# ECONOMIC GROWTH STRATEGIES

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Good afternoon. Thank you for the opportunity to speak to you on "improving economic growth." It is good that your group sees the importance of this issue. Since 2000 the US has grown at an average rate of 2.1% while Pennsylvania has growth at 1.6%. And of course, as you know, if the state on average is lagging behind, big parts of our state are lagging even further behind, while a few prosperous areas pull the load.

This situation can be fixed, though, and we at the Commonwealth Foundation think the solutions are actually quite simple. Also, let me give you a bit of good news: just this month the business news service Blomberg ranked the 50 states on what it called economic diversity: the variety of balance of industries in each state. Pennsylvania ranked #1.[1] The days of dependence on heavy industry are long gone. Gas is a wonderful resource to have but we aren't overly dependent on that either. We have a good base from which to grow and the industries we need are already here.

To grow faster from Pennsylvania's solid industrial base, though, we must to do the following:

(1) Keep people in the state
(2) Become more attractive to the investors and high earners who bring financial capital
(3) Ensure that everybody in the state who can work, is working.

More workers and more capital equals more growth.

When I say keep people in the state I am referring to the fact that in the five years ended 2017 Pennsylvania had net outmigration of almost 100,000 people, that is, 55 people a day, and about 2/3rds of those were aged 20-34: people who are starting out in life and looking for opportunities but apparently don't see them in Pennsylvania. The educational attainment group with the biggest outmigration were people with a college degree or more.[2]

It's hard to make your state grow faster when the most dynamic slice of your population is leaving. Why is this happening? The reasons why people move are varied and they include things like weather that can't be controlled. But we do know something important about migration in aggregate. A study from the Cato Institute, *Tax Reform and Interstate Migration*, very strongly

[1] "Recipe for Most Diverse Economy Starts With Steel and Chocolate." Lee Miller and Wei Lu, Bloomberg News, August 5, 2019. https://www.bloomberg.com/news/articles/2019-08-05/recipe-for-most-diverse-economy-starts-with-steel-and-chocolate

[2] PA Independent Fiscal Office. "Migration Data by Age Group and Educational Attainment." July 2, 2019. http://www.ifo.state.pa.us/Releases.cfm?id=282

shows that while there are other moving parts, there is a definite flow of people from high tax states to low tax states. I won't rehash the study here except to say the evidence is very clear.[3] And, hardly any state is a higher tax state than Pennsylvania.

The median Pennsylvania household pays 13.8% in combined state and local taxes or about $8,000 per household, according to the personal finance service Wallethub.[4] Only Connecticut and Illinois have a higher tax burden, and both of those states have very severe economic problems, partly as a result.

A lot of the tax burden in Pennsylvania is admittedly at the local level but the state personal income tax of 3.07% is not as low as it looks. This is because, unlike any other state, Pennsylvania specifies eight different classes of income depending on source. Each one is treated separately and you can't carry losses from one to reduce your liability in another. This is a big penalty to people who own small businesses or do a lot of investing, exactly the type of people this state needs to retain and attract.

The state should collapse these eight classes into one and it should cut the rate at least down to 2.8% which is where it was before the last hike, during the Rendell administration. Revenue offset could be achieved by broadening the base on the state sales tax, which currently has 23 exception categories.

It is important to act now on personal taxation because a change in the federal treatment of state and local taxes (no longer fully deductible at the federal level) has many high earners in states like New York, New Jersey and Connecticut re-evaluating their place of residence. If Pennsylvania were to lower its own state and local tax burden, it has a once-in-a-generation chance to pull a tremendous amount of income and investment capital into the state.

The corporate tax rate, at 9.99%, may be an even bigger problem than the personal tax rate. It is the third highest in the nation and even Governor Wolf favors cutting it. In addition to lowering the rates the state should allow more use of net operating losses: that is, the ability to use business losses incurred in past bad years to offset tax liability in good years. Pennsylvania is one of just two states that cap the use of NOLs, which makes little sense since it particularly harms the kind of cyclical, high-fixed-cost manufacturing and heavy industrial firms that employ high-wage technical labor and that Pennsylvania wants to keep.

Revenue offsets here can come from ending Pennsylvania's $800 million in corporate welfare: giveaways to private business in order to try and induce more hiring or more innovation. As I said at the outset: Pennsylvania has the industrial base that it needs. We don't need to bribe corporations to come. Also, it makes little sense to overspend on special favors for individual well-connected businesses when we could just cut taxes for every business in the state. Commonwealth

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[3] Edwards, Chris. Tax Reform and Interstate Migration. Cato Institute: September 6, 2018. https://www.cato.org/publications/tax-budget-bulletin/tax-reform-interstate-migration

[4] "Worst States to be a Taxpayer." John Kiernan, Wallethub, March 12, 2019. https://wallethub.com/edu/t/best-worst-states-to-be-a-taxpayer/2416/

Foundation estimates that by eliminating corporate welfare we could afford a revenue-neutral cut in the corporate income tax down to about 7%.

Another point on the spending side: I mentioned the Taxpayer Protection Act in the morning session as a means to improve budgeting practice and contain spending. I want to emphasize here that this legislation is also a *growth measure*. Spending discipline creates the space to cut taxes, and it keeps more money in people's pockets.

Away from taxes, pursue regulatory simplification. Every little bit helps. The PA code contains 154,000 rules totaling 13 million words according to the Mercatus Center at George Mason University. If you were to read it end-to-end continuously without stopping, it would take you six months. A law that requires the repeal of two unnecessary rules for each new one created would be a huge pro-business gesture. Something similar was just put in place by executive order at the federal level in 2017.

Tax and regulatory reform together will help retain people and money in the state and, if done right, attract them. But we can also unleash more of the human resources we already have, and reduce poverty in the bargain. We can do that by ensuring that everybody in Pennsylvania who is able to work, does work.

About this time last year the Pittsburgh Post-Gazette published an excellent report called "The Vanishing Rural Workforce," quoting many employers in West-Central PA, many offering wages above $15 with training and benefits, who were having trouble hiring.[5] Strangely this was happening side-by-side with the heavy use of disability benefits by working age men in those same areas. A commentary piece published by one of my colleagues in Investors Business Daily around the same time gave the example of Channellock, a well-known tool brand headquartered in Meadville, Crawford County.[6] Again, the president of that company offers high wages and a training program and he can't fill vacancies. In light of situations like this it is terrible when you see the department of Human Services report that there are hundreds of thousands of able-bodied childless Medicaid recipients who report no income, or that more than 200,000 people on food stamps are not working. The measure of a humane social policy isn't how many people are using it long term: quite the opposite! The measure of success is how many people can get away from it and into stable work. In this present economic environment we know the jobs are there. People respond to both expectation and incentive, so while there should be more work requirements for beneficiaries, we also need to make sure our programs give good incentives. Benefit cliffs, whereby a worker can lose his benefits if he takes more hours or gets a raise, need to be eliminated.

As I said at the outset this is all pretty simple. Keep people in the state, incentivize work, give people money by cutting their taxes. That's the formula for economic growth. Thank you.

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[5] "Vanishing Rural Workforce: Fayette County Employers Struggle to Fill Jobs." *Pittsburgh Post-Gazette.* Kris Mamula. July 18, 2018. https://www.post-gazette.com/business/career-workplace/2018/07/18/Vanishing-rural-workforce-Fayette-County-employers-struggle-to-fill-jobs/stories/201807150035

[6] "Work Requirements Could Solve Missing Workers Crisis." *Investors Business Daily*. Commentary piece by Charles Mitchell. December 11, 2018. https://www.investors.com/politics/commentary/work-requirements-missing-workers/