Policy Implications: A Panel Discussion

Moderator Patricia M. Flynn

Dean of the Graduate School of Business and Professor of Economics, Bentley College

This panel will discuss the policy implications of the evidence that was evaluated during the first four sessions. Some of the questions we will address were highlighted by Boston Fed President Cathy Minehan this morning in her opening remarks:

- Which economic development policies have proved most cost-effective?
- Are state and local development programs consistent and coordinated, or do they work at cross purposes?
- Could the federal government enhance the benefits or reduce the costs of interjurisdictional economic competition by restraining it to some degree?
- If such restraint is desirable in theory, is it possible in practice—or even constitutional?
- Is voluntary interstate cooperation a viable and desirable option?
- What suggestions have emerged from the day's deliberations for the direction of future research and analysis?

I will add two topics to that list. The first arose from a discussion at lunch today: What would one tell a governor or legislator about what works and what does not work regarding economic development policies? Should he or she vote in favor of policies—such as those that came up recently in Massachusetts regarding Raytheon or Fidelity—that make economic concessions in order to retain firms, and thus jobs, within the state? The second topic is one that public policymakers should definitely give high priority to in discussions about economic competition: What are we competing for?

We have talked a lot about state competition, but we have not really gone into the nature of the firms or the jobs for which states and regions have been competing quite aggressively in recent years. These bidding contests often involve as many as 39 states competing for one plant. We know that some jobs are more mobile than others. For example, relatively standardized assembly jobs are more likely to move in response to lower wages or taxes than are R&D positions. What states are willing to pay should be related to what they are likely to gain economically. An excerpt from a 1993 *Wall Street Journal* article entitled, "Why German Firms Are Deciding To Locate Their New U.S. Plants in the Carolinas," is particularly relevant to our discussions today:

> In the Carolinas, Germans have also found a work force willing to tolerate management practices that Americans often find idiosyncratic, if not obnoxious. Like many German companies, the Robert Bosch GmbH plant in Charleston insists on an orderly workplace. Sweaters and jackets aren't draped over chairs; they are to be stowed in lockers. Employees are organized by assigned code names, making them sound like library call numbers. The top training manager is known as UO-ch/TRN, and that is how his memos are addressed, even though his name is James Winkler. Under him are UO-ch/TRN1, UO-ch/TRN2 and so forth. "I hated it at first," says Mr. Winkler, who reports to the plant manager, UO-ch/PM. "People sometimes refer to it as alphabet soup," says MAS1, or marketing services' Margret Nordquist. But the employees have adapted. "You avoid having to write all those long names, and if the person [in a particular job] changes, the correspondence will still go through." Such adaptability has more than made up for the skill levels of many of the workers. . . . (May 4, 1993).

The article provides a classic reminder of the importance of focusing not just on the number of jobs for which we are competing but also on the nature of those jobs.

We have a panel of four experts who have written extensively on these topics and have also been active in providing guidance to state and local authorities and to other countries on their economic development policies.

Panelist Bennett Harrison

Professor of Urban Political Economy, Milano Graduate School of Management and Urban Policy, The New School for Social Research

From the mid 1980s through the early years of the first Clinton Administration, policymakers were enamored of the "three waves of development" theory. The interjurisdictional tax competition of the post-World War II era had (it was thought) been substantially superseded by the local infrastructure strategy (industrial and science parks, and the like). Then came the third wave of so-called "entrepreneurial" approaches, emphasizing how—through R&D, training, and collaborative networks—governments could stimulate investment, technology, and employment by private sector firms.

By 1995, Peter Eisinger—himself initially an advocate of the "entrepreneurial" approach—was teaching us that, far from seeing each strategy succeed the last, we were observing all three in play simultaneously. In particular, tax competition among localities certainly has not withered away. If anyone doubts that, talk to the people who participated in the competition for the Mercedes-Benz plant that finally settled near Birmingham. Analysts in the U.S. Treasury Department and at HUD who had hoped that the savings in reduced tax expenditures would partly finance assistance to entrepreneurial programs found themselves mightily disappointed.

Tim Bartik has taught us that local tax expenditures may be progressively redistributive if they are suitably targeted toward high unemployment areas and populations. But as we all know, tax expenditures are notoriously difficult to target. This is not to say that even poorly targeted tax expenditures do not have indirect distributional consequences. As Pat Flynn reminds us, all development policies aimed at resource reallocation affect the pattern of derived demands for labor, requirements for skill, attitudes about training, and so forth. The point is that the imprecision (or political impotence) of targeting reduces our confidence that economic development policy via tax expenditures can be *progressively* redistributive. My own inclination is to encourage governors and mayors to eschew tax expenditures whenever possible, in favor of direct programs whose probable distributive impacts are reasonably clear. I know that this may be pushing on a string, given the present ideological climate. Such is life.

Let me now shift gears from policy to theorizing. In her remarks this morning, Caroline Hoxby explicated what is implicit in most regional economic work since the 1930s (but not hers): the Ricardian notion that, when push comes to shove, interjurisdictional competition is substantially conditioned by largely exogenous resource endowments, and that firms and individuals are scanning the alternative costs and benefits of different locations and making more or less rational choices about where to settle (or branch or partner). But that is not how cutting-edge economic theory says decision-makers make decisions anymore. If this had been a meeting on strategic trade theory, or the new industrial organization, or economic geography, we would be expressing open surprise at the lack of sophistication of most prevailing regional models. In those fields, at least conceptually, modeling has gone way beyond comparative statics and reduced forms, and even beyond thinking in terms of stable, unique general equilibria.

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For one thing, we know that firms to some extent *create* local competitive advantage. They build local segments for their supplier chains, they intervene in the design of school curricula to meet particular needs of the companies or preferences of the managers, and they transform local attitudes and self-conceptions. One need only read Rosabeth Moss Kanter's case studies in *World Class* to see how entire approaches by governors and mayors (for example, peddling cheap labor) can undergo transformations when world-class companies arrive. For all the loose and even romantic thinking about the bases for the Japanese "miracle" of the previous two decades, strategic interaction between the public and private sectors is certainly part of the success of Japanese economic development. Urban and regional economics and public finance in this country would greatly

benefit from incorporating, as formally as possible, the endogeneity of the bases for local and regional (let alone national) advantage.

I was surprised that the papers today paid so little attention to agglomeration and clustering. If any one idea is most responsible for reviving scholarly interest in the theoretical foundations of local economic growth and development, it is this one. My surprise is enhanced by the fact that so much of the basic research on this subject has been conducted by scholars in the Boston area. (I am thinking of Piore and Sabel, Porter, Enright, Katz, Kanter, Glaeser, Henderson, and Jaffe, and my own recent papers on the subject, published while I was at the Kennedy School.) The policy implications of that work are that people ought to be thinking to some extent about eschewing or at least reconsidering subsidies to individual firms or to classes of firms (such as small and medium-size enterprises), in favor of assistance or support that promotes or rewards clustering that might achieve particular kinds of critical mass by maximizing local transactional, learning, labor-sharing, and other linkages. I am not unreservedly advocating such programs, I am merely observing that, analytically, this is the cutting edge of many areas of economic and geographic theory.

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I appreciated Andy Reschovsky's taking seriously the question of a potential interstate "race to the bottom" in the era of devolution through block grants. That phase was first coined by Supreme Court Justice Louis Brandeis in the 1920s, about the same time that he called the states "laboratories of democracy." It strikes me that the likely continued decline of federal budgetary obligations for economic development does not just mean that local governments will find it increasingly difficult or risky to pursue redistributive objectives. All manner of efficiency questions are also tied up with devolution, from the increasing risk of chronic overbuilding of science and industrial parks and hotels and sports stadiums to excessive duplication of job-training programs. One thing I am trying to fight these days in my "practice" is the idea that every little community group should reinvent its own social service offerings, especially as regards work force development, rather than partnering with one another and with mainstream organizations to achieve network economies. I hope we will find a way to convince local governments and private foundations to actively encourage such networking. But overall, and more generally, I do not see how heightened and hard-to-reverse interjurisdictional tax-cutting and deregulatory competition can be avoided, absent the "reinvention" of strong federal guidelines and, yes, even regulations.

I close with a related point about devolution. Dick Nathan and Irwin Feller have both pointed out that no level of American government has a worse track record at self-evaluation than state governments. Yet with devolution, the center of gravity of more and more public programs will be at the state level. There is enormous room for improvement in the art of program evaluation at the state level, and this is something we will need to work on.

Panelist William F. Fox

Professor of Economics and Director of the Center for Business and Economic Research, College of Business Administration, University of Tennessee at Knoxville

It seems to me that a good part of the discussion today had nothing to do with tax concessions or economic development initiatives per se, except for the final paper by Peter Fisher and Alan Peters. Most of the rest of the discussion was about state policies. The symposium program did not promise a discussion of incentives, but we should remember that we are evaluating a set of state policies that were adopted for a wide range of reasons, only one of which is economic development. In making their decisions, the legislative and executive branches must look at the whole range of implications and balance economic development with the other reasons why these programs happen. Every program has some implications for economic development. My discussions with policymakers lead me to conclude that economic development factors are being considered more and more. The list of incentives (a measure we heard criticized in another context earlier today) is growing very rapidly, as every state seems to believe it must play this game in some fashion or other. The question we need to ask is whether or not these programs have an impact.

The only person I remember talking today about what we mean by economic development is Bob Tannenwald, who gave us a bit of a definition. We should keep in mind that when policymakers are worried about economic development effects, they presumably have something specific in mind. Are we talking about jobs, income, or growth? Are we talking about effects for people who are already in the state? Bob Ady commented on the fact that today few employees move with a new plant. If we are talking about that kind of economic development, then perhaps just worrying about the people who are already in the state is sufficient. But in a lot of cases, we may be designing economic strategies for people who are not even in the state yet. So who are we worrying about? What measure of economic development do we have in mind? The question is key, because if we know what we are trying to achieve, then we have a better shot at devising strategies to meet that particular end.

I would also point out that much of the literature and much of the discussion heard today ignore the overall dynamic effects of what is likely to go on. I worked on the in-lieu-of-tax agreement for the Nissan plant in Tennessee about 15 years ago. After this work, we got a plant with 2,200 employees that quickly expanded to 6,000 employees. What a great economic impact that must have had on Rutherford County, a small county outside of Nashville, I thought. Then I went back almost a decade later and could not find any evidence that the area grew faster or that its income was higher relative to other places in Tennessee. In fact, nothing seemed to be different about the county except that more of its employment was in manufacturing than before. As it turned out, when Nissan came in, it paid high wages and skimmed off the best employees. It also raised land rents. As a result, other activity—such as other new businesses starting up—that might have occurred in Rutherford County did not happen. So you have to be aware of the difference between the short-term and the long-term impacts of having major business facilities come into a particular area. There were no signs that the location created unexpected or excessive effects on the public sector. The county was able to absorb Nissan, maintain preexisting tax rates for about 10 years, and continue to deliver expected services.

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What about the overall effects? Today we have focused almost exclusively on the impact of policies on business location. In my view, many other factors might also respond to economic development policy. The migration of the labor force or even of retirees can have implications. If only a few employees move with a plant when it relocates, the desirability of recruiting a plant is quite great, as most of the impact will be on people already in the state. On the other hand, when you recruit a plant, if all the employees stay where they are but continue to work for the firm via the Internet, you may wonder what benefit you received when you gave tax incentives to the plant to locate in a particular state or locality. As the way business is transacted adjusts and changes over the next five to ten years, the potential for electronic commuting could have important implications.

A man who runs a company in New York City told me that when his firm hires someone new, they never ask the person to move to the City, where it costs them $21 a square foot for office space. They have the following rules for conducting their business. If they are dealing with a client, they do it face to face. And once a month, the firm itself has a face-to-face meeting. Most of their other work requires communicating information and data, and they do that over the Internet. Our discussion today has focused mainly on manufacturing, which represents only one out of six jobs now. That means that five out of six jobs are in other industries with much more potential for this different way of doing business.

What counsel should we give policymakers for their economic development policies? First, you certainly want to avoid reading too much into any one piece of research—you want to look for the preponderance of evidence before you conclude anything.

Second, do taxes matter? Mike Wasylenko answered "Of course—to some degree." Bob Tannenwald went on to make a related point: We need to separate in our minds statistical significance, which is often of value to us as we try to publish a paper, from the public policy impact, which in most cases is much smaller.

Third, in terms of taxes, much of the emphasis in the literature and what we talk about is tax rates. The tax *structure* is probably more important. Massachusetts recently changed its tax structure for banking, but until then it levied a tax on 100 percent of the worldwide income of banks headquartered in Massachusetts and on none of the income of banks that were headquartered elsewhere. The issue there was not the tax rate but the tax structure (although Massachusetts also had the highest tax rate, which made it a particularly interesting setting). We should concern ourselves more with whether we are taxing businesses on a destination or an origination basis, for example, than with interstate differences in rates.

Finally, the key thing for states is to pay a lot of attention to competitor states. These states may include neighbors as well as states with similar industry compositions and demographic factors. In fact, the states all do that. I have never worked in a state that did not have a set of states it regarded as its competition. Probably the most important thing to do with tax and expenditure policies is to keep them roughly in line with those of your competitors rather than trying somehow to be unique and different. To take another example from the banking industry, some early movers such as Delaware and South Dakota were very effective at new policies that recruited back-office operations and headquarters. A number of states tried similar policies right afterward, but the evidence does not show that they were effective. There is probably a real lesson in the fact that the first two were successful, however.

Let me conclude by asking whether interstate competition should be discouraged. We heard discussion in Daphne Kenyon's paper about the fact that competition has the advantage that it gets businesses operating in an environment in which taxes become purely benefit taxes. That is a real plus. She and others went on to talk about the fact that neither policymakers nor researchers normally talk about the distributional consequences for people and geographic areas from gaining or losing jobs. On this issue of competition, I worry particularly that as we attract economic activity to one community, we leave behind unused infrastructure and people who formerly had a job in another community. None of that gets considered in analyses of the overall impact of competition.

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I would conclude that competition does not solve all problems, but nevertheless I would be particularly concerned about having the federal government tell the states how to formulate their tax policy. That is not something I would like to see, and I cannot imagine how you would set up rules to control it. It reminds me a bit of the NCAA trying to regulate the recruitment of football and basketball players. Extremely detailed rules get written to cover every possible recruiting scenario. Despite decades of effort, universities still fail to understand the rules and the rules are deliberately or inadvertently violated. That is a good metaphor for what it would mean to ask the federal government to step in. Very detailed rules would be necessary, and the states would routinely violate the rules, even if unknowingly. Finally, I believe competition does have the very good effect of helping keep state and local government tax and expenditure patterns within a narrow set of bounds.

Panelist Peter D. Enrich

Associate Professor, Northeastern University School of Law

I begin with a critical disclaimer: I am not now and never have been an economist. I come from a somewhat different perspective: I am an attorney and law professor who spends much of his time dealing with state and local tax policy. I follow the debates about the economic impacts of interstate competition for business with great interest, but my primary concern at present is the practical question of whether and how the competition should be constrained. Specifically, I want to direct our attention to two questions: First, is there a problem with state and local governments competing to attract economic activity? And second, if there is a problem, what can be done about it?

Much of today's conference has focused on another question that is closely related to my first topic: Do state and local policies significantly influence business location decisions? The evidence seems, at best, murky and complex, but I think that at least one conclusion can safely be drawn from this symposium—either state and local policies do have a significant impact on business location decisions and the level of economic activity, or they do not.

This may not seem like a terribly informative conclusion to draw, but in fact, I believe it may prove useful because, if either side of this disjunction is true, we have a problem on our hands. Let's briefly examine each possibility.

What if state policies have no significant effect? The problem then is evident: State and local governments are devoting substantial resources to programs that serve no useful purpose, resources that could better be devoted to other, presumably more constructive purposes. If state policies instead do have a significant effect on business location decisions, a problem still remains. To the extent that tax, spending, or regulatory policies are seen to have significant impacts, states and localities are likely to become increasingly aggressive about exercising these tools. And as they do so, the policies of the competing jurisdictions will tend to cancel one another out, and the substantial resources states and localities devote to them ultimately will gain them nothing. Even if such programs have substantial effects initially, in the end they will leave states where they began, again at significant cost.

This may be an oversimplification, but I believe it captures the essence of a serious problem. Those of us who work with state and local policymakers realize, moreover, that understanding the problem does very little to dampen the enthusiasm of political leaders for these policies. They have much to gain politically by pursuing such policies, regardless of the magnitudes of their economic effects, and political leaders remain largely impervious to whatever the empirical evidence may be.

What if state policies have no significant effect on business location decisions? Then governments are devoting substantial resources to programs that serve no useful purpose. And if they do have a significant effect, a problem still remains.

The problem is most pronounced with regard to tax policies, for several reasons. In the case of spending policies, when the state puts more money into education or infrastructure ostensibly for economic development ends, we at least wind up with some concrete benefits, such as better roads or better-educated children, even if such policies do not ultimately serve economic development purposes. When states compete in the regulatory arena by relaxing the stringency of their constraints on business, such a strategy does not have a guaranteed benefit but it does impose an obvious cost, one that is perceived directly by political constituencies in the form of diminished environmental safeguards or reduced protection for workers. This cost serves as a powerful check on the extent of the competition to deregulate.

By contrast, competition by means of tax concessions generates neither concrete collateral benefits nor evident, cautionary costs. Tax breaks for businesses provide nothing of value to the citizenry aside from the additional economic activity they purport to stimulate. In fact, to the extent that they do not achieve their economic ends, they diminish the capacity to provide governmental services. At the same time, the costs of tax concessions—costs in the form of reduced revenues that ultimately translate into service reduc-

tions or tax increases—are conveniently diffuse and indirect, and tax breaks are often designed so that much of the revenue loss is deferred into future years. Moreover, policymakers can always tell the story—and perhaps even believe it—that the tax breaks will stimulate enough economic activity to avoid any real revenue losses.

Finally, from the perspective of the businesses that lobby for governmental support, tax breaks offer the most attractive incentives, both because they are likely to be long-lived and because they offer the most direct financial benefits to the business bottom line. So it is little surprise that tax policy is the arena where we have seen the most dramatic interstate competition, as well as the arena where the dangers of such competition are most evident.

What do we do about this problem? A number of strategies are possible, several of them mentioned already today. First, one may hope that interstate competition will reach a sort of equilibrium. Perhaps as the level of tax breaks rises, and states see their small impact, the impetus for similar programs for other businesses will taper off. I am not convinced this will happen, however, so long as voters remain as deeply concerned as they currently are about their economic fortunes. We have seen that even as the economy approaches full employment, voters remain deeply anxious about job security, and politicians feel impelled to show that they are doing something to help.

What about regional agreements, truces, or compacts? Recent examples of states agreeing to restrain their competition have proved short-lived. States have little incentive to abide by such agreements, and no effective way to enforce them against one another. What about congressional action to set limits to state competition? In this era of devolution and states' rights, that seems to be a rather idle hope.

I would like to suggest a different strategy, one that is more likely to occur to lawyers than to policymakers or economists, but one that does offer significant promise: I believe the courts are in a position to put a stop to a great deal of the interstate, intergovernmental competition, at least in the tax arena. In an article in the *Harvard Law Review*, I argue that the Constitution's Commerce Clause provides a substantial obstacle to a wide range of tax breaks states offer to business.[1] As the Supreme Court has said, the Commerce Clause addresses "a central concern of the Framers that was an immediate reason for calling the constitutional Convention: The conviction that in order to succeed, the new Union would have to avoid the tendencies towards economic Balkanization that had plagued the relations among the Colonies and later among the States under the Articles of Confederation."[2] The historical rivalries among the states that motivated the Commerce Clause bear striking parallels to the current interstate competition to lure businesses with tax incentives. On numerous occasions, the Supreme Court has invalidated state tax measures that discriminate in favor of local economic activity or that penalize out-of-state activity, on the ground that such discrimination violates the Commerce Clause. My suggestion isthat because they limit their benefits to companies which locate their activity in-state, a wide range of the tax breaks that states use to attract business are guilty of this same discrimination and, hence, are unconstitutional.

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If this is such a clear constitutional problem, why hasn't it already been addressed by the courts? States, after all, have been using these tax measures for many years. The answer is simple: The parties who typically are in a position to deploy the Commerce Clause in litigation are business taxpayers. But this group has shown no interest in bringing challenges to tax credits or property tax abatements, for example. An out-of-state business may be disadvantaged by such provisions, but in general businesses are clever enough not to want to kill the goose laying their golden eggs. So the issue simply has not come before the courts.

Does this mean that such challenges will never make it to court? I think not; several other groups may well bring suit. States themselves may challenge the tax policies of other states that are stealing business from them. Alternatively, interested parties who are concerned about state fiscal resources—citizen-taxpayer groups or labor unions—also are often in a

[1] Enrich, Peter D., 1996, "Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business," *Harvard Law Review*, vol. 110, December, p. 377. See also Hellerstein, Walter and Dan T. Coenen, 1996, "Commerce Clause Restraints on Business Development Incentives," *Cornell Law Review*, vol. 81, no. 4 (May), p. 790.

[2] See Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979).

position to bring such suits. Neither of these strategies has been pursued yet. I would not be surprised, however, if in the near future we see states or interest organizations begin to raise such challenges. If so, they will put the courts in a position to alter radically the ground rules for interstate competition.

A further hope is that once such cases start to be brought before the courts, the political dynamics for congressional action will change dramatically. If states and businesses find that the Commerce Clause precludes state business incentives unless Congress sets the parameters and provides the authorization for them, that will create a powerful incentive for Congress to try to figure out a reasonable balance in what states should be permitted to do. Judicial intervention may be the needed catalyst that can bring all the interested parties to the table to determine how much interstate competition really is consistent with the healthy functioning of the states and the national economy.

Panelist Robert D. Ebel

Executive Director, National Tax Association

My task is to follow up on previous speakers' remarks by commenting on how one might use the information from today's symposium in giving advice to policymakers. Four points need to be to be covered: the merits and limits of the methodology we have been discussing; the need to be watchful for potentially inconvenient institutional features, which may not be reflected in statistical and econometric studies; caveats regarding how to interpret the spending–economic development relationship; and the possible merits of an increased federal role for the purpose of dampening some aspects of what many now consider destructive interstate tax competition.

First, on methodology. As Michael Wasylenko notes, today we have focused almost entirely on statistical studies. For at least two reasons, this is appropriate. First, statistical studies account for a large part of a very robust literature. Second, such studies provide research analysts and policymakers alike with a systematic and reliable tool for making useful statements on applied policy matters. Within this context, I would note that even the practitioner who considers such studies not particularly relevant (as Robert Ady said, "Tax elasticities are highly suspect") may nonetheless often make the argument for their importance. I accept that, as Ady points out, state and local taxes do not come into play in a firm's location and expansion decision except, perhaps, as a final element among many in the firm's decision process. (He cites other factors, such as nearness to markets and transportation costs.) He concludes that taxes therefore do not matter until the very end of a long string of decisions, but that is exactly the point where the statistical study contributes to the policy discussion. It is at that margin—the last element—where many business location and expansion decisions are made. Thus, while it is indeed true that the Hawaiian sugar industry is not likely to move to Idaho because of Hawaii's high state taxes (despite what a representative of the Hawaiian Sugar Planters' Association once claimed), it is also true that once a firm makes the big, first-cut regional and market decisions, it is at the margin where taxes may matter, particularly in the intra-regional context. The next step—just how much taxes (or other fiscal variables) do matter—is just what statistical studies set out to examine and what makes them useful. It is the job of the economist to think and advise in these terms, even if the word "elasticity" never makes it from the technical appendix to the policy memorandum.

At the same time, just as it is important to bring statistical studies to bear on the tax–economic development policy decision, it is critical to combine that statistical evidence with good judgment. The merit of statistical studies—their preciseness and rigor—can also be the source of their misuse. To draw on a metaphor provided in his book, *Economics as a Science*, Ken Boulding notes that one may think of economic technique (in today's context, the statistical study) as useful only to the extent that it defines a kind of "policy mesa," where the job of the applied economist is to think of economic welfare as a large tableland with a great variety of policies a society can adopt. The search for the high point on the tableland (for example, the precise elasticity coefficient) is probably fruitless. On the other hand, the mesa has cliffs, and it is the job of the economist to give advice and to warn politicians of where the cliffs are.

Once again, it is the responsibility of the economist to keep a systematic focus on the relevant statistical study; that is why estimating elasticities is important. But it is just as important to understand the

tableland factor and, thus, to not believe "too much" in the preciseness of the study results, however elegant they may appear in a scholarly journal. This is particularly true when one factors in the nature of bargaining that Edwin Mills and Bennett Harrison have discussed here today.

On a second and related point, if statistical studies are to deliver the benefits promised for them, the analyst must be constantly be aware of certain institutional realities that may greatly reduce the practical value of one's findings. Consider, for example, the study that relates levels (or changes in levels) of state business taxes to economic development. Implicit in this relationship is the view that tax levels are largely policy-driven; that is, that by adjusting a tax rate or base, policymakers can influence tax payment levels. But what if we drop this seemingly fundamental arithmetic truth? Some tax administrators (as well as business taxpayers) argue that unless some sort of sweeping change occurs (such as abolishing the corporate tax), corporations often simply ignore such policy adjustments. Why? Because rather than "pay" taxes in the conventional sense of calculating tax due (rate times base), they tithe. That is, they take a long-run financial view of their business operations by smoothing out the level of tax to be paid over a period of time. To keep on this path, they simply negotiate their taxes due from year to year—even if this means in some periods a firm may intentionally overpay a tax bill. If this is true for large state corporate taxpayers, and some evidence suggests that it is, the statistical study that assumes a change in taxpayer behavior as taxes change may miss the mark entirely.

With respect to expenditures, we have been discussing the importance of three types of spending: public safety, transportation, and education. The general message is that these factors often matter—perhaps significantly so—where it is understood that a relationship (usually thought to be positive) exists between the level of spending and some economic development variable(s). Thus, for example, the question is often posed whether more spending on schools is associated with economic development. In an aggregate context (for example, in a country or state), this reasoning seems to make sense. But what about the circumstance of local policy—the level at which many decisions on transportation, schooling, and public safety are made? Consider, for example, the typical problem of metropolitan interactions. The urban literature suggests that the central city must spend more on public safety to address the fact that it is the metro area's center for a crime-prone population; more on transport because of congestion (or, perhaps, diseconomies resulting from poor traffic management); and more on schooling because of having a disproportionate share of the metro area's poor. Thus, it may be that in a metro area context, lower spending on these three categories is associated with economic development in a suburban area, yet higher spending in the central city has little or no impact on development. Does this mean lower spending for the metro area as a whole makes sense? Probably not. A massive cross subsidy (center subsidizes suburbia) may just be going on here. If so, we may be incorrectly estimating, perhaps in a very big way, the true tax price of public expenditures.

The very end of a long string of decisions is exactly the point where the statistical study contributes to the policy discussion. It is at that margin—the last element—where many business location and expansion decisions are made.

Finally, let me address the question of the appropriate federal role in interstate competition. The issue: Should the federal government (regulators, legislators, or the courts) intervene to promote or to dampen interstate competition? I will argue strongly that federal policymakers should do neither—that they should make every attempt to remain neutral in the state/local tax and economic development process. Although intervention may bring some short-term gains (even though interventionists have yet to make a very good case), it is surely true in a longer perspective that a policy that allows subnational governments to act on their own is clearly preferred. As one looks over the world's economies, the evidence is rather convincing that countries that give subnational governments wide latitude in tax and spending decisions grow faster than more centralized nations. In this era of growing international competitiveness, it would be a great mistake to ask Washington to get involved in the state/local tax and expenditure policy process, in any almost any manner. Interstate competition has its flaws; but federal intervention in the state fiscal process would be far more costly.