

# BACON'S REBELLION

The Op/Ed Page for Virginia's New Economy

## It's the Global Economy, Stupid

**A "flat" world is opening Virginia's economy to ferocious foreign competition. Business people worry about it every day. Our candidates for statewide office appear to be clueless.**

By James A. Bacon

**E.** Morgan Massey may be 78 years old, but he's still piloting his own private plane, and he'd just finished a week of flight training when I caught up with him on the phone a few weeks ago. Over his long career, he has created more wealth than any but a handful of Virginia entrepreneurs, and he did it in the brutally competitive U.S. coal industry, battling geology, other coal operators and the United Mine Workers of America. After building the A.T. Massey Coal Company into one of the largest coal mining enterprises in Central Appalachia, he set about developing empires abroad, founding new ventures to extract coal from Venezuela and China.

Everyone knows that the Chinese economy is booming but Massey worries that Americans do not fully appreciate, as he has come to, the competitive threat that China poses to the United States. China isn't satisfied with its new-found role as the workshop of the world. It's setting its sights upon supplanting the U.S. in science, research and technology. Massey, who has witnessed extraordinary changes in the decade or so that he's been visiting his coal mines in Shanxi province, fears the loss of America's economic primacy.

The Chinese secondary school system is far ahead of the U.S.', Massey asserts. U.S. universities are better, but they're "losing ground fast." The Chinese are graduating literally millions of students from college every year now, and every one of them has studied English, the lingua franca of the global economy.



What's more, while Americans dabble in psychology and art history, the Chinese are mastering difficult disciplines such as engineering and chemistry.

India, he adds, is following the same trajectory as China. "If we don't get more technical people in industry," he says, "we're going to be left behind India and China very soon."

Massey knows first-hand that -- to borrow the title of Thomas Friedman's new book, "*The World is Flat*" -- the globe is indeed taking on a horizontal aspect. A flat world is Thomas Friedman's metaphor for the fact that technology has leveled the playing field and the U.S. faces unprecedented challenges to its economic superiority from countries that it once wrote off as Third World basket cases.

Massey finds much truth in the book, as he should, because he has been something of an economic rolling pin himself, intro-

ducing state-of-the-art management practices in a Chinese coal industry once marked by abysmal productivity and a fatality rate not seen in the U.S. for a century. In the Richmond area where I live, "*The World is Flat*" is *de rigeur* reading among the executives of multinational and other leading companies, as it is, no doubt, across much of Virginia.

Unfortunately, not one candidate for statewide office has demonstrated in public statements even a passing familiarity with the book or the economic trends that it documents. I've been following Virginia politics for a long time. I remember Jerry Baliles, the trade governor, George Allen and his Silicon Dominion, Jim Gilmore and his fascination with the IT sector, and Mark Warner, a financier of that very same tech sector. Never have I seen a campaign so relentlessly parochial in its concerns, so oblivious to the global realities that shape the Commonwealth.

So far, the biggest issue in the gubernatorial campaign has been the "debate" debate -- whether Jerry Kilgore would include independent Russ Potts on the podium with Tim Kaine. We've heard about Jerry Kilgore's accent and Tim Kaine's stint as a missionary. We've read articles about poll results and fund raising. We've been told that Kaine wants more "school resource officers" in schools to help fight gangs, while Kilgore wants to crack down on meth labs. Kaine tweaks Kilgore because one of his contributors has been accused of Medicaid fraud, while Kilgore paints Kaine as hostile to guns. Through it all, the cam-

campaign machines of both candidates crank out e-mail blasts in a never-ending game of "gotcha," pointing out niggling inconsistencies in the other's public record.

The foolishness rages unabated, even though none of it seems to resonate with the public. In a Rasmussen poll of 500 likely voters released last week, 28 percent said that the economy was their No. 1 concern, more than any other issue by far. But Virginia's candidates have all but abandoned the elemental wisdom of Bill Clinton's 1992 election campaign and its watch words, "It's the economy, stupid."

Virginia candidates don't talk about the economy except in the most superficial of terms. The economic development platforms of both candidates are weak: ridden with cliches and conventional wisdom. There is no analysis of the competitive strengths and weaknesses of Virginia's economy, much less any idea of what it takes -- beyond such bromides as building a 21st-century transportation system and preparing Virginians for 21st-century jobs -- to compete in a global arena. (See Kilgore's "[Commonwealth of Opportunity](#)" plan. Read [Tim Kaine's plan](#).)

What, then, should the candidates be talking about? I don't have the space to outline a detailed economic development strategy here. What I hope to do is lay out a framework for thinking clearly about Virginia's economic strategy.

**T**he classical economists analyzed a nation's economic development in terms of three inputs: land, labor and capital. In recent decades, economists have added one more: technology. These are helpful categories for dis-

secting Virginia's economic competitiveness, and we shall walk through them point by point.

**Capital.** The major U.S. institutions regulating the flow of capital reside at the federal level: The U.S. Treasury, the Federal Reserve Board, the Securities Exchange Commission, etc. There is only one thing that state and local governments can do to encourage or discourage the flow of capital into their borders, and that is to set rates for business taxes.

All other things being equal, lower taxes are better for economic growth than higher taxes. Low taxes help in two ways. First, companies invest their capital where they generate the highest return, and they most assuredly take into account the impact of business taxes, not to mention tax-like exactions such as contributions to unemployment compensation and to worker's comp. Second, businesses with lighter tax burdens generate higher profits, which they can plow back into expansion, growth and the funding of start-ups.

People can make snide jokes about low taxes and Mississippi, but the record is indisputable: Over the past 50 years, low-tax states have, on average, displayed consistently higher rates of job creation and income growth than high-tax states (As an aside, Mississippians' per capita income increased 12.3 percent between 2001 and 2004, ranking it 8th in the nation -- well ahead of Virginia's 9.0 percent increase.)

Of course, the need for low taxes must be balanced against the need for government services such as education and transportation. The trade-off between taxes and services makes it imperative that Virginia

strive continually for ever-higher levels of efficiency in state and local government. The task of restructuring government, retiring outdated and ineffective programs, reforming administrative processes and bolstering employee productivity cannot be limited to periods of budget crisis. It must be relentless and ongoing. To remain attractive to corporate capital in a marketplace where dollars can fly overseas with the blink of a cursor, Virginia must make it the highest priority to drive down the cost of government and reduce the burden of taxation.

**Labor.** In the knowledge economy, employees are valued for their creative capabilities: their ability to imagine new possibilities, to conceptualize new products and services, to research new technologies, to invent new business models and to solve complex problems. The relevant measure of a state or region's labor assets is not the size of the workforce, but the depth and scope of skills that workers possess. Most politicians grasp the connection between education and economic prosperity, with the consequence that virtually every one is willing to throw huge sums at education. But there is more to building human capital than erecting new schools and colleges.

There are three key elements to building human capital: Development (education and training), recruitment and retention. It's not sufficient simply to invest in education, as states and regions experiencing brain drain can testify. Increasingly, states and regions are competing for the talented individuals -- be they artists, university scientists, executive chieftains or start-up entrepreneurs -- who create disproportionately to innovation and wealth creation. Unfortunately, there is little in-

stitutional knowledge in Virginia about what it takes to induce these creative geniuses to relocate here, and even less about what it takes to keep them.

We can hazard a few guesses, but they are tentative. All other things being equal, successful people like to keep the money they earn; in other words, they prefer low tax environments over high-tax environments. But there's more to the picture than taxes. Creative people also value quality of life, which may require an investment of public resources in local amenities. Creative people seek communities with a strong sense of history and place, with an active arts and cultural scene -- populated by lots of other creative people. Unfortunately, state government has barely taken the first steps to engage with local governments in figuring out to measure, much less recruit and retain, Virginia's human capital.

**Land.** In classical economics, land was rated according to its fertility: its ability to yield an agricultural surplus. Today, with a hyper-productive farm economy, agricultural yield is not a significant issue. Cutting-edge economic thinking now focuses on the role of land in spatially separating human activities. Over the past 50 years, real estate development has been scattered, disconnected and increasingly low density. The costs of this inefficient pattern of land use are so diffused that the public generally does not perceive them. Yet inefficiencies are pervasive and deeply embedded in the cost of delivering government services and utilities, in the cost of providing mobility and access (i.e. transportation), and in the cost of and access to housing. By driving up taxes, increasing congestion and running up the cost of housing, in-

efficient human settlement patterns affect Virginia's competitive posture at the most basic level.

Other critical issues relate to the physical design of the built environment. Some people find modern suburbia, with its auto-centric streets, massive parking lots and garish signs, to be intimidating and unattractive. In a parallel critique, some find suburbia too fragmented and disconnected to lend itself to the building of true communities. Ugly, soulless places are ill equipped to compete for top creative talent.

**Technology.** In a global economy built upon continual innovation, it is crucial that Virginia develop a strong technology base. Funding Virginia's research universities is one aspect of this challenge. But Virginia also needs to build an entrepreneurial culture, with supporting institutions, capable of taking breakthroughs from university labs into a global marketplace. State officials have done some productive thinking in this realm, though it would be comforting to see indications that our candidates for statewide office are conversant with it.

Most Virginians, like most Americans, have come to regard prosperity as their birthright. But as the devastation of once-prominent industries such as textiles, shoes, apparel and furniture have vividly demonstrated, Virginians are no more resistant than anyone else to the hurricane gusts of economic change. We may comfort ourselves that our high-tech jobs will survive even if our low-tech jobs did not. But if we look closely at what's happening in India and China, we'll see how fragile those hopes are.

We must flex every muscle,

tighten every sinew, to create a culture of productivity and innovation. We must be fanatical in our devotion, bending every sector of government, every institution of learning, every not-for-profit organization, to the cause of competitiveness. For while we are sleeping, 1.3 billion Chinese and one billion Indians most certainly are not. And though they live on the other side of a very flat world, they are getting closer every day.

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