



# Mark Haveman, Executive Director, Minnesota Center for Fiscal Excellence

## A mixed Minnesota scorecard on business attractiveness

A Civic Caucus Focus on Competitiveness Interview

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### Present

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### Summary

According to Mark Haveman, executive director of the Minnesota Center for Fiscal Excellence (MCFE), scholars say the economic competitiveness of a state or region is comprised of two basic elements. The first is foundational competitiveness, human capital, physical infrastructure, quality of life and related factors, most of which have a strong public goods orientation to them. The second is investment attractiveness, the actual tax and cost climate. Both clearly matter, but he says much of the current political debate surrounds which competitiveness element deserves more of our attention. To provide some light on this debate, MCFE conducted a review of 10 national competitiveness and business climate studies to evaluate Minnesota's relative performance and national rankings in each area compared to other states.

Haveman explains that Minnesota continues to excel in the area of foundational competitiveness. It consistently ranks in the top 10 states in the education, composition and deployment of its labor force and maintains high rankings in innovation capacity, information technology adoption and public goods, such as infrastructure. One weak spot is higher education, where Minnesota is lagging on several important measures. With respect to investment attractiveness, Minnesota shows pockets of comparative advantage within a generally more challenging business tax and cost climate.

As important as public goods and services are, Haveman notes, their tax prices also matter. Because Minnesota is already at more of a competitive disadvantage with respect to its general tax and cost climate, future gains in foundational competitiveness should come from prioritizing foundational

competitiveness spending in the state budget and aggressively pursuing redesign to obtain greater returns on public spending and investments.

## Background

Mark Haveman is executive director of the Minnesota Center for Fiscal Excellence (formerly known as the Minnesota Taxpayers Association). He joined the organization in 2002 and took over the organization's leadership role in 2008. He is the author of numerous research and education publications on state and local tax policy and government finance.

Haveman was a member of Governor Tim Pawlenty's 21<sup>st</sup> Century Tax Reform Commission, served four years on the Board of Trustees of the Governmental Research Association and has served on policy and project advisory boards for the Lincoln Institute of Land Policy, U.S. Environmental Protection Agency, the National Institute for Standards and Technology, as well as for several state agencies, academic institutions and private foundations.

He received his B.A. from Calvin College in Michigan and his MBA from the University of Michigan.

## Discussion

**In Minnesota, two sides of the competitiveness argument are in a heated political battle: "more investment" vs. "lower taxes."** Mark Haveman, executive director of the Minnesota Center for Fiscal Excellence, said his organization set out to study where Minnesota stands on both issues. The result of their research, a report titled *Finding Our Balance: Taxes, Spending and Minnesota Competitiveness*, came out in February 2013. For more details on the state rankings and the findings, see the executive summary and full report [here](#).

**Harvard Business School Professor Michael Porter's work provided the analytical framework for examining competitiveness.** Porter is a leading authority on the competitiveness and economic development of nations, states and regions. He says there are two separate but highly related dimensions to competitiveness: foundational competitiveness and investment attractiveness.

**Foundational competitiveness.** This is the collection of public goods (such as skilled employees, specialized infrastructure, technological knowledge, etc.) and related macro/micro economic factors affecting workforce productivity. "It's the core stuff any economy has to have to grow and thrive," Haveman said.

**Investment attractiveness.** All else being equal, companies will look to invest where there's a more attractive cost and tax climate, given similar underlying foundational benefits.

MCFE selected 10 competitiveness studies: five focused on foundational competitiveness issues and five focused on tax and cost climate.

**Minnesota continues to rank very high in nearly all areas of foundational competitiveness.**

It's consistently in the top 10 national rankings in education, composition and deployment of its workforce.

It has equally superior rankings in state innovation capacity (patents, venture capital, industry research and development, etc.)

Minnesota is among the national leaders in information technology adoption across most sectors, including government.

Public goods-environmental outcomes, security and infrastructure-remain strong.

The crack in the foundation, Haveman said, lies in higher education, where Minnesota ranks 29<sup>th</sup> in affordability, 36<sup>th</sup> in average college debt, 38<sup>th</sup> in non-industry research and development (R&D) and 47<sup>th</sup> in higher education spending efficiency, i.e., spending per degree conferred at the University of Minnesota, the state's only public research university.

There is little evidence of slippage in Minnesota's foundational competitiveness over the last 10 years. If the budget cuts and fiscal restraint of the last decade has had a detrimental impact on state foundational competitiveness, there is little evidence of it to date.

"Minnesota is retaining a strong comparative advantage in these areas over its regional competitors," Haveman said. He defined regional competitors as Minnesota's border states.

In the area of investment attractiveness, Minnesota offers pockets of competitive advantage, even with its more challenging business tax and cost climate. "We do some things well," Haveman noted. For example, he said, Minnesota's tax policy is quite supportive of high value-added, capital-intensive manufacturing. Features like Minnesota's exemption of tangible personal property from the business property tax and research and development credits are reasons why Minnesota scores well on some cost of new investment measures. "That's huge, he said. "It helps manufacturing in the state." But Moody's ranks Minnesota's state and local tax climate as 39<sup>th</sup> in the nation, likely due to its inclusion of individual income taxation in business climate analysis.

Haveman noted business support and research operations pay more in sales tax as a share of their total tax burden than other types of facilities. They also have the highest tax rates on new investment. At the same time, he noted that business services represent the second largest source of job creation in Minnesota over the last decade.

"Given all this," he said, "it's completely understandable why there was such a major backlash against the new business-to-business sales taxes the Governor originally proposed, then dropped. That was a shot at the heart of the state economy."

The state's chief concern in the area of investment attractiveness appears to be its labor costs relative to foundational competitiveness. "Labor competitiveness is not cheap labor," he explained. "It's the cost of labor relative to expected productivity." Of concern is that Minnesota's performance on the cost of labor relative to workforce education and on the cost of labor relative to workforce productivity has been declining.

There is a disconnect between Minnesota's foundational strengths and private-sector actions and performance over the last 10 years. This disconnect between what we have and the performance we would expect appears consistent across the spectrum in measures of private sector activity and performance.

The state ranks 13th in patents, 12th in venture capital and sixth in industry R&D, but it ranks 44th in entrepreneurial activity, 26th in initial public offerings (IPOs) and 29th in direct foreign investment.

Minnesota ranks 12th in STEM (Science, Technology, Engineering and Math) job concentration, but 37th in STEM job growth.

It ranks third in level of workforce education and fourth in higher education degree output, but 34th in long-term job growth.

**Both academic and survey research says that a more challenging business tax and cost climate can offset the benefits of strong foundational competitiveness.**

Haveman said foundational competitiveness issues clearly matter in business decision-making, but their tax prices and costs also matter. Site selection surveys have shown that collectively, sets of investment attractiveness factors (such as labor costs, corporate tax rate, occupancy/construction costs, state and local incentives, and energy costs) have more influence on business decisions than the foundational competitiveness factors (such as highway accessibility, availability of skilled labor, low crime rate, health care facilities and ratings of public schools).

Haveman explained his interpretation of the survey with an agricultural analogy: "Minnesota has an exceptionally fertile field for growth, but if the economic return remains better elsewhere, the field still might not be planted."

**Minnesota may have a lower margin for error in its tax and cost climate than other "high tax" peer states.**

One of Harvard Professor Michael Porter's main areas of emphasis is his concept of "traded cluster strength." It captures the idea that networks of interrelated institutions, companies, and organizations spark creative energy, innovation and knowledge and skill transfers that prompt new business growth and economic activity.

He gave Silicon Valley in California as an example of the power of cluster strength, noting a place where businesses often locate and grow, regardless of how objectionable the general tax and fiscal climate may be. "If you are in IT or the high-tech engineering area, you sort of have to be there," he said. "The same thing is true of the financial services industry in New York."

Haveman noted that Porter's measure of traded cluster strength shows that, Minnesota ranks much lower in trade cluster strength (39th and trending 44th in the nation). "Minnesota does not appear to be a place where a business absolutely needs or wants to be in spite of the tax and cost climate," he said.

**The individual income tax is an increasingly important competitiveness issue.**

Haveman said some of the best rates of economic growth have occurred not where labor is cheapest or smartest, but where compensation can go the furthest. The Minneapolis metro area ranks 13th highest (at \$116,518) among the 50 largest cities in the nation in terms of 2011 wages needed to provide an after-tax, cost-of-living-adjusted income of \$100,000. Minneapolis ranks 21 to 26 percent above its regional competitors.

"If we're going to have an income-tax disadvantage of 21 to 26 percent above our regional competitors, we better be able to deliver on the return to justify that extra tax burden," Haveman said.

**The study reached two conclusions/recommendations, one in the area of spending and one in the area of tax reform:**

1. **Prioritize foundational competitiveness improvements and pursue spending decisions from a value-received perspective.** Haveman explained that like tax revenue (income, sales and property), spending is a three-legged stool: adequacy, priority and productivity. Too much emphasis on tax adequacy will leave the stool unbalanced. "If Minnesota expects businesses to continue to accept higher cost and tax burdens than imposed elsewhere, they must receive a higher clear and tangible return on that investment than can be achieved elsewhere," he said.
2. **Approach tax reform as a long-term investment in state competitiveness.** He offered five action items: (1) Stop treating the tax code as a stimulus mechanism; (2) Embrace a Hippocratic oath: "first, do no harm;" (3) Don't turn our comparative disadvantages into major tax-outlier problems; (4) Don't undercut the smart tax-policy investments we have in place; and (5) Ensure business tax revenues result in a high rate of return on investment.

In response to questions and comments from the interviewers, Haveman made the following points:

**There is no such thing as a best state business climate.**

"Different businesses place different emphases on different factors," he said.

**Recently passed public subsidies for business expansion at the Mayo Clinic, 3M, Mall of America, and others show that Minnesota has embraced the "deal" in its economic development policy.**

Minnesota has now invested more heavily in the "deal model" of economic development policy: a less friendly general tax climate pockmarked by the provision of special tax advantages, granted on assurances of construction activity and job creation. "The benefits of that strategy will be very visible," he said. "The problem is we won't know, and can never know, the amount of entrepreneurial activity, in-migration of talent, expansion interest, and business siting that never materialized because our new tax and cost environment disqualified us from further consideration."

An interviewer commented that deal-driven development has lots of payoff for elected officials and that subsidies in our tax code are another kind of deal making. Haveman noted that former Federal Reserve Bank economist Art Rolnick and others have long argued against highly incentive-laden tax and economic development policy.

**Private and public organizations promoting economic development in the Twin Cities and Minnesota do an excellent job of preaching the strong foundational competitive advantages of Minnesota.**

An interviewer countered that state government doesn't have the economic development expertise to take advantage of Minnesota's good traits.

**The state's previous decade of relative underperformance nationally appears to now be turning.**

Some recent reports now rank us ahead of the class in several key economic metrics.

**Some business tax expenditures are justified.**

A strong case can be made that favorable treatment and tax breaks should be given to R&D activity, because of its positive spillover effects.

**The structure of taxation matters and *how* you spend matters as much as *how much* you spend.**

"If we ask business to spend more, we must demonstrate they're getting a sound value return on that investment," Haveman said. "This is where the whole issue of redesign comes in. We need to provide better value and better return for the tax dollars being raised."

**Tax reform is not in our future.**

"We are essentially paralyzed with respect to tax reform," he said, "because the political support is simply not there to go to the area where we still have some semblance of maneuverability: the sales tax." He added, "Tax fairness has been such a powerful topic of discussion in this state, but other principles also matter."