

## **Innovation, Efficiency and Productivity Incentives**

**DRAFT, v.1**

### **Background**

North Dakota has a strong history of creating a positive business climate that has attracted and supported the growth of many businesses, including manufacturing companies. North Dakota's manufacturing industry has remained strong even while the industry has declined in other states. A strong pro-business regulatory and tax climate combined with a low cost structure, particularly wages, and a productive and hard-working population, has helped us attract and support growth in the manufacturing industry.

Today's globally competitive marketplace presents challenges to North Dakota manufacturers. Our traditional low cost model is no longer superior. North Dakota is now faced with international competitors whose labor costs are a fraction of those in the United States. In addition, North Dakota companies are faced with increasing costs for healthcare, energy and transportation, and consumers that demand increasing lower cost products. In order to keep their costs per unit low enough to compete, North Dakota's manufacturers will be forced to increase productivity while decreasing costs. The only way to achieve this will be through automation.

There are exceptions to these challenges, which should be noted. Manufacturing companies that operate in high margin industries, along with those that are resistant to global competition for market access due to logistical advantages, will be less affected by international competition.

Another issue challenging North Dakota's manufacturers is a workforce availability shortage. In fact, two-thirds of the manufacturing businesses surveyed by the Greater Fargo Moorhead Economic Development Corporation's workforce retention and expansion program listed workforce availability as their number one barrier to growth in 2007.

With few unemployed seeking work, it is clear that we must better utilize our existing workforce and focus on quality of jobs rather than quantity. We must do more with the workers we have, increasing productivity and output by using machines and robots to replace and supplement human labor.

Not only is automation a benefit for businesses, as it helps address workforce shortages and global competition, it is also a benefit to workers and to the State of North Dakota. Aside from the obvious benefit of retaining jobs by maintaining competitive, working in an automated environment requires a higher level of skills; highly-skilled positions demand a higher salary for workers; and higher

salaries equal higher tax revenues for the State of North Dakota, therefore bolstering the State's economy.

Aggressive, innovative public policy that focuses on quality of jobs, not quantity, and that is relevant to today's economy, is the first step to addressing our challenges.

Bottom line: we must worry about the long-term viability of manufacturing companies in North Dakota. In order to address these challenges we propose tax incentives that encourage innovation, productivity and efficiency.

### **Review of Best Practices**

Many states in the United States are concerned about the viability of their manufacturing industry. North Dakota is among the 35 states that offer a sales tax exemption for manufacturing purchases.

A review of state policies produced very little in the way of incentives focused on automation, innovation and increased productivity and efficiency. Perhaps the most closely related is Ohio Manufacturing Machinery and Equipment Investment Grant Program and Investment Tax Credit Programs. These programs were created to encourage the expansion of existing operations by upgrading machinery and equipment with new technology, but were not aimed at automation, innovation, or productivity. In addition, the Ohio program just applies to increases in spending over the previous year.

The Greater Fargo Moorhead Economic Development Corporation contacted the California Manufacturers Association, and Legislative Director of Tax and Corporate Liability Gregory Hines had no knowledge of any such tax credits. The GFMEDC also talked to a representative from the National Association of Manufacturers, who was also unaware of any such tax credits.

Because there is currently no tax incentive rewarding automation, innovation and productivity and efficiency gains in manufacturing, North Dakota could be a pioneer in this policy area.

### **Proposed Tax Credits**

#### **Automation/productivity tax credit**

The purpose of an automation/productivity tax credit is to encourage the expansion of North Dakota manufacturing and to alleviate the challenges of workforce shortages and to help ND businesses compete against global competitors.

Proposed credit:

7.5 percent North Dakota corporate income tax credit on eligible equipment purchases. The total value of the credit is divided equally over five years and the manufacturer is permitted to carry forward unused tax credit amounts for up to three years.

Eligible equipment includes automation and robotic technologies used in the manufacturing process.

The goals of the tax credit are:

- Retain and expand manufacturing companies and jobs
- Increase workforce productivity
- Address workforce shortages
- Assist in company's ability to meet market demand
- Transition North Dakota incentives to encourage higher-paying jobs
- Enhanced utilization of North Dakota's incumbent workforce

### **Lean Manufacturing tax credit**

The purpose of the lean manufacturing tax credit is to promote the retention and expansion of North Dakota manufacturing companies through enhanced quality, productivity and efficiencies. This is critical to the survival of local companies as they face very stiff competition from companies based in low-cost countries.

Proposed credit:

10 percent North Dakota corporate income tax credit on eligible expenditures necessary in the implementation of lean manufacturing.

The goals of the tax credit are:

- Retain and expand manufacturing companies and jobs
- Increase workforce productivity
- Address workforce shortages
- Assist in company's ability to meet market demand
- Transition North Dakota incentives to encourage higher-paying jobs
- Enhanced utilization of North Dakota's incumbent workforce

### **Innovation tax credit**

The purpose of the innovation tax credit is to encourage innovation in North Dakota manufacturing businesses in order to diversify and grow product offerings; to encourage companies to move out of commoditized product lines and into emerging product lines in order to stay in business, retain jobs and maintain competitive in the global economy. The innovation tax credit will serve as a supplement to the research & development expenditure tax credit and would

target small manufacturing companies that may not have their own engineering departments.

Proposed credit:

20 percent North Dakota corporate income tax credit on eligible research projects with North Dakota research universities.

Goals of the tax credit are:

- To retain and expand manufacturing companies and jobs
- To respond to global competition
- To encourage product diversification through innovation
- To encourage research relationships and technology transfer between North Dakota businesses and North Dakota research universities