P brief

Washington Research Council

PB 03-09 *June 23, 2003*

The Bill for Boeing

BRIEFLY

Washington State constantly competes with other states for jobs and businesses. The current battle for the 7E7 assembly plant is unique only in its size and visibility. The cornerstone of the state's bid to Boeing is a large package of targeted tax incentives. That it was necessary for the state to offer such a large package for Boeing indicates that Washington's basic business climate requires continued improvement, building upon recent progress.

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Introduction

The Boeing Company is considering developing a new wide-bodied airplane, the 7E7. This plane, recently dubbed the Dreamliner, is intended to replace the 757 and 767, which have not sold well in recent years. Under intense competition from Airbus, the company announced that it had to do everything in its power to reduce its costs. To that end, it initiated a national competition between states to be the site of assembly for the new plane.

For a number of years, the company has complained that the costs of doing business in this state are significantly higher than in other states. This year, under the pressure of the impending decision, the legislature made progress in a number of areas including transportation, unemployment insurance and workers compensation. However, the cornerstone of the effort to reduce Boeing's cost of doing business in the state is a set of targeted tax incentives passed by the legislature in the recently concluded second special session.

Governor Locke signed the bill containing the Boeing tax incentives, HB 2294, on June 18th, two days before the June 20 deadline for states to respond to the company's request for proposals for the 7E7 assembly site.

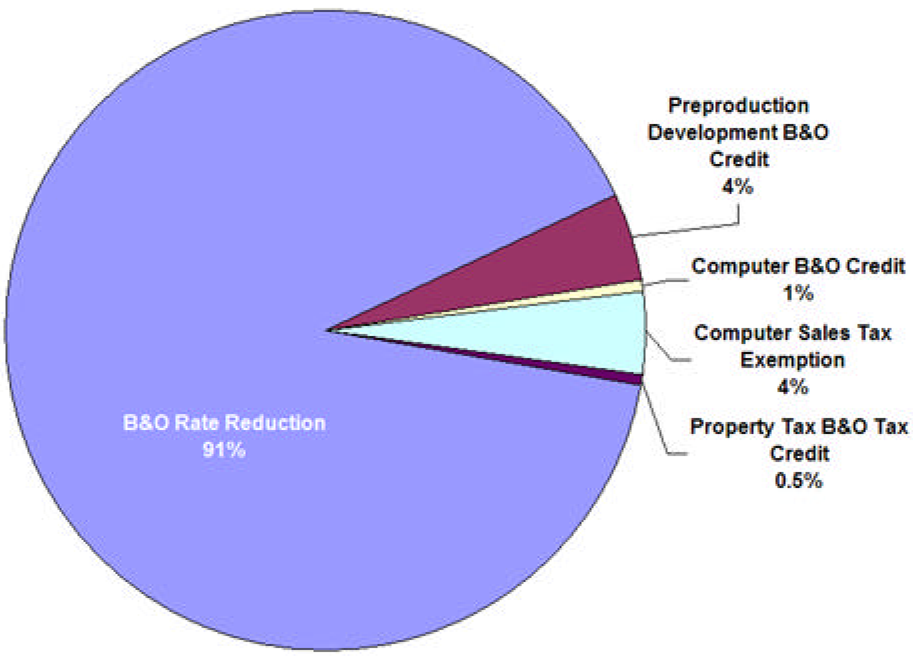
HB 2294 does not specifically mention Boeing or the 7E7. The tax incentives are contingent on the governor signing a memorandum of agreement with an aircraft manufacturer to "site a significant commercial airplane final assembly facility" in the state. The facility is to be used to assemble a super efficient airplane, defined to be a twin aisle airplane with capacity for 200 to 350 passengers, a range exceeding 7,200 nautical miles, a cruising speed of about 85 percent of the speed of sound, and fuel economy 15 to 20 percent better than comparable current airplanes. These are the general characteristics that have been discussed for the 7E7.

The bill contains eight specific tax changes.

B&O Rate Reduction: The bill creates a separate B&O tax category for manufacturing commercial airplanes and their components. The general B&O rate for manufacturing is 0.484 percent. The rate for commercial airplanes will drop first to 0.4235 percent beginning October 1, 2005 (a 12.5 percent reduction) and then to 0.2904 percent (a 40 percent reduction) on July 1, 2007 or on the date that final assembly of the 7E7 commences, if that is later. The rate reverts to 0.484 percent on July 1, 2024.

Preproduction Development B&O Credit: Aircraft manufacturers will be allowed a credit against B&O taxes equal to 1.5 percent of preproduction development expenditures towards new products, prod-

Chart 1: Distribution of Tax Incentives For 7E7 Built at Everett ($3.2 Billion over 20 Years)



Source: Department of Revenue, WRC

uct lines, models, or model derivatives. So that this provision will not reduce state revenue during the 2003–05 biennium, credits earned before July 1, 2005 must be carried forward and used after that date.

Computer Software and Hardware B&O Credit: Aircraft manufacturers may take a credit against B&O taxes for investments in computer hardware and software used for design and engineering made between January 1, 1995 and the effective date of HB 2294. The amount of the credit will be equal to 8.44 percent of the purchase price (This approximately equals the sales tax that was paid on the hardware and software). For any one company the credit is capped at $10 million per year and $20 million total.

Computer Hardware and Software Sales and Use Tax Exemption: Purchases of computer equipment and software used in the development, design, and engineering of commercial aircraft are exempted from the sales and use taxes.

Construction Sales and Use Tax Exemption: Labor, materials and fixtures incorporated in buildings constructed for manufacturers of super efficient airplanes are exempted from sales and use taxes.

Property Tax B&O Tax Credits: B&O tax credits will offset property taxes that would be due on new privately owned investments in plant and equipment of airplane and component manufacturers.

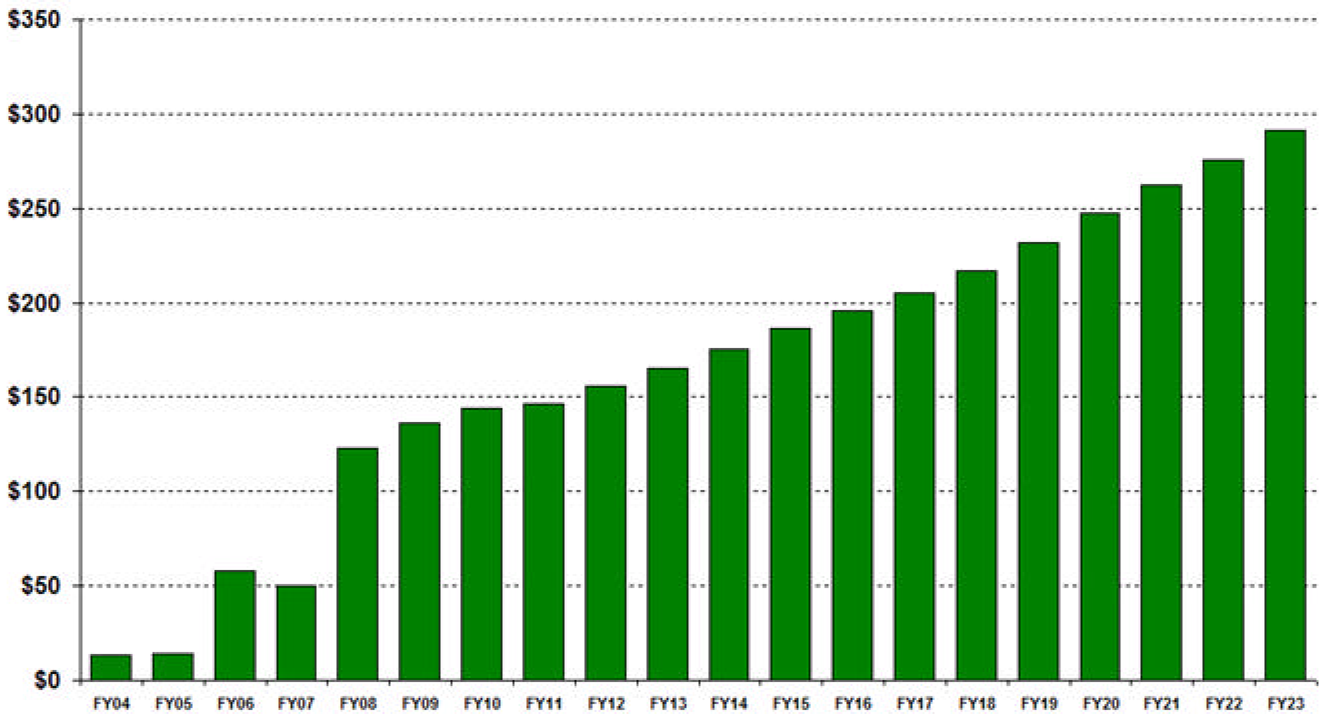
Leasehold Excise Tax Exemption: Publicly owned property is exempt from the property tax. The leasehold excise tax is imposed in lieu of the property tax on leases of public property to private parties. If a public port district constructs facilities for use by a manufacturer of airplanes or airplane components, lease payments will be exempt from the leasehold excise tax.

Property Tax Exemption: Property located on the property of a public port district, owned by a manufacturer, and used exclusively in the production of super efficient airplanes is exempted from the property tax.

All of the tax incentives expire on July 1, 2024.

The Department of Revenue has prepared estimates of the value of these tax incentives over the 20-year period that they would be in effect. The calculations lay out three scenarios: the 7E7 is assembled at

Chart 2: Tax Incentives by Year For 7E7 Built at Everett



Source: Office of Financial Management, WRC

Everett; it is assembled at Moses Lake in a privately built facility; and it is built at Moses Lake in a Port-built facility. The values of the tax exemptions are \$3.3 billion, \$3.7 billion and \$3.4 billion respectively under the three alternative scenarios. (The value of the incentives is higher for the Moses Lake site because it would require substantially more new construction.)

In all three cases, the bulk of the value, \$3.0 billion, is due to the reduction in B&O rates. (See Chart 1.)

The annual value of the incentive grows year by year, due to inflation and growth in the market for aircraft. For example, the estimated value of the incentives for the Everett site increases from \$144 million in fiscal year 2010 to \$291 million in fiscal year 2023. (See Chart 2.)

The true cost to the state of these incentives, however, should be gauged against the revenue that would be lost if the 7E7 to be built elsewhere.

The Office of Financial Management (OFM) has estimated the potential impact on the state's economy in the year 2015 of winning the 7E7 assembly plant.

OFM assumes that the 7E7 assembly plant would employ 1200 in 2015 and that Boeing would employ an additional 3,400 at other state facilities to support the 7E7 program. Instate suppliers and subcontractors to the 7E7 program are assumed to provide an additional 3,600 jobs, so that the overall impact on state aerospace employment is 8,200. The income spent by these aerospace workers would generate 9,100 jobs through the normal multiplier process. Thus the 7E7 would increase employment in the state by about 17,300 overall. This activity would generate $65 million annual tax revenue to the state general fund.

Many observers expect the 7E7 to be the first of a new generation of airplanes that Boeing will introduce over the next 20 years and expect that the site selected to assemble the 7E7 will also be the site where these other new models will built. Thus failure to win the 7E7 would set the stage for a long-term erosion of Boeing employment in Washington. Under varying scenarios, OFM posits that 20,000 to 48,000 other Boeing jobs might follow the 7E7 jobs out of state by 2015, accompanied by 4,000 to 9,600 supplier and subcontractor jobs. The loss of these aerospace jobs would cost an additional 56,000 to 134,000 indirect jobs.

By this tally, the number of jobs ultimately at stake with the 7E7 decision ranges from 73,300 to 151,900 in 2015. The tax revenue associated with these jobs ranges from $265 million to $540 million. In contrast, the tax incentives are expected to reduce tax revenues by $180 to $200 million in 2015.

In early June, Governor Locke reportedly warned legislators that the package of tax incentives targeting the 7E7 would make them gulp. Perhaps they did. Nevertheless only one senator and only 10 representatives voted against the package. Washington entered the battle for the 7E7 with a state tax system that raises an unusually large share of its revenue through taxes on business and a state constitution that prohibits the sorts of business incentives that many other states will offer Boeing. A “big gulp” tax incentive package was necessary for the state’s bid to be viable. (Maybe the plane should be numbered the 7-Eleven.)

It is important to recognize, however, that the state is constantly competing with other states for jobs and businesses. The 7E7 battle is unique only in its size and visibility. That it was necessary for the state to offer such a large package for Boeing indicates that Washington’s basic business climate requires continued improvement, building upon recent progress. And even then, sometimes the prize will justify an additional sweetener.

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