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## Fragile Progress, But Most State Business Costs Still High

Despite a decade of progress, high business costs in key areas continue to hold back the Massachusetts economy, and more must be done to make the Commonwealth competitive, according to a comprehensive report released today by three of the state's leading business associations.

Ten years ago, Massachusetts ranked well above the national average in all five areas analyzed in the report – health care, electricity, unemployment insurance, workers' compensation and taxes – but since then a series of reforms has narrowed the gap in each category. The improvement in workers' compensation has been particularly dramatic. Nevertheless, Massachusetts businesses continue to pay a premium in the other four areas, with costs well above average in health care, electricity, unemployment insurance, and corporate and personal income taxes.

“While the state’s immediate fiscal problems are at the top of everyone’s agenda, policy makers and others must remain focused on the fact that economic recovery – and future tax revenues – are directly linked to maintaining and improving Massachusetts’ competitive position,” said Massachusetts Taxpayers Foundation president Michael J. Widmer. “It would be folly for the Commonwealth to attempt to solve its short-term fiscal problems at the expense of long-term economic competitiveness.”

The report, *Fragile Progress: Reining In Massachusetts’ High Business Costs*, was prepared by the Massachusetts Taxpayers Foundation with the Associated Industries of Massachusetts and the Greater Boston Chamber of Commerce. It compares business costs in Massachusetts with those in other states, particularly the other high technology, large industrial and New England states with which the Commonwealth competes. Significant findings include the following:

- **Health Care.** Double-digit increases in health care costs top the list of business cost concerns. Premiums for family health insurance plans, which in 1993 were second highest in the nation, were still the third highest in 2000, and they remain higher than in any other high tech state.
- **Electricity.** Commercial rates were 25 percent above the national average in 2000; though improved from a 36 percent gap in 1997, most competitor states still have lower electricity costs. Industrial rates are even further above average.
- **Unemployment Insurance.** The state's average UI costs remain among the highest in the nation, despite a considerable decline over the past decade. In 2002, the average cost per employee was 70 percent above the national average and the seventh highest in the country.

- **Workers' Compensation.** Workers' compensation costs in Massachusetts have fallen significantly while retaining strong protections and benefits for workers.
- **Taxes.** Massachusetts has one of the heaviest personal income tax burdens in the country and higher-than-average corporate income and property taxes, but sales taxes are relatively low.

“Monitoring our business costs and comparing them against those of our rival states is a baseline measure of economic competitiveness,” said Chamber President and CEO Paul Guzzi. “This is especially true during the recovery phase of the business cycle, when a higher cost structure has proved in the past to be a serious drag on growth.”

Added the Associated Industries of Massachusetts President Rick Lord, “The importance of protecting these gains cannot be overstated. The state's fragile economy makes it even more important that we improve our cost competitiveness. Threats to our position include not only direct imposition of costs, such as increases in taxes and rates, but new mandates that could shift public costs to business.”

The report makes several recommendations to preserve and strengthen the reforms and policies that have produced significant progress in reducing business costs relative to other states over the last decade. These include:

- Preserving the tax reforms that have improved the state's competitiveness and helped keep jobs in Massachusetts.
- Adopting major reforms to the state's unemployment insurance experience rating system so those employers who avoid laying off employees are not subsidizing those who do.
- Rejecting any proposed changes to the workers' compensation system without clear and convincing evidence that the benefits will exceed costs.
- Staying the course in electricity restructuring and steering clear of any changes that would slow the progress toward lower electric rates.
- Avoiding new mandated health care benefits or expanded HMO liability and resisting efforts to further shift costs from public to private sources in an attempt to close the budget deficit.

MTF is an independent, nonprofit organization that conducts research on state and local taxes, government spending and the economy; the Foundation's previous work on business costs won a national award. A.I.M., with 7,500 members, is the largest employer association in the Commonwealth and has focused on reducing the costs of doing business in order to promote investments that sustain and create well-paying jobs. The Greater Boston Chamber of Commerce is a broad-based association representing more than 1,700 businesses of all sizes from virtually every industry and profession in the region, and provides leadership in creating a healthy climate for economic development and job creation.

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## **Fragile Progress: Reining in Massachusetts' High Business Costs**

### **Summary of Findings and Recommendations**

**Health Care.** Although the rate of employer health care premium rate hikes eased during the mid-1990s, health care cost increases paid by employers and consumers alike have again returned to double digit annual levels, nationally and in Massachusetts.

Premiums for both single and family plans in the state remain above national and competitor averages, but unevenly so: The state's family premiums, which in 1993 were second highest in the nation, were still the third highest by 2000, and they remain higher than in any other high tech state. The single plan cost gap between Massachusetts and the nation is now just 2.4 percent, but only one other high tech state had higher single plan costs than Massachusetts.

**Recommendation.** The rising cost of health care is a major issue for all Massachusetts businesses. Recognizing this fact, the Commonwealth should not impose new mandated health care benefits, expand HMO liability, or enact other laws that produce higher costs. Policy makers must also avoid continuing to shift costs from public to private sources in an attempt to close the state's budget deficit, as was effectively done by tapping the Medical Security Trust Fund. Adding to these cost burdens would exacerbate an already serious problem and lead to an increase in the state's uninsured population.

**Electricity.** Commercial and industrial electricity rates in Massachusetts have been well above average over the last decade, but the gap is closing. Commercial rates were 25 percent above the national average in 2000, compared to a 36 percent gap in 1997. Most competitor states have lower commercial rates, though costs in other New England states are higher.

While the industrial rate gap has also improved in recent years, Massachusetts remains high relative to competitor states. Industrial rates in Massachusetts were 81 percent above the national average and fourth highest in the nation in 2000.

Enactment of utility restructuring legislation in 1997 is already paying some dividends, though the act's full benefits will take years to unfold. A number of new, cleaner and more efficient generating plants being built or in the pipeline promise to lower rates by increasing the supply of electricity; a competitive electricity market is also beginning to emerge. In 2001, only four percent of all electricity used by Massachusetts businesses came from competitive sources; by 2002, that figure had risen to 34 percent.

**Recommendation.** The continued evolution of competitive wholesale and retail electricity markets requires stable rules, prices and supplies. Massachusetts must stay the course in restructuring and not make any sudden or severe changes that would slow the progress toward lower electricity rates.

**Unemployment Insurance.** Although the state's average UI cost has declined considerably over the past decade (as has the state's effective tax rate on wages), it remains among the highest in the nation. In 2002, the average cost per employee in Massachusetts was 70 percent above the national average and seventh highest in the country. Though high, that's a major improvement over the 150 percent gap in 1992. Also in 1992, employers in only two other states paid a higher effective tax rate on total

wages; in 2001, 11 states, including five competitor states, exceeded Massachusetts' effective UI tax rate.

In addition, state policy perpetuates an inherent inequity: the experience rating system does not fully allocate costs to firms that drive up UI costs by routinely laying off workers. As a result, the majority of the state's employers shoulder a disproportionate share of UI costs, in essence subsidizing heavy users of the system.

**Recommendation.** Having averted an 80 percent increase in rates for 2003, attention must now turn to systemic reforms that will replenish the trust fund while allocating costs more equitably. Specifically, major reform of the experience rating mechanism must be part of any effort to stabilize the system.

**Workers' Compensation.** By far the state's greatest business cost success story, workers' compensation costs have fallen while retaining strong protections and benefits for workers. The 1991 reforms and their implementation demonstrate the capacity of state policy to lower costs in areas over which the state has significant influence. Costs per \$100 of payroll were 51 percent above the national average in 1989; they were 20 percent below the national average in 2002, when only two of our competitor states had lower rates.

**Recommendation.** Reform of the workers' compensation system, which was on the verge of collapse in 1991, is one of the true success stories of the last decade. We urge that no changes be made to the current system without clear and convincing evidence that any adjustment is necessary. Any proposed modifications should be subject to an independent and thorough cost/benefit analysis.

**Taxes.** The Commonwealth has one of the heaviest personal income tax burdens in the country and higher-than-average corporate income and property taxes, but one of the lowest sales tax burdens and relatively low fees and charges. Since 1992, Massachusetts has narrowed its disparity with other states for personal income taxes but has lost some ground on corporate income and property taxes.

In general, the corporate income tax burden in Massachusetts remains above that of competitor states. Corporate income taxes in Massachusetts compared to personal income were 26 percent above the national average in 2000; the gap with other states has narrowed since 1996. All taxes and fees relative to personal income were 11.5 percent below the national average in 2000, but 13.0 percent above average on a per capita basis.

**Recommendation.** Over the past decade the legislature has approved a number of tax changes that have improved the competitiveness of the Massachusetts economy. These reforms have focused on key sectors, including manufacturing, banks, insurers and mutual fund companies. The organizations authoring this report, which strongly supported these changes when initially proposed, oppose efforts to undo these incentives that have helped to keep jobs in Massachusetts. It would be folly for the Commonwealth to attempt to solve its short-term fiscal problems at the expense of long-term economic competitiveness.