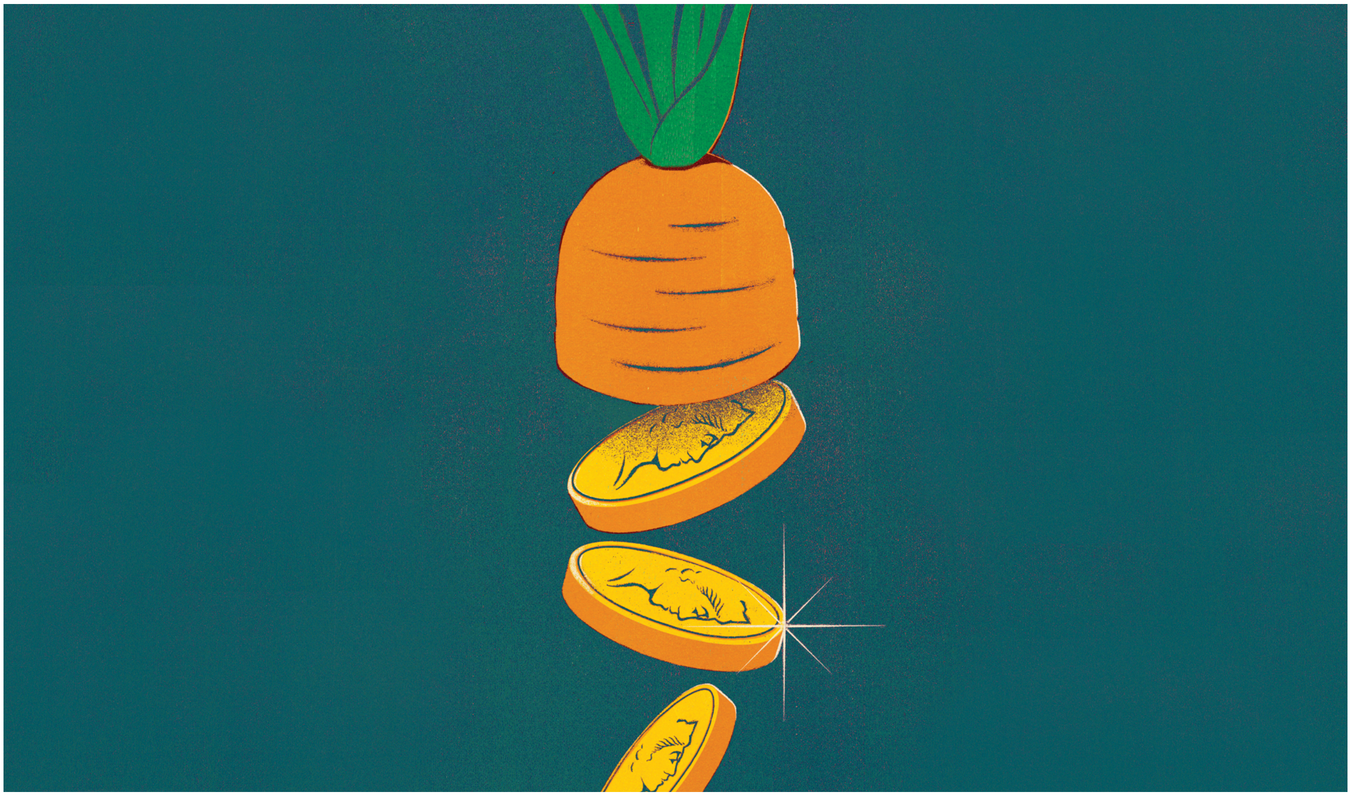

PERSPECTIVE

Are Tax Incentives Good for Cities and States?

BY KATHERINE BARRETT AND RICHARD GREENE

A little more than 30 years ago, the State of Alabama used hundreds of millions of dollars in tax incentives to attract a giant Mercedes-Benz plant to the state. That was the beginning of an escalating battle on the part of cities, counties, and states to attract business by handing over large amounts of taxpayer dollars.

According to David Brunori, visiting professor of public policy at George Mason University and senior director at RSM US—which provides audit, tax, and consulting services to the public sector—"they've been proliferating ever since, and the number has grown every year since 1992. In fact, there's a whole industry that does nothing but look for tax incentives for companies."

The big question, of course, is whether this is genuinely good business for cities, which generally give up property taxes, and states, which largely forfeit income taxes. Most experts, as well as much academic literature, say that the answer to this is no.

Shayne Kavanagh, senior manager of research in GFOA's Research and Consulting Center, said, "There is compelling evidence that these things are often not effective." He noted that many places use tax incentives largely because they don't want to take the chance of being the only player who isn't in the game—even if there's little to nothing to win. "It's an arms race phenomenon in games theory," he said. "If you don't do it, the next guy will."

The costs of tax abatements can be huge, and when property tax money is used in cities, those dollars aren't available for other important services. The obvious losers are the schools, which tend to be the largest single users of property taxes. According to a report by Good Jobs First, "Schools in New York State lost at least $1.8 billion in fiscal year 2021 to corporate tax abatements."[1]

The irony here is obvious. Businesses are attracted by a well-educated workforce, and if the schools suffer and fail to attract businesses in any one year, it makes the city less attractive for further economic development in the future. To make matters worse, there isn't much evidence that the tax incentives are a powerful economic incentive tool in the first place.

Nathan Jensen, professor of government at University of Texas at Austin and an authority on the topic, said: "Academic research shows that the majority of firms would have made the same decision, to relocate, expand or stay, even without incentives. In these cases, incentives are just a transfer of taxpayer-funded benefits to firms for no new economic activity."[2]

Despite this, corporate America has long been able to pit one city against another when it comes time to settle or expand. It's a giant game of poker in which corporations can easily bluff their way into a big payoff.

One of the most notorious examples of this was uncovered a few years ago by *The New York Times*, which reported that, "In total, over five years, 12 companies threatened to leave New Jersey and move to Blue Hill Plaza (in New York) unless the state provided tens of millions in tax credits. None followed through on the threat. In fact, an investigation by *The New York Times* suggests that most of the 12 companies never seriously considered moving to New York. But all 12 received lucrative tax credits from New Jersey to stay—more than $100 million in total, according to documents obtained by the *Times*."[3]

The promises made by the corporations involved frequently don't come to pass. Katherine Loughead, senior policy analyst at the Tax Foundation, said, "We've seen countless examples of massive tax incentive deals offered to companies that overpromise but underdeliver, tying up taxpayer resources in the process."

Unfortunately, as much as elected officials may enjoy the ribbon cuttings and newspaper headlines when a new deal is announced, the details can be difficult to find. "A lot of this is very nontransparent," says Loughead. "Many of these incentive deals are made behind closed doors to a mystery company going to locate in the state."

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With all this in mind, why do states and localities continue to fixate on tax incentives?

One clear reason is essentially political in nature. It's difficult for elected officials to take credit for many of the things that genuinely attract new businesses, like good education systems, a willing workforce, local amenities like golf courses and, naturally, the weather. Even the most hyperbolically inclined politician in the world simply can't take credit for blue skies and a temperate climate.

But whatever the incentives, "voters think they work," Jensen said. "If a company comes to your area because of other factors involved in the location, the mayor or the governor can't take credit for it. But if they give out incentives, they can take credit."

One area in which tax incentives are sometimes seen as a worthwhile approach is when they are used to attract business to blighted inner city areas that are desperate for investment of any kind. These are frequently given through tax increment financing (TIF) districts that are designed so that local governments can use increased tax revenue generated in designated areas to pay for development costs in those areas. Governments often issue bonds in anticipation of the increased revenue generated in the district and then can use the proceeds to pay for upfront development costs.

This sounds like a win-win situation, but there are some serious shortcomings to this means of using taxes to create incentives for business development in blighted areas. Josh Goodman, a senior officer who works on state fiscal policy for the Pew Charitable Trusts, ticks off three:

- Tax revenue in the districts may have increased even without the creation of the TIF district and, if so, schools miss out on revenue they otherwise would have received. This is particularly likely when local governments create TIF districts in neighborhoods where investment is occurring and property values are rising prior to the creation of the TIF district.
- Businesses and residents that otherwise would have located elsewhere in the locality may choose to locate in the TIF district instead. As a result, revenue from these taxpayers that would have gone to general purposes is used for the TIF district instead.
- Depending on how the bonds are structured and the willingness of local leaders to accept a default, there could be some risk that general dollars will be needed to pay the debt service on bonds if incremental increases in tax revenue in the district aren't sufficient to do so.

Another challenge Goodman brings up is that TIFs are designed to help the people in the geographically targeted areas, "but most people don't work where they live. So, they could go to the distressed area for their jobs, and then travel back to their homes elsewhere."

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1 Christine Wen and Greg LeRoy, "Corporate Subsidies versus Public Education: How Tax Abatements Cost New York Public Schools," Good Jobs First, February 2023.

1 Nathan M. Jensen, "Job Creation and Firm-specific Location Incentives," *Journal of Public Policy*, published online by Cambridge University Press, March 28. Available at https://www.cambridge.org/core/journals/journal-of-public-policy/article/abs/job-creation-and-firm-specific-location-incentives/8DEF2F1624A629AEA87B71A533E4EB9D

1 Nick Corasaniti and Matthew Haag, "Businesses Are Cashing In on Empty Threat to Leave New Jersey," The New York Times, September 24, 2019.