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AND
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TAX EXPENDITURES AND ECONOMIC DEVELOPMENT

Executive Summary

For the next several years, the Commonwealth will continue to face two significant challenges: one economic, the other fiscal. Nearly two and a half years have now passed since the official end of the 2001 recession, yet Massachusetts continues to struggle to recover from it. In fact, between March 2001 and January 2004, the Commonwealth witnessed a 6.3 percent decline in payroll employment, the steepest drop in the nation and a total loss of more than 211,000 jobs. In addition, Massachusetts must cope with a budget deficit in excess of a billion dollars for the fourth consecutive fiscal year. A portion of this deficit is attributable to the Commonwealth’s sluggish economy, but permanently reduced revenue levels resulting from tax cuts enacted over the past decade are more to blame.

Given these challenges, this report examines an issue that lies at their intersection – namely, the Commonwealth’s efforts to use tax expenditures to promote economic growth and to foster job creation. Among its central findings are the following:

• Tax expenditures intended to promote economic development in Massachusetts are projected to total approximately $1.3 billion in FY 2004, an amount equal to 12.8 percent of tax expenditures generally.¹ Tax expenditures to achieve such ends are concentrated within the corporate income tax; in FY04, economic development tax expenditures within the corporate income tax are anticipated to reach $810 million. Economic development tax expenditures within the personal income tax are expected to be $108 million.

• In the aggregate, the amount of revenue Massachusetts annually forgoes as a result of economic development tax expenditures has remained relatively constant over the last ten fiscal years.

➢ However, economic development tax expenditures within the corporate income tax grew substantially during the past decade, while those within the personal income tax declined appreciably. Between FY 1995 and FY 2004, corporate income tax expenditures for economic development purposes rose more than $218 million, from $591.7 million to $810.3 million; expressed as a percentage of corporate income tax receipts, they rose from 53.6 percent to 80.8 percent over that ten year span.

¹ All figures in this report are expressed in constant FY 2003 dollars, except where otherwise noted.
• While personal income tax expenditures geared towards economic development fell by 10.2 percent per year, much of the decline can likely be attributed to reductions in the personal income tax rate. (The value of tax expenditures rises and falls with changes in tax rates. Thus, the reductions in the personal income tax rate that were put in place in 1999 and 2000 have reduced the value of tax expenditures within the personal income tax.)

• Economic development tax expenditures dwarf appropriations made for the same purpose. In FY 2004, economic development appropriations are expected to total $219.7 million – or nearly one-sixth the value of tax expenditures made to achieve similar ends. Even at their peak over the last ten fiscal years – $261.7 million in FY 2001 – economic development appropriations were still less than one-fifth of the economic development tax expenditures made that year.

• While tax expenditures constitute one of principal means through which the Commonwealth attempts to attract and to retain businesses, a new comprehensive review of the national evidence on state tax policy and economic development suggests that the resources Massachusetts dedicates to such tax expenditures could be used more effectively elsewhere. In *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Robert G. Lynch, the Chairman of the Department of Economics at Washington College, shows that there are “little grounds to support tax cuts and incentives – especially when they occur at the expense of public investment – as the best means to expand employment and spur growth.”

• At the same time, most public sector evaluations of corporate tax incentives available in the Commonwealth either have not been conducted, despite legal requirements that they occur annually, or have found that such incentives have not met their economic development goals. Research conducted by private sector organizations suggests that corporate tax incentives have led to job growth, but that research appears to be fundamentally flawed, as it simply assumes that the Commonwealth does not have to pay for corporate tax incentives.

• As the Legislature crafts its fiscal and economic strategies for the years ahead, it should recognize the annual billion-dollar commitment the Commonwealth currently makes to economic development tax expenditures and determine whether continuing to allocate Massachusetts resources in that manner is the most effective means of stimulating economic growth. In particular, it should consider whether re-allocating some portion of that billion-dollar sum, either to direct appropriations for economic development purposes such as worker training and technical assistance or to support for core government services like education, might better achieve sustained and widespread economic prosperity over the long run.
Introduction

Each year, as the Legislature crafts its version of the Commonwealth’s budget, it must strive to meet a wide variety of challenges. In recent years, two in particular have stood out: one economic, the other fiscal.

Nearly two and a half years have now passed since the official end of the 2001 recession, yet Massachusetts continues to struggle to recover from it. Of particular concern, the latest data from the U.S. Bureau of Labor Statistics indicate that Massachusetts has experienced the sharpest drop in employment of any state in the nation since the start of that recession. Between March 2001 and January 2004, the Commonwealth witnessed a 6.3 percent decline in payroll employment, a total loss of more than 211,000 jobs. To be sure, employment across the country has suffered as well, but the national decline has been much less severe – just 1.8 percent over the same span. In fact, the decline in employment in Massachusetts has been so protracted that total payroll employment is now at its lowest point since January 1998, meaning that all of the employment gains associated with latter portion of the 1990s boom have been erased.

At the same time, Massachusetts must cope with a sizable budget deficit for the fourth consecutive fiscal year. The Executive Office of Administration and Finance indicated last July that it expected a deficit in excess of $1 billion in FY 2005, while more recent press accounts reveal that the House Ways and Means Committee estimates that the gap may be as much as $1.5 billion. A portion of this deficit is attributable to the Commonwealth’s sluggish economy, but permanently reduced revenue levels resulting from tax cuts enacted over the past decade are more to blame.2

Given these particular challenges, it is worth examining an issue that lies at their intersection – namely, the Commonwealth’s efforts to use tax policy to promote economic growth and to foster job creation. State policymakers allocate hundreds of millions of dollars of the Commonwealth’s economic resources each year through preferences embedded in the state’s tax code known as tax expenditures. Though often overlooked, tax expenditures share many common features with direct appropriations. Both have the same fiscal impact and both seek to achieve the same goals; in the case of economic development, they aim not only to help workers acquire the skills they need, but also to attract employers to the Commonwealth and to retain those already based here. There are two key differences between tax expenditures and direct appropriations, however. In sharp contrast with direct appropriations – which must be renewed each year

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2 For more information on the source of Massachusetts’ structural deficit, see Trading Places: The Role of Taxes and Spending in the Fiscal Crisis, Massachusetts Budget and Policy Center (February 13, 2003), available at www.massbudget.org.
and are thus continuously reviewed, assessed, and altered – tax expenditures, once enacted, are largely permanent and subject to little subsequent scrutiny. Moreover, a substantial body of research suggests that many tax expenditures may not be as cost-effective as direct appropriations in achieving their stated economic development goals.

Accordingly, this report describes the extent to which the Commonwealth has relied on tax expenditures as a means of promoting economic development over the past ten years. It also discusses the shortcomings of this approach to promoting economic development, reviewing a new major national study on the impact of tax policy on economic development, as well as efforts to evaluate Massachusetts’ business tax incentives.

One further point should be made here at the outset. The focus of this report is, obviously, upon tax expenditures (and, to a lesser extent, direct appropriations) specifically intended to stimulate economic growth and to bolster Massachusetts’ collective skill base. However, many of the budgetary policies the Commonwealth pursues simply to enhance the quality of everyday life for its citizens – from support for public universities to the maintenance of roads – also help to make Massachusetts a desirable place to do business. Therefore, in weighing the effectiveness of certain tax expenditures, consideration should be given to the outcomes that might result from redirecting those resources towards programs and services that advance not only the Commonwealth’s economic well-being but its social interests as well.

**Tax Expenditures – A Primer**

As even casual observers of events on Beacon Hill can attest, the annual appropriations process consumes a great deal of time and energy. It begins in December, when executive branch agencies transmit to the Executive Office of Administration and Finance (EOAF) estimates of the funding required to maintain the programs that they manage and the services they provide. It continues on through April and May when the House of Representatives and Senate debate their versions of the budget and lasts until the Governor signs the final version of the Legislature’s budget into law, which may or may not occur before the start of the fiscal year on July 1st. During that span of six-plus months, dozens of hearings take place, scores of press conferences are held, and thousands of constituents meet with their elected officials, all with the intent of influencing how the Commonwealth uses its resources to meet public needs.
Of course, despite the effort they require and the attention they receive, direct appropriations are by no means the only way in which the Commonwealth provides funding for public services, economic development initiatives included. The Commonwealth also forgoes millions of dollars in tax revenue each year – due to provisions in Massachusetts tax law known as tax expenditures – to draw businesses to the state or to encourage them to engage in certain kinds of behavior.

Near the start of each calendar year, as required by law, EOAF releases a Tax Expenditure Budget for the coming fiscal year. The Tax Expenditure Budget lists the various tax expenditures related to three types of taxation in Massachusetts – the personal income tax, the corporate excise tax, and the sales and use tax – and provides estimates for the amount of revenue lost due to each one. It defines tax expenditures as follows:

Tax expenditures are provisions in the tax code, such as exclusions, deductions, credits, and deferrals, that are designed to encourage certain kinds of activities or to aid taxpayers in special circumstances. When such provisions are enacted into the tax code, they reduce the amount of tax revenues that may be collected. In this sense, the fiscal effects of a tax expenditure are just like those of a direct government expenditure. Some tax expenditures involve a permanent loss of revenue, and thus are comparable to a payment by the government; others cause a deferral of revenue to the future, and thus are comparable to an interest-free loan to the taxpayer. Since tax expenditures are designed to accomplish certain public goals that otherwise might be met through direct expenditures, it seems reasonable to apply to tax expenditures the same kind of analysis and review that the appropriations budget receives.3

In other words, tax expenditures are, in effect, identical to spending appropriated through the annual budget process. Both seek to achieve certain policy goals through the use of the state’s economic resources. Both tax expenditures and appropriated spending are financed by the taxes and fees that individuals and businesses pay. While the link between taxes paid and appropriated spending may seem more direct – the money comes in, the money goes out – the link between taxes paid and tax expenditures – the money doesn’t come in at all, so other taxes have to be higher – is no less strong. In the end, both tax expenditures and appropriated spending have the same ramifications for other programs and the same impact on the state’s bottom line. Resources foregone because of tax expenditures – just like resources used for line-item appropriations – can not be used to meet other needs.

Admittedly, there are some differences between tax expenditures and appropriated spending, but these differences are largely advantages that tax expenditures enjoy over appropriated spending. More specifically:

- **Tax expenditures occur automatically.** When the Legislature and the Governor decide to create a program – for instance, a new homeland security initiative – or even to continue an existing one – such as aid to local school districts – they must approve funding for it each and every year, no matter how dire the need it meets or how popular it may prove with the public. If revenue becomes insufficient or if other spending priorities become more important, then the merits of sustaining that program must be carefully weighed. Ultimately, if funding is not approved for that program, then it ceases to operate.

  In contrast, when the Legislature and the Governor agree to create a new tax expenditure, it is fixed in place, with no need for annual approval and without regard to existing fiscal conditions. In this respect, it may be considered the converse of appropriated spending. Rather than requiring a vote in favor of continuation, a tax expenditure continues until a vote in favor of eliminating it occurs.

- **Tax expenditures are more politically palatable.** Ask most legislators how they would like to be portrayed – as someone who cut taxes or someone who increased spending – and chances are good that their answer will generally be the former. As a result, it’s easy to see how tax expenditures, since they are often described as tax cuts, are frequently perceived as the more viable option for achieving a particular goal.

  Tax expenditures may not receive as much scrutiny as appropriated spending, but their impact on the state’s fiscal picture should not be overlooked. Tax expenditures for the current fiscal year for the three major types of taxes that the Commonwealth collects – the personal income tax, the corporate income tax, and the sales tax – are expected to reach $10.1 billion, or more than three-quarters of the total amount of revenue these three forms of taxation are expected to generate in FY 2004. In other words, in the absence of tax expenditures, Massachusetts would be expected to collect $22.8 billion in FY 2004.

4 This report excludes from its analysis the tax expenditure Massachusetts incurs for its failure to levy the 5 percent sales tax on sales of services. According to the most recent Tax Expenditure Budget issued by the Executive Office for Administration and Finance, this particular tax expenditure will cost the Commonwealth $4.2 billion in FY 2004 (expressed in constant FY 2003 dollars). If this tax expenditure were included, it would comprise roughly 30 percent of all tax expenditures in Massachusetts. Moreover, methodological changes adopted by the Department of Revenue within the 10 year time frame used in this report have more than tripled the estimated annual cost of this tax expenditure. Thus, including this tax expenditure would skew the results of the overall analysis. References to “tax expenditures” for the remainder of the report should be taken to mean all personal income tax, corporate income tax, and sales tax expenditures, excluding the tax expenditure incurred from the failure to tax sales of services, unless otherwise specified. Lastly, all figures in this report are expressed in constant FY 2003 dollars.
from the personal income tax, the corporate income tax, and the sales tax, rather than the $12.7 billion these three taxes are currently projected to yield.\textsuperscript{5}

**Figure 1.**

![Graph showing Tax Receipts and Tax Expenditures, FY95-FY04](image)

As Figure 1 indicates, tax expenditures have grown considerably over the past decade. In FY 1995, tax expenditures amounted to $7.8 billion; for FY 2004, they are expected to reach $10.1 billion, reflecting a real annual growth rate of 2.9 percent. Obviously, some portion of this growth can be attributed to the overall rise in revenue – as the underlying tax base grows, so too do the value of tax expenditures. In the end, though, the real annual growth rate for the three main categories of tax revenue between FY 1995 and FY 2004 was just 1.2 percent, meaning that tax expenditures grew more quickly than tax revenue overall. This growth can also be seen if one looks at tax expenditures as a share of revenue collected. In FY95, tax expenditures amounted to 69.2 percent of the three affected categories of revenue while, in FY04, they were 79.7 percent.

\textsuperscript{5} On one hand, this may overstate the amount of revenue the state could expect to collect in the absence of tax expenditures, as it fails to take into account any interaction that may occur between various tax expenditures. On the other, the annual Tax Expenditure Budget fails to include estimates for many provisions in the tax code that EOAF has identified as tax expenditures, thus reducing the final total. FY 2004 revenue estimates for the personal income, corporate income, and sales taxes are taken from the Department of Revenue’s Benchmark Ranges (which have been updated in accordance with the January 15, 2004 announcement of a consensus revenue estimate for fiscal year 2005).
It should also be noted that the amount, and the share, of tax revenue dedicated to tax expenditures varies with the form of taxation, as seen in Figures 2 through 4. Of the three forms of affected revenue, tax expenditures within the sales tax are the largest, both in dollar terms and as a share of revenue foregone. In FY 2004, sales tax expenditures are expected to be $5.5 billion, which represents 152 percent of the total amount of revenue this tax is projected to yield. Restated slightly differently, the sales tax will give up, through tax expenditures, almost one and a half times the amount of revenue it expects to bring in to the Treasury in FY 2004. Corporate income tax expenditures are estimated to be $947 million, an amount equal to 95 percent of anticipated revenue. Finally, personal income tax expenditures mean that the Commonwealth will likely forego an additional $3.6 billion in tax revenue in FY 2004; such expenditures amount to 45 percent of personal income tax revenue overall.

Figure 2.

Of course, just as the purposes for which funds are appropriated each year vary widely, so too do the purposes for which the Commonwealth makes tax expenditures available. Of note, a significant fraction of those tax expenditures are designed to enhance the equity of the tax system as a whole. For instance, in FY 2004, the Commonwealth is expected to forego a total of $857.6 million in revenue in order to exempt purchases of food, clothing, and medical supplies from the sales tax. That tax falls more heavily on low-income families and individuals, since they dedicate a larger portion of their incomes to basic consumption; without those exemptions, the sales tax would be even more regressive. The remainder of this report focuses on just one class of tax expenditures: those intended to foster economic development in Massachusetts.
Tax Expenditures for Economic Development

One similarity between direct appropriations and tax expenditures is that they often attempt to achieve the same broad policy goals. For instance, just as Massachusetts appropriates considerable sums each year to provide health insurance coverage to people across the state, so too does the Commonwealth annually forego a sizable amount of tax revenue in order to exempt from taxation the compensation that individuals receive in the form of employer-provided health care. Similarly, each year, the state budget funds a number of different child care programs; at the same, under certain circumstances, the tax code allows people who incur child care expenses out of their own pockets to deduct a portion of those costs in determining the taxes they owe. Most importantly – in the context of this report – just as Massachusetts spends millions of dollars through the appropriations process to promote economic development, so too does the Commonwealth devote a wide array of tax expenditures to the same purpose.

In fact, of the more than 175 tax expenditures identified by EOAF, at least 60 appear to be designed to promote economic development. To be sure, only a few of these appear to be intended to aid individuals in acquiring the skills they need to succeed in the labor force – such as the tuition tax credit – or to prod employers to employ certain groups of workers – such as the deduction for businesses located in a poverty area. Instead, the large majority of these expenditures are aimed at directly reducing the costs businesses incur, especially those for capital investments.

In designating a particular tax expenditure as one devoted to economic development, this report relies on a recent study conducted by the Council on State Governments (CSG) for guidance. The study, released in 2000 and entitled State Business Incentives: Trends and Options for the Future, defines business tax incentives as “any credits or abatements of corporate income, personal income, sales-and-use, property or other taxes to create, retain or lure business.”6 The study also lists fifteen different types of business tax incentives, including sales and use tax exemptions for new equipment, tax exemptions for raw materials used in manufacturing, tax incentives for the creation of new jobs, tax exemptions to encourage research and development, and accelerated depreciation schedules for industrial equipment. It finds that Massachusetts offers each of these different types of incentives, with one exception: Massachusetts does not offer tax credits for the use of specified state products.

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All told, as Figure 5 shows, workforce and economic development tax expenditures in Massachusetts are expected to total roughly $1.3 billion for FY 2004. This amount equates to 12.8 percent of tax expenditures generally and to 10.2 percent of the three categories of affected revenue. As Figure 5 further demonstrates, such tax expenditures are concentrated principally within the corporate income tax code. For FY04, economic development tax expenditures within the corporate income tax are anticipated to reach $810 million, 85.6 percent of corporate tax expenditures and 80.8 percent of corporate income tax revenue as a whole. In contrast, economic development tax expenditures within the personal income tax are expected to be $108 million in FY 2004 or just 1.3 percent of personal income tax revenue. The comparable figures for economic development tax expenditures through the sales tax are $375 million or 10.4 percent of all such revenue. Finally, it is worth pointing out that the decline in economic development tax expenditures between FY01 and FY02 is not due to conscious efforts to reduce the availability of such expenditures, but is largely the result of the national recession that lasted from March to November of 2001.

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7 Examples of the corporate income tax expenditures that are not considered among those relating to economic development for the purposes of this report are the deductions that companies are permitted to use for expenses for the removal of barriers to the handicapped (Item 2.303 in EOAF’s annual Tax Expenditure Budget) and for certain expenditures for alternative energy sources (Item 2.312).
Of the tax expenditures for which the annual Tax Expenditure Budget provides revenue estimates, the five largest that are designed to promote economic development (and the revenue loss attributable to each in FY 2004) are as follows:

- **Unequal weighting of sales, payroll, and property in corporate excise apportionment formula ($232.6 million)** To determine the corporate income tax liability of companies that operate in multiple states, state tax laws rely on what is known as an apportionment formula. Traditionally, states have used an equally-weighted, three-factor apportionment formula, which averages the share of a given corporation’s total property that is situated in the state, the share of the corporation’s total payroll that is located in the state, and the share of the corporation’s sales that are made in the state. This formula is the result of a broad consensus that states that provide services to a corporation’s property and workers, as well as states that provide a market for the corporation’s output, should be able to tax a portion of the corporation’s profits.

  Massachusetts deviates from this formula in two respects. First, as a result of changes in tax law adopted in the mid-1990s (discussed in greater detail later in this report), defense contractors, manufacturers, and mutual fund companies all base their tax liabilities in Massachusetts solely on the fraction of their total sales that they make within the Commonwealth. Second, the apportionment formula used by all other corporate tax filers, rather than giving equal weight to all three factors, gives double weight to the sales factor. These deviations, in turn, are deemed to be a tax expenditure in EOAF’s accounting.

- **Sales tax exemption for materials, tools, fuels, and machinery used in manufacturing ($220.1 million)** Under Massachusetts law, purchases of materials, tools, fuels, and machinery that are later used in the manufacturing process are exempt from the sales tax if they either become part of the product to be sold or are consumed or directly used in the manufacturing process.8

- **Corporate excise tax accelerated cost recovery system for equipment ($219.0 million)** Consistent with federal law, the Massachusetts tax code uses depreciation schedules for tangible personal property that assume that depreciation occurs over a shorter period than the expected useful life of such property. As the annual Tax Expenditure Budget states, “the excess of accelerated depreciation over what is considered to be normal depreciation for tangible personal property . . . is a tax expenditure.”

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8 While it could be argued that this and similar sales tax exemptions are necessary to prevent the “cascading” of costs in the prices of manufactured goods, the Executive Office of Administration and Finance counts such exemptions as tax expenditures and the Council on State Governments’ report cited earlier considers them business tax incentives. This report follows their practices.
- **Corporate excise tax net operating loss carryover ($110.9 million)**
  This tax expenditure permits companies that have sustained a loss in a given year to use that loss (i.e. “carry it over”) to offset future profits – and thus lower their tax liabilities – for up to five years.

- **Corporate excise tax credit for research and development ($83.9 million)** Massachusetts law grants corporations credits against taxes owed for certain research and development investments. As described in the Tax Expenditure Budget, “the amount of the credit is equal to the sum of 10% of qualified research expenses each year in excess of a base amount, and 15% of basic research payments, in excess of a base amount. The credit is limited to the first $25,000 of excise plus 75% of any excise in excess of $25,000. Unused credits may be carried over to subsequent years.”

Taken together, these five credits alone will account for roughly $867 million of the $1.3 billion in economic development tax expenditures that are expected to be made in FY04.

Overall, economic development tax expenditures have remained relatively constant over the last ten years. In FY 1995, economic development tax expenditures amounted to $1,223 million (in constant FY 2003 dollars) or 10.8 percent of affected tax revenue. For FY 2004, they are expected to be $1,293 million or 10.2 percent. However, this trend does not hold for each of the three categories of tax expenditures. In fact, economic development tax expenditures within the corporate income tax grew substantially during the last decade, while those within the personal income tax declined appreciably. Economic development tax expenditures made through the sales tax also grew, albeit at a much slower pace. More specifically, between FY 1995 and FY 2004, corporate income tax expenditures for economic development purposes rose more than $218 million, from $591.7 million to $810.3 million, an annual rate of growth of 3.6 percent. In addition, economic development tax expenditures within the corporate income tax, expressed as a percent of receipts, rose from 53.6 percent to 80.8 percent over that ten year span. In contrast, sales tax expenditures in this area rose by just 0.8 percent annually, while personal income tax expenditures geared towards economic and workforce development fell by 10.2 percent per year due, in part, to reductions in the personal income tax rate. (The value of tax expenditures rises and falls with changes in tax rates. Thus, as the personal income tax rate was reduced from 5.95 percent in 1999 to 5.3 percent by 2002, the value of tax expenditures within the personal income tax fell as well.)
In turn, the adoption of a single sales factor apportionment formula for defense contractors and manufacturers in 1995, and for mutual fund companies in 1996, helps to explain, in large part, the increase in corporate income tax expenditures for economic development purposes. EOAF estimates that the unequal weighting of the state’s apportionment formula cost the state $93.6 million in FY 1995 and $232.6 million in FY 2004, an increase of some $139 million. EOAF’s estimate for this particular tax expenditure encompasses more than the cost of single sales factor alone, but other data suggest that single sales factor comprises the majority of that sum. For instance, the unequal weighting of Massachusetts’ apportionment formula will yield a tax expenditure of $253.7 million in FY 2005 (in current dollar terms). Of that amount, $199 million is attributable to the use of single sales factor by defense contractors, manufacturers, and mutual fund companies, according to estimates prepared by the Department of Revenue. Two other corporate income tax expenditures that help account for growth in this area are the research and development credit and the investment tax credit. After adjusting for inflation, the revenue loss due to these two credits grew by $34.2 million and $28.4 million respectively between FY95 and FY04.

**Economic Development Tax Expenditures Dwarf Economic Development Appropriations**

As noted earlier, tax expenditures often seek to achieve the same policy goals as programs that are funded through the annual appropriations process. Efforts to spur economic development in Massachusetts are no exception. However, whether due to the inherent advantages that tax expenditures enjoy over appropriated spending or to other factors, tax expenditures, in the aggregate, clearly have been preferred as a means of promoting economic development within the Commonwealth. As Figure 6 demonstrates, throughout the past decade, the amount of funds devoted to economic development through tax expenditures has dwarfed those made available through the appropriations process. Over the last ten years, economic development appropriations have ranged from a low of $137.8 million in FY 1995 (after adjusting for inflation) to a high of $261.7 million in FY 2001. Once the economic development package that was enacted in November 2003 is included, they are expected to total $219.7 million in the current fiscal year; of note, that package accounts for roughly one-third of economic development

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9 EOAF’s estimate includes the cost of any deviation from the equally-weighted, three-factor apportionment formula that states have traditionally used to determine the fraction of the profits earned by a multi-state corporation that are subject to taxation in a given state. Thus, it includes not only the impact of single-sales factor for manufacturers and mutual fund companies, but also the effect of the double-weighted sales factor that Massachusetts uses for all other corporate taxpayers.
appropriations for FY04. In comparison, the low for economic development tax expenditures during this period occurred in FY 2002, when they equaled $1.17 billion; the high of $1.31 billion was reached in FY 1998. As a result, the ratio of economic development tax expenditures to economic development appropriations did not fall below 4.5:1 over the course of the past decade. In several years, it reached as high as 8:1. All told, between FY 1995 and FY 2004, the amount of revenue Massachusetts has failed to collect as a result of economic development tax expenditures is six times greater than the amount of revenue it has dedicated to economic development appropriations.

Figure 6.

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Data on economic development appropriations are taken from annual general appropriations acts, as well as supplemental appropriations, and encompass both line-item appropriations devoted to economic development purposes and funds earmarked for economic development purposes within larger line-items. Furthermore, while it is clear that a significant fraction of state appropriations — from support for public universities to highway maintenance — has some effect on the Commonwealth’s economy, these data attempt to isolate appropriations that have economic development as their main purpose. Finally, these data do not include any federal funds that Massachusetts may receive for economic development (e.g. through the Workforce Investment Act), nor do they include any funds made available through the Commonwealth’s capital budget. In the end, the above comparison is simply intended to highlight the preferences of policymakers, as revealed through the annual appropriations process, and the trade-offs they choose to make in creating, sustaining, or expanding tax expenditures. State appropriations and tax expenditures are only two parts of a broader effort to promote economic development, but they are parts over which the Legislature and the Governor have substantial control.
The advantages that tax expenditures have over appropriations manifest themselves in another way in Figure 6. After initially falling at the start of the recent fiscal crisis, economic development tax expenditures have returned, over the course of FY03 and FY04, to near-peak levels. In contrast, economic development appropriations have fallen sharply during the fiscal crisis – from $261.7 million in FY01 to $219.7 million in FY04. In other words, because they are embedded in the tax code and thus occur automatically, tax expenditures for economic development have been better able to weather the Commonwealth’s ongoing fiscal storm.

**The 2003 Economic Development Package: A Case Study**

On November 26, 2003, Governor Romney signed into law House No. 4328, “An act relative to investments in emerging technologies to promote job creation, economic stability and competitiveness in the Massachusetts economy.” Hailed by legislative leaders as a “targeted investment [that] will support emerging technology companies that can revive our economy, provide our families with financial security and supply a sustainable tax base to fund our education, public safety, elderly, disabled and assistance programs,” the measure, at first glance, appears to defy the tendency displayed during the past decade to favor tax expenditures over appropriations as a means of fostering economic development. As approved by the House of Representatives and the Senate, the bill appropriated $84.9 million in FY04 for a variety of funds and projects, including the John Adams Innovation Institute, the Emerging Technology Fund, and the Massachusetts Research Center Matching Fund. At the same time, it created a number of new tax expenditures – such as the Medical Device User Fee Tax Credit – and expanded several existing ones – like the research credit – at a FY04 cost of $17 million. However, because tax expenditures are permanent, the five- and ten-year costs for those portions of the bill, as approved by the Legislature, were $114 million and $281 million respectively, while the appropriations were simply a one-time expense.

The vetoes issued by Governor Romney simply exacerbated this longer-term disparity, dropping appropriations to $37.5 million, but reducing the five- and ten-year costs of the tax expenditures contained in the package less dramatically – to $99 million and $251 million respectively. In the end, most of the Governor’s vetoes were overridden, bringing appropriations in the measure back to $72.4 million. Nevertheless, when viewed from a longer-term perspective, the package still gives greater emphasis to tax expenditures.

One final contrast between economic development tax expenditures and workforce development appropriations can be found in Figure 7. As noted earlier, many tax expenditures are designed to lower the cost of capital investments for companies operating in Massachusetts, while very few are geared towards helping workers acquire the skills they need to secure employment – or to remain employed – in an ever changing labor market. Yet, of the five main categories of economic development appropriations

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11 Were it not for the November 2003 economic development package, this fall would have been considerably sharper. With that package included in FY04 appropriations, the decline since FY01 is 16.1 percent; if that package were excluded, then the decline would have been 43.2 percent.

12 Conference Committee Agrees on $100 Million Package to Grow Jobs, Jumpstart Economy, General Court of the Commonwealth of Massachusetts, November 19, 2003.
shown in Figure 7, spending on workforce development comprised the plurality each year. That is, in FY 1995, appropriations for programs such as Adult Basic Education comprised 33.9 percent of economic development appropriations, the single largest category that year. From FY 2000 through FY 2003, they made up roughly half of such appropriations, falling below that mark in FY 2004 only because of the level of funding in the November 2003 economic development package for other purposes.13

Figure 7.

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13 This report separates economic development appropriations into five categories, as follows:

1. **Workforce Development** – This category consists of appropriations designed to aid individuals in obtaining or enhancing particular skills as well as in finding employment. As such, it includes funding for Adult Basic Education and the Employment Services Program in which TAFDC recipients participate. Spending in this category totaled $95.3 million in FY04 or 43.4 percent of all economic development appropriations.

2. **Technical and Financial Assistance** – Spending on programs, initiatives, or offices that provide information, consulting advice, or assistance in securing financing to businesses seeking to locate in Massachusetts or to expand their Massachusetts operations makes up this category. In FY04, Massachusetts appropriated $55.5 million for such ends. Two of the principal line-items included here are for the Massachusetts Office of Business Development and the Small Business Development Center at the University of Massachusetts.

3. **Tourism** – Appropriations in this category, which amounted to $17.2 million in FY04, are intended to attract tourists to the Commonwealth and to assist Massachusetts’ travel industry. The two main line items in this category are for the Office of Travel and Tourism and for Local Tourist Councils.

4. **Infrastructure** – Appropriations in this category, which are geared towards building and maintaining structures that attract businesses and visitors to Massachusetts, such as the new Boston Convention Center, totaled $22.9 million in FY04. (Again, these figures do not include any funds provided through the Commonwealth’s capital budget.)

5. **Research** – Items in this category include appropriations for the Massachusetts Biotechnology Research Institute and for projects at state colleges and universities. Such funds summed to $23.6 million in FY04.

6. **Other** – All remaining line-items, such as those for the administration of Executive Office of Economic Development, are included here. Appropriations in this category amounted to $5.3 million in FY04.
Are Tax Expenditures an Effective Means of Promoting Economic Development?

As the preceding section demonstrates, tax expenditures constitute one of the principal means by which the Commonwealth attempts to promote economic development. Like any set of policies, such tax expenditures entail tradeoffs – for every dollar the Commonwealth fails to collect due to a particular tax break, it has one less dollar to devote to another priority. Consequently, the question must be asked: “Are tax expenditures an effective means of promoting economic growth?” The answers provided by a new, comprehensive review of the national evidence on state tax policy and economic development, as well as by data and analyses originating in Massachusetts, suggest that the resources the Commonwealth currently dedicates to such tax expenditures could be used more effectively elsewhere.

“Rethinking Growth Strategies”

In recent years, the notion that state tax policy can influence critical business decisions – and do so in a cost-effective manner – has enjoyed considerable prominence in public debates about economic development in Massachusetts. For instance, when Governor Romney in June of this past year signed legislation to extend the Investment Tax Credit (ITC) for five years, he claimed that the credit “…is one of the vital tools we have to attract employers and to stimulate job growth in Massachusetts.” At the same time, Lieutenant Governor Healey contended that the impact of the ITC has been “…overwhelmingly positive, with an increase in jobs and additional investment in buildings and equipment in Massachusetts.”14 Similarly, last October, in announcing his proposal to provide tax rebates to certain manufacturing companies for hiring additional employees, Governor Romney asserted that it would “…help businesses expand and give them incentives to stay right here in Massachusetts …”15

A new, comprehensive review of hundreds of econometric analyses, business surveys, and representative firm studies conducted over the past several decades on the topic of state and local tax policy and economic development suggests that such prominence is unwarranted. In Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development, Robert G. Lynch, the Chairman of the

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15 Romney Work for Resurgence of Massachusetts Economy, Commonwealth of Massachusetts – Executive Department, October 20, 2003.
Department of Economics at Washington College, shows that there are “…little grounds to support tax cuts and incentives – especially when they occur at the expense of public investment – as the best means to expand employment and spur growth.”\(^{16}\)

Among Lynch’s key findings are the following:

- **State and local taxes are only a very small portion of total business costs.** According to Lynch, “…after federal deductibility, all state and local taxes paid by businesses … accounted for only 0.8 percent of their costs.”\(^{17}\)

- **Tax incentives intended to promote economic development fall well short of achieving those goals.** In Lynch’s words, “[s]tatistical and econometric studies are nearly unanimous in concluding that state and local tax incentives fail to attract a significant number of new businesses, create numerous jobs, or substantially enhance economic performance.”\(^{18}\) Indeed, further reinforcing the notion that the resources dedicated to tax incentives could be better utilized is the fact that “…the data indicate that most incentive-receiving firms would have undertaken their projects even without the incentives.”\(^{19}\)

Importantly, while some recent studies have suggested that tax cuts and incentives could yield positive economic results, Lynch points out that many such studies suffer from a common flaw. Specifically, they assume that tax cuts and incentives can be provided without any corresponding reductions in public spending.\(^{20}\) One need only look to Massachusetts’ on-going fiscal crisis to understand that such an assumption is baseless. Yet, as is discussed below, not only do reductions in public spending have deleterious effects on states’ economies, but those effects may well outweigh any potential gains from tax cuts or incentives.

- **Public services can play a vital role in attracting and retaining businesses.** Since state and local taxes constitute such a minor fraction of businesses’ total costs, it is “…other ‘costs of conducting business’ [that] are the most important factors affecting business investment decisions.” Lynch’s research leads him to include in this set of costs:

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\(^{17}\) Ibid, p. 4

\(^{18}\) Ibid, p. 25

\(^{19}\) Ibid, p. 16

\(^{20}\) Ibid, p. 28
the cost and quality of labor, the proximity to markets for output . . .
access to quality transportation networks and infrastructure (e.g., roads,
highways, airports, railroad systems, and sewer systems), quality-of-life
factors (e.g., good schools, quality institutes of higher education, health
services, recreational facilities, low crime, affordable housing, and good
weather), and utility costs.21

In other words, the availability of quality public services appears to be an
important determinant of business investment decisions and, thus, could be the key
to states’ long-term economic security.

• **Given the role that public services can play in attracting and retaining
businesses, increasing taxes to fund those services can have a positive economic impact.** Conversely, cuts in spending on public
services can have a negative one. In his review, Lynch examined six
studies that assessed the results of increasing taxes and using that revenue to
bolster spending on public services. Taken together, the findings of these studies
suggest that such an approach “…may accelerate state and local growth.” A 2003
study of Michigan’s options for closing its budget deficit is especially noteworthy.
It projected that if Michigan were to increase taxes by $925 million, rather than
cutting spending by an identical amount, “…the net impact on state employment
would be an increase of 7,610 jobs and an increase in state personal income of
$309 million.”22

Though not included in Lynch’s review, a study released last spring by the Fiscal
Policy Institute of New York (FPI) corroborates this point.23 Specifically, the
study uses an economic model developed by Regional Economic Models, Inc.
(REMI) to simulate both the effect of reducing education funding by $1.84 billion
as well as the effect of maintaining education funding through a $1.84 billion
increase in the personal income tax (borne solely by New York taxpayers with
incomes in excess of $100,000). It then compared the two approaches and found
that, relative to the former, the latter approach would increase employment in New
York by 58,000 jobs in 2004 and would add another $1.53 billion to New York’s
Gross State Product. Moreover, the relative benefits of the tax increase would
grow over time, with the number of additional jobs rising to 61,000 and the jump
in GSP expanding to $1.87 billion by 2007.

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21 *Ibid*, p. 6

22 *Ibid*, p. 44-45

23 *Schools, Taxes, and the New York Economy: An Economic Analysis of a Balanced Budget Alternative to the
Governor’s School Aid Cuts*, Fiscal Policy Institute, April 24, 2003.
In the end, Lynch concludes, “…state and local tax cuts and incentives are probably not the best use of public revenues, even when the object is to encourage business firms to put more people to work.” On the other hand, “…by stimulating growth, generating jobs, and providing direct benefits to residents, improvements in state and local public services can be one of the most effective strategies to advance the quality of life…” for everyday people.24

In some respects, Lynch’s conclusions simply echo sentiments expressed several years ago by the former Secretary of the Treasury, and the one-time Chairman of Alcoa, Paul O’Neill. In his confirmation hearing before the Senate Finance Committee on January 18, 2001, Mr. O’Neill remarked:

I never made an investment decision based on the tax code. If you make an investment for 20 years and you do not know pretty well how that investment is going to pay for the cost of capital, assuming the status quo ante with the tax system, then you are not a businessman, you are a gambler.

... if you are giving money away I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements; they do it because they can see that they are going to be able to earn the cost of capital out of their own intelligence and organization of resources.25

Massachusetts-specific Data and Analyses

Although Lynch’s study synthesizes analyses from across the country, little evidence has been produced in Massachusetts that would contradict his conclusions. Public sector evaluations of corporate tax incentives available in the Commonwealth either have not been conducted, despite legal requirements that they occur annually, or have found that such incentives have not met their economic development goals. Research conducted by private sector organizations suggests that corporate tax incentives have led to job growth, but that research appears to be fundamentally flawed, as it simply assumes that the Commonwealth does not have to pay for corporate tax incentives, one of the key errors that Lynch found in other studies.

As discussed earlier in this paper, one of the principal economic development strategies adopted by the Commonwealth during the 1990s was the introduction of “single sales factor.” Advocates for single sales factor argued that it would lead to job growth in the Commonwealth on the grounds that, by removing the other factors that had traditionally been included in the apportionment formula – namely, the share of a

25 Hearing before the Committee on Finance, United State Senate, 107th Congress, 1st Session, on the Anticipated Nomination of Paul O’Neill to Be Secretary of the Treasury, January 17, 2001, S. Hrg. 107-5.
company’s payroll in Massachusetts, as well as the share of its property located here—
companies permitted to use single sales factor would no longer face a disincentive to the
expansion of their Massachusetts operations. Indeed, when single sales factor was
enacted, the head of the Associated Industries of Massachusetts proclaimed, “By
adopting the single sales [factor] apportionment formula for Massachusetts
manufacturers, the Legislature today took a bold step towards restoring Massachusetts as
a manufacturing state.”26

To ensure that it would be able to evaluate whether single sales factor was a cost-
effective means of promoting economic development, the Legislature further changed the
law to require the companies that used single sales factor to report, among other things,
the number of jobs they added or lost in the Commonwealth and to do so on an annual
basis. In addition, the Legislature stipulated that:

The commissioner of revenue shall annually prepare a comprehensive report
utilizing the information [provided by defense contractors] and [from] other
sources describing and evaluating the impact, if any, of the utilization of the
single sales factor only upon the defense industry . . . The commissioner's report
shall be filed not later than October first of each year with the clerk of the senate
and the clerk of the house of representatives who shall forward the same to their
respective committees on ways and means and to the joint committee on
taxation. Said report of the commissioner shall be a public record . . .27

Similar mandates were imposed regarding manufacturers and mutual fund service
companies. In fact, the law concerning mutual fund service companies goes one step
further and requires the Commissioner of Revenue to “…set forth any recommendations
[he or she] may have for any amendments…” to the law governing single sales factor for
mutual fund service companies and to describe the reasons for his or her
recommendations.

For defense contractors and manufacturers, single sales factor – and the reporting
requirements associated with it – took effect in 1996.28 For mutual fund service
companies, it took effect in 1997. Thus, even assuming a three year lag in reporting
(since corporate tax returns are often filed after the end of the calendar year and are
frequently amended at later dates), the Department of Revenue should have, by now, filed
14 reports – 5 for defense contractors, 5 for manufacturers, and 4 for mutual fund service

26 “Corporate Tax Breaks Approved,” Boston Globe, November 16, 1995, p. 45
27 M.G.L. Chapter 63, Section 38(k)(5)
28 Manufacturers did not begin to use single sales factor in full until 2000. From 1996 to 1999, they used an
apportionment formula that weighted sales at 60 to 90 percent.
companies. Yet, only five exist – the 1996, 1997, and 1998 reports for defense contractors, the 1996 report for manufacturers, and the 1997 report for mutual fund service companies. In other words, despite statutorily mandating its provision, the Legislature does not have the most basic information it needs to evaluate the effectiveness of one of the single largest economic development incentives available in the tax code.

The scant information that is available from the Department of Revenue is nevertheless revealing. For instance, the three defense contractor reports indicate that, from 1995 to 1998, the number of people employed in Massachusetts by defense contractors using single sales factor fell 11 percent, from 14,889 to 13,300, the availability of single sales factor notwithstanding. The lone mutual fund report that is available suggests that, even if single sales factor created an incentive for such companies to hire additional employees, it hardly did so in a cost-effective manner. According to that report, mutual fund industry employment in Massachusetts grew by 1,631 people in 1997; that report also includes a Department of Revenue estimate that the tax savings to mutual fund companies that year was in the range of $55 million to $75 million. Thus, even if one were to assume that every mutual fund job created in Massachusetts in 1997 was due solely to the existence of single sales factor – a dubious proposition at best – then the cost to the Commonwealth for each job created ranged from $33,722 to $45,984. Interestingly, that lone mutual fund report also estimates the weighted average salary for all mutual fund employees in Massachusetts in 1997 to be $34,890. Of course, paying 1,631 people an annual salary of $34,890 should only cost $56.9 million, meaning that the Commonwealth, rather than simply providing an incentive to hire additional employees, may have paid for the full salary of each new hire. What’s more, if the revenue loss was closer to the upper end of the range estimated by the Department of Revenue, then the Commonwealth may well have paid more than the full cost.

Of the reports available from the Department of Revenue, only the single report on manufacturers seems to hint at desirable results, as it indicates that employment among so-called “Section 38” manufacturers electing to use the phased-in single sales factor rose by 16,632 people in 1996, with only modest costs to the Commonwealth (approximately $10.4 million in tax savings). However, data from the Bureau of Labor Statistics indicate that such gains were not realized throughout the Commonwealth as a whole that year, as average monthly employment in the manufacturing sector was 417,367 in 1995 and 415,992 in 1996. That brief snapshot also stands in stark contrast to the longer term trend in Massachusetts manufacturing employment. Between November 1995, when the original single sales factor legislation was adopted, and February 2004, a period during which manufacturers reaped a total tax savings in excess of $400 million, the number of manufacturing jobs in Massachusetts fell from 418,400 to 321,900, a drop of 23.1 percent. As Figure 8 shows, the decline in Massachusetts was noticeably steeper than the 16.8 percent drop for the United States as whole during this time frame.
The Massachusetts Office of the Inspector General has also raised serious questions about both the efficacy of a number of corporate tax incentives in promoting economic development and the rigor with which they are administered. In a January 23, 2004 letter to the Commissioner of Revenue, Inspector General Gregory W. Sullivan stated that “…the abuse of economic development tax credits is costing the taxpayers millions of dollars…” and that such abuse “…may undermine [those credits’] long-standing purpose of economic growth and job creation …”29 While the Inspector General urged the Commissioner to strengthen the Department of Revenue’s oversight of a number of tax incentives – including the Investment Tax Credit, the Full Employment Credit, and the Research Tax Credit – he singled out the Economic Development Incentive Program (EDIP) for particular scrutiny. Created in 1993, the EDIP is “…an economic development program that uses local and state tax credits to attract new businesses to the state, encourage job retention in certain areas, and promote private investment.”30 The state component of the EDIP is the Economic Opportunity Area (EOA) credit, which provides corporate excise taxpayers with a credit against taxes owed equal to 5 percent of the cost of an investment in a certified project in an Economic Opportunity Area.


Opportunity Area. The body responsible for certifying such projects is the Economic Assistance Coordinating Council (EACC), which consists of 14 economic development officials and is co-chaired by the Director of Business and Technology and the Director of Housing and Community Development. Of note, the Inspector General pointed out that although the certification of EOA’s “must be based on statutorily created criteria, the EACC has granted approval in numerous cases where the criteria had not been met. Also, the OIG found that there is virtually no review and verification of the information businesses submit to the EDIP as the basis for a tax credit request.”31

In response, the Co-Chairs of the EACC – Barbara Berke, the Director of Business and Technology, and Jane Wallis Gumble, the Director of Housing and Community Development – as well as the Director of the EACC, George Mazareas, stated, in a letter to the Inspector General dated February 13, 2004, that they “strongly disagree with the criticism … leveled at the EDIP.”32 They argued that municipalities play a significant role in administering the EDIP and not only challenged the OIG’s characterization of two specific projects that utilized the EDIP but also explained why those two projects were in fact eligible for the program.

The history of the investment tax credit (ITC) in Massachusetts provides one final example of the Commonwealth’s haphazard record of evaluating economic development tax incentives. In 1993, the value of the ITC was temporarily increased from 1 percent of investments in qualified tangible property to 3 percent of such investments; the period for which it was increased was originally scheduled to terminate for tax years after January 1, 1996. Legislation enacted in 1996 mandated that the Joint Committee on Taxation study the effectiveness of the ITC. In its report issued in June 1997, the Committee noted that it had received testimony from businesses in support of maintaining a 3 percent ITC, but that most of that testimony consisted of anecdotes. According to the report, “No empirical data was offered . . . with respect to the amount by which capital investment increased or the amount by which employment increased as a result of the more generous credit.”33 Moreover, information provided by the Department of Revenue in conjunction with the study proved either inconsistent or incomplete. Consequently, the Committee concluded that it “cannot recommend that the investment tax credit be increased permanently to three percent at this time . . . It would be premature to recommend [doing so] without further analysis of the issue . . .”34 In 1999, the Legislature included, as part

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31 Ibid., p. 2.

32 Letter from Barbara Berke, Director of Business and Technology, Jane Wallis Gumble, Director of Housing and Community Development, and George Mazareas, Director of the Economic Assistance Coordinating Council, to Inspector General Gregory W. Sullivan, February 13, 2004

33 Memorandum from Senator Warren E. Tolman and Representative Peter Larkin to the Members of the Joint Committee on Taxation, June 2, 1997, p. 2.

34 Ibid., p. 7.
of the FY 2000 budget, a provision mandating that businesses utilizing the ITC provide additional information about the number of jobs they were able to create as a result of the credit, as well as a description of the size and the type of the investments they made to qualify for the credit. The provision further required the Department of Revenue to compile a comprehensive report on the ITC on an annual basis, utilizing the new information provided by businesses claiming the credit. However, Governor Cellucci vetoed the provision, arguing that it would impose “…unacceptable compliance burdens on businesses.” Despite this lack of information about the credit, the Legislature and the Governor have repeatedly approved extensions of the 3 percent ITC. In fact, the economic stimulus package passed by the Legislature on November 19, 2003 and signed into law by Governor Romney one week later makes the 3 percent ITC permanent.

Finally, a series of studies produced over the course of the past year suggests that economic development tax incentives have produced positive results in Massachusetts. However, those studies appear to commit one of the cardinal errors identified by Lynch, in that they assume tax incentives can be provided without having to cut public spending or raise other taxes to cover the costs associated with such incentives. More specifically, since April 2003, the Associated Industries of Massachusetts Foundation has released three separate studies, prepared by the accounting firm Ernst & Young, that attempt to assess the economic and fiscal effects of the investment tax credit, single sales factor, and the research credit respectively. Each of these studies assumes that the tax incentive in question helped to reduce businesses’ operating costs and, as a result, lead to higher employment and personal income levels in Massachusetts than would be the case if the incentive in question did not exist. However, it appears that the studies on single sales factor and the research credit do not take into account the reductions in spending or the higher taxes that would be necessary to compensate for the revenue loss due to those incentives. As Lynch has observed, of course, “…any jobs that might be gained by cutting taxes [in this instance, through tax incentives] can be more than offset by the jobs lost as a result of cuts in public services.”

35 The Economic and Fiscal Effects of the Massachusetts Investment Tax Credit, Ernst & Young, April 14, 2003; The Economic and Fiscal Effects of Single Sales Factor Apportionment for Massachusetts Manufacturers, Ernst & Young, May 14, 2003; and The Economic and Fiscal Effects of the Massachusetts Research Credit, Ernst & Young, August 13, 2003

36In a footnote to its investment tax credit study, Ernst & Young notes that its “estimate of the net state fiscal impact of the [credit] does not assume a revenue neutral increase in other taxes to pay for the cost of the ITC. If a balanced-budget constraint were imposed on the model, the positive economic feedback would be reduced by approximately 32 percent.” The precise meaning of a “balanced budget constraint” in this context is unclear. It is similarly unclear whether any attempts were made to model the economic effect of higher public spending as an alternative use of the funds devoted to the ITC.

37Lynch, op. cit., p. ix.
Conclusion

As this report has demonstrated, the Commonwealth’s efforts to use public resources to promote economic development extend well beyond the annual appropriations process. In each of the past ten fiscal years, after adjusting for inflation, Massachusetts has distributed over $1 billion through provisions in the tax code, commonly referred to as tax expenditures, in an attempt to stimulate growth. Indeed, the funds made available through the appropriations process for economic development purposes ultimately constitute just a fraction of such tax expenditures. In FY 2004, even after taking into account the $72.4 million appropriated in the November 2003 economic development package, economic development appropriations are anticipated to amount to just one-sixth of economic development tax expenditures.

All too often, however, it is only that small fraction that is ever examined or revisited. While it is incumbent upon the Legislature to ensure that public resources are well spent even in times of plenty, the combination of the Commonwealth’s ongoing budget crisis and the difficulties it has experienced in trying to recover from the 2001 recession provides still greater impetus. Consequently, as the Legislature crafts its fiscal and economic strategies for the years ahead, it should recognize the billion-dollar annual commitment the Commonwealth currently makes to economic development tax expenditures and determine whether continuing to allocate Massachusetts resources in that manner is the most effective means of stimulating economic growth. In particular, it should consider whether re-allocating some portion of that billion-dollar sum, either to direct appropriations for economic development purposes such as worker training and technical assistance or to support for core government services like education, might better achieve sustained and widespread economic prosperity over the long run.
Appendix A. Tax Expenditures and Receipts, FY 1995 - FY 2004

All figures in millions of constant FY 2003 dollars; all years are fiscal years

"Total" reflects personal income, corporate income, and sales and use taxes only

All figures exclude tax expenditure incurred from failing to subject sales of services to the sales and use tax

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<td>13,631</td>
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<td>12,399</td>
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<td>7,906</td>
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<td>186</td>
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<td>151</td>
<td>105</td>
<td>101</td>
<td>92</td>
<td>108</td>
<td>1,621</td>
<td>1,621</td>
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<td>814</td>
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<td>833</td>
<td>822</td>
<td>700</td>
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<td>340</td>
<td>333</td>
<td>336</td>
<td>345</td>
<td>362</td>
<td>373</td>
<td>371</td>
<td>358</td>
<td>375</td>
<td>3,540</td>
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## Appendix B. Economic Development Appropriations, FY 1995 - FY 2004

All years are fiscal years

### Constant FY03 Dollars

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<td>17,791,807</td>
<td>19,400,568</td>
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<td>41,451,446</td>
<td>42,136,170</td>
<td>62,111,731</td>
<td>44,994,782</td>
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<td>54,906,617</td>
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<td>Research</td>
<td>5,415,695</td>
<td>6,244,887</td>
<td>3,894,324</td>
<td>5,908,570</td>
<td>5,531,334</td>
<td>5,962,396</td>
<td>5,452,866</td>
<td>5,896,348</td>
<td>2,489,562</td>
<td>23,581,187</td>
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<tr>
<td>Other</td>
<td>6,807,136</td>
<td>6,475,478</td>
<td>9,588,229</td>
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<td>9,347,391</td>
<td>10,566,931</td>
<td>10,079,454</td>
<td>5,840,015</td>
<td>5,286,536</td>
<td>5,296,536</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td>137,795,920</td>
<td>145,191,017</td>
<td>157,814,210</td>
<td>190,637,750</td>
<td>228,274,508</td>
<td>229,847,535</td>
<td>261,674,327</td>
<td>241,815,771</td>
<td>183,532,629</td>
<td>219,658,856</td>
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</table>

### Change from prior year (dollars)

<p>| | | | | | | | | | | |</p>
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<tbody>
<tr>
<td>Workforce Development</td>
<td>7,395,097</td>
<td>12,623,193</td>
<td>32,823,540</td>
<td>11,573,027</td>
<td>31,826,792</td>
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<td>(19,658,556)</td>
<td>(58,283,142)</td>
<td>36,126,227</td>
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<tr>
<td>Technical, Financial Assistance</td>
<td>12,6%</td>
<td>8.7%</td>
<td>20.8%</td>
<td>19.7%</td>
<td>0.7%</td>
<td>13.8%</td>
<td>-7.6%</td>
<td>-24.1%</td>
<td>19.7%</td>
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</tr>
<tr>
<td>Tourism</td>
<td>5.4%</td>
<td>8.7%</td>
<td>20.8%</td>
<td>19.7%</td>
<td>0.7%</td>
<td>13.8%</td>
<td>-7.6%</td>
<td>-24.1%</td>
<td>19.7%</td>
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<tr>
<td>Infrastructure</td>
<td>52.7%</td>
<td>55.5%</td>
<td>60.3%</td>
<td>72.9%</td>
<td>87.2%</td>
<td>87.8%</td>
<td>100.0%</td>
<td>92.4%</td>
<td>70.1%</td>
<td>83.9%</td>
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### Percent of Annual Total

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<tbody>
<tr>
<td>Workforce Development</td>
<td>33.9%</td>
<td>39.4%</td>
<td>42.7%</td>
<td>48.8%</td>
<td>46.7%</td>
<td>51.2%</td>
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<tr>
<td>Technical, Financial Assistance</td>
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<td>11.2%</td>
<td>10.2%</td>
<td>9.5%</td>
<td>10.3%</td>
<td>12.1%</td>
<td>10.9%</td>
<td>9.7%</td>
<td>9.1%</td>
<td>25.3%</td>
</tr>
<tr>
<td>Tourism</td>
<td>12.6%</td>
<td>12.3%</td>
<td>12.3%</td>
<td>10.9%</td>
<td>9.2%</td>
<td>10.2%</td>
<td>9.3%</td>
<td>9.0%</td>
<td>10.3%</td>
<td>7.8%</td>
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<tr>
<td>Infrastructure</td>
<td>31.2%</td>
<td>28.4%</td>
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<td>22.1%</td>
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<td>Research</td>
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<td>3.1%</td>
<td>2.4%</td>
<td>2.6%</td>
<td>2.1%</td>
<td>2.4%</td>
<td>1.4%</td>
<td>10.7%</td>
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<tr>
<td>Other</td>
<td>4.9%</td>
<td>4.5%</td>
<td>6.1%</td>
<td>5.5%</td>
<td>4.1%</td>
<td>4.3%</td>
<td>4.0%</td>
<td>4.2%</td>
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### Appropriations versus Tax Expenditures

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<td>1,299</td>
<td>1,304</td>
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<td>1,293</td>
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<td>145</td>
<td>158</td>
<td>191</td>
<td>228</td>
<td>230</td>
<td>262</td>
<td>242</td>
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<tr>
<td>Ratio</td>
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<td>8.12</td>
<td>7.91</td>
<td>6.85</td>
<td>5.14</td>
<td>5.65</td>
<td>4.98</td>
<td>4.84</td>
<td>6.55</td>
<td>5.89</td>
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## Tax Expenditures and Economic Development

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