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# Fair Weather or Foul?

## Maine's Business Climate Revisited

“Our vision is a high quality of life for all Maine citizens. Achieving this vision requires a vibrant and sustainable economy supported by vital communities and a healthy environment.” (Maine Economic Growth Council, *Measures of Growth 2002*)<sup>1</sup>

### Introduction

There is no shortage of analyses of the problems of Maine's economy, or of proposed solutions. Once again, a number of recent reports have argued that Maine has a highly unfavorable business climate, characterized by excessive taxes and excessive regulation. These reports go on to argue that Maine must improve its business climate through such suggested changes as an overhaul of the tax system, elimination of property taxes on business equipment purchases, reducing the state's regulatory burden, and reducing Maine's supposedly high “tax burden.” Although the support for these proposals is framed as being “irrefutable,” in reality many of the analyses are based on questionable data and methodologies. Other data also cast doubt on the idea of a “crisis” in Maine's business climate. And it seems reasonable to ask whether the proposed reforms would truly benefit the state as a whole, or whether they would primarily benefit a small number of large corporations which stand to gain disproportionately from these changes.

### Are Business Climate Perspectives Appropriate to Analyze Economic Well-Being?

Business climate studies emphasize a narrow range of economic indicators in analyzing the nature of the economy, such as local and state tax burdens, the availability of tax breaks and incentives for business, the extent of government regulation, and the costs of workers' compensation. Anything which is seen as a cost for business is “bad” because it is regarded as an impediment to investment decisions, employment growth, and profitability, and hence “bad” for the overall well-being of the state and its people. However, these analyses are often simplistic and misleading, by leaving out many other important variables related to economic development.

In contrast, the sustainable economic development perspective used by the Maine Economic Growth Council, the Corporation for Enterprise Development (CFED), and other groups, is an alternative framework which offers a broader and more inclusive picture of the state's economy. For example, the Economic Growth Council makes it clear that the economic well-being of a state is actually a function of a total of 60 interrelated economic and social measures, not simply the “business climate” measures.<sup>2</sup> And, as the CFED points out, “much of what is done in the name of business climate fails to help either a community's business or its residents.”<sup>3</sup>

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<sup>1</sup> Maine Economic Growth Council, *Measures of Growth 2002: Performance Measures and Benchmarks to Achieve a Vibrant and Sustainable Economy for Maine*; Eighth Report of the Maine Economic Growth Council. Augusta, ME: Maine Development Foundation, 2002.

<sup>2</sup> *Ibid.*

<sup>3</sup> William Schweke, Brian Dobson, and Carl Rist; *Improving Your Business Climate: A Guide to Smarter Public Investments in Economic Development*, Executive Summary, Corporation for Enterprise Development, 1996. <http://www.cfed.org/> Follow links: Business Incentive Reform Clearinghouse/Alternatives to Incentives/Improving Your Business Climate (excerpt)

## What About the Business Climate Claims of Harmful and High Corporate Taxes in Maine?

It is often assumed that there is a clear and obvious relationship between tax levels and other business climate indicators, on the one hand, and a state's economic well-being — or business well-being — on the other. However, the growing literature on economic policy and taxation suggests that there is no consistent relationship between the level of taxes in a state, and economic growth<sup>4</sup>. As one economic analyst concludes, “states appear to overestimate the degree to which taxes affect economic outcomes and hence are not very receptive to the finding that taxes have little effect.”<sup>5</sup>

Furthermore, business climate studies which claim that Maine's tax burdens and corporate taxes are threatening the state's economic future are based on doubtful data and methodologies. For example, the recent study by the Institute for a Strong Maine Economy (ISMEC) argues forcefully that Maine's very high tax burden will continue to be a major obstacle for the state's long-term economic well-being, unless there are major reforms in Maine's tax structure to reduce tax burdens. The data cited by the study looks quite alarming, supposedly showing that Maine has the HIGHEST tax burden in the country.<sup>6</sup>

However, one source of the tax data for the ISMEC study is the Tax Foundation, whose methodologies have been dismissed as seriously flawed, even by Federal Reserve Chairman Alan Greenspan<sup>7</sup>. While Tax Foundation figures are being presented by some as irrefutable, other critics such as the Center on Budget and Policy Priorities point out that the methodology used by the Tax Foundation is very misleading. One of the largest problems, for example, is that their tax burden figures are actually based on the taxes of high income households, but the numbers are presented as though they represent average or typical households.<sup>8</sup>

What do others say about the question of Maine's corporate taxes and tax burden? For starters, it is clear that Maine's corporate taxes have not been growing in recent years, as a proportion of total state revenues (in Maine's State General Fund). Rather they have been decreasing slightly, as Figure One<sup>9</sup> demonstrates:

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<sup>4</sup> Michael Wasylenko, “Taxation and Economic Development: The State of the Economic Literature.” *New England Economic Review*, March/April 1997, pp. 46-47.

<sup>5</sup> *Ibid*, p. 48.

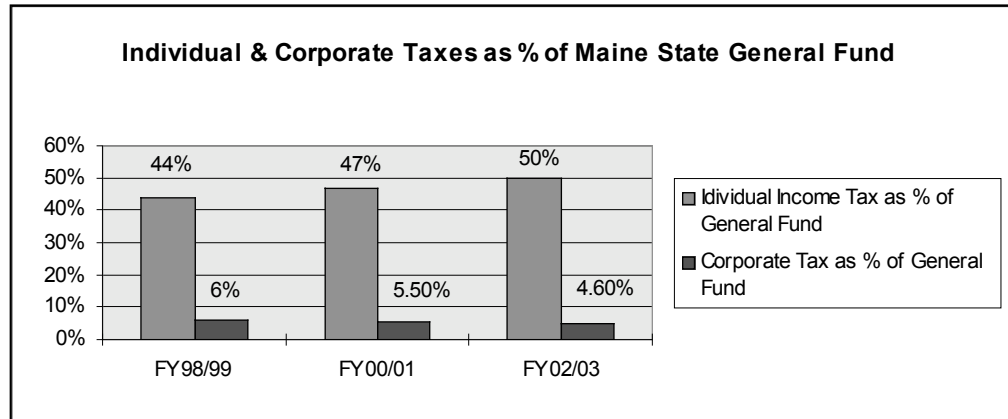
<sup>6</sup> Institute for a Strong Maine Economy. *No Place to Hide: Confronting Maine's Economic Future*, p. 11. [http://www.ismec.org/investors\\_only/whitepaperfinal.pdf](http://www.ismec.org/investors_only/whitepaperfinal.pdf)

<sup>7</sup> Lav, Iris J., et al., “Tax Foundation Figures Lead to Inaccurate Impression of Middle-income Tax Burdens.” Center for Budget and Policy Priorities: <http://www.cbpp.org/4-12-02tax.htm>. Lav also points out a number of other problems with the Tax Foundation's methodology, such as attributing corporate taxes to families that do not earn at a level to incur these taxes; counting capital gains taxes while discounting the income from these same capital gains; and counting some taxes twice.

<sup>8</sup> *Ibid*.

<sup>9</sup>Source: Neves, Anthony. “Challenges for Maine's Tax System,” in *Choices*, vol. VII no. 1, January 23, 2001, p.1. Augusta, Maine: Maine Center for Economic Policy.

**Figure One<sup>9</sup>**



In addition, other recent tax figures do not support the idea of high tax burdens in Maine or of inordinately high corporate taxes compared to other states. For example, U.S. Census Bureau tax data show that in 2000, Maine ranked **18<sup>th</sup>** among the 50 states in corporate income taxes per capita, lower than all other New England states except Vermont and Rhode Island, and only \$3 above the national average.<sup>10</sup> Per capita corporate net income taxes for Maine, at \$118 for 2000, dropped sharply to \$75 for 2001, according to the U.S. Census Bureau.<sup>11</sup> And, despite the hysteria in these business climate reports about Maine's supposed #1 ranking in terms of the tax burden, Maine has actually ranked consistently lower than most other New England states, and certainly not in the top ten. As Table One shows, Maine's national ranking in total taxes per capita fell from 13th in 1999 to 17<sup>th</sup> in 2001. This picture differs quite dramatically from the dire situation offered by ISMEC and other studies calling for lower taxes.

**Table 1: National State Rankings for Total Taxes Per Capita, 1999-2001, New England States<sup>12</sup>**

State	1999		2000		2001	
	Total Taxes	Per Capita Rank	Total Taxes	Per Capita Rank	Total Taxes	Per Capita Rank
Maine	\$2,028	13	\$2,087	14	\$2,074	17
New Hampshire	\$892	50	\$1,372	47	\$1,410	47
Connecticut	\$2,232	1	\$2,987	1	\$3,092	1
Massachusetts	\$2,386	5	\$2,544	5	\$2,700	5
Vermont	\$2,337	6	\$2,436	7	\$2,532	7
Rhode Island	\$1,912	15	\$1,941	18	\$2,118	15

These figures suggest, in other words, that there are some serious problems with the numbers offered in recent business climate reports. In addition, some recent data show that there are some encouraging signs in Maine's economy. For example, Maine's real personal income growth (4.1 percent) and real per capita income

<sup>10</sup> The Public Policy Institute of New York State, Inc. *State Corporate Income Taxes Per Capita 2000*. <http://www.bcnys.org/ppi/2001/00stcorptxpc.htm>.

<sup>11</sup> U.S. Census Bureau, State Government Tax Collections, 2000, and *ibid.*, 2001. <http://www.census.gov/govs/statetax/0020mestax.html>; <http://www.census.gov/govs/statetax/0120mestax.html>.

<sup>12</sup> U.S. Census Bureau: *States Ranked By Total Taxes and Per Capita Amounts: 1999, 2000, 2001*. <http://www.census.gov/govs/statetax/99staxrank.html>; <http://www.census.gov/govs/statetax/00staxrank.html>; <http://www.census.gov/govs/statetax/01staxrank.html>.

growth (“a remarkable 3.3 percent”) in 2001 were significantly HIGHER than either the New England average or U.S. average figures.<sup>13</sup>

## **Are Lower Corporate Taxes and Less Regulation Good for All of Maine’s Citizens?**

At its core, the business climate perspective has two siren calls which are described as urgently necessary to help the state as a whole: lower corporate taxes and reducing “excessive” state regulation. Are these really for everyone’s benefit, in the long run?

As Figure One shows, corporate taxes as a proportion of Maine’s general fund have been decreasing slightly in recent years. Projected shortfalls in the state budget are already creating major headaches for state policymakers, and are likely to have negative impacts on the public as programs are cut. This may not be the best time to reduce revenues further by additional cuts in corporate taxes. Recent analyses have also shown that corporate tax expenditures such as the BETR program (the Business Equipment Property Tax Reimbursement) and other business tax breaks are growing at an astronomical rate, and such expenditures are in effect decreasing state revenues still further. As pointed out earlier, the BETR program alone “will have drained \$143.5 million from state resources in the five-year period from FY 1997 through FY 2001.”<sup>14</sup>

In addition, data on the BETR program and on other state tax incentives show that it is primarily large businesses which are benefiting.<sup>15</sup> Many of the very largest corporations in the state receive double tax breaks on the same investments through BETR and TIF (Tax Increment Financing) tax refunds (a practice known as “double dipping”).<sup>16</sup> Small business owners, on the other hand, are left to struggle for their existence in the context of skyrocketing health insurance costs, which put health insurance virtually out of reach for both owners and employees.

Finally, the fact that the corporate businesses climate premise calls for less regulation raises an interesting question: would most Maine citizens really want to return to the kind of conditions that existed in Maine prior to the development of effective governmental regulations in recent decades? These were the reality before such regulations: polluted rivers and air, no control over the dumping of toxins such as mercury, and dangerous levels of lead in homes. Businesses were free to discriminate against employees or customers, and people had few protections from fraudulent business practices. Workers had significantly less safety protections on the job before OSHA regulations. It is doubtful that a retreat from such regulations would benefit anyone but a small number of large businesses.

As a state, we place a high value on a clean, safe and livable environment, in both the home and the workplace, as well as in the wild. This is one of the features of Maine’s quality of life that attracts many people to live in Maine, and it is critical to attracting qualified and skilled workers, as well as entrepreneurs looking to

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<sup>13</sup> “Economic Insight/State Edition: Maine,” Economic Information Systems, <http://www.econ-line.com>. Also, according to this source, Maine’s employment growth ranked number one in the nation in 2001 (1.2 percent, compared to .9 percent for the U.S. as a whole).

<sup>14</sup> Bureau of Labor Education, “Maine’s Development Dilemma: 2001 Update”, Winter/Spring 2001, p. 3. (Online version available as a PDF file at <http://dll.umaine.edu/ble>, scroll down and follow link.

<sup>15</sup> Orlando Delogu, “‘BETR’ is a Windfall to a Handful of Corporations and Unfair to Everyone Else.” Augusta, ME: Maine Center for Economic Policy, February 2000. [http://mecep.org/MEChoices00/ch\\_2\\_00.htm](http://mecep.org/MEChoices00/ch_2_00.htm).

<sup>16</sup> Bureau of Labor Education, *ibid.*, and Arn H. Pearson and Lisa Prosiensky, “Anatomy of a Tax Loophole: How Corporate ‘Double Dipping’ Costs Maine Taxpayers Millions.” Portland: Maine Citizen Leadership Fund, 2000.

create sustainable businesses.<sup>17</sup> In sum, lower corporate taxes and reduced regulation for businesses will largely benefit only one sector of the state, and not the population as a whole.

## CONCLUSIONS

The current calls for a more welcoming business climate are not anything new, for the most part, but are a repetition of familiar corporate themes: taxes are too high, we have too many regulations. While tax reform in Maine may indeed be necessary, given the inordinately high level of local property taxes in our current system, the tax burden faced by individuals and households needs to be carefully distinguished from the tax responsibilities of corporations.

It's important to note that many of Maine's economic problems have their roots in national trends. The political shift since 1981 towards less regulation, reduced corporate taxes, decentralization, and devolution from the federal government to state and local governments is in large part responsible for the serious fiscal challenges currently faced by states and municipalities nationwide.<sup>18</sup> The simple solutions offered by business climate advocates are not likely to alleviate the challenging and complex fiscal problems that Maine will be facing over the next few years. Rather, they will help the few, at the expense of the many.



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<sup>17</sup> Corporation for Enterprise Development. *Key Findings for 2001, Natural Resource Management and Performance*. <http://drc.cfed.org/?section=main&page=kf4>.

<sup>18</sup> "Toward A System of Public Finance for the 21<sup>st</sup> Century: A Framework for Public Discussion"; Fiscal Transitions Panel, National League of Cities; July 2000, p.1. (<http://www.nlc.org/pubfin.pdf>), p. 3.