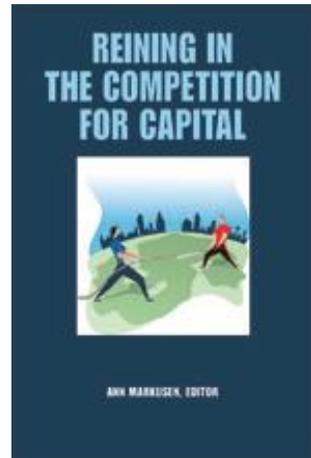


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Nine Concrete Ways to Curtail the Economic War Among the States

Greg LeRoy
Good Jobs First



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Nine Concrete Ways to Curtail the Economic War among the States

Greg LeRoy
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More than 10 years ago I wrote a book titled *No More Candy Store: States and Cities Making Job Subsidies Accountable* (LeRoy 1994), which likened the choices that many companies faced between all of the “sweet” job subsidy deals offered by competing states and cities to a kid in a candy shop. Too often a mess resulted—very few jobs were created and/or the company went out of business or relocated. One could get very depressed thinking about how hard it will be to solve this crazy “candy store” mess. A lot of people with huge financial self-interests are tied to the status quo: footloose corporations, site location consultants, accounting firms and tax consultants, industrial real estate brokers, mayors, governors, and building contractors.

Given how deeply entrenched this wasteful system has become, only an *organizing approach* to the problem can undo it. By this I mean reforms that bring everyday taxpayers back into the process, that actively enable and encourage grassroots groups like community organizations, environmentalists and labor unions, as well as journalists and government watchdogs, to wade in. With all due respect to some who have proposed sweeping lawsuits or legislation that I would call “silver bullets,” such ideas don’t stand a chance against a problem so deeply embedded as this one.¹

Reforms, of course, involve legislation. Some new laws are necessary, but they should be simple laws based on common sense that are strongly enforced—laws with clear intentions that courts cannot pervert. Don’t forget, today’s candy store mess is a dream for lawyers and accountants, since it consists of so many hundreds of convoluted laws and tax gimmicks.

SUNSHINE: THE BEST ANTISEPTIC

The first two necessary reforms involve disclosure. Taxpayers need to see how much money each company received in tax breaks and other subsidies—especially corporate income tax breaks that are usually undisclosed.

This disclosure is the cornerstone of reform. Think about other major reforms the United States has enacted in the past 40 years.

- When community groups alleged that banks were discriminating against minorities or those living in older neighborhoods by denying loans to worthy borrowers because of their race or their address, they demanded and won the Home Mortgage Disclosure Act. That law requires banks to disclose the number and dollar value of all their housing loans every year, by census tract. The data revealed blatant discrimination, and prompted Congress to pass the Community Reinvestment Act, which has enabled hundreds of community groups to win billions of dollars for neighborhood revitalization from many of the nation's largest banks.
- When community groups and labor unions alleged that chemical factories and other big polluters were endangering their health with toxic emissions, they demanded and won the Toxic Right to Know law, which requires companies to disclose the content and quantity of all emissions. Using that data, coalitions have won hundreds of agreements with companies to reduce hazardous emissions and otherwise improve local safety.
- During Watergate, when citizens became frustrated with reports of corruption, they demanded to know who was giving money—and how much—to politicians. The resulting disclosure produces data compiled by the Federal Elections Commission. And while many people call our campaign finance system “legalized corruption,” at least we know who bankrolls whom. If we did not have that information, none of the more recent campaign finance laws, like McCain-Feingold, could have taken hold.

REFORM 1: STATE ECONOMIC DEVELOPMENT SUBSIDY DISCLOSURE

By disclosure, I mean annual, company-specific, public reporting of costs and benefits. How much did each company get? Which subsidy program did the money come from? What did the company do with the money? How many jobs did it create? How well do the jobs pay? Do they provide health care?

Seems pretty simple, doesn't it? Every state and city should be able to disclose such basic facts. But as we've seen in so many horror stories, most governors and mayors aren't watching the store. Some even pretend to perform cost-benefit analysis by adding up their own press releases.

Twelve states have already enacted some form of economic development subsidy disclosure (Connecticut, Illinois, Louisiana, Maine, Minnesota, Nebraska, North Carolina, North Dakota, Ohio, Texas, Washington State, and West Virginia). These states vary a lot in terms of the quality and completeness of their disclosure, but we certainly have enough experience now to talk about what works best. (You can see details about each state's disclosure law in Chapter 3 of our research manual, *No More Secret Candy Store*, at www.goodjobsfirst.org.)

Any state can be investigated, regardless of whether it's on the list. You can normally get quite a bit of information about deals in a state, especially if you are willing to wage a paper war under the state's Open Records Act or Freedom of Information Act. With a lot of time and persistence (and possibly some money for processing charges), you might be able to cobble together as much information as you could get quickly for free in a state with disclosure. But taxpayers shouldn't have to wage a costly paper war with bureaucrats; they should be able to quickly and easily find out where their economic development money is going and whether their taxpayer investments are paying off. That's what I mean by disclosure. Indeed, the information should be on the Web, just like it already is in some states.

Let's look at an example. Minnesota is one of my favorite disclosure states. Although the Gopher State's law does not cover corporate income tax breaks, it does cover lots of other subsidies—and the data are on the Web! Since its original law was passed in 1995 and improved

twice later, hundreds of Minnesota deals have been disclosed every year. Figure 8.1 shows an example of one deal, in Caledonia, Minnesota.

So here we have a tax increment financing deal (box 11) worth \$275,515 (box 16) to create one new job (box 17) at Dairy Queen (box 12) paying \$4.50 an hour (box 18). Now, I don't know how many ice cream cones they sell in Caledonia in February, I mean, I really hope that's a full-year job. Health care? I doubt it. I suppose we should be grateful that the company is reporting an actual wage of \$5.15 an hour, but then, that may be due to the federal minimum wage getting raised in the interim. But isn't that an awfully big subsidy for a poverty-wage job? Until the state enacted disclosure, Minnesotans didn't know there were deals like this happening.

Notice how unbureaucratic this disclosure system is. A city staff person fills in the top half of the form (based on its files from the original deal), then she calls the company and asks about jobs created and wages paid. Then she mails the form to the state Department of Employment and Economic Development (DEED) in St. Paul, and DEED scans the forms and posts them on its Web site.

Of course, I prefer a state's disclosure system to include corporate income tax breaks, and some already do. West Virginia has been reporting on every company that claims any major kind of corporate income tax credit for more than a dozen years. Maine has been disclosing three since it enacted disclosure in 1998. North Carolina enacted disclosure in 2002; you can see company-specific data at www.dor.state.nc.us/publications/williamslee.html.

More information on the disclosure form would be helpful. Will these jobs be accessible by public transportation? Does this deal involve a relocation? If so, from where and to where? Were the jobs accessible by public transportation before? Will they be accessible after the relocation? Otherwise, how do we know if the jobs are even available to low-income workers who cannot afford a car?

Figure 8.1 1998 Minnesota Business Assistance Form

received
APR 24 1998

1998 Minnesota Business Assistance Form*
(Please return by April 15, 1998)
Please type or print in dark ink. 97-592

1. Funding governmental agency name
EDA

2. Agency street address
231 E. Main St.

3. City
55921

4. Phone number (area code)
507-724-2632
5. Fax number (area code)
507-724-5258

6. Type of governmental agency
 City County Regional State
Other (Please indicate):

7. Name of business receiving assistance
Also Discount Stores
Dairy Queen

8. Industry of business (SIC code)
Also Discount Stores - 2279
Dairy Queen - 5812

9. Type of assistance (e.g. loan, TIF, grant, infrastructure, etc.)
TIF

10. Name of TIF district or applicable:
1-3 Also-Dairy Qn

11. Date of business assistance agreement
11/20/95

12. Date assistance first provided
pending

13. Total project funding (including any other assistance)
1996 \$275,515

14. Average hourly wage level paid by business receiving assistance
\$4.50/hr

15. Actual average hourly wage paid to employees hired since business received assistance
Also-DQ \$5.85
Dairy Queen \$5.15

16. Number of new jobs created since business received assistance
1 new job
Dairy Queen 4/20
PT-3 11-14
PT-4 PT-1

17. Actual performance since project placed in service (Please indicate number of employees at each wage level and indicate the corresponding benefit level.)

21. Job Creation		Hourly Wage Level	22. Hourly Value of Voluntary Benefits (%)	23. Job Creation	Hourly Wage Level	24. Hourly Value of Voluntary Benefits (%)
Positions	Part-time	(incl. benefits)	Less than \$7.00	Positions	Part-time	(incl. benefits)
1		\$7.00 to \$7.99	4.32	3	1, 2, 3	\$7.00 to \$7.99
		\$8.00 to \$9.99				\$8.00 to \$9.99
		\$10.00 to \$11.99				\$10.00 to \$11.99
		\$12.00 and higher				\$12.00 and higher

18. Date the business received assistance from governmental agency
4/24/98

*For -- Do not submit forms for this program unless you are submitting this form in 1998.
We complete one form for each business assistance agreement you receive in 1997 which provided \$25,000 or more in public funds. Each assistance agreement will be submitted from indicators that are served. Do not submit this form if your agency has not agreed in 1998.

An actual disclosure form from Minnesota: a company got a TIF (box 11) worth \$275,515 (16) to create 1 new job (17) at Dairy Queen (12) paying \$4.50 an hour (18)

Originally rec'd 10/30/97
on old form ✓

REFORM 2: DISCLOSURE TO CORPORATE SHAREHOLDERS OF STATE TAXES PAID

Publicly traded companies (those that are listed on stock exchanges) already disclose how much they pay in federal income tax each year, in their annual reports and Forms 10-K. They also already disclose how much they pay in all state and local taxes, but they are only required to disclose the total from all 50 states in one aggregate number. So, for instance, when looking at General Motors' Form 10-K, it is not possible to determine how much the company's taxes have gone up or down in Michigan the past dozen years.

The solution would be simple: require publicly traded companies to include a 50-state matrix in their Form 10-Ks showing how much tax they paid in each state. Breaking it down into three categories in each state would be best: income tax; property tax; and sales, utility, and excise taxes. This would surely produce data that would grab people's attention. We already know from accountability campaigns in states such as Connecticut and New Jersey that many big companies there pay tiny amounts of income tax—as little as \$200 a year, far less than low-income families—thanks to gimmicks like the Delaware royalty loophole.

If taxpayers learned that large companies in their state were paying almost no income tax, they would demand to know why. Indeed, a 1986 revelation by Citizens for Tax Justice that many huge corporations were paying zero federal income tax was memorialized in the famous poster: "I pay more income tax than General Electric, W.R. Grace, General Dynamics, Boeing, Dow Chemical, and Lockheed All Put Together!"

The ensuing outrage prompted a major progressive reform, closing some corporate loopholes; the 1986 law is considered the best thing to happen to the federal tax code in decades. There is a large body of evidence from both state-specific and national studies that companies are gaming state income tax codes even harder than Uncle Sam's. For example, the Center on Budget and Policy Priorities points out that in the second half of the 1990s, when the U.S. economy was sizzling, federal corporate income tax revenues grew an average of 6 percent a year. But *state* corporate income tax collections rose at just half that rate. Same

companies, same profits, same years, half the tax (Mazerov 2003, p. 3). Combined reporting would solve much of that.

REFORM 3: CLAWBACKS OR MONEY-BACK GUARANTEES

A clawback rule or contract simply says that a company must hold up its end of the bargain, otherwise taxpayers have some money-back protection. Eighteen states and dozens of cities already use clawbacks, which basically after a company gets a subsidy (say, two years later), it must create a certain number of jobs at a certain wage and benefit level. The clawback may also require other public benefits such as a certain number of dollars invested to modernize a facility. Then, if the company does not meet the targets, taxpayers get paid back. The rule can be prorated so that, for example, if the company falls 10 percent short, it has to pay back 10 percent of the subsidy; it can also be set for a steeper penalty, if the company falls far short.

I can hear the business lobbyists wailing again about poisoning the “business climate.” But I think just the opposite is true. From the mid-1980s to the mid-1990s, there was a string of lawsuits in which cities tried to get subsidy money back from companies that were shutting plants (*Chicago v. Hasbro/Playskool*; *Norwood, Ohio v. General Motors*; *Duluth v. Triangle*; *Yonkers v. Otis Elevator*; *Ypsilanti Township v. General Motors*). The latter is best known: Ypsilanti Township alleged that statements made by GM in public hearings amounted to an oral contract obligating the company to stay in exchange for huge property tax breaks.

Now, given the prevailing business climate dogma, these lawsuits were huge events, with mayors risking their cities’ reputations for being friendly to business. The lawsuits speak to incredible frustration and anger, even desperation. If the cities had negotiated clawbacks with the companies, it’s unlikely that there would have been any lawsuits. The companies’ obligations would have been spelled out in black and white—just like any private-sector contract—and there would likely never have been a dispute. Clear obligations on both sides of the table and no litigation: isn’t *that* a good business climate?

REFORM 4: JOB QUALITY STANDARDS

Why give a company a subsidy and then allow it to pay a poverty wage? Subsidizing low-wage jobs only means taxpayers get stuck with even higher, hidden costs—in the form of Food Stamps, Medicaid, Earned Income Tax Credit, and housing assistance. Thanks to the living wage movement—and to good old common sense—this reform is already taking root. As of our last updated survey, at least 43 states, 41 cities, and 5 counties now attach wage and/or health care requirements to economic development incentives (Purinton 2003).

I hasten to add that while these numbers have risen sharply since I began surveying for them in 1989, we still have a long way to go. Most jurisdictions still only apply these rules to one program (we found a total of 165, including 107 state rules) but if the 50 states have an average of 30 or more subsidies each, or a total of at least 1,500, that means about 93 percent of state subsidies still allow companies to pay as little as that Dairy Queen in Caledonia, Minnesota.

REFORM 5: UNIFIED DEVELOPMENT BUDGETS

About 35 states publish what is called a tax expenditure budget. That is, they provide the legislature with a report that says the state lost X dollars in revenue to A, B, and C tax credits. But most of these reports are incomplete or unreliable. Incredibly, there is no standardized national set of accounting rules or guidelines for the states to track these expenses. (A group called the Government Finance Officers Association, which is the largest professional association of state and local treasurers and comptrollers, formed a committee to study the issue of subsidies in the late 1980s, but its work never went anywhere. The Government Accounting Standards Board, which sets guidelines for how governments should keep their books, has no firm rules telling states how to account for tax expenditures.)

This is a big issue because tax expenditures for economic development (i.e., companies claiming corporate income tax credits or sales or utility tax exemptions that remain undisclosed) often dwarf other forms

of spending such as grants that do show up clearly in budgets because they require appropriations. It's no exaggeration to call appropriations the top of the iceberg and tax expenditures the bottom. So most state legislatures are flying in the dark when it comes to the big picture. They don't know how big the bottom of the iceberg is, much less what they are getting for it.

The solution is a unified development budget, as advocated for by groups in Texas, California, North Carolina, and Illinois. A unified development budget provides legislators with a comprehensive inventory of all forms of spending for economic development, including all the tax breaks as well as all the appropriations. Illinois enacted a unified development budget requirement as part of its disclosure law in 2003, but the first such budget issued by the state was very incomplete. In other states, research groups have cobbled together their own versions, a tedious exercise requiring a lot of budget sleuthing.

Although there is not yet much experience with this safeguard, the idea is sound. Give taxpayers and lawmakers a document that puts the whole iceberg on the table every year or two. A document that treats tax breaks no differently than appropriations, that portrays them both correctly as simply different forms of the same thing: state spending. And then let people decide if they have the right balance. Chances are, with an accurate mapping of the whole iceberg, more people will turn their attention to the previously hidden bottom part, the secretive tax breaks, where most of the money is. Especially in times of budget deficits and fiscal strain, there is a better chance that legislators will look at both the top and the bottom as they seek to balance their budgets.

REFORM 6: SCHOOL BOARD INPUT ON ABATEMENTS AND TIF

As Good Jobs First documented in 2003, only two states effectively shield school funding from revenue losses caused by property tax abatements and revenue diversions caused by tax increment financing (TIF). A few states give school boards limited input, but the great majority give school boards no say in the process (Good Jobs First 2003). It's a big issue for school finance; although local revenue sources for schools

are less important than they used to be, as states play a greater role, property taxes remain the largest single source of funding for K-12, and in some states, they still account for more than half. But with 43 states allowing abatements and 48 using TIF, the threat to school funding is present in every state.

It's crazy public policy when you think about it: voters elect members of the school board and expect them to meet their obligation to educate the kids. But then along comes a city council or a county board doling out abatements or TIF, eating the school board's lunch. Call it an inter-governmental *free* lunch. Can you imagine the opposite happening: school boards unilaterally grabbing chunks of the budget for police and fire services?

Protecting education funding matters doubly for economic development. Good schools are a key amenity that help cities attract and retain good employers, especially those that require highly skilled (read: well-paid) workers. And with the baby boom generation approaching retirement, the growth rate of the U.S. labor force is plummeting, suggesting that we may face chronic skilled labor shortages. For both these reasons, the states and regions with good schools will be the economic development winners of the twenty-first century.

School boards should have a full voting seat on any board that abates or diverts property tax revenue away from schools. And school boards should have veto power over that portion of property tax that would be lost to the schools in each specific abatement or TIF deal.

REFORM 7: A FEDERAL "CARROT" AGAINST JOB PIRACY

The federal government often uses the power of its purse as a "carrot" to entice the states to reform their programs. A fraction of federal highway funding was held back from states until they raised their legal drinking age to 21. The No Child Left Behind Act uses federal funds to encourage school reform (though many doubt its effectiveness).

There is no reason the same idea could not apply to economic development. Ten percent of a state's money from the U.S. Departments of Commerce and Labor could be held back until a state adopted certain reforms. Just a few strategic ones would suffice: a certification by

the governor that the state will not use taxpayer dollars to pirate jobs from another state, and adoption of disclosure and a unified development budget.

REFORM 8: PROPERLY DEFINE SITE LOCATION CONSULTANTS AS LOBBYISTS

Miriam Webster's Collegiate Dictionary defines lobbying as "to attempt or influence or sway (as a public official) towards a desired action." That sure sounds like the work of a site location consultant to me, since the deals they orchestrate routinely involve the passage of local ordinances for property tax abatements, industrial revenue bonds and/or zoning, and bigger deals sometimes involve state legislation as well.

Site location consultants work both sides of the street; that is, they work for companies looking for places and places looking for companies. It is an apparent conflict of interest that allows them to profit by controlling the key information about a deal. It's like a trial lawyer who represents children who got cancer from a nearby chemical plant also working for the chemical company. Or better yet, like a blackjack dealer who knows what your down card is.

Somehow, site location consultants have come to occupy a space where they defy norms about professional ethics and the proper representation of opposing parties. Let's be clear: there *are* opposing interests at play here. Companies want to pick the public pocket for every dime they can get, and public officials (or at least most of them) are trying to land the deal while spending as little as possible. But the bargaining table is sloped sharply because the site location consultant controls all of the information between the company and the sites competing for the deal. And in some cases, the site location consultant has a monetary self-interest in upping the ante of subsidies because he is working on commission of up to 30 percent of the value of those subsidies.

To help remedy this, states ought to legally classify site location consultants as lobbyists. In many states, that would require them to disclose at least a little about their activities. More importantly, it would block them from receiving success fees (read: commissions) and thereby remove their most outrageous incentive to fuel the candy-store arms race.

The long-term objective here is to split the profession into two. Site location consulting ought to consist of fish and fowl, i.e., consultants who work for companies and others who work for cities, counties, and states. There should be a robust, adversarial process in which the taxpayers benefit from a side of the profession that specializes in aggressive bargaining, professional cost-benefit analysis, and cold market judgments about corporate behavior.

REFORM 9: PROMOTE SMART GROWTH AND CURTAIL THE “ECONOMIC WAR AMONG THE SUBURBS”

In some respects, the “war among the states” alarm is misleading. Far more common than state versus state competitions for deals like the Boeing 7E7 are deals in which two or three jurisdictions within the same metro area compete for a deal. Indeed, when we looked at 29 subsidized corporate relocations in the Twin Cities metro area, only one company had even considered locating just across the state line in Wisconsin. Most relocating companies cannot afford to move to another state; they want to retain their workforces, and stay close to their customers and suppliers. They simply need more space or a better location within the same metro area.

The state versus state competitions tend to be more high-profile, such as those involving new auto assembly plants, so many people are unaware that intraregional competition is far more common. Only four states—Connecticut, Ohio, Minnesota, and Maine—collect information about subsidized relocations as part of their disclosure systems, and none has ever analyzed the data. To their credit, local development officials in some regions, by informal arrangements, seek to deter the use of subsidies to pay for relocations within their areas.

States should deny subsidies altogether to retail deals (except in truly depressed inner-city markets that are demonstrably underserved, such as those that lack basic retail items such as groceries, medications, and clothes). Retail is not economic development; it is what happens when people have disposable income. (It has lousy upstream ripple effects—all those goods from China—and paltry downstream ripple effects, since retail jobs are overwhelmingly part time, low wage, and

without health care.) And big-box retail, which has become so expert at mongering subsidies, undermines existing retailers and is a primary cause of abandonment of urban core areas and the loss of open space at the suburban fringe.

States should also repeal point-of-sale sales tax collection rules. That is, they should not allow the city where a retail sale occurs to collect any share of the tax. Allowing one suburb to build a mall that pirates sales tax revenue from the core city and dozens of surrounding suburbs simply undermines the tax base of older areas. And it creates a perverse incentive for another suburb to build yet another mall further out, and so the leap-frog sprawl continues. For the same reason, those states that allow sales tax to be “TIFed” should repeal it; that just puts the perverse incentive on steroids. In today’s sprawling metro areas, people live in one jurisdiction, work in another, and shop in a few others. Sales tax revenues ought to be shared statewide and regionally, reflecting that reality.

In metro areas, states should explicitly link economic development to public transportation, so that in order to get a subsidy, the project must be accessible by transit (i.e., within a quarter of a mile of a regularly served transit stop). That would reduce companies’ abilities to whipsaw suburbs against each other (by taking exclusionary suburbs out of the race), steer more jobs onto the transit system, help low-income families gain access to more jobs, give more commuters a choice about how to get to work, and improve air quality. In a 50-state survey, we found that not a single state effectively coordinates any of its subsidy programs with public transit, even though the average state now has more than 30 subsidies. It is a huge wasted opportunity for transportation dollars to leverage smart growth, since states spend five times more on economic development than on public transportation (Khan 2003). In 2006, the Illinois legislature passed a “location efficient incentives” bill, which the governor signed into law. Illinois thus became the first state to intentionally make such a link, giving a slightly larger state tax credit to deals located close to transit and/or affordable housing.

Finally, states should deny development subsidies (as Maryland does under its Smart Growth Act) to any kind of deal that is not located in an area that already has infrastructure. Making developers bear the full infrastructure cost of sprawling fringe development helps tip the scales in favor of urban reinvestment. If land use policies bring jobs and

tax bases back to older areas, the need for subsidies to revitalize those areas will diminish.

ACCOUNTABILITY AND THE “BUSINESS CLIMATE”

I can hear the business lobbyists howling already. “This is invasion of taxpayer privacy. This will threaten small businesses. This will poison the business climate,” they’re crying. Well, to them, I say three things.

First, there is no evidence that any of the 12 states cited here have harmed their business climates by having disclosure. (Nor, for that matter, is there evidence that any state has hurt its business climate with any other kind of reform I have cited, such as wage rules or money-back guarantee clawbacks.) As the person who has been out there publicizing these safeguards for 12 years, I think I would have been presented with such evidence if there was any, and I have not.

Second, nothing proposed here will invade anyone’s privacy or harm any small businesses. By disclosure, I am not talking about public release of any companies’ state income tax returns. I am not talking about seeing a company’s profits or losses, nor am I talking about disclosure of how much most companies paid in state income tax. But I do think that as a taxpayer, I ought to have the right to see how much a company claimed on a tax credit. Because when a company claims a credit and pays less income tax, it is the same thing as if the government wrote a check to the company for some other economic development purpose, like a training grant. When a company claims an income tax credit, it means the company is paying less for public services and I have to pay more. I want to know how much more.

Third, lots of other kinds of tax breaks and subsidies are already public information. If a company gets a property tax abatement, I can see the details at the county tax assessor’s office. If a company got a training grant, I can get that file at the Workforce Investment Board. If a company got a low-interest industrial revenue bond, I can go the county industrial development authority and get that information. Why should income tax credits be treated any differently? They were sold to us as “jobs, jobs, jobs,” so we should be able to see how much those jobs are costing.

Notes

A more detailed version of the remedies discussed here was published in LeRoy (2005).

1. In May 2006, in *DaimlerChrysler v. Cuno*, the U.S. Supreme Court ruled that the plaintiffs lacked standing in federal court to contest a state investment tax credit that a lower court had ruled unconstitutional. In a separate ruling, the Supreme Court upheld a ruling by the same lower court that a property tax abatement was constitutional.

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