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Business Taxes and Economic Development

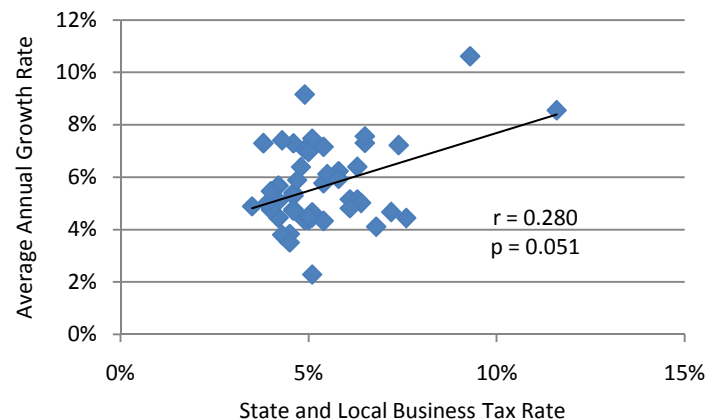
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Many have argued that taxes, such as the business personal property tax, keep companies from investing in West Virginia, and that states with low business taxes have stronger economic growth. However, evidence suggests that taxes may have a minor impact on a state's economic development. Instead, factors like the availability of inputs, access to markets, infrastructure, quality public services and schools, a highly trained workforce, and a high quality of life are all more important.

Lower business tax rates show no clear connection with higher GSP growth.

Using annual private sector Gross State Product (GSP) as a proxy for "economic growth," data from the business cycle that occurred before the start of the recession (2001 to 2007) show no obvious correlation between state and local business tax rates and economic growth (the overall business tax rate was measured as total business taxes paid as a percent of private GSP). There was also no correlation between the business tax rate and the total private GSP growth and per capita GSP growth during that time frame. Lower business tax rates show no clear connection with higher GSP growth.

Average Annual Private GSP Growth from 2001-2007, and Overall State and Local Business Tax Rate in Each State in FY 2007

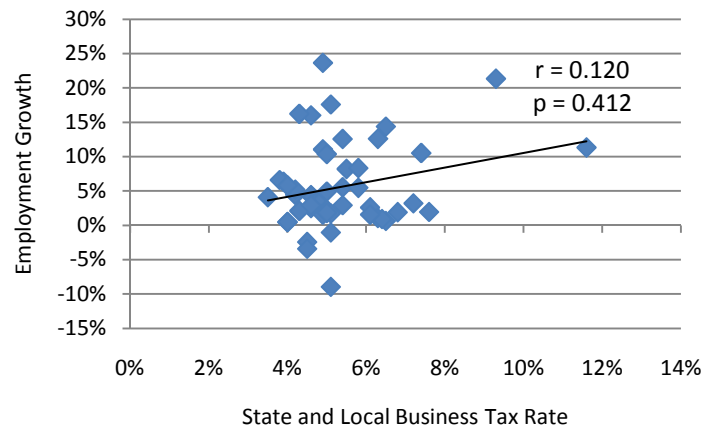


Source: Council on State Taxation and Bureau of Economic Analysis

Employment growth shows no clear relation to the business tax rate.

Data from the previous business cycle also show no obvious correlation between employment growth and the overall state and local business tax rate in each state. Like with private GSP, lower business tax rates do not appear to be associated with higher job growth.

Employment Growth from 2001-2007, and Overall State and Local Business Tax Rate in Each State in FY 2007



Source: Council on State Taxation and Bureau of Labor Statistics

Taxes are the least significant cost factor for business location decisions.

A study by leading corporate site selection consultant Robert Ady of Ady International Company found that businesses typically use five main cost factors in determining the geographic location of their facilities. Of these factors, taxes were the least significant factor in the decision to locate in a particular community. The study concluded that "the site selection data do not suggest any correlation between low taxes and positive economic growth, or between high taxes and slow growth."

The Relative Importance of Costs in Business Location Decisions

Cost Factor	Manufacturing Operations	Office Operations
Labor	36%	72%
Transportation	35%	0%
Utilities	17%	8%
Occupancy	8%	15%
Taxes	4%	5%

Source: Robert M. Ady, "Discussion," New England Economic Review (March/April 1997): 77-82.

Small differences in wages can offset large tax changes.

West Virginia is a low wage state, with private hourly wages averaging \$4.07 lower than its border states. A relatively small change in wages can far exceed any savings from even a substantial reduction in taxes. For example, businesses in West Virginia paid \$3.5 billion in state and local taxes in 2009. If that amount were cut by a third, the savings would be offset by only a \$1.00 increase in hourly wages.

Offsetting Hourly Wage Increases for State and Local Business Tax Cuts in West Virginia, 2009

Overall Business Tax Cut	Value of Tax Cut	Offsetting Hourly Wage Increase (2000 hours; 577,386 private employment)
5%	\$175 million	\$0.15
10%	\$350 million	\$0.30
15%	\$525 million	\$0.45
20%	\$700 million	\$0.60
33%	\$1.16 billion	\$1.00

Source: U.S. Bureau of Economic Analysis and the Council on State Taxation.

Variations in energy costs offset variations in taxes.

Industrial electricity costs in West Virginia are an average of 2.66 cents/kilowatt hour lower than its border states. Like the wage differential, the difference in electricity costs more than offsets any differences in taxes. For example, West Virginia's property tax on machinery, equipment, and inventory is estimated to cost businesses \$250 million. However, if an industrial firm were to locate in a border state to avoid the property tax, the increase in electricity costs would more than offset the savings from avoiding the tax.

The Energy Cost Differential Between West Virginia and Surrounding States, 2008

	Cents per Kilowatt Hour Difference from West Virginia	Value of Cost Differential (114 billion kwh consumed in WV by industrial sector, 2008)
KY	+0.71	\$814 million
MD	+6.15	\$7.05 billion
OH	+1.99	\$2.28 billion
PA	+2.82	\$3.23 billion
VA	+1.63	\$1.86 billion

Source: U.S. Energy Information Administration

West Virginia's costs of doing business are among the lowest in the country.

According to the business cost index developed by Forbes.com, West Virginia has the fourth lowest costs of doing business in the country. The costs in the index included taxes, labor, and energy costs. West Virginia's overall business tax rate is high, mainly due to the structure of the state's economy. West Virginia has a very capital-intensive economy, with substantial tax collections from the coal industry, like severance taxes; however, West Virginia's low labor and utility costs more than offset the cost of taxes, giving it the lowest cost of doing business compared to its surrounding states.

Business Cost Rankings and Overall State and Local Business Tax Rate, West Virginia and Surrounding States, 2009

	Business Cost Rank	Overall State and Local Tax Rate
KY	16	4.8%
MD	42	4.0%
OH	30	5.1%
PA	38	4.6%
VA	20	3.5%
WV	4	6.9%

Source: Forbes.com and the Council on State Taxation



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