REMAPPING DEBATE
Asking "Why" and "Why Not"

"But everybody does it" — Cities and states addicted to soliciting for corporate favors

Original Reporting | By Mike Alberti | Corporate influence, Open government

Sept. 12, 2012 — When executives from the European aircraft manufacturer Airbus announced their plans to build a new $600 million factory in Mobile, Alabama in early July, local politicians wasted no time in congratulating themselves. "We have worked a long time and have put in many hours to make this announcement a reality," Alabama Governor Robert Bentley said in a press release. "This project will create thousands of well-paying jobs that the people of this area need and deserve."

ECONOMIC DEVELOPMENT OR CORPORATE WELFARE?

This is the first in a series of articles examining the widespread phenomenon of states and localities providing incentives — that is, subsidizing — to private businesses in the United States. These subsidies, in the words of one private consultant, have become so prevalent as to be "a normal part of business" and "an expected part of every location decision."

In this article, we focus on what is and is not known about the economic impact that these subsidies have both on a local level and on a national level.

In future installments of the series, we will examine the lack of transparency that is a hallmark of incentive programs, the lack accountability of the elected officials who provide them, and a range of ideas for how the incentive "system" might be reformed.

— Editor

Airbus wasn't coming to Mobile for free: state and local officials had offered the company an incentive package worth more than $158 million for the plant. To some experts, those subsidies — and the fact that Airbus will compete directly with U.S. companies like Boeing — made the deal disturbingly familiar.

"Airbus is eerily reminiscent of what began happening with the automotive companies in the 1980s," said Kenneth Thomas, a political scientist at the University of Missouri-St. Louis who has spent much of his career studying economic development incentives. "That's not really a happy story, so I see some reason to be worried."

Thomas was referring to the long-standing trend of Southern and Western states luring foreign automakers to build plants in their states. "Those plants were a big part of the reason for the decline of the Big Three," Thomas said, meaning Chrysler, Ford, and General Motors. He pointed to research showing that for all 20 of the new automotive plants that opened in the U.S. and Canada in the 1980s, there was a different plant that closed in another location. The jobs at the closed plants were overwhelmingly well-paying, union jobs; the jobs at the new locations were overwhelmingly lower-paying, non-union jobs. Many economists believe that this shift diminished the overall productivity of the U.S. automotive sector, as well.

In the process, the automakers have extracted huge sums from public coffers. Alabama set a new record when it paid $300 million for a Mercedes plant in 1993, and nearly every transplant has received subsidies of some kind.

he experience of the auto industry is representative of the way in which companies pit states and local governments against one another to see which will come up with the largest subsidy package. This kind of "bidding war," which has escalated greatly in the last decade, has at best no net effect on national employment or economic growth, Thomas said, and may actually be harmful. Airbus, for example, almost certainly would have located somewhere in the United States, if not in Alabama, even without subsidies.

"We've just created a system where we pay them a lot of money to do something they would have done anyway," Thomas said.

Zero-sum?

Every state has at least one program through which it offers subsidies — most have several — and these types subsidies are widely used by counties and municipalities, as well. The subsidies come in multiple forms, and are often not directed at a specific company, but at categories of companies that are grouped by geographic area, industry, or other criteria related to job-creation or investment.

Despite the huge amount of money that is widely believed to be spent on subsidies, the system is surprisingly opaque. No state provides full information on the value of its annual incentives, and data on local government incentives is even more sparse, with few reporting any data at all, making an accurate tally impossible.

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The only comprehensive estimate of the full dollar amount comes from Thomas, who took available data from a few relatively transparent states and local governments and extrapolated from that data to yield a national estimate. He estimated that in 1996 the value of those subsidies was $48 billion. In 2010, that total had grown to $70 billion. Thomas readily acknowledges that the figure is conservative and that the total is likely higher, perhaps much higher.

For all the money spent, the majority of research on the economic impact of incentives has found that, at the national level, there is either no effect at all, or a modest negative effect.

Arthur Rolnick, a senior fellow at the Humphrey School of Public Affairs at the University of Minnesota and a former senior vice-president of the Federal Reserve Bank of Minneapolis, has been urging states to stop participating in bidding wars for decades. “It’s at best a zero-sum game,” he said. “The evidence is pretty clear that these incentives don’t actually create jobs; they just move them from one part of the country to another.”

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In some cases, the incentives might play a part in an international companies decision to locate in the United States, Rolnick said, but more often than not the companies would have located somewhere in the country without any incentives, as Rolnick believes was the case with both Airbus and Mercedes.

“There might be a very small number of cases where the companies came here instead of going to Canada or Mexico,” he said, “but companies don’t just decide to move to a new country because some officials were offering them some money.”

Subsidies as toxic to the national economy?

Mark Partridge, an economist at Ohio State University, agreed, and added that there is good evidence that even when foreign companies do locate in the United States, there is often a negative effect on domestic businesses, cancelling out much of the employment gains, as was the case with the foreign auto transplants.

And, especially as companies seek to lower their labor costs by locating in Southern states, Partridge said, the bidding wars may actually have negative consequences for the national economy as a whole. “If I offer incentives to move a BMW plant from Michigan, where the transportation network is the best and there are lots of well-trained workers, to South Carolina, where the infrastructure is not nearly as good but costs are cheaper,” he said, “then that plant will probably have a lower productivity.”

“The net cost to BMW might still be lower in South Carolina, but to society the cost is higher,” Partridge concluded.

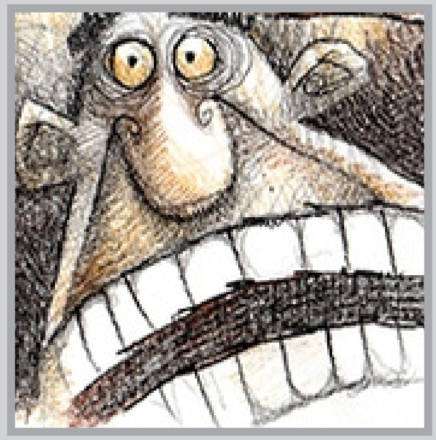
Local benefits exaggerated

Claims that subsidies to business help a locality spur economic growth and increase employment are grossly exaggerated, explained Peter Fisher, the research director of the Iowa Policy Project and one of the country’s foremost experts on subsidies.

“What we know is that the vast majority of this investment would have happened even without a subsidy,” Fisher said, so the job creation figures that states and local governments put out “are often misleading.”

In a comprehensive review of the economic literature in 2004, Fisher and a colleague, Alan Peters of the University of Iowa, concluded that, at best, subsidies are responsible for about 10 percent of the jobs that are created by the businesses that receive them. The rest, he said, would have been generated anyway. A more recent review, in 2007, found that incentives can be slightly more effective if they are well-targeted, but that state and local officials often drastically overestimate their value while underestimating their cost.

INCENTIVE HORROR STORIES



VIEW STORIES

Amid the few examples of success, every state has at least one horror story of a big subsidy deal that has gone bad or an incentive program that has not produced the desired results. Companies have taken large incentives only to close down or relocate a few years later. They have often misreported or overestimated the number of jobs created in an effort to increase the incentive amount.

“The winner’s curse”

Robert Lynch, a professor of economics at Washington College, in Maryland, explained that many of the studies that have found a positive impact from subsidies assumed that even as tax revenue was being spent on incentives, the level of public services remained constant.

“They’re assuming that when a government writes a company a check or cuts their taxes, there are no ancillary effects of that spending,” Lynch said. “In reality, we know that that’s not the situation. What happens is that when you cut taxes, you either have to cut services or raise taxes somewhere else to make up for it.”

If a local government is, for example, giving out tax abatements to some companies, that may mean that same money is not going into the school system, Lynch said. At the state level, it may mean that roads are not getting fixed, or that public employees are being laid off.

Indeed, there are many examples of state and local governments diverting funds from other priorities to pay for subsidies. After making the deal with Mercedes in 1993, for example, Alabama found that it did not have enough money to pay for all of the incentives. After defaulting on a $43 million payment to Mercedes, Alabama was forced to borrow from the fund designated for state employee pensions at a 9 percent interest rate.

Nonetheless, Many state and local elected officials remain undeterred. When asked to present empirical evidence to support their claims that their incentives have created jobs and been a net gain for their communities, however, few can readily do so.

Race to the bottom

Other state and local officials, by contrast, do seem aware of the dubiousness of the policy, but said that, when the practice is so widespread, they don't have the option to "unilaterally disarm."

In a 2008 interview with a local newspaper, Jim Byard Jr., who was then the mayor of Prattville, Alabama, was asked why the town was paying retail stores to locate there. "Offering incentives for retail growth is horrible public policy," he said. "But that is the world we live in. Other cities are trying to land these same stores, and we compete against one another." Byard is now the director of Alabama Department of Economic and Community Affairs.

> "Offering incentives for retail growth is horrible public policy," the then-mayor of Prattsville, Alabama acknowledged back in 2008. "But that is the world we live in. Other cities are trying to land these same stores, and we compete against one another."

Alan Levin, the director of the Delaware Economic Development Office, said that, in his ideal world, no states or local governments would offer subsidies. "I would love to be able to compete solely on the basis of our workforce, location, and quality of life," he said. "But when a company says this is how much money you need to put up to come to the table, it's hard to walk away from that all the time. You either play that way or you don't get to play at all."

Indeed, pitting one state against another to pressure both to increase their original incentive offers has become a cottage industry in itself. "Site location consultants," as they are generally known, have been a part of most of the largest incentive deals during the last two decades. Many are small firms dedicated solely to location consultants, but some larger consulting firms, such as Ernst and Young and Deloitte also have site-consulting branches. These consultants are retained by businesses not only to evaluate the appropriateness of a given location, but also to negotiate with state and local governments to squeeze out the maximum subsidy.

In his book, "The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation," the author Greg LeRoy cites an article written by a consultant for the prominent consulting firm Wadley-Donovan Group that describes the firm's tactics: Site location consultants "negotiate incentives for the new project in two or three finalist locations, preferably in different states," the consultant writes. "Generally speaking, [they should] spend the most time negotiating in the preferred location [and] use offers from the alternate areas for leverage."

Mark M. Sweeney, a co-founder of Macallum-Sweeney Consulting, another prominent firm, has written that incentives have come to be seen as "a normal part of business" and that they are now "an expected part of every location decision."

Wrong priorities?

According to Rolnick, whether officials truly believe that offering incentives is good policy or they feel that their hands are tied, the end result is the same: "Private companies have been able to extract more and more public dollars," he said.

"Think what states could do with $70 billion right now," Thomas said. "That would be enough to hire back every employee that has been laid off during the recession. That isn't a zero-sum game. Those are real jobs that people don't have anymore.""There are a lot of places now that don't have any eco-

Subsidizing big box stores

Most economists have long understood that subsidizing retail and hospitality investment is usually a poor policy choice, as those types of businesses compete directly with other local businesses, greatly mitigating any employment gain that results from that investment, if not creating a net loss in jobs. Nevertheless, it is routine for state and local policy makers to offer large subsidies to retailers, especially large chain businesses and "big box" stores such as Target, Wal-Mart, Borders, and Lowe's.

A 2011 analysis of the incentives given in the St. Louis metro area, for example, found that more than 80 percent of the $5.8 billion paid out over the previous 20 years had gone to chain stores and shopping centers, while the region as a whole saw very little economic growth in those sectors.

"Despite massive public investment, the number of retail jobs has increased only slightly and, in real dollars, retail sales or per capita spending have not increased in years," the report said. "Furthermore, the region has seen a shift from goods producing (higher paying jobs) to service producing (typically lower paying) jobs, suggesting that although there are more jobs, they are of lower quality."

And, according to several economists and policy experts, the subsidization of large chain stores puts smaller local businesses at a disadvantage. "When politicians are making the decisions to subsidize a Wal-Mart, they need to understand that they are actively putting pressure on the other local businesses in the area," said Arthur Rolnick of the University of Minnesota. "If all of those other businesses close five years down the line, that probably won't look like such a good decision anymore."

nomic development strategy at all except to look for some companies to throw money at," Rolnick addded. "That's really a shame, because we know what does create net jobs, what they should be doing instead. Educating your kids creates jobs. Maintaining your roads and bridges and public universities creates jobs. And those are exactly the things that our elected officials are getting sidetracked from doing."

Peter Fisher of the Iowa Policy Project agreed. "This is truly a case of private gain at public loss," he said. "At a time when state budgets have huge holes in them, our infrastructure is deteriorated, we're laying off some public workers and cutting the pensions of others," the problem of states and localities wasting money on corporate subsidies "has hardly been a part of the conversation at all."

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