REMAPPING DEBATE
Asking "Why" and "Why Not"

Imagining an alternative to State-eat-State

Original Reporting | By Diana Jean Schemo | Economy, State government, Taxes

February 9, 2011 — For nearly five years, the 12 states ringing the Great Lakes have worked together in an entity called the Great Lakes Economic Initiative, designed to promote development of the former industrial belt through a "shared regional policy agenda." But when lawmakers in one member state, Illinois, voted to raise income and corporate taxes recently, it was not the limited attempt at interstate solidarity that prevailed. Fellow governors in neighboring member states raced to trash talk Illinois, in an effort to lure away the state's businesses.

> What if, instead of persistently undercutting each other, states banded together in interstate agreements? "That's a good question," said Maryland Governor Martin O'Malley.

Indiana Governor Mitch Daniels likened Illinois to the Simpsons, "the dysfunctional family down the block." Wisconsin Governor Scott Walker — who took office pledging to strip down government regulations — revived an old tourism slogan: "Escape to Wisconsin," he told business owners in Illinois.

The tendency of states to try to outbid their neighbors — with business incentives or lowered tax rates — has serious consequences. Practiced among Republican and Democratic governors alike, the dog-eat-dog approach has, according to much research, caused states to squeeze their own coffers and weaken environmental regulations, while lavishing subsidies both on firms that relocate anyway, and on those that might have stayed even without incentives.

Are states failing to imagine another very basic possibility? What if, instead of persistently undercutting each other, they banded together in interstate agreements? What if they agreed on a common floor for environmental or business regulations? What if states agreed not to fish for jobs in their neighbor's pond, or sought region-wide revenue increases that would eliminate the fear of being left behind or outgunned?

"That's a good question," said Maryland Governor Martin O'Malley, the keynote speaker at a recent luncheon sponsored by Governing magazine. O'Malley had just finished describing a more limited environmental project linking Maryland and six other states to reclaim the Chesapeake Bay.

"I do think there's an opportunity for Maryland, D.C. and Virginia to market themselves as one big powerhouse economy, and they haven't done that," the governor said. What about a common strategy or set of ground rules for attracting industry to the region? What gets in the way of that?

O'Malley paused a moment, seemingly mystified. "It's not something we've thought about much," he admitted.

Tax warfare

O'Malley is not alone. While states have occasionally gotten together to market the advantages of their regions, as the Maryland governor suggested, that cooperation seldom extends to a truce in the tax incentive arms race.

Andrew Reschovsky, a professor of public administration at the University of Wisconsin's Madison campus, was similarly nonplussed. "Is it happening anywhere?" he asked. "I don't know. I don't think they're widespread, if there are examples."

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While allowing that he did not see anything "inherently impossible" in such agreements, Reschovsky said the mental obstacles were formidable. Citizens, and politicians, tend to build a sense of community linked to their cities or states. "There's an identity that gets created, often made worse by sports competitions," he said. For politicians, that effect is multiplied: so deeply rooted are the reflexes of competing to win, that the alternative — co-operation — seems utterly alien, even suspect.

John Binienda, Speaker of the House in Massachusetts, bristled as he recounted two companies that chose Rhode Island over Massachusetts, one a pharmaceutical firm and the other a video game production firm, 38 Studios, run by former Red Sox pitcher Curt Schilling. 38 Studios had announced last fall that it was moving from Maynard, Mass. to Providence, taking 450 jobs with it. Binienda said he could not imagine — actually, he seemed offended to have been asked about — cooperating with Rhode Island to avoid such cross-border warfare over jobs.

"That'll never happen," he said. "We're not going to do anything to help Rhode Island, and Rhode Island is not going to do anything to help us," Binienda said.

"If I can get a company called Curt Schilling Productions in Worcestor, Massachusetts rather than in Providence, Rhode Island, I'll do whatever I have to do to get that name and that company in Worcestor."

What about the research showing that such tax incentives are unnecessary giveaways? Wouldn't states benefit if they could mutually agree to avoid these giveaways?

"To make a buck," Binienda said, "you got to spend a buck."

Money for nothing

There is no shortage of research that might give policymakers contemplating cross-border raids pause — no matter how dire the economic landscape. A study last September by Jed Kolko at the Public Policy Institute of California found that no more than two percent of annual state job gains or losses come from businesses that relocate from another state. The vast majority of jobs created come from existing businesses that expand (42 percent) and from new companies starting up (56 percent).

In another study, Robert Tannenwald, a senior fellow at the Center on Budget and Policy Priorities, examined the fierce competition among states to offer tax credits and production subsidies to the film industry. In 2002, only a few states offered such incentives. Now, some 43 do, at a cost of $1.5 billion last year. But the single most thorough study of the practice, done in Massachusetts, found that such investments failed to create lasting jobs or lay the foundation for a local film industry. "The cost far exceeds the benefit," wrote Tannenwald, a former economist at the Federal Reserve Bank of Boston.

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Spurring the rush to attract entertainment projects, Tannenwald said, is the belief that films mean jobs, and can even promote tourism. States officials believe that if they don't compete, they lose—despite evidence that the cost may outweigh the gains. "You're caught in a vicious cycle.

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Old eyes, new world

In a world of global trade, said Ed Morrison, an economic policy advisor at Purdue University's Center for Regional Development, companies that relocate seldom move to the next state. "Companies that need lower costs can and do move to lower cost locations," he said. "It used to be Mexico, then Singapore and Taiwan, then it was China and now it's even lower cost locations, like Vietnam."

On his blog, Morrison derided the sniping for jobs by Wisconsin and Indiana's governors as self-defeating. "Since when is kicking your neighbor, who is trying to pick themselves off the floor, smart policy?" he asked. "Illinois is the largest state economy in the Midwest. Neighboring states need Illinois to be stable and growing, not hobbled and senseless."

Instead, Morrison is surveying the country for examples of regional collaboration that cross city, county, and state borders. One example he cites is not technically governmental, but does involve collaboration between and among 25 counties spanning the Louisville metropolitan area and parts of Southern Indiana.

Two area chambers of commerce share the responsibility of handling economic development throughout the region. As a result of a 2007 agreement, they are pledged not to pressure elected officials to entice existing companies to relocate by dangling tax incentives, unless the move entails a net growth in jobs.

"We have the ability to recommend what these incentives are," said Joseph F. Reagan, president and chief executive officer of Greater Louisville, Inc., the metro Louisville chamber of commerce. "The governments could overrule us if they want to. We tell them, 'We think it's in your best interest not to use taxpayer money to move dollars around in the region, because it's not adding jobs to the region.'"

> "If we were looking at it the traditional way, with each of us in our silos, we would have missed those opportunities," said the president of the metro Louisville chamber of commerce.

Reagan says the cooperative approach is working. He recalled a biotech startup that chose to set up operations in the region. Rather than officials on the Indiana side of the border urging the company to deal only with specialists at Purdue University, with those on the Kentucky side urging contact only with the University of Louisville, the joint approach presented the company with the access to the complementary areas of expertise of both universities. "If we were looking at it the traditional way, with each of us in our silos, we would have missed those opportunities," Reagan said. "The real key is a lot of relationship building, and seeing what unites rather than divides us, whether its shared research or infrastructure."

In another exception to states fighting between and among themselves, the Multi-State Tax Commission brings together fiscal experts from many states to ensure that corporations with offices in more than one state do not hide assets or conceal earnings. 18 member states pool their resources to conduct joint audits of multi-state corporations.

Stephen D'Amico, a former state legislator from Massachusetts, led the charge against tax credits for the film industry, branding it "the worst case of corporate welfare." If states could broadly avoid the "race to the bottom" by entering into interstate agreements, he said, they would recoup tax revenues that could could be used to fill budget deficits, and improve education, and modernize infrastructure. He estimated the savings at $50 billion a year, citing the 2007 book, "Free Lunch," by David Cay Johnston. (Disclosure: Johnston is a contributing writer for Remapping Debate.)

Such agreements would also offer crucial political cover for the state leaders as they rebuild their revenue base, D'Amico noted. For the moment, any state that cuts tax incentives to industry or that raises corporate taxes, as Illinois did, is vulnerable to a cross-border job raid from its neighbors. "If that threat goes away, the whole thing unravels," D'Amico said.

Morrison, of Purdue University, agreed, and says that there was another more essential benefit to cooperating rather than competing. In the global marketplace, he contends, social networking and the ability to pool resources without regard to borders are key. Rather than subsidizing individual companies, states and cities could use those revenues to expand the capacity for broad groups of citizens and companies to compete more effectively on the global stage. "You could invest it on broadband infrastructure, on creating hot spots where people could come together easily to work, on entrepreneurship training for middle and high school students, and internships for community college students."

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A way forward

What might the benefits of a less cutthroat approach to job creation look like?

The largest and most prominent example is found in the approach of the European Union. In addition to the fact that significant elements of trade, environmental, and monetary policy are now determined centrally, there is strong social pressure for member states to avoid "smokestack chasing," said Tannenwald, of the Center on Budget and Policy Priorities.

It is largely unheard of, Tannenwald noted, for members to offer tax incentives or subsidies to persuade a firm in one country to pull up stakes and relocate to another. "If a country were to do that it would be shunned," Tannenwald said. "There's no European Union police or army that would go after you or that would prosecute you, but you would be persona non-grata, or country non-grata."

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