Attachment B

HB 1142

Snookered

The corporate tax incentive game is a money-loser, but states keep playing.

If you sat down and drew up the ideal plan to invest $80 billion every year in economic development across the United States, you would think of a lot of exciting things. You could pour the money into research and form the basis for new product breakthroughs in a wide variety of fields. You could invest in America's workforce to make it more skilled and flexible. You might assist manufacturing companies in upgrading their factories and equipment, or help universities attract the best students from around the world for science and engineering programs, or improve our transportation infrastructure.

The one thing you almost certainly would *not* do with $80 billion a year is create a decentralized system of providing tax breaks and other subsidies to profitable businesses in different economic sectors, often with little accountability for how the money is spent and no recourse if the company goes south. Yet, as a highly publicized series in *The New York Times* last December showed, this is exactly the system that state and local governments around the country have created over the past four decades.

Though the issue of economic development incentives has been around for a long time, the *Times* used solid footwork and a lot of groundbreaking data analysis to draw the most complete picture of our incentive system to date. By combing through a variety of databases, the newspaper's reporters examined 150,000 incentive deals and came up with the $80 billion price tag. They also cast the story in David-versus-Goliath terms, clearly suggesting that unsophisticated government agencies—especially local governments—get snookered on a regular basis by slick corporations that often take the money and break their promise to deliver jobs.

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The bottom line was depressingly familiar. When asked whether the tax breaks and subsidies actually created jobs, elected officials and economic development experts couldn't say for sure. All they knew—or so they said—was that they didn't dare *not* put these incentives on the table, for fear that the companies would locate or relocate elsewhere.

And therein lies the biggest problem with America's decentralized economic development incentive system: It may or may not work. In fact, there's considerable evidence that it doesn't work, but it operates kind of like the ante in a poker game. Throwing the money into the pot doesn't mean you'll win the game. All it means is that you get to play.

Whether you win depends a lot on how the business sectors you are dealing with approach the poker game. Sophisticated businesses tend to play their poker hands based on skill. "Sure, we'll take the money you ante up with, but that's not really what we are looking for," they'll say. "We also need a skilled labor force, a good transportation system, connections to research institutions, perhaps a favorable regulatory environment—because those are the things we really need to run our enterprises profitably and no amount of cash is going to make up the difference if these things are lacking."

Manufacturing in the South is undergoing a renaissance in large part because both governments and companies play this game with skill. "Yes, we have incentives, low taxes, and light regulations, but we also have the things you really need as well," government officials respond. It is no coincidence, by the way, that these other things are often place-based and hard to move, meaning the companies are less likely to skip town.

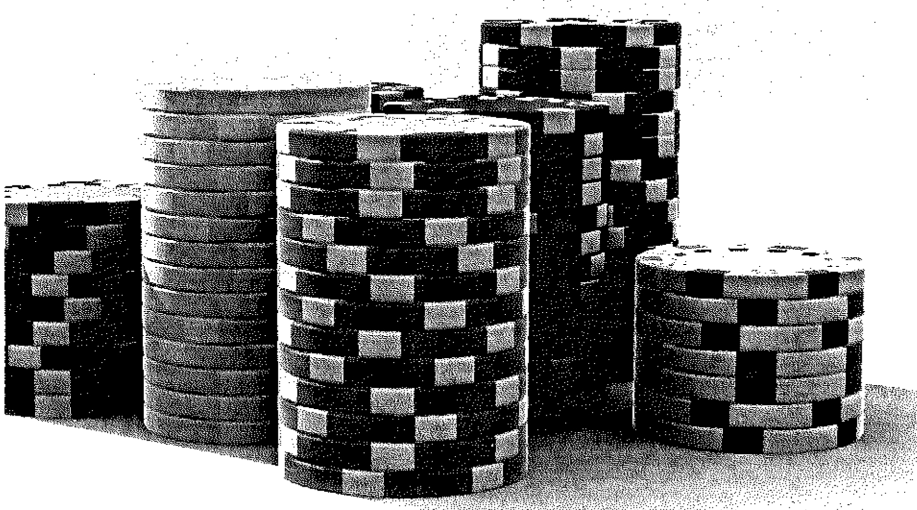
In other situations, however, governments and businesses play a very simple, bald game of up the ante. Some manufacturers insist on subsidies and promise jobs, but they take the subsidies and then leave town. General Motors' up-the-ante approach during its bankruptcy was the subject of much of the *Times'* reporting.

The film industry plays a similar game of, "If you're dumb enough to give me your money, I'm dumb enough to take it." Movie productions search all over the United States and Canada seeking ever more subsidies and tax credits. Some localities are just excited to land a Hollywood film shoot, while others try to use the shooting as a foundation to build a bigger infrastructure that will attract more value-added pieces of the business. But the bulk of the film business remains headquartered in Los Angeles, which has an enormous infrastructure that is virtually impossible to duplicate anywhere else. Even so, the studios still try to extract more subsidies out of the state of California, which is under constant pressure to up the ante—or else.

The great comedian Jack Benny had a running joke with Ed Sullivan, the host of his namesake TV show, one of the most popular in America in the 1950s and '60s. What would happen if Sullivan didn't show up for his own show? Being on the Ed Sullivan show was the biggest thing in American entertainment, but Sullivan himself didn't actually do anything. Pressed for an answer, Sullivan said he had no idea. Finally, Benny would delivered his classic deadpan punchline: "Don't ever stay home to find out."

That's the dilemma states and localities in America face in dealing with financial incentives. A lot of the time they don't seem to do anything. But no one knows whether the companies would turn up in town without them. So the politicians follow Jack Benny's advice: They keep putting money on the table just to find out what will happen. **G**

Email wfulton@smartgrowthamerica.org



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