

THE BOTTOM LINE

By choosing the Idaho or Oregon side of the line, many businesses can find themselves able to lighten their regulatory burden, reduce their taxes, and pick up valuable financial incentives unavailable to them in Washington. Our state's border communities have become increasingly business-friendly, with responsive local officials and progressive, creative chambers of commerce and economic development organizations. Yet, many of the decisions affecting businesses throughout the state are made in Olympia by Puget Sound area legislators. These legislators should realize that their actions have consequences that reverberate down the line.

Across State Lines

Business leaders today face competition from everywhere. Increasingly, trade knows no boundaries. Consequently, policymakers, economists, and business owners spend a lot of time considering the effects of worldwide commerce. Geographically positioned in the nation's northwest corner, Washington has always had a strong international focus, led by aerospace and nurtured by natural resource, agricultural, and technology industries. In recent years, the focus has intensified.

Advanced technologies allow firms of all sizes to move operations offshore. Manufacturing, assembly, customer service, and marketing functions often are dispersed. Physical location matters less. Costs matter more. A shrinking planet poses both opportunities and threats for American employers and workers.

Yet, in many Washington communities, the competitive threats come not from Bangalore, Dublin, or Hong Kong. They come from places like Post Falls, Coeur d'Alene and Portland—from Moscow, Idaho not Moscow, Russia. Border communities in Idaho and Oregon vie with their Washington state neighbors for development. Among the benefits the Idaho and Oregon communities tout are economic incentives unavailable in Washington, lower business costs, and a can-do, pro-development attitude often missing here.

In this Washington Alliance for a Competitive Economy (WashACE) report we look at competition on the state lines separating Washington from neighboring Idaho and Oregon. While the issues vary between communities and between industries – the reason we sometimes refer to the business climate as a mix of microclimates – some important lessons can be learned from the general comparisons we undertake here.

When times are good – and things here are certainly better now than they have been for several years – we tend to forget the competitive challenges faced by those who run businesses and create jobs in Washington. Already, legislators have greeted a strengthening economy with new regulations, higher costs, and an unsustainable state budget. Across the state line, Idaho presents businesses with tax and regulatory relief, lower costs, affordable housing, and attractive relocation incentives. Oregon offers generally low business taxes and no sales tax. While neither state can claim to offer business nirvana, each competes with Washington for business, particularly smaller and midsize firms. And each can provide unique benefits to firms looking to expand or relocate. In the Puget Sound, the large population, premier research institutions, international ports and transportation hubs, and strong in-

dustry clusters somewhat cushion the effects of high business costs and punishing public policies. In our border counties, few such buffers exist.

A COSTLY STATE FOR BUSINESS

Recent studies demonstrate consistently that Washington imposes higher business costs than either Oregon or Idaho. (Some of these comparisons are summarized in Table 1.) Although Washington continues to experience higher international migration, Idaho and Oregon have enjoyed higher domestic migration, suggesting competitive success in US relocations. Home

ownership rates, which indicate both housing affordability and residential stability, are substantially lower in Washington than in Idaho and Oregon.

According to the Milken Institute's Cost of Doing Business Index, Washington ranks as the nation's eighth most expensive state, while Idaho ranks 46th and Oregon ranks 30th. Milken ranks business costs on five measures – wages, taxes, electricity, industrial rent, and office rent. Washington exceeds the U.S. average on four of them, scoring lower only on electricity costs. Idaho exceeds the U.S. average on only one factor, taxes, while Oregon is above average only in office rent.

Unemployment insurance taxes per employee in Idaho and Oregon are

substantially lower than those in Washington: \$685 per worker here, \$594 in Oregon and \$331 in Idaho. All three states rank in the top ten. Washington, of course, ranks first. The 2003 UI reforms in this state, amended by the Legislature this session, would have moved the state closer to the mainstream, although even were the reforms to have taken full effect, analysts expected Washington to continue to impose among the nation's highest UI costs. This year's amendment, although intended to be cost neutral, is projected eventually to drain the unemployment insurance trust fund by an estimated \$200 million.

In Washington, workers' compensation benefits (and therefore costs) are fourth highest in the nation; Idaho ranks 20th and Oregon 30th. On nearly every comparison of costs, Washington is the more expensive place to do business. Granted, these costs will impact businesses differently. For some, the higher costs will be offset by other factors (access to markets and labor pools, the resources offered by major universities, or efficient

Table 1: Business Cost Comparisons

	Washington		Idaho		Oregon	
		Rank		Rank		Rank
Unemployment Insurance Taxes (per employee, 2004 Q1)	\$685	1	\$331	10	\$594	3
Cost of Doing Business (Milken Index)	107.9	8	84.4	46	91.7	30
Workers' Compensation Benefits Paid	\$624	4	\$353	20	\$291	30
Union Members as a Share of Employment	20.9%	6	8.6%	37	16.4%	15
State Minimum Wage	\$7.35	1	\$5.15	13	\$7.25	2
Business Taxes as Share of GSP, Rank among Western States (Utah State Tax Commission)	4.07%	1	2.55%	3	1.78%	7
Business Taxes as Share of GSP, Rank among 50 States (Ernst & Young)	5.1%	4	4.2%	37	3.7%	46
Business Taxes as Share of State and Local Taxes (Ernst & Young)	50.1%	10	38.8%	39	33.8%	49
Home Ownership Rates	65.9%	43	74.4%	8	68.0%	39
Revenue per KwH from Industrial Customers	4.52¢	23	4.74¢	20	5.47¢	14
Revenue per KwH from Commercial Customers	6.15¢	36	5.47¢	48	6.55¢	34
Net Domestic Migration to State (July 2002 to July 2003)	5,687	19	10,132	11	13,300	10
Net International Migration to State (July 2002 to July 2003)	27,216	12	2,907	39	14,755	19

Source: WashAce 2005 Competitiveness Redbook and Updates

transportation channels). For others, the costs may prove prohibitive, leading them to rethink expansion plans or, in extreme circumstances, to move across the state line.

Analysts at the Utah State Tax Commission have compared tax burdens among selected Western states. The Utah study focused on major taxes in Fiscal Year 2003 and found that Washington’s initial business tax burden ranks highest among the seven states compared (Arizona, California, Colorado, Idaho, Oregon, Utah, and Washington). At 4.07 percent of Gross State Product (GSP), the business tax burden in Washington is sixty percent higher than the 2.55 percent paid in Idaho and more than twice the 1.78 percent paid in Oregon. Household taxes in Washington were lowest among the seven, amounting to 5.21 percent of personal income. Oregon ranked third, with household taxes representing 6.78 percent and Idaho was fourth, at 6.47 percent.

Dr. Neil Bruce, chairman of the Department of Economics at the University of Washington, sliced tax data from a different source, the Department of Commerce’s Bureau of Economic Analysis, and reached a similar conclusion. Bruce calculated business tax burden, defined as taxes on production and imports less subsidies (TOPI), as a share of GSP. Using this

measure, Washington’s business tax burden (2001 data) amounted to 8.9 percent of GSP, compared with 6.6 percent in Idaho, 4.9 percent in Oregon, and 7.1 percent for the U.S.

Ernst and Young (E&Y) this year released a study comparing business taxes by state for fiscal year 2004. This study considered a more comprehensive set of taxes than did the Utah study. (The unemployment insurance tax is the most notable tax that is included by E&Y but excluded by

Utah.) E&Y put Washington’s business tax burden at 5.7 percent of private sector gross state product, tied for 9th highest nationally. Idaho’s business taxes were 4.2 percent of private sector GSP (37th nationally), while Oregon’s were 3.7 percent (46th). E&Y calculate that businesses pay 50.1 percent of state and local taxes in Washington (10th nationally), businesses in Idaho pay 38.8 percent (39th), and businesses in Oregon pay 33.8 percent (49th).

Our look at interstate competition will focus on three regions. Kootenai County, Idaho is paired with Spokane County, Washington; Latah County, Idaho, with Whitman County, Washington, and Clark County, Washington, with the Oregon counties in the Portland metropolitan area. Table 2 summarizes population and employment changes in the three regions between 1970 and 2004. In each instance, the community on the Washington side of the line has lagged its competitor across the line in the pace of job creation.

Table 2: Population and Employment Comparisons

	Population			Wage and Salary Employment		
	1970	2004	% Growth	1970	2004	% Growth
<i>Spokane</i>	289,129	435,644	51%	103,422	209,794	103%
<i>Kootenai</i>	35,579	122,350	244%	9,821	48,900	398%
<i>Whitman</i>	38,061	40,146	5%	12,153	17,933	48%
<i>Latah</i>	25,099	35,169	40%	7,528	16,469	119%
<i>Clark</i>	129,619	392,403	203%	36,095	125,737	248%
<i>Clackamas</i>	167,095	363,276	117%	36,893	140,368	280%
<i>Multnomah</i>	553,956	672,161	21%	295,933	448,862	52%
<i>Washington</i>	159,182	488,253	207%	42,694	232,806	445%

Source: Bureau of Economic Analysis

CONTRASTING TAX STRUCTURES

Nowhere in the nation do two states stand in such sharp contrast as across the Washington-Oregon line. Between the two states, Oregon economist Bill Conerly says, “We have something to offer everyone. That’s a good thing for the region.” Because of our tax structures, low-margin, high-volume businesses may prefer to operate in Oregon, where the corporate income tax affords them a better deal. On the other hand, high-margin, low-volume businesses may fare better with Washington’s gross receipts tax. Or, as Conerly points out, sometimes it may be advantageous to start business in Oregon and move across the line when the business becomes highly profitable. When it comes time to sell the business, the Oregon capital gains tax provides a reason to move operations across the line. Oregon’s property tax policies have often been more flexible than Washington’s, working to the benefit of new and expanding capital-intensive manufacturers.

General tax considerations aside, Washington’s high minimum wage, land use and labor regulations, and the relative absence of economic incentives work against a Washington location for many businesses, even those that may find our gross receipts tax preferable to the income tax.

Idaho’s tax system presents the more typical U. S. pattern of the three-legged stool often cited by tax analysts and economists. The mix of sales, property, and income taxes does provide some relief for many businesses, especially retailers.

Liz Cosko, owner of Potting Shed Creations in Troy, Idaho, shares a common small business and retail view of Washington’s business and occupation tax.

“It seems that Washington is against small business,” she says, contending that the B&O is a convoluted tax that makes compliance difficult. Similarly, the regulatory structure in Washington makes business operations challenging. She recently moved her garden product manufacturing business from Pullman to Troy when it came time for her to expand operations.

Obviously, relocation can be very difficult, even under the best of circumstances. Employers value certainty and stability; relocation can upset relationships with customers, suppliers, and employees. Sometimes, however, conditions present an opportunity to evaluate what may have been a nearly accidental initial business location decision.

COMPETING FOR BUSINESS

Businesses often begin where they do because that’s where the owner lives or wishes to live. The idea starts small and expands. As the small business grows, expansion decisions may cause owners to reflect on where they can maximize the return on their investments. Headquarters may not move – they’re often driven by different business considerations – but manufacturing, distribution, and customer service functions may.

State lines define political boundaries, not labor markets. The geographic considerations that make an Inland Northwest location important do not automatically channel business activity to Spokane. Northern Idaho draws on the same labor pool, and has nearly the same easy access to the airport, medical centers, universities, and training facilities. In Clark County, employers tout Portland’s cultural and recreational amenities.

Within a region, the competition is often friendly, though still intense.

As Paul Kimmel says, within the region, “the avenue of commerce flows both ways.” Kimmel is a County Commissioner in Latah County, Idaho,

and the executive director of the Moscow Chamber of Commerce. Kimmel says the “line between us is somewhat artificial. We share the same labor markets, trade, and values.”

“It’s the state issues,” he says, that differentiate the communities.

Business and civic leaders all along the state line routinely express similar sentiments where communities face competition from neighboring cities.

Jon Eliassen, head of the Spokane Area Economic Development Council, says the EDC views Idaho as a “secret weapon” for recruiting firms to the region. “We’d rather see jobs in Post Falls (Idaho) than in Bend (Oregon),” he says. Wherever jobs locate in the bi-state metropolitan area, everyone benefits from the increased retail trade, construction, and wealth that business expansion generates. And when firms look regionally, Eliassen has an opportunity to share some of the advantages Washington offers, including no corporate income tax and community empowerment zones.

Ideally, more new jobs would land on the Washington side of the line. Our communities, however, often operate with handicaps created by public policy.

As Scott Morris, president of Avista Utilities, says, “Each state offers something a little different depending on what you want.” Morris is uniquely qualified to comment. Not only does Avista do business in all three states, Morris, who currently chairs the Washington Economic Development Commission, has been a leader in economic development councils in Oregon and Washington. He believes the comparative advantages of Oregon and Idaho differ. People believe Idaho has a friendlier business climate – more customer focused, less regulatory – than does Washington, Morris says, while Oregon’s chief advantage may be its rich portfolio of economic incentives.

Washington’s comparative strengths, he believes, include good public schools, a strong higher education system; excellent health care research and development centers in Seattle and Spokane; the absence of an income tax; and, access to venture capital through the financial community in Seattle. Morris also believes that the state’s recent commitment to increasing infrastructure investment sends a positive signal that Washington will address its transportation problems.

Business owners will set up and expand based on the unique requirements of their industries. When costs drive the decision, however, Washington’s regulatory climate, high minimum wage, extraordinary reliance on business taxes, and relative lack of economic incentives make this state a tough sell.

ACROSS THE IDAHO LINE

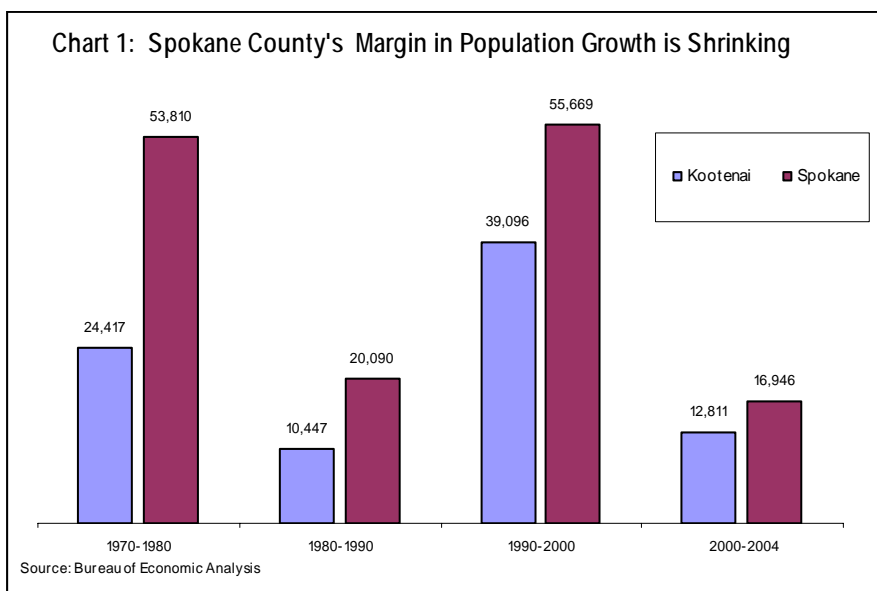
Idaho enjoys a reputation for courting business. Lower labor costs, lower taxes, a business-friendly approach to regulation and land use, and generous incentives combine to make the state attractive to firms looking to expand or relocate. Idaho recruits business aggressively and often successfully, going so far as to cold-call CEOs in California to tout the state’s advantages. While Idaho, a right-to-work state, has a reputation for conservative government, there’s nothing conservative about the way Idahoans promote the state to outsiders.

After a tough 2001 and 2002, Roger Madsen, head of Idaho’s Commerce & Labor Department, says the state added 10,000 jobs, with growth occurring in nearly every county, making the state one of the fastest growing in the nation. People come for a variety of reasons, he says, citing the balanced tax system, good schools, outdoor opportunities, great scenery, safe envi-

ronment, and low cost of living. Businesses attracted by the lower cost of operations in Idaho tell Madsen they sometimes have to argue to get people to relocate to the state, but once in the state, it’s hard to get them to leave.

Boise, Idaho recently garnered high marks from two influential national magazines. Inc. Magazine recently named Boise the best city in America for doing business. Citing a trend away from the once-chic urban centers that dominated the new economy toward smaller cities, Joel Kotkin wrote, “Thanks to lower housing and labor costs, more favorable regulatory environments, and, in some cases, lower taxes ... smaller cities are proving ideal places for doing business – especially in a globalized economy in which companies operate under relentless pressure to keep costs low and quality high.” Boise also topped Forbes rankings of “Best Places for Business and Careers.”

While not a border community, the advantages the city enjoys – in regulation, tax policy, housing and labor costs, and ability to offer development incentives – extend statewide.



Two pairs of counties provide a good perspective on the cross-border competition between Washington and Idaho. Along the state line, the greatest concentrations of population and employment can be found in Spokane County, Washington and adjacent Kootenai County, Idaho.

Kootenai County, with the cities Coeur d’Alene and Post Falls, has enjoyed particularly rapid growth in the last decade. Further south, Whitman County, home of Washington State University, sits across the line from Latah County, Idaho, home of the University of Idaho. The two universities are the largest employers in

their respective counties.

SPOKANE COUNTY, WASHINGTON – KOOTENAI COUNTY, IDAHO

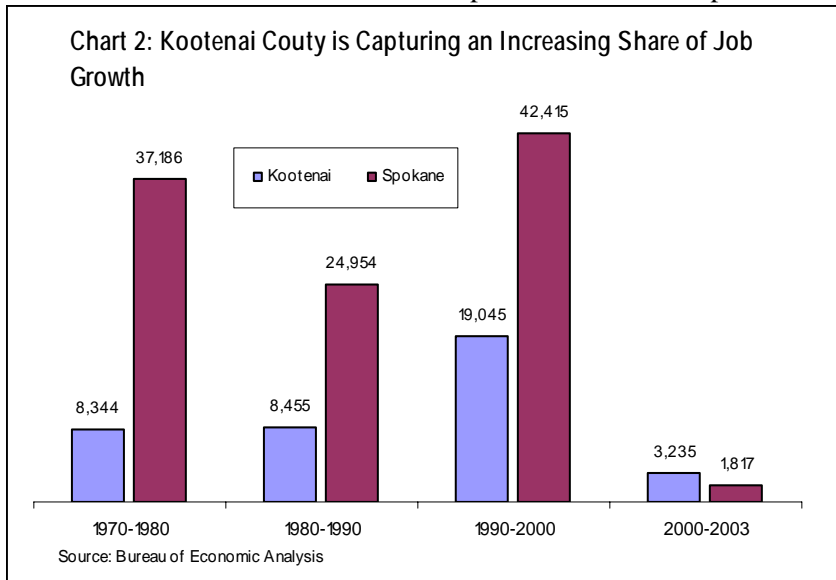
Spokane, Eastern Washington’s premier city, is the capital of the Inland Northwest. The county is a vibrant regional center for higher education, manufacturing, health care, professional and business services, and government, including the Fairchild Air Force Base. Since 1990, the county’s population has increased about 19 percent, below Washington’s statewide growth of 25 percent. State analysts anticipate that the county will grow by 11.5 percent between 2000 and 2010.

Across the line, Kootenai County experienced strong and balanced economic growth in recent years. “From 1987 to 2000, Kootenai County’s economy grew at an astounding rate as it diversified its manufacturing base, expanded its tourism sector, and added call centers. ... The pace of growth slowed after the U.S. downturn began in early 2001, but since the summer of 2003, Kootenai County’s economy once again is growing at a strong clip.” (Idaho Commerce and Labor, Undated)

With a population of 435,644, Spokane County is nearly four times the size of Kootenai’s 122,350. But as Table 1 shows, the pace of employment growth in Kootenai County has been much more rapid, 398 percent com-

pared with Spokane's 103 percent since 1970. Of course, large percentage changes occur more easily on small bases. Nonetheless, the employment numbers underscore the rapid pace of development occurring just east of the state line that has some Spokane employers concerned and others intrigued.

Chart 1 shows population growth by decade since 1970, extending to the period 2000-2004. Spokane continues to add more people each decade, but



the margins are shrinking. Chart 2 breaks down the employment changes by decade, showing that the growth in Kootenai County accelerated dramatically in the 1990s.

For a closer look at the industrial structure, consider Chart 3, which presents job quotients for twenty broad industrial groupings. The job quotient for an industry in a county is that industry's employment in the county as a share of employed county residents, divided by the industry's national employment as a share of total national employment. If a job quotient is greater than one, the industry is a larger share of the county's economy than it is of the overall national

economy. (Note: This differs slightly from the "location quotient" often cited in economic development literature, which applies a similar technique to compare the regional economy with the nation. Because we are interested in intra-regional differences, WashACE modified the technique to look at county level data.)

Spokane's traditional strengths in finance and insurance, healthcare and management of business enterprises are shown by the job quotients greater than one in these three sectors. Kootenai's traditional strengths in forestry, outdoor recreation and tourism show up in the job quotients for forestry, recreation and accommodations. Kootenai's higher growth rate yields the higher job quotient in construction, and the county's relatively high job quotient in administrative services reflects in part its success in attracting call centers.

Both counties have below average concentrations of manufacturing and information sector jobs. Kootenai County has a higher concentration of retail sector jobs than Spokane County – the result, at least in part, of Idaho's lower sales tax rate and minimum wage.

Does the rapid growth in Kootenai County mean that the center of the Inland Northwest is moving east? Not at all. Spokane can be assured of regional prominence for a long time. But it does mean that some firms desiring an Inland Northwest location can save money by locating in Idaho, without sacrificing access to the educational, cultural, medical, and recreational amenities of Spokane.

Mark Sonderen, president of family-owned Sonderen Packaging, weighs the decision carefully. He considers Spokane "one of the greatest places in the world to live." But he also believes that Washington has become an increasingly difficult place in which to do business. Although the state's sales tax exemption for machinery and equipment significantly eased his tax burden – the packaging business is highly capital intensive – other tax and regulatory burdens concern him. Ergonomics regulations, ultimately re-

pealed by the voters, would have made doing business considerably more difficult.

Sonderen Packaging has been at break-even for five years, he says. In Idaho, that means he would have had no corporate income tax liability. In Washington, the business and occupation tax (B&O), which is based on gross receipts, applies even when you are not profitable.

As Jon Eliassen, head of the Spokane Area Economic Development Council (EDC), points out, for profitable manufacturers the state’s relatively low B&O rates compare very favorably with Idaho’s income tax. The EDC uses the B&O tax in its promotional materials, which say the tax “benefits companies with higher profit margins because even as the profits grow, only the gross receipts are taxed.” Idaho’s corporate income tax rate of 7.6 percent

will impose a greater liability on some firms.

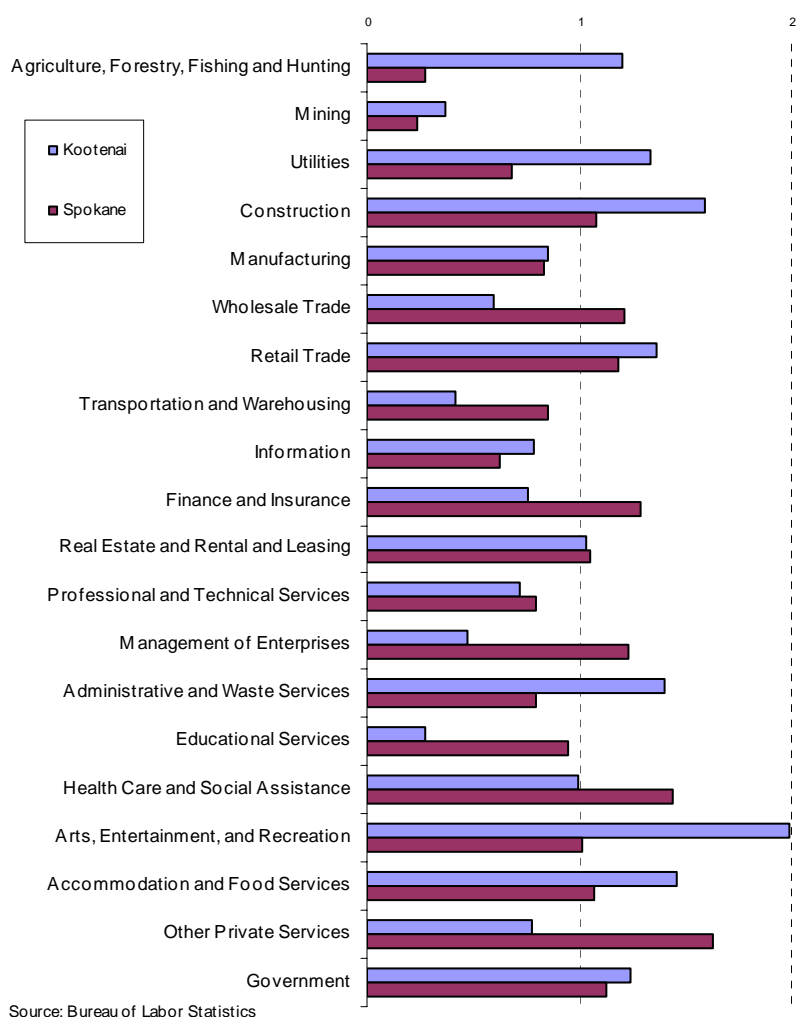
Low-margin operations, however, may well fare better in an income tax system. The absence of a personal income tax can be particularly appealing to owners of small businesses and to firms recruiting highly compensated employees.

Idaho’s unemployment insurance (UI) taxes are lower than those in Washington. Although Washington made progress two years ago with a major UI reform, the 2005 legislature retreated on some of the 2003 provisions. While the consequences of this year’s changes are uncertain, it’s clear that they will not hasten cost savings for the system. Along with the state legislature’s consideration of family leave bills, “pay or play” health insurance requirements, expansion of health care mandates, such policy swings cause Sonderen to question the commitment of Washington’s political leadership to job creation.

“Our business is so competitive,” he says, “that all of those little bits count.”

People tell him that he should not overreact, because in Washington the pendulum always swings back.

Chart 3: Job Quotients Show the Traditional Strengths of the Two Counties



Sometimes the environment favors business; sometimes, it doesn’t.

To that, he responds, “In Idaho, the pendulum doesn’t swing. You don’t have these large shifts in policy.”

Patrick Jones, director of the Institute for Public Policy and Economic Analysis at Eastern Washington University, expresses skepticism about

business climate generalizations, noting – as has WashACE – that conditions vary among industries. He has heard the anecdotes about Washington losing out to Idaho for some relocations, like Buck Knives, yet he’s not persuaded that Idaho overall has the edge.

When it comes to the array of inducements Washington economic development teams can offer a business, though, he says, “The toolbox we have for recruitment in Washington State is pretty barren.”

Although both states offer various incentives to expanding or relocating businesses, Washington’s packages frequently fail to equal those available in Idaho. As reported in our 2003 WashACE economic incentives case study, Washington offers relatively few of the economic incentives used by other states to attract and retain business. Often, the availability of financial inducements can make the difference.

EMPIRE AIRLINES

The competition for Empire Airlines, which operates and services a fleet of planes for clients, including Federal Express, provides a recent example of the resources Idaho can put in play. The company, headquartered in Coeur d’Alene, Idaho, wanted to consolidate operations and expand their maintenance and conversion (from passenger to cargo) facilities. The company performs major inspection and repair work. Routine maintenance can be handled easily at their facilities at the Spokane airport, but the more intense inspections and repairs, which can take weeks to perform, require larger facilities.

Spokane officials hoped the business would move to the airport. In addition to securing a significant headquarters operation, the move would have helped establish Spokane as the site of the West Coast’s only major conversion facility, an additional selling point in promoting the airport to other industrial and transportation operations.

From August 2003 through December 2004 the two states competed. In the end, the package offered by Idaho was compelling. From a cash standpoint, Washington could not compete.

Washington and Spokane put together a financing plan that amounted to a \$200,000 grant and \$3 million in low-cost loans. “It was the best deal Washington could have offered,” says Dave Bruckardt, an executive at Sterling Savings Bank and a member of the Spokane Airport Commission, “but it wasn’t good enough.”

By contrast, according to a project analysis by the Washington team, Idaho offered \$5.8 million in grants (including the cost of expanding a runway at the Coeur d’Alene airport) plus access to low-interest loans.

Tim Komberec, Empire’s CEO, says the decision was a difficult one. The money Idaho offered, a million dollars in outright cash assistance (disregarding the runway improvements and other infrastructure investments made to the airport attendant to Empire’s expansion) “wasn’t the whole decision, but it sure had an impact.”

Still, the company had to look at the full range of factors, including the cost of infrastructure and ferrying airplanes. Komberec says he still can’t say which state had a tax advantage; he thinks Idaho did, but he can’t prove it. An array of tax considerations are involved – personal property taxes, property taxes, income taxes, and the B&O tax. The B&O becomes a factor when Empire works on planes owned by other companies; the current work

done in Spokane is on Empire's own planes. Empire may have been eligible for some tax relief under the aerospace incentive package adopted for Boeing. So, the tax implications were not clear cut.

There were other factors, intangibles that might have tipped the balance to Idaho, regardless of Washington's offer. Todd Woodard, director of marketing and public relations for the Spokane International Airport, notes that Komberec has longstanding ties to Idaho, where Empire was founded and serves on the Coeur d'Alene Airport board. Idaho did not take these intangibles for granted. Governor Dirk Kempthorne called Komberec personally, according to Woodard, and the state's lieutenant governor made two personal visits.

In the end, the tangibles – the cash on the table offered by Idaho – may have made the intangibles irrelevant.

BUCK KNIVES

Specific tax breaks appear to have mattered less to Buck Knives than the chance to move to a more conservative policy environment that offered predictability and lower costs. Two years ago, the San Diego manufacturer, announced that it would leave California, driven out by high electricity, labor, and unemployment insurance costs. The company considered sites in Bend, Oregon; Post Falls, Idaho; and Spokane, Washington. Ultimately, Idaho won the competition. The new factory, which officially opened in May, will bring 225 new jobs to Post Falls.

C. J. Buck, the company president and CEO, told the Spokane Spokesman-Review, "What tipped the scales to Idaho was the conservative, business-friendly legislative environment." He went on to say, "it was really close between Post Falls and Bend. We just had more faith in the Idaho Legislature." (The Spokesman Review, January 15, 2003)

In a Business Week interview, Buck expanded on the decision. "We looked at the Pacific Northwest as a matter of lifestyle. ... In the end, [it was] the legislative climate in Idaho, [which] is incredibly business-friendly. There is an understanding that making life easier on local business benefits the state ... so the legislature in Idaho is not passing onerous business legislation." (Business Week Online, November 21, 2003)

Washington's consideration of ergonomics regulation, a hot issue when the Buck Knives decision was being made, may have played a role as well, according to several Spokane business leaders. A company fleeing California's tax and regulatory environment surely paid attention to the prevailing political breezes in Washington.

Shaun O'L. Higgins, Director of Marketing and Sales for the Spokesman-Review and former chair of the Spokane Economic Development Council, says the Buck Knives decision reflects a smart marketing decision by Kootenai County. Rather than saying, "let's make Coeur d'Alene the biotech capital of the world," they assess their strengths and go for it. Buck Knives, an outdoor company, is a perfect fit for Northern Idaho, he says.

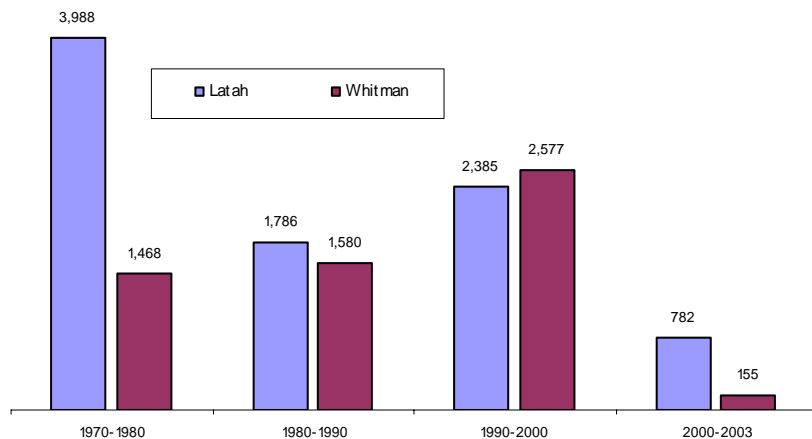
CALL CENTERS

Rich Hadley, president of the Spokane Area Chamber of Commerce, credits Idaho's lower costs and financial incentives for the decision of some firms to locate operations on the other side of the state line.

Hadley cites as an example the U.S. Bank customer service center recently located in the Coeur d'Alene area. Expected to create 500 new jobs in the

next five years, the center will occupy a \$15 million, 60,000-square-foot facility. In announcing the selection of Coeur d'Alene for the center, Rick Barton, regional president of the bank in North Idaho/Palouse, said, "The

Chart 4: For the Last 25 Years, Population Growth in the Two Counties Has Been Fairly Even



Source: Bureau of Economic Analysis

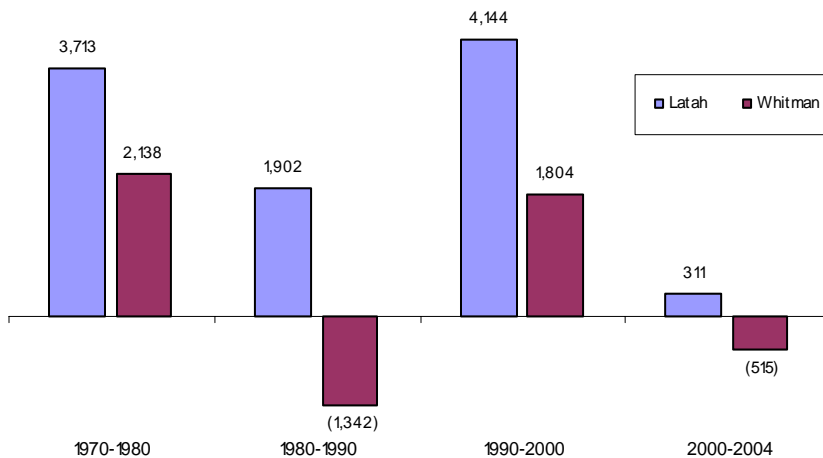
pro-business environment in Coeur d'Alene combined with a skilled and available labor force, access to workforce training and higher education, and U.S. Bank's existing presence in the market were key factors in our decision to build the call center here." (U.S. Bank Press Release, May 4, 2004)

Several of those factors apply equally to Spokane, but Idaho's lower minimum wage and workers' compensation premiums, plus the availability of workforce training funds, mean a considerable savings to the company compared with the cost of operating in Washington, says Hadley.

Idaho's workforce development training fund reimburses employers for a percentage of training costs. Jim Schmidt, a Qwest executive in Boise, says the training credits, which can go up to \$3,500 per employee, are particularly valuable for call center operations, which involve considerable employee training. Qwest operates four call centers in Idaho. In making a location decision, the company looks at the overall business climate in the state. For telecom, Idaho has several strengths: a good regulatory environment, a specific investment tax credit for broadband, and, of course, the workforce training credit. In the past, Schmidt says, base wages at Qwest's call centers averaged between \$40,000 and \$50,000. Responding to competitive pressures, Qwest now starts new hires at \$12 an hour with a full benefit package.

Such call center jobs can be especially attractive in rural or remote communities. Maytag Services, a division of Maytag Corp., recently announced that it would open a customer contact center in Yakima. Dave McFadden, president of New Vision, the Yakima County Development Association, said several factors weighed heavily in the company's decision. An existing facility was available in the community. Further, the city came up with

Chart 5: In Job Growth, However, Latah County has Outpaced Whitman County



Source: Bureau of Economic Analysis

some of its own money for economic incentives, including funds for employee training, something unusual for Washington cities. McFadden says mid-size and rural communities have the stability and cost structure to be competitive, if they have the required telecom infrastructure. He agrees, however, that "Idaho's programs on job training are more flexible, customer-focused. They'll literally write companies checks."

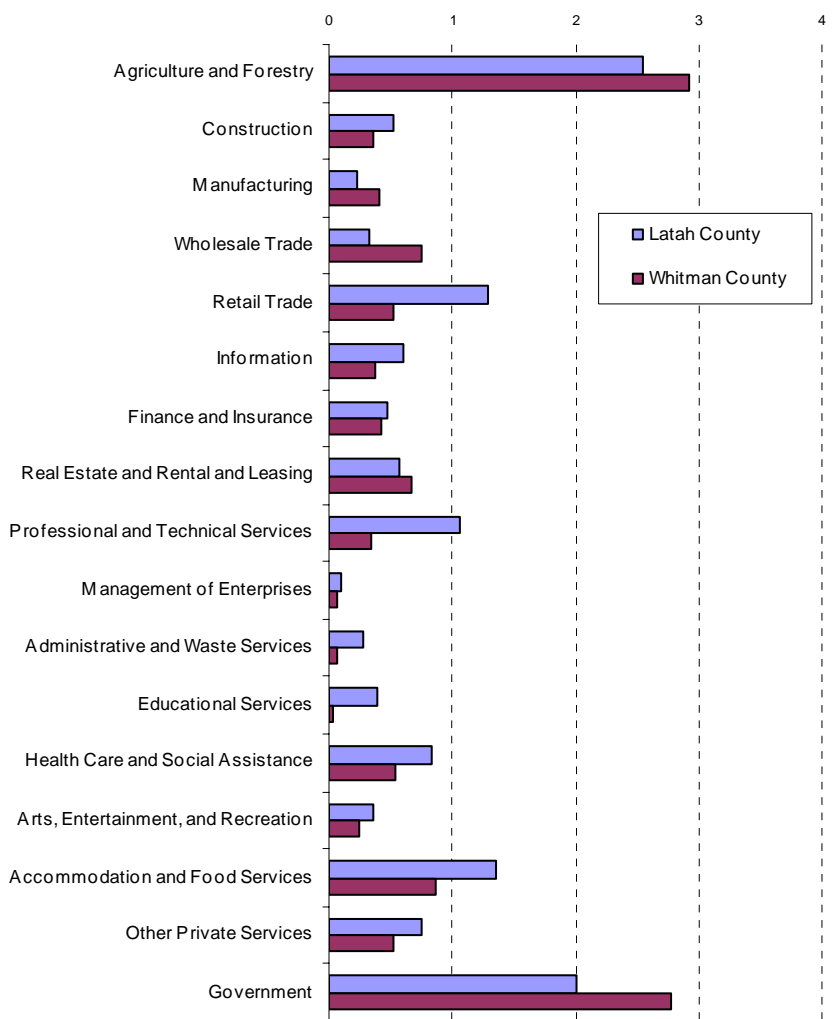
WHITMAN COUNTY, WASHINGTON – LATAH COUNTY, IDAHO

Since 1970, Latah County, home of the University of Idaho and the city

of Moscow, has grown 40 percent, to a 2004 population of 35,169, about eight times faster than neighboring Whitman County, home of Washington State University and the city of Pullman, which grew by 5 percent, to 40,146. Job growth in the two counties shows a similar pattern, with Latah increasing employment by 119 percent while Whitman increased by 48 percent.

As Chart 4 shows, Latah grew faster than Whitman in the 1970s and 1980s, lagged slightly in the 1990s, and outpaced Whitman in the early years of this decade. Job growth over the period, however, has been consistently faster on the Idaho side of the line, as Chart 5 shows. Whitman lost jobs in the 1980s and in the 2000-2004 period.

Chart 6: Job Quotients Show that Latah County's Private Sector is More Vibrant.



Source: Bureau of Labor Statistics

A look at the job quotients shown on Chart 6 provides more detailed information on seventeen broad industrial sectors. (For confidentiality reasons, the Bureau of Labor Statistics does not release data on mining, utilities and transportation for these counties.) In both counties, large job quotients occur only in the agriculture and forestry sector and in the government sector. In Whitman County the agricultural and forestry jobs are primarily agricultural; in Latah, they are primarily in forestry.

In both counties, the high concentrations of government jobs result from public universities, Washington State University and the University of Idaho. In absolute terms, there are far more government jobs than agriculture and forestry jobs in both counties. Government jobs represent 62 percent of covered employment in Whitman County and 45 percent in Latah County. WSU enrollment at Pullman is 50 percent greater than UI enrollment at Moscow (18,500 vs. 11,500). The two universities are the main economic drivers of the two counties. Their health is largely independent of the local business climate.

Looking at the other fifteen industrial sectors, where local business climates matter more for location, the job quotient for Latah County is greater than that for Whitman County in twelve cases. The only three cases with job quotients greater than one are in Latah County.

The difference in retail is particularly striking. Even though it has a larger residential and student population, Whitman County has only about half the retailing jobs that Latah has. Here, again, Idaho's lower sales tax, lower minimum wage, and absence of a B&O tax would appear to favor retail development east of the state line.

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Jerry Finch, a Whitman County Commissioner, believes that part of Whitman's problem over the past decade can be attributed to the county's comprehensive land use plan.

"The old comp plan forced businesses to Idaho," he says. Since then, the county has taken steps to improve the situation, making it easier to develop. The county has become forward thinking on zoning, opting out of the state's Growth Management Act but complying with most of its provisions.

Finch's Idaho counterpart, Paul Kimmel, a Latah County commissioner who is also head of the Moscow Chamber of Commerce, believes local governments on both side of the state line are generally business friendly now. He says the big differences are in state policies.

Kimmel cites lower labor costs, particularly the lower minimum wage, which he believes is particularly attractive for retail and lower-wage service businesses. Plus, he says, workers' compensation costs are well below those in Washington and "we don't have that onerous B&O tax."

Liz Cosko moved her business, Potting Shed Creations, from Pullman to Troy, Idaho (east of Moscow in Latah County). She agrees with Kimmel. When asked if conditions are better for her in Idaho, she says, "Absolutely!"

She likes being out from under the "convoluted" B&O tax and the high minimum wage.

"Idaho welcomed us with open arms," she says, providing incentives, including a low-cost loan to acquire the firm's new building.

Intangibles also come into play. "It seems that Washington is against small business," she says. "In Washington, I'm considered insignificant with my business size (21 employees)." But in Idaho, she's met with enthusiasm, as well as with incentives.

Part of the reason may simply be the relative size of the state. Idaho, with 1.4 million people, is about one-fifth the size of Washington. You can still get a call returned from the Commerce Department or the governor's office, Kimmel says. "You don't have to know somebody who knows somebody."

Susan Fagan, with Schweitzer Engineering Labs in Pullman, has watched the business climates in both communities, and believes things are improving on the Washington side. She sees more business-friendly governmental leaders, increasing infrastructure investment (new roads, widening arterials), and smarter zoning policies. Like Finch, she believes the old comp plan pushed business to Idaho.

State policies, however, continue to make a difference. Workers' compensation costs, unemployment insurance, health care mandates, and business taxes continue to make Washington a tougher place to do business.

One sign that things are looking up is the siting of a new Wal-Mart Supercenter in Pullman. Finch says, if Wal-Mart comes, "that's going to break the anti-business reputation logjam."

The company's decision to look to Pullman – they already operate a store in Moscow – came as a surprise to Latah County political leaders. And while they're concerned, they are not alarmed. Kimmel, showing the proactive business attitude Idaho politicians are noted for, says Wal-Mart has assured them that they won't close the existing store. "If they do," he says, "we'll bring a Target in."

Echoing the regional theme expressed in Spokane, Kimmel says, "The avenue of commerce flows both ways." He points out that WSU is the second

largest employer in Latah and says that 40 percent of SEL’s workforce lives in Idaho. The key to both communities, he believes, involves making sure that there are “landing zones” for the technology coming off the two universities campuses. Both communities provide incubator facilities to assist start-up businesses.

STAYING COMPETITIVE

Paul Kimmel, of Latah County, Idaho, has described the line between his community and Whitman County, Washington, as “somewhat artificial.” He speaks of shared values, a shared labor pool, and marketplace.

In Eastern Washington communities along the Idaho line, that’s often true. Whether we’re talking about metropolitan Spokane or smaller towns like Pullman and Clarkston, Eastern Washington communities tend to connect culturally and politically with their Idaho neighbors. Businesses in these communities tap many of the same customers, access the same transportation networks, and hire from the same labor market.

ACROSS THE OREGON STATE LINE

A similar regional identity exists along the Oregon border. Washington competes most directly with Oregon in the Portland metropolitan area, which straddles the state line in Southwest Washington. The federal government’s definition of the Portland Metropolitan Statistical Area comprises

five counties in Oregon (Columbia, Clackamas, Multnomah, Washington and Yamhill) and two in Washington (Clark and Skamania). Most of the 2.1 million residents of the region live in just four counties: Multnomah with 672,000 residents; Washington, 448,000; Clark, 392,000; and Clackamas, 363,000. In 2003, Multnomah County had 47 percent of the four counties’ jobs. Portland, in Multnomah, is the region’s dominant city, with 539,000 residents.

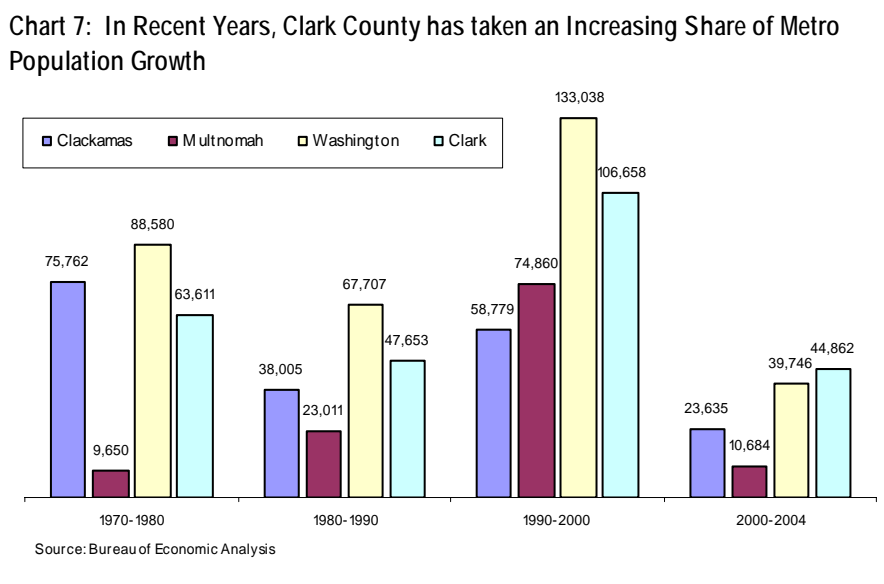
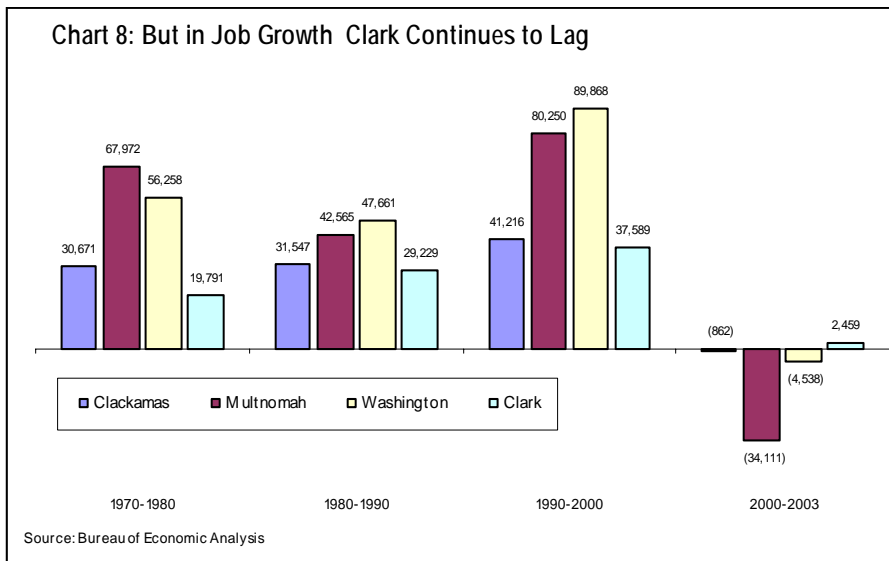


Chart 7 shows population growth for the four counties for the decades of the 1970s, 1980s, and 1990s and for the last four years. Over the period,

the majority of the population growth has occurred in the three suburban counties. Washington County had the greatest growth in all three decades; Clark County had the second greatest growth in the 1980s and 1990s. Over the last four years, Clark County has led in population growth.

From 1970 to 2000, job growth was strong in the center of the metropolitan area, Multnomah County, as shown in Chart 8. Nevertheless, the majority of new jobs were created in the suburban counties. This pattern of suburban job growth is seen nationwide. Suburbs that had initially served as bedroom communities sending residents to work in the central city are increasingly job centers in their own right. Over the three decades, job growth was particularly strong in Washington County. In contrast, Clark County had the smallest job growth in each of the three decades and added fewer than one half the number of jobs that Washington County added. From 2000 to 2003,

the metro area lost jobs, with the greatest drop by far occurring in Multnomah County. Employment in Clark County grew slightly over the period.



As it captured the smallest share of the job growth during the booming 1990s, it is not surprising that Clark County suffered the least when the boom turned to bust.

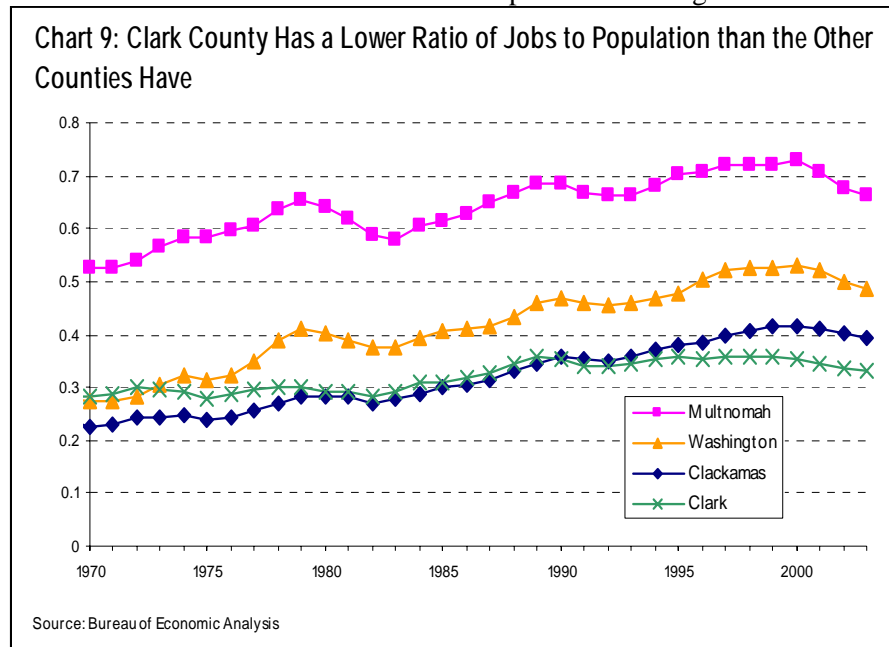
Slicing the data differently in Chart 9, we plot the ratio of jobs to population for the four counties from 1970 to 2003. In all four cases, this ratio has trended upward, meaning an increasing share of the population is employed. The upward trend has been weakest for Clark County. Clark County's ratio of jobs to population exceeded those of Washington and Clackamas Counties in 1970, but it has now fallen below those counties' job-population ratios.

More than the other suburban counties, Clark County remains a bedroom for those working elsewhere.

This point is reinforced when we look at the job quotients in Chart 10. In only one sector, construction, does Clark have a job quotient that equals or exceeds 1. Clackamas has four such sectors; Washington County, seven; Multnomah, sixteen. In the majority of industries, Clark has the smallest job quotient.

Echoing the cases in Spokane and Whitman Counties, Clark County's job quotient in retail trade is less than those of the three Oregon counties. Public policies favoring retail sales in Oregon include the absence of B&O and

sales taxes and a lower (though still high) minimum wage.



The contrast between Clark County, Washington and Washington County, Oregon is stark. Between 1970 and 2003 the rates of population growth were comparable: 193 percent for Clark County and 202 percent for Washington County. Over the same period, Clark County's growth in employment, 243 percent, lagged far behind Washington County's 434 percent.

POLICY DIFFERENCES

Oregon's success in the past has been attributed to several strong competitive advantages: no gross receipts tax, remarkably generous

incentive programs, low property taxes, good public services, and no sales tax. The Oregon income taxes – corporate and personal – posed disadvantages for some businesses, certainly, but job growth continued apace.

In Clark County today, however, business leaders perceive that the comparative advantage historically enjoyed by Oregon may be disappearing, although it has not yet shown up decisively in the employment data.

Oregon’s disappearing edge, however, may be due more to problems south of the state line than to improvements made in Washington.

“Until the last couple of years,” says Mike Worthy, president of the Bank of Clark County, “Washington was plainly disadvantaged compared to Oregon.” He particularly cites the raft of concessions Oregon state and local governments could regularly exploit to lure new business investment. While

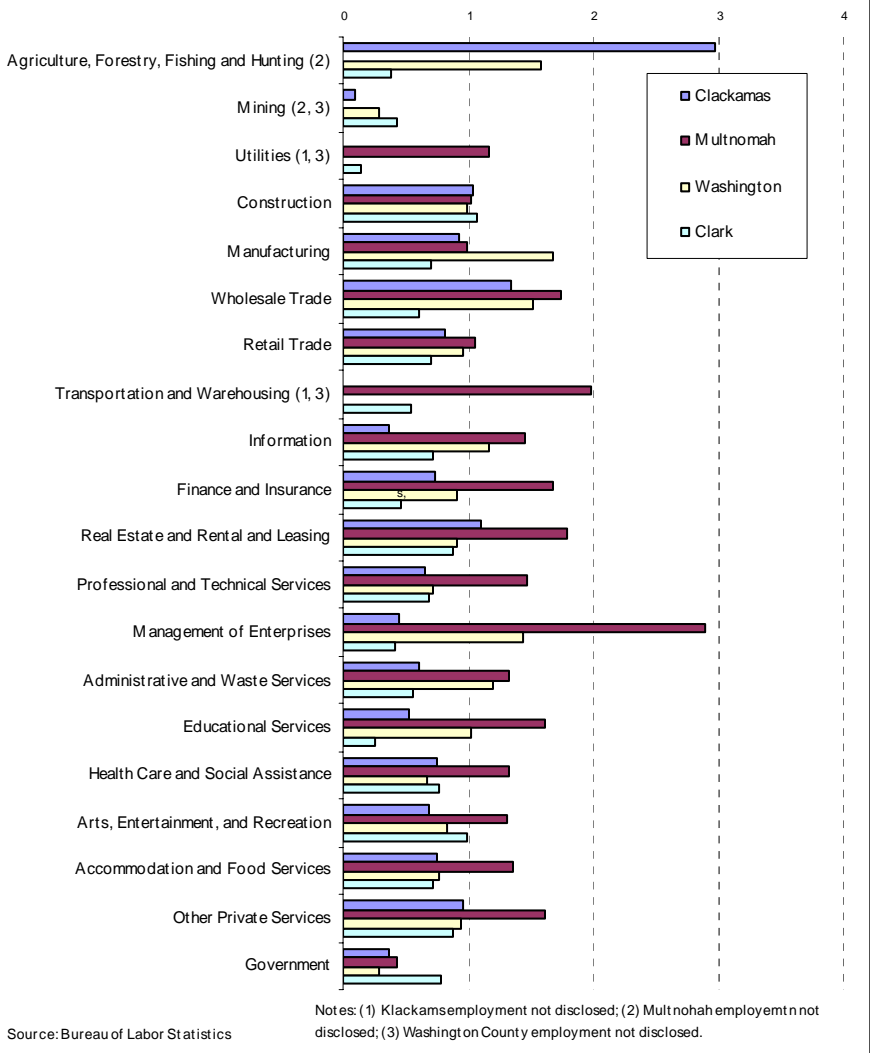
Washington may occasionally put together a major package, like that used to secure the Boeing 787, there’s little available in this state for firms with 200-300 employees, he says.

But Worthy thinks the “comprehensive dysfunction” besetting Oregon, highlighted by the ongoing state budget crisis, has shaken business confidence in the state. Oregon’s budget problems have led even some business leaders there to question the role played by the state’s economic incentive programs.

Nonetheless, he says, “on paper, the best place is Portland for business, but Vancouver’s a better place to live.” He says about 60,000 people commute to Portland from Clark County. While many complain about the commute, Worthy, who formerly worked in the Seattle area, points out that for people moving to Southwest Washington from other urban areas, the commute is not that big a deal.

A leader in Southwest Washington’s technology community also believes Oregon’s competitive advantage has eroded. John Marck, President of Sharp Microelectronics of the Americas, cites a number of Washington’s strengths: no income tax, lower property taxes (though he thinks that may

Chart 10: Low Job Quotients for Clark County Mean that Many Residents work Outside of the County



be changing), a better public school system, and better transportation on the Washington side of the river. “I think we have a wonderful story to tell, Southwest Washington does,” he says.

Echoing sentiments we heard from economic development professionals along the Washington-Idaho line, Bart Phillips, president of the Columbia River Economic Development Council (CREDC) in Vancouver, says, “We’re a region. ... The market knows us as Portland. We just offer a different business look.”

Phillips, like economist Bill Conerly and others, says that the sharp differences in tax policy works both ways, giving Washington a strategic advantage sometimes. For closely held companies anticipating a liquidity event,

Washington offers an opportunity to avoid capital gains and income taxes. And, “if you have fairly good margins, Washington is where you want to be. If you’re in commodities, low margins, then Oregon is better.”

Bob Alexander, the economic development director of the Portland Development Commission, agrees in almost the same terms. “For closely held companies and high income individuals,” he says, “it’s generally advantageous to be in Vancouver.” Other businesses, like distribution and logistics businesses, usually do better in Oregon. Although that may vary depending on how the company is organized. Business income taxes and local taxes have been a problem.

The CREDC has enjoyed some recent successes, though there are still more people moving in to live than for jobs. Phillips believes Washington offers better schools, a better quality of life, and greater affordability – making it worthwhile for many people to live in Clark County and commute, even if it means paying the income tax.

PLEXSYS INTERFACE PRODUCTS, INC.

PLEXSYS Interface Products, Inc. decided it was worth crossing the river to spare its employees the hassle. The technology firm, which specializes in modeling and simulation for aircraft control and airspace management, announced this year that it would move its corporate headquarters from Portland to Camas. PLEXSYS vice president Jon Stacey emphasizes that the move provides significant tax advantages for the company’s employees living in Washington.

A desire to own their own building caused company officers to consider a move. Working with their accounting firm, they looked at the costs of operating in Washington versus Oregon, finding a slight corporate tax advantage for Washington. But the personal income tax savings for employees sealed the deal. Seventy-five percent of the affected employees (about 27 employees work in the region) live in Washington. With an average salary of \$72,000, the typical employee would save \$3,500 in Oregon personal income taxes by working and living in Washington. Two of the company’s three officers will relocate to Clark County. Multnomah County’s new 3.5 percent personal income tax also factored into the decision.

Oregon’s high profile budget problems have led some business leaders to support the local taxes for education. Alexander, of the Portland Development Commission, says he heard comments to the effect that “we don’t want to be in ‘Doonesbury,’ ” referring to the nationally syndicated comic strips lampooning of the state’s budget-driven need to shorten the school year in 2003. But for others, the local income tax adds to the state’s competitive drag for high wage workers.

“Good software engineers are hard to find,” said Stacey, “and retaining them is very important to us. ... It takes six months to spin up one of these people.” Most of the complaints top management heard had to do with the income tax. For PLEXSYS, the personal income tax can be considered “a direct business cost, in that it affects productivity.”

They quickly found an ideal building site on a golf course in Camas. Since making the decision, PLEXSYS executives have been pleased with the support they’ve received from Camas, the availability of affordable housing – “particularly in the outer suburbs, like Battle Ground” – and the quality of the public schools.

CONCANNON PAPER, INC.

The search for a building to own also led Mike Concannon, president of family-owned Concannon Paper, Inc., to leave Oregon for Washington. He founded the paper products distribution business seventeen years ago in Oregon, serving a regional market. He looked initially in Portland, but could find nothing suitable – “no land to speak of in Northwest Portland, most buildings were older, a little dilapidated, and I couldn’t find anything reasonably priced.”

“I really had my eyes opened” when I looked in Washington, he says. He found a thriving building community and an abundance of commercial buildings, lower land costs and more land available. “It became a matter of economics and choices.” He figures he saved about \$300,000 just on property costs compared to locating in Oregon.

“Once I began to investigate the tax structure and estate planning issues,” he says, “it became even clearer for me how much easier it was to do business [in Washington].”

While it’s too early for him to say that all of the projections will pan out, Concannon says, “Logistically, this particular move for us was a slam dunk.” And one that has not made any significant difference in the way their business operates.

OREGON’S REMAINING EDGE

Concannon and PLEXSYS fit the conventional story of Washington’s comparative advantage. While not determinative, estate planning issues played a role in the Concannon decision. High margins and high wages make Washington a better place for PLEXSYS. The availability of good building sites mattered greatly for both.

More broadly, however, Oregon remains alert to opportunities to lure major corporate location and expansion. As John Marck says, “Oregon is very, very aggressive in proactively trying to go out and solicit large companies. I wonder if Washington is not a bit reactive.” One of this state’s problems, he believes, is “not having a comprehensive and aggressive plan to encourage businesses to stay here and others to migrate here.” In particular, he points to high and rising taxes, a lack of sharp budget management, and limited economic incentives.

“It’s not like Washington has a world-wide reputation for being business-friendly, although there has been some improvement,” he says. In other words, the state cannot rest upon its laurels. “It must continuously and proactively compete aggressively.” He notes Oregon’s effective use of incentives, saying that attracting large companies, particularly technology firms, brings a host of benefits to the region, including high wage jobs and necessary infrastructure investment, “which can be very significant.” (WashACE highlighted Oregon’s Strategic Investment Program and associated property tax exemptions in a September 2002 Washington Roundtable report, *Economic Incentives: Keeping and Attracting Business*.)

Oregon’s ability to respond swiftly and flexibly to firms considering location in the state stand in stark contrast to Washington, according to Scott Morris, who calls Oregon an “incentive rich” state. Of Washington, he says, “Our incentives are like going to a boutique and a tailor. In Oregon, it’s off the rack.” In Washington, it’s not always clear whether you qualify for a tax incentive, you need to check with various state agencies. It’s a tedious process, he says, compared to the simple, user-friendly approach taken by Oregon.

Oregon Governor Ted Kulongoski uses his strategic reserve fund effectively to recruit new business to the state, says Morris. Yahoo Inc. recently announced that it would locate a new 170-person customer service center in Hillsboro, a fast-growing Portland suburb in Washington County. Among the incentives provided the company are \$180,000 from the governor's strategic reserve fund, a \$100,000 workforce training grant and additional financial assistance from the cities of Hillsboro and Beaverton and Washington County. The governor also authorized \$600,000 for Royal Caribbean Cruise Lines to locate a customer service center in Springfield, Oregon, contingent on job creation. Spokane was the other top contender for the center. Oregon put together a package that included property tax waivers worth hundreds of thousands of dollars and more than a half-million dollars in additional subsidies.

Both McFadden and Morris praise legislation passed this year establishing a discretionary development account in the governor's office. The initial \$15 million funding is a start, they say.

CONCLUSIONS & RECOMMENDATIONS

State policies make a significant difference in determining whether a business will have a better chance of success on one side of the line or the other. Economists often hedge their bets by citing the Latin expression, *ceteris paribus*, "other things being equal," knowing that rarely will that be true. With respect to border counties, things other than public policy are, in fact, generally equal. Employees can choose to live in the community that offers them the best housing, access to good schools, and so on, while working in another. The short commute across the state line will still be half that experienced by many workers in the metropolitan Puget Sound region.

But by choosing the Idaho or Oregon side of the line, many businesses can find themselves able to lighten their regulatory burden, reduce their taxes, and pick up valuable financial incentives unavailable to them in Washington. Our state's border communities have become increasingly business-friendly, with responsive local officials and progressive, creative chambers of commerce and economic development organizations. Yet, many of the decisions affecting businesses throughout the state are being made by Puget Sound area legislators meeting in Olympia. They should realize that their actions have consequences that reverberate down the line.

As several of the business leaders we spoke with emphasized, how a state is perceived also matters. Public policies, of course, may change over time, for better or worse. Firms considering expansion or relocation value stability, evidence that policymakers take a consistent, long-term approach to regulation and taxation, with a commitment to economic vitality. When the pendulum swings wildly from year-to-year, the vacillation sends a negative signal to the market.

RECOMMENDATIONS

1. State and local officials must focus on minimizing the costs of doing business in Washington State. Our tax structure places an extraordinary burden on businesses. While major structural change may be neither likely nor desirable in the short term, within the existing tax structure several actions can be taken to reduce our competitive disadvantage.
 - a. A major goal of the 2003 unemployment insurance reform was to bring UI costs for employers closer to the national

- average. Recent amendments to that legislation do not relieve lawmakers of the obligation to pursue additional reforms to achieve that objective.
- b. A generally high business tax burden makes the strategic use of economic incentives more necessary. Incentives matter most for location and expansion decisions within a region. The newly-created governor's strategic reserve fund provides the state a reasonable, albeit limited, tool to use in recruiting new business or enabling existing business to expand.
 - c. New or expanding business often requires supportive infrastructure investment. Adequate and predictable funding of the state's primary infrastructure partnership, the Community Economic Revitalization Board (CERB), can increase Washington's competitiveness by reducing the initial infrastructure costs for business.
2. Budget sustainability has become a major concern for business. Oregon's volatile fiscal situation has reduced that state's competitiveness in just a few years. Businesses looking for long-term stability must have confidence in a state's fiscal management. Adopting a sustainable budget within existing resources must be a top consideration for the governor and legislature.
 3. Washington's minimum wage places border communities at a competitive disadvantage, particularly with respect to retail and restaurant employment. Legislators should embrace policies to lessen the disadvantage, such as allowing a tip credit or temporary training wage for new hires.
 4. The retail sales tax places retailers at a competitive disadvantage relative to Oregon and Idaho. Even selective increases in the tax on certain products (e.g., tobacco) have the effect of increasing the incentive to shop on the lower cost side of the state line. To limit retailers' competitive disadvantage, avoid further selective increases in the retail sales tax.
 5. Maintain a focus on those areas where Washington has a competitive advantage. Continue to emphasize accountability in public education, local permitting and zoning flexibility. Programs to enhance housing affordability make communities more attractive and should be encouraged.
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