Indiana’s Golden Straightjacket

One of my favorite books from recent years is Thomas Friedman’s “The Lexus and the Olive Tree.” Friedman is the Pulitzer Prize-winning columnist from the New York Times. His book is about globalization, the increasingly interconnected international economy.

Friedman is good at thinking up clever terms for abstract ideas. One that Indiana should pay attention to is “golden straightjacket.” The golden straightjacket is the set of rules about property, banking, trade and taxes that businesses look for when they decide where to invest. “Golden” because adopting these rules leads to economic growth. Profits are higher and more certain in places that obey these rules, so businesses invest, creating more jobs and higher incomes. “Straightjacket” because there’s not much room for any state or nation to deviate from the rules. Wearing the straightjacket can get very uncomfortable.

Indiana’s tax restructuring debate is about how tight we want to wear the golden straightjacket. Parts of our tax structure break the rules and probably keep businesses from investing in our state.

Almost everywhere, property is taxed based on market value, its predicted selling price. Not in Indiana. We base our property tax on our own assessing rules. Businesses that know how to calculate their property’s tax value in the other states must learn different rules if they relocate in Indiana. Our assessment rules are more subjective than market value rules. This means that even businesses that understand the rules can’t know exactly how they will be applied. Some businesses surely say, “Why bother?” and go elsewhere.

Indiana has taken the first steps toward solving the assessment problem. The new rules for our ongoing reassessment are closer to market value. They’re not quite market value, though, and it’s not clear how well the new rules will be applied. The straightjacket requires market value, done well.

Hardly anyone taxes inventories with the property tax. But Indiana does. Businesses might consider putting their distribution facilities along the many interstate highways that run through Indiana. However, when they find out that they’ll pay a property tax on these goods, some decide to go somewhere else. The straightjacket requires that we not tax inventories.

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Just about everywhere, corporations are taxed based on the profits that they earn. Indiana has profit taxes, but we also have a gross income tax. It taxes corporations on their total revenue, whether they earned a profit or not. Most start-up businesses lose money for a few years before becoming profitable. In other states, these companies don’t pay such a tax. In Indiana, they just might. Many start-ups decide to start elsewhere. The straightjacket requires that we tax profits, not gross revenues.

Making these changes would reduce the taxes collected from businesses. That might help business investment, too. Though Indiana is a low-tax state, our business taxes are a little higher than our neighbors’.

Now for the main problem. Tax cuts must be paid for, and that can be done in one of two ways: spend less or raise some other tax. We could spend less, but businesses also look for good education, good roads and utilities, and good police and fire protection. Places that don’t provide these things don’t get economic growth, even if their taxes are low.

Or, we could raise some other tax. We could invent some new business taxes, but they might discourage business investment as much as the taxes we’re changing. That leaves taxes on households, like the individual income tax, or the sales tax. That’s what makes the golden straightjacket so uncomfortable.

The trouble with the golden straightjacket is that the uncomfortable tightening comes first. Most people would pay more in household taxes. The golden part comes later. Investment increases only after businesses see that Indiana has changed its tax structure. It’s a gamble. Most people pay higher taxes, but it’s no sure thing that most people would benefit from the added jobs and higher incomes. But with Indiana lagging further and further behind the rest of the country, it may be time to take a chance.

4-25-02

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