

PERSPECTIVE

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A REPORT TO LEAGUE MEMBERS ON SIGNIFICANT STATE GOVERNMENT DEVELOPMENTS

May 1998

Moving the Business Climate to the Next Level in Southwestern Pennsylvania

In the fall of 1997, the Advanced Manufacturing Network of the Pittsburgh High Technology Council engaged the Pennsylvania Economy League, Capital Division, to provide an analytical, factual, and comparative understanding of the business climate of Pennsylvania and the Southwestern Pennsylvania region. This *Capital Perspective* summarizes the findings and recommendations of that study.

The analysis focuses on one sector of the economy - value-added manufacturers and innovative industries. These industries exhibit emerging strengths and promising growth trends by incorporating new technologies and processes and devoting resources to research and development. In addition, they include new-growth industries such as information technology and robotics, and companies in traditional industries such as industrial equipment and chemicals.

Important Business Climate Factors for Value-added Manufacturers/Innovative Industries

A state's business climate plays an important role in the statewide economic growth and strongly influences the growth of each of its regions. Since it is necessary to adapt a good business climate to the continually evolving economy, public policy makers must keep a constant vigil on key business climate factors, especially those factors related to industries exhibiting emerging strengths and promising growth.

In Pennsylvania and the Southwestern Pennsylvania region in particular, value-

added manufacturers and innovative industries exhibit characteristics which are important to the growth of the state and regional economy. Employment in value-added manufacturing and innovative industry is growing at a faster rate than most other sectors of the economy. At the same time, payroll for these jobs is significantly higher than average. In addition, most value-added manufacturers and companies in innovative industries are relatively small, employing less than 100 employees.

Employee productivity, trainability and availability are the most important factors in the growth of value-added manufacturers-innovative industries. New competitive conditions and changing technologies make employee-related issues a particularly difficult problem for employers not only in Pennsylvania, but in most other areas of the country as well. Business taxes follow

employee issues in order of importance for these industries. Also of concern are mandated employee costs such as workers' compensation and unemployment compensation, and regulatory impediments.

The results of this analysis focus attention on the issues which are most important to these industries.

Benchmarking the Competition

Certain regions in other states have demonstrated economic success based on growth in value-added and innovative industries. An examination of the business climate policies in these states provides a benchmark for measuring Pennsylvania's comparative position. More important, benchmarking identifies successful public policies and programs which can be replicated or modified for application in Pennsylvania.

The results of benchmarking reveal that Pennsylvania is not alone in its search for a qualified technical workforce. One avenue pursued by other states to address this problem is making extensive use of their community college systems to increase the skill levels of existing and future employees in targeted occupational areas. North

Carolina is often cited as having a model system.

Pennsylvania's business tax structure is viewed as non-competitive in terms of rate and base despite recent changes. While Pennsylvania offers many of the same tax credits available in other leading states, legislated limitations severely restrict a broad application, especially to many growing small value-added manufacturers and innovative companies. Massachusetts is one state which provides attractive tax credits, although its tax rate is high.

Pennsylvania significantly improved its competitive position when it passed workers' compensation reform. However, Pennsylvania remains at a significant disadvantage in unemployment compensation costs when compared to the competition.

Recommendations for Moving Southwestern Pennsylvania to the Next Level

Pennsylvania's business climate has had a reputation as being high cost, and therefore, less competitive within its region as well as nationwide. However, the General Assembly and Governor Ridge succeeded in making a number of significant improvements which benefit Pennsylvania's business community. Most of these changes are just now taking effect. Some of the most notable

improvements include a major overhaul of the workers' compensation law, a variety of reductions to business taxes, and electric utility deregulation. However, PEL's benchmarking analysis indicates that more needs to be accomplished.

Value-added manufacturers and innovative industries are typically made up of small

businesses that are relatively high in job growth, especially as a result of export sales out of the state. In addition, they require employees with technical skills and are research and development intensive. Therefore, policy changes which best fit these characteristics can be influential in their growth.

Although there are many factors which make up a state or region's business climate, these recommendations first spotlight issues related to business taxes. Rather than address tax policy indiscriminately, a long range plan which incorporates broad-based reductions in taxes is needed. The eventual goal of this strategy is to bring the tax burden on Pennsylvania businesses, as measured by business taxes as a percent of total taxes, in tune with competing states.

That policy should focus first on the corporate net income tax and base. A second priority should address the Capital Stock and Franchise Tax.

For fiscal year 1998-99 the following four specific actions should receive the highest priority:

- Adopt net operating loss provisions similar to those in other states' laws for the corporate net income tax.
- Adopt a "single sales factor" apportionment formula for the corporate net income tax.
- Raise the exemption in the capital stock and franchise tax and eventually eliminate the tax.
- Institute a targeted job training tax credit in Pennsylvania.

The following are recommendations for the fiscal years 1999-2000 through 2002-2003:

- Reduce the corporate net income tax rate to 7%.
- Dramatically expand the research and development tax credit including the provisions reserving a significant part for small business.
- Expand the job creation tax credit and target to smaller businesses.

In addition to business taxes, state government influences the business climate for value-added manufacturers and innovative industries in many other ways. For example, several leading states are addressing the shortage of technical workers at both the state and regional levels. In most of these efforts, programs target certain industries and skills essential to the success of those industries. To address this shortage Pennsylvania state government should:

- Support initiatives which focus on and increase resources devoted to expanding post-secondary technical skill training.
- Support expansion and improvement of state-level "school-to-work" initiatives.

State government contributes to the cost of labor by mandating employee related expenses such as workers' compensation and unemployment compensation, and by influencing health care costs. To improve its competitive position Pennsylvania should:

- Legislatively address Pennsylvania's unemployment compensation laws to bring costs to employers down to a level competitive with similar companies in other states.
- Oppose legislation which unnecessarily adds to the cost of health insurance.

Regulatory impediments seriously retard the growth of small value-added manufacturers and innovative companies, especially in their key early stages of development. For improvements in the regulatory process, Pennsylvania state government should:

- Promote a fair balance between economic growth and environmental standards.
- Promote continued change and improvement in environmental permitting processes.

Conclusion

Economic growth for any region depends on a continual assessment and overhaul of its economy. Successes in rebuilding one part of a regional economy must be closely followed by yet another. New industries which are efficient and globally competitive adapt best to the ever changing economy. While regional factors play a major role in this continual transition, state government economic development policies also contribute significantly.

Policy makers must keep a constant vigil on a state's and region's business climate. Changes in competitiveness compared to other states and countries is now a given. The recommendations in this report address some of the changes needed in Pennsylvania to remain competitive for continued growth opportunities in the economic sectors of the future.

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