the conclusions of the Competitiveness Report contradicted by the Tax Foundation's State Business Tax Climate study?
- Are the conclusions of the Competitiveness Report consistent with the results of other studies of the relative "business climate" of the states?
- Is the Competitiveness Report saying that "taxes don't matter"?
- Can economists get "any results they want" when doing studies such as the Competitiveness Report?
- If Michigan's business taxes are close to the national average, what explains Michigan's recent poor economic performance?
- Are the findings of the Competitiveness Report contradicted by Michigan's widespread use of economic development incentives such as the MEGA program? In other words, if Michigan's business taxes are competitive, and if elimination of the Single Business Tax will at most have only a modest effect in increasing economic growth, then why does the state of Michigan believe it necessary to use large tax incentives to attract business growth?
- Are the findings of the Competitiveness Report contradicted by the negative opinions held by many Michigan businesses about the SBT?
- Does the Competitiveness Report support any specific business tax reform for the State of Michigan?
- How does the Upjohn Institute seek to ensure the objectivity of its research?

Q: Are the conclusions of the Competitiveness Report contradicted by the recent report by the Anderson Economic Group (the “Anderson Report”)?

On overall state and local taxes, both the Competitiveness Report and the Anderson Report conclude that Michigan is currently slightly below the national average. (See the Anderson Report, “Benchmarking for Success: A Comparison of State Business Taxes,” by Patrick Anderson and Caroline Sallee.)

Only on average state and local business taxes is there a qualitative difference in the findings of the two reports, and even this difference is not large. The Competitiveness Report concludes that Michigan’s business taxes are modestly below the national average, and the Anderson Report concludes that Michigan’s business taxes are slightly above the national average. Both reports agree that Michigan is not a particularly high business tax state. Nor is Michigan a particularly low business tax state.

A technical appendix to this memo examines in detail the reason for the modest difference between the Competitiveness Report and the Anderson Report about Michigan’s position in average state and local business taxes. Briefly, the difference occurs mainly for two reasons: 1) the Anderson Report does not, in its main text, include as a business tax the sales tax on business inputs, whereas the Competitiveness Report does include the sales tax on business inputs as part of overall state and local business taxes; and 2) the Anderson Report’s business tax data are for Fiscal Year 2004, whereas the Competitiveness Report’s business tax data are for Fiscal Year 2005.

Our view is that the main statistical findings of both reports are quite consistent once one understands what data are examined by the two reports.

Q: Are the Competitiveness Report’s conclusions contradicted by the recent report on the “Best States for Business” by Forbes magazine, which ranks Michigan as forty-fifth?

Our view is that our report and Forbes magazine’s do not consider the same issues, and therefore there is no conflict between the two reports. (See the August 15, 2006 Forbes report.)

Briefly, we conclude that the Forbes overall index of state business climate, and three of the six subindices, are mainly driven by a state’s recent growth experience. Because Michigan has recently grown quite slowly, Michigan ranks poorly for a good business climate in the Forbes report.

Only one of the Forbes subindices, on business costs, seeks to measure business taxes. However, this subindex also includes labor costs, and we believe that it is, indeed, labor costs and not the state’s business tax costs that drive this subindex.

Michigan's poor ranking on the Forbes index tells us that Michigan is growing slowly. This should be of concern to Michigan's citizens. However, the Forbes index has little to do with how competitive Michigan is in business taxes, or with whether business tax cuts will help to significantly increase Michigan's growth, which are central concerns in the Competitiveness Report.

A technical appendix is available which examines what the Forbes report is measuring in more detail.

Q: Are the conclusions of the Competitiveness Report contradicted by the Tax Foundation's State Business Tax Climate study?

The overall ranking of state business tax climates by the Tax Foundation ranks Michigan as twenty-sixth. (See "State Business Tax Climate Index," by Curtis Dubay and Scott Hodge, February 2006.) This is consistent with the Competitiveness Report's conclusion that Michigan is close to average in state and local business taxes.

The Tax Foundation does rank Michigan forty-ninth in its Corporate Tax Index, which is one of five indices that make up the overall State Business Tax Climate Index. This low ranking occurs because the Tax Foundation chooses to compare Michigan's Single Business Tax (SBT) with corporate income taxes in other states.

The state's SBT is not a corporate income tax. The Single Business Tax has a much larger tax base than the typical state corporate income tax. For example, the SBT base includes payroll, not just profits, and the SBT base includes unincorporated businesses, not just incorporated businesses.

The SBT was created in 1975 to replace seven state and local business taxes in Michigan. The previous state corporate income tax was only one of these seven taxes, and in fact constituted only 39 percent of the revenue of the seven state and local business taxes that were replaced by the SBT. (See "The Single Business Tax: Looking Back 30 Years," by Jay Wortley, Michigan Senate Fiscal Agency, March/April 2006.)

The SBT's creation allowed for the elimination of some other state and local business taxes, such as the business property tax on inventories, and the corporate franchise fee, thereby lowering Michigan's business taxes in these areas compared to some other states.

Q: Are the conclusions of the Competitiveness Report consistent with the results of other studies of the relative "business climate" of the states?

There is little consistency to be found when reviewing past "business climate" studies. Peter Fisher provides a good review of studies of state business climates. (See "Grading Places: What Do the Business climate Rankings Really Tell Us?" by Peter Fisher, June 2005.) According to Fisher's review, Michigan's ranking on four other business climate indices includes ranks of sixth best, twenty-fourth, ninth, and thirty-fourth. Therefore, it

is by no means the case that all rankings of state business climate consider Michigan to be an unattractive state.

In addition, it is not clear that these various indices of state business climate in fact provide valid measures of state competitiveness on business taxes or of the overall state business climate. As Fisher points out, the many state characteristics included in these studies, and the weights given these characteristics, are arbitrarily chosen. The resulting rankings do not appear to be highly correlated with measures of overall state and local business taxes.

In contrast, the overall state and local business tax measure that is used in the Competitiveness Report implicitly weights different features of state and local business taxes by a natural metric: how much that feature affects business costs. Similarly, the measure of state and local business taxes on business investment used in the Competitiveness Report implicitly weights different features of state and local tax systems by how much they affect the costs of making investments.

Q: Is the Competitiveness Report saying that “taxes don’t matter”?

No. Business taxes do make a difference to a state’s economic growth, but the overall revenue collected by state and local business taxes is not the sole determinant of state economic growth. A state’s economic growth is affected not only by how much businesses pay in taxes to state and local governments, but also by the tax structure and the public services supported by tax revenue. For instance, different types of business taxes, even if they raise the same revenue, may impose different incremental tax burdens on businesses investing in new plants and equipment or hiring additional workers, and thereby affect these business decisions. How a state and local business tax cut is financed also affects a state’s economic growth. For example, it matters to a state’s economic growth whether a business tax cut is financed by increases in other taxes or by cuts in spending, and it matters whether those cuts in spending affect the quality of public services. Both public spending and the quality of public services affect economic growth.

Specifically, the Competitiveness Report reaches these conclusions about the effects on Michigan’s economy of different ways of eliminating the Single Business Tax (SBT):

- If SBT elimination is financed by cuts in public spending that reduce the quality of public services, the growth in overall (both public and private) employment in Michigan over the next ten years will probably be close to what it would have been if the SBT had been retained. This doesn’t mean that the SBT elimination doesn’t matter to businesses. Rather, it means that the positive effects on Michigan’s economy of SBT elimination are offset by the negative effects of lower public spending and public services.

- If SBT elimination is financed by cuts in public spending that do not reduce the quality of public services, the annual growth rate of Michigan’s overall employment growth over the next 10 years is estimated to be increased by 0.09 percent per year, or an extra 4,000 jobs a year.
- If SBT elimination is financed by extending the sales tax to services, annual state employment growth over the next 10 years is estimated to be increased by 0.13 percent per year, or an extra 6,000 jobs a year.
- If SBT elimination is financed by a new business tax system that collects the same overall revenue but eliminates any incremental tax burden on new capital investment, annual state employment growth over the next 10 years is estimated to be increased by 0.16 percent a year, or an extra 7,000 jobs per year.

All of these effects on Michigan’s annual employment growth are modest in size when compared to Michigan’s current lag in growth behind the U.S. economy of about 1.5 percent a year, or a lag of about 70,000 jobs per year. However, this does not mean that these effects on growth do not matter. They obviously matter to any individual whose employment prospects would be affected by faster Michigan growth.

Q: Can economists get “any results they want” when doing studies such as the Competitiveness Report?

Not if their work is based on sound empirical research and is consistent with economic theory. In our view, findings that are supported by sound research and accepted theories should be given greater weight in making policy decisions.

The Competitiveness Report bases its findings on a large economic research literature that rigorously examines the magnitude of the effects of taxes and public services on state economic development, and uses it a nationally known and carefully reviewed economic model of the state’s economy.

Q: If Michigan’s business taxes are close to the national average, what explains Michigan’s recent poor economic performance?

This question is directly addressed in the Competitiveness Report. The Report finds that Michigan’s poor economic performance since 2000 can be largely explained by the problems of the domestic automobile industry and the multiplier effects this has had on Michigan’s economy.

Q: Are the findings of the Competitiveness Report contradicted by Michigan's widespread use of economic development incentives such as the MEGA program? In other words, if Michigan's business taxes are competitive, and if elimination of the Single Business Tax will at most have only a modest effect in increasing economic growth, then why does the state of Michigan believe it necessary to use large tax incentives to attract business growth?

The widespread and growing use of economic development incentives by Michigan and many other states can be interpreted as being quite consistent with the Competitiveness Reports. The use of these incentives is consistent with the notion that state governments realize that both taxes and public services matter to business location decisions, which is an important theme of the Competitiveness Report. It is also consistent with the Competitiveness Report's suggestion that one way to affect business location decisions is to lower effective tax rates on business investment and reinvestment while maintaining overall revenue and public services. There are several ways to do this. One way is to use economic development incentives to offset the tax burden on investment, which would effectively lower the tax rate on investment and reinvestment. Even states with overall low business taxes, such as North Carolina, frequently use incentives that lower the tax burden on new investment while maintaining public revenues as much as possible; for example, North Carolina recently provided over \$240 million in cumulative economic development incentives for a new Dell plant. Another way is to lower the tax rates on business investment by providing investment tax credits or investment tax deductions, while raising taxes on other business activities that are not as crucial for promoting economic growth.

Q: Are the findings of the Competitiveness Report contradicted by the negative opinions held by many Michigan businesses about the SBT?

Surveys suggest that although most business owners and managers favor repealing the SBT, they also don't feel the SBT has much impact on their own business. Of the businesses polled by EPIC-MRA this year, 71 percent of business owners supported eliminating the SBT. However, when asked whether the SBT helped or hurt their business, or whether it really didn't have a significant impact, 52 percent said it really didn't significantly affect their business, (See the EPIC-MRA report.)

While there is considerable business resentment of the SBT and support for eliminating the SBT, the feeling is not as fervent or universal as one might expect, which may be due to the SBT's modest size compared to overall state and local business tax costs in Michigan, overall labor costs, or business costs in general. It may also be due in part to the large number of businesses that do not pay any SBT.

The relevant issue addressed in the Competitiveness Report is the impact on the economy when elimination of the SBT is financed in a way that may affect some other tax or may affect demand for business goods or services or public service quality. This question is not the same one that businesses are typically asked regarding the SBT. Businesses are

typically asked whether the tax imposes higher costs on their business. They are not asked the followup question of whether or not the reduction or elimination of public services (such as infrastructure or education) would affect their businesses. That's a difficult question for a business owner or manager to answer. It depends on details (such as how much public spending cuts affect demand for the goods and services of Michigan businesses) that are better known from a good econometric model of the Michigan economy than from the experiences of an individual business owner or manager.

Q: Does the Competitiveness Report support any specific business tax reform for the State of Michigan?

No, the report could be consistent with a wide variety of business tax reform policies in Michigan.

Nevertheless, the findings of the Competitiveness Report suggest specific issues that should be considered in deciding on Michigan business tax reforms. These issues include the following:

- Any business tax reform should consider how the proposal will be financed and the economic effects of this financing, as business tax cuts are unlikely to be self-financing.
- Any business tax reform that requires a cut in public spending should consider the economic effects of this public spending cut, and the economic effects of any cuts in public service quality that may occur because of cuts in public spending.
- Business tax reforms should consider the effects of these proposals on the tax burden on business investment or reinvestment.

However, the Competitiveness Report does not consider many other issues that would be important in deciding on a specific business tax reform, including the following:

- The Competitiveness Report does not consider the fairness of the SBT compared to other forms of business taxation.
- The Competitiveness Report does not consider the feasibility of reducing public spending while minimizing negative effects on public services.
- The Competitiveness Report does not do any comprehensive benefit-cost analysis of the specific tax reform proposals analyzed in the report. The true benefits and costs of these proposals go beyond their effects on economic growth.
- The Competitiveness Report does not consider the appropriate mix of business vs. household taxes.

- The Competitiveness Report does not consider the appropriate level of state and local taxes and public services.

Considering any of these issues goes well beyond the scope of the Competitiveness Report, which focuses more on the economic growth impacts of eliminating the SBT under different scenarios.

Q: How does the Upjohn Institute seek to ensure the objectivity of its research?

The Upjohn Institute is an independent, nonprofit, and nonpartisan research organization. Whether research is funded by an outside grant or not, the analysis is based on the best evidence available and on methodologies that are well-accepted by the economics profession. The Institute always makes its final research results public, independent of the funder's opinion of the research. Therefore, the Institute never agrees to funded research projects that are subject to outside censorship and control. These conditions applied to the Competitiveness Report project as well as all our other projects.

Submit your question to webmaster@upjohninstitute.org.