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Several Reasons Why Business Tax Cuts Don't Work

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About 10 years ago, West Virginia lawmakers phased in large corporate tax cuts. This included a series of reductions to the corporate income tax rate, which dropped from 9 percent to 6.5 percent over this time period, and phasing out the business franchise tax. At the same time, lawmakers enacted a manufacturing property tax credit on inventory. While growing severance tax collections from the Marcellus Shale boom masked the impact of the tax cuts for several years, this is not the case anymore. All together, the revenue loss in 2015 alone was estimated at $225 million, or about 5 percent of West Virginia's general revenue fund budget.

At the time these business tax cuts were implemented, they were lauded as a way to grow our state's economy. The **West Virginia Chamber of Commerce**, among others, said they would "spur economic growth, job creation and additional tax revenues." The libertarian-leaning **Cato Institute** said in 2008 that West Virginia's business tax cuts were "probably the most pro-growth tax reforms of any state." As a result of the business tax cuts over the past 10 years, West Virginia's "business tax competitiveness" as ranked by the conservative **Tax Foundation** grew from 37th best to 18th best in the nation — the second biggest increase by any state over that time frame.

There has not been a rigorous academic study on the economic impact of the business tax cuts in West Virginia, but a casual look at economic growth indicators shows no obvious correlation. Between 2007 and 2016, West Virginia's personal income and job growth continued to rank below the U.S. average, as well as that of our five border states. In fact, West Virginia has approximately 5,900 fewer private sector jobs (as of December 2016) than before the tax cuts took effect (December 2006).

While the decline in the coal industry certainly played a role in West Virginia's weak economic performance, other industries — such as manufacturing, construction and business services — also performed well below national growth rates. Meanwhile, some industries have grown well over the tax cuts put in place — including natural gas and oil and the health sector.

There are several reasons why the business tax cuts may have failed to produce the anticipated growth that many thought would occur:

• State and local taxes are a small share of business costs. Nationally, they comprise approximately 1.8 percent of business costs — so a reduction of this amount is not going to affect most companies' bottom lines. The real costs of doing business — the 98.2 percent — are labor, occupancy, electricity, business support services, machinery and equipment, raw materials, transportation and other costs. Variations in these costs can far outweigh marginal tax rate differences between states.

• Economic growth is heavily influenced by factors other than business tax cuts. This includes factors largely outside of West Virginia's control — such as climate, global energy prices, trade agreements, access to raw materials, economic recessions, federal fiscal and monetary policy and federal regulations — and other factors the states have more control over – including a skilled workforce, infrastructure, available sites and the overall quality of life.

• Product demand — not taxes — is the primary driver of hiring. Business production depends on the ability to sell products, and broad-based tax cuts that provide just a few thousand dollars (on average) will not incentivize hiring in most cases.

• Business taxes are highly exportable. Because multistate corporations likely received the bulk of the business tax cuts, it's highly likely that a good portion of the business tax cuts flowed to other states. Another portion of these tax cuts also went to the federal government because businesses can deduct them from their federal income tax liability, which increases federal tax payments. Since most job growth in West Virginia comes from in-state businesses — 83 percent from 1995 to 2013 — the tax cuts probably did little to help expand the economy.

• It's a zero-sum game. Because West Virginia must balance its budget, this means that we as a state must pay for the tax cuts by reducing state services, raising other taxes or both. These actions can slow the economy, offsetting the economic benefit of the tax cuts. It is not a coincidence that West Virginia has had to make severe budget cuts at the same time that the state has lowered taxes — or that the business tax cuts are one driving factor behind the state's consistent budget gaps since 2014.

• Most academic research shows state tax levels have little impact on economic growth. In a review of 38 peer-reviewed articles in academic journals and books since 2000, the analysis shows 20 of the studies find no significant link between state tax levels and economic growth, while only seven found a significant link, with 11 finding mixed or inconsistent results. For example, **John Deskins**, director of the **WVU Bureau of Business and Economic Research**, conducted three studies on the link between state taxes and economic growth since 2000 and found very inconsistent results. In one study, Deskins found that state corporate income tax rates do not have a significant impact on economic activity, while the sales tax does.

As lawmakers reconvene to take up tax reform and close an estimated $500 million budget gap, it is imperative that they understand that further reductions in business taxes will likely result in more cuts to vital public services that could deprive businesses of the number one thing they need to thrive, which is a skilled, educated and healthy workforce to produce and buy their goods.