Discounting our way to prosperity

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By Sean O'Leary - Sunday columnist (seanoleary@citlink.net) , journal-news.net

By the time this column is published, we may know whether Royal Dutch Shell has awarded West Virginia the much discussed ethane "cracker" plant that brings with it the promise of 12,000 high-paying jobs. It's a prize badly needed in West Virginia and one that has rightly concentrated the minds of the governor and legislature, who have put together a tax reduction package worth more than $300 million in an effort to lure the plant.

The $300 million figure was arrived at by Sean O'Leary in an analysis published by the West Virginia Center for Budget and Policy.

(Note: The "Sean O'Leary" who authored the WVCB report and the "Sean O'Leary" who writes this column are different people.)

In his report O'Leary argues that the cost to the state and localities of providing the tax breaks is not trivial because the facility will create additional need for public services. Meanwhile, he says there is little evidence that tax breaks play a significant role in determining where businesses locate.

Regardless of whether the cracker plant ultimately comes to West Virginia, the question of whether tax incentives attract businesses and jobs is important because both political parties are committed to reducing business taxes as a means of stimulating economic growth. Indeed there seems to be a consensus that through tax cuts West Virginia can discount its way to prosperity.

This year, in the face of future cost increases for entitlements and other programs, West Virginia reduced business taxes by $15 million. Republicans in the Legislature want to use growing natural gas severance tax revenues to create a permanent "tax reduction fund" that would be used to eliminate the tax on business equipment and inventory. Meanwhile, we're in the midst of lowering the corporate net income tax rate from the current 8.5 percent to 6.5 percent by 2014.

It's all being done in an effort to make West Virginia more competitive as a place to do business. And there's a prima facie case for the need to do so because West Virginia faces serious obstacles.

We have the oldest, least-educated, most disabled and most impoverished populace in the country. Cultural opportunities are few. High speed Internet access is sporadic, and our environment is among the nation's most toxic. These are serious drawbacks for companies looking to relocate.

So, we have a choice. Correct these flaws, which will be a daunting, time-consuming task requiring spending and investment. Or put the money that could be used to correct the flaws into tax cuts in the hope that potential employers can be bribed into locating here, even as they hold their noses while doing so. But are business tax cuts a big enough incentive?

It's not likely. An examination of the economics of the cracker plant illustrates why.

First, we should note that, even without additional breaks, West Virginia's business tax burden is already competitive. The Tax Foundation ranks West Virginia's business tax climate as 23rd best in the nation, substantially ahead of our primary competitor for the cracker plant, Ohio, which comes in at 39th.

Still, we have offered Royal Dutch Shell about $12.1 million per year in tax savings for the next 25 years. That sounds like a lot of money, but Royal Dutch Shell will spend $3.2 billion to build the plant and something north of $500 million a year to operate it. So, over 25 years, the tax breaks will reduce Royal Dutch Shell's operating costs by only about 1.5 percent, little more than a rounding error.

Meanwhile, through free market forces, West Virginia already offers much more significant cost advantages. On a position-by-position basis, wages in West Virginia are 20 percent lower than they are nationally. For the cracker plant, that translates into a labor and supplier cost savings of more than $76 million annually - six times the amount the state is offering in tax reductions. We offer other significant market-based advantages as well.

Because these free market savings dwarf the proposed tax incentives, we have to ask ourselves whether the tax incentives are needed, or are we just leaving money on the table?

Companies deciding where to locate first must determine that there's a qualified workforce, the necessary supplier base and a quality of life that will make their managers open to relocating. Only then do they consider operating costs of which taxes are, as we have seen, a small part. That's why, if West Virginia can meet businesses' primary needs, our built-in labor cost advantages will usually enable us to win and tax cuts won't matter.

The problem is that too often we can't meet businesses' primary needs. We're vastly undereducated. Our supplier base is not well-developed. Due to geographic isolation and environmental degradation, our quality of life is not attractive. And our funding for education, especially higher education, remains low given the level of need.

Only by addressing these problems can we create an environment that's attractive to business. And the money that would otherwise be squandered on superfluous tax cuts is necessary to do that. The cracker plant may come to West Virginia, but if it does it will be in spite of the tax breaks rather than because of them. The same can be said for most business relocations.

West Virginia has been a cheap place to do business for a long time. If we could have discounted our way to prosperity, it would have happened long ago.

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