Glimpse at a Lost Future Gives Direction to Tax Reform

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What West Virginia would have been like if 1999 reform ideas had been enacted.

Story By Rob Capehart and Cal Kent

What if the leadership of our state would have taken off its political glasses and pursued the agenda put forth by Gov. Cecil H. Underwood's Commission on Fair Taxation?

What if many of the business interests in this state would have been cured of their debilitating case of short-sightedness?

What if West Virginia would have enacted "real tax reform?"

No one knows for sure; however, unlike any other tax proposal in the state's history, the Center for Business and Economic Research at Marshall University conducted an extensive eight-month study of the Commission's proposals using a highly sophisticated economic model.

Ten years later, the results of that study help us answer the question "What if ...?"

If the state had wanted to create a tax structure that would have as its goal the destruction of jobs, the perpetuation of low wages and the continuing of below-average growth, the tax structure they would have devised is the current one. One reason why West Virginia workers are paid less than workers in other states and the state's failure to generate jobs for many of its people is the archaic and anti-job tax structure that now is in place.

The current tax system is anti-jobs for the simple reason that jobs follow investment, and our tax system punishes investment.

In fact, West Virginia has consistently ranked near the bottom of all the states in investment per worker. West Virginia workers have less capital (equipment, machinery and technology) to work with than workers in other states. Two results flow from this. The first is lower wages because West Virginia workers are less productive. The second is fewer jobs because West Virginia workers are less competitive.

The question always asked is: "Why does the state not attract more and better paying jobs?" The answer is the lack of investment that would create those jobs and support the higher wages. As long as the West Virginia tax structure penalizes investment, wages will be low and fewer jobs will be created.

What is needed is a system that would increase investment in the state, improve the competitive position of the state's industries and lower the cost of doing business in the state. If this could be accomplished, the state would generate better and more employment opportunities. The result would be higher wages and more jobs.

The recommendations of the Commission on Fair Taxation directly addressed the issue of job creation. By replacing a tax structure that penalizes those firms that are productive and make a profit and those firms that invest heavily in the state, investment will be encouraged. That will lead to more and better-paying jobs. The current net corporate income tax is a tax on efficiency and job creation because it taxes only firms that make profits and, then, at a comparatively high rate.

The business franchise tax is levied only on the value of the assets of the firm. The personal property tax is levied on equipment, machinery and inventories. The result is firms that invest in the state are penalized, and firms that do not invest as heavily in the state are rewarded.

Measuring the Results

There are methods to model the effects of tax changes on a state's economy and jobs. The Center for Business and Economic Research conducted extensive modeling of the recommendations of the Commission on Fair Taxation proposed in 1999. CBER used the REMI Model, which is the most widely used and accepted methodology for determining the impact of policy alternatives. The model allows comparisons between the economic effect of existing policies and different proposals for change. It provides estimates of changes in output, income and employment.

With regard to taxes on business, the Commission recommended: repeal of the taxes on capital; elimination of a number of exemptions to the sales tax; broadening the profits tax; replacing a number of narrow-based business taxes with a broad-based business tax that taxes all businesses equally; and, most importantly, the repeal of the personal property tax on inventory, machinery and equipment.

First, CBER forecasted a significant increase in net employment. In 1999, the Commission's proposal would have produced 15,000 additional new jobs over and above any that would have been produced if the current tax structure remained in place. Under the current tax system, these 15,000 jobs would not be available to West Virginia's youth, forcing them to leave the state and look elsewhere.

Second, CBER forecasted a considerable increase in output -- estimated at $2 billion under the Commission's proposal. This increase also will generate additional taxes for the state, making it easier to supply the public services the people demand.

Third, CBER predicted an increase in disposable income as illustrated by the $1 billion increase anticipated under the Commission's proposal. This income could be spent on an improved standard of living, enhanced education and better health care. In turn, these expenditures expand the state's revenue base. Prosperity for the people means prosperity for the state.

Virtually every sector of the state's economy did better in the economic modeling -- even those providing highly paid professional services. The modeling illustrated that under the Commission's proposal, output increased in every sector with manufacturing leading the way.

Historic growth rates of more than 4 percent over and above the current anemic growth were predicted for the production of nondurable goods, retail and wholesale trade. Durable manufacturing, telecommunications and utilities, as well as agriculture and forestry would have expanded by an additional 2 percent which is significant.

Construction was also predicted to grow -- by a whopping 6.8 percent over and above 1999 estimates.

New and better-paying jobs would have resulted from tax reform as well. Projections showed employment rising over the ensuing five years in every sector of the state if the proposals had been adopted. These are employment increases above what would have been the case if the current tax structure was maintained.

The most impressive gains were in construction, nondurable manufacturing and agriculture/forestry. There always has been a desire to create jobs to keep the state's young people home. The Commission's proposals would have accomplished that objective.

It was not the primary purpose of the Commission on Fair Taxation to propose a tax structure that would stimulate the state's economy. But the result of the quest for a fairer tax system would have resulted in a tax structure that would have done just that.

Gov. Joe Manchin's Tax Modernization Project concurred with the earlier report noting "the current West Virginia tax structure on business creates artificial barriers that prevent the flow of capital into West Virginia."

The Project concluded the business tax burden to be 70 percent greater than in the average state. Its analysis concluded, "First and foremost goal of modernization of the tax system should be to reduce the tax burden on capital formation and job creation."

The Project did not advocate the adoption of the single business tax as the Commission had proposed but called for a "responsible reduction" in the business franchise tax. The Project also called for a "modest reduction" in the corporate net income tax, which was the seventh highest in the nation at 9 percent.

While the Project did not accept the single business tax advocated by the earlier group, it saw some form of value-added taxation as possibly "appropriate" in the future.

The 2007 Legislature responded to the Project's recommendations.

The business franchise tax was reduced from 0.7 cents per $100 to 55 cents, which reduced state revenue by an estimated $26 million. In the same legislation, the corporate net profits tax rate was lowered from 9 to 8.5 percent, moving the state's burden from seventh highest to 14th highest in the nation. In addition, it proposed study of ways to improve the current structure, such as minimum business taxes, combined corporate income reporting, abusive tax avoidance transactions and net income allocation formulas.

Conclusion

The recognition by both the Commission and the Project regarding the negative impact of the business tax environment in the state is important. The first steps have been taken, but no one should conclude that more does not need to be accomplished. Clearly jobs are being lost and income foregone.

Extensive modeling of the income and jobs impact of alternative tax structures, such as was done for the Commission's proposals, would substantially increase the quality of the debate and point future direction.

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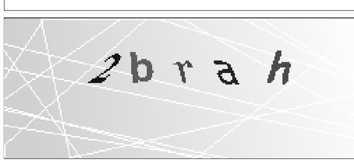

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