CORPORATE POWER QUICK TAKE

AMERICAN ECONOMIC LIBERTIES PROJECT

What You Need to Know About the Interstate Compact Against Corporate Tax Giveaways

State legislators in 13 states have filed legislation to form an interstate compact against the use of tax incentives to entice corporations to move from one location to another.

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The compact aims to fix the prisoner's dilemma of state economic development: State lawmakers feel compelled to offer tax incentives and other giveaways to large corporations to move, invest, and supposedly create jobs because every other state does it. By instituting a cease-fire amongst the states, the compact can foster the development of more impactful, equitable, and cost-effective economic policies that focus on small businesses and the real needs of communities.

1. WHAT IS AN INTERSTATE COMPACT AGAINST CORPORATE TAX INCENTIVES?

A legislative fix to prevent states from using targeted corporate tax incentives to poach corporate facilities from other states. Each state that approves the compact agrees to not use tax breaks or other monetary incentives to entice corporations located in any other state that also joins the compact, and also agrees to a set of data-sharing practices that will bring more transparency and accountability to a public policy area lacking both. It's a step toward a full cessation of all company-specific incentives.

2. BACK UP: WHAT'S A CORPORATE TAX INCENTIVE?

A tax break or other monetary benefit given to a specific company in order for it to open a new facility or maintain a current one, create or retain jobs, or undertake other actions that supposedly have wider community benefits. These can take many forms, such as reducing property taxes, providing tax credits per job created, or simply giving a cash grant to a corporation in exchange for certain actions. They're problematic policies, which research shows to be ineffective at achieving their main purpose: creating jobs and boosting economic growth. They also foster corruption and take money away from programs and services that would benefit more people.[1] Finally, their administration is often secretive, undermining local democracies.[2]

3. THAT SEEMS BAD. IS THERE ANY EVIDENCE THESE DEALS ARE GOOD FOR THE ECONOMY?

There is not. Reams of research, in fact, have shown that corporate tax incentives have a negligible effect on economic growth, job creation, or incomes.[3] As Prof. Richard Florida put it, "there is virtually no association between economic development incentives and any measure of economic performance."[4]

Most of the time, incentives don't entice corporate leaders to do anything they wouldn't have done anyway, as location decisions are based on several other business factors, such as workforce requirements, supply chains, and other local laws. According to Tim Bartik of the Upjohn Institute, between 75 and 98 percent of granted incentives have no bearing on where a firm ultimately chooses to locate.[5]

4. OK, BUT DO THEY HAVE CONCRETE HARMS?

Yup. Incentives take money out of communities that governments could have used on other things. This is particularly problematic for local schools: Since many incentives reduce a corporation's property taxes—and property taxes are the primary way in which American schools are funded—school budgets tend to bear the brunt of these

1 Felix, Alison and James R. Hines Jr., "Who Offers Tax-Based Business Development Incentives?," The Federal Reserve Bank of Kansas City Economic Research Department, November 2011, https://www.kansascityfed.org/publicat/reswkpap/pdf/rwp11-05.pdf

2 Garofalo, Pat, "Believed to Be Facebook," Boondoggle, May 20, 2020 https://boondoggle.substack.com/p/believed-to-be-facebook

3 See: Garofalo, Pat, *The Billionaire Boondoggle: How Our Politicians Let Corporations and Bigwigs Steal Our Money and Jobs* Thomas Dunne Books, March 2019; LeRoy, Greg, "The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation," Berrett-Koehler Publishers July, 2005; Florida, Richard, "The Uselessness of Economic Development Incentives," *CityLab*, December 7, 2012, https://www.bloomberg.com/news/articles/2012-12-07/the-uselessness-of-economic-development-incentives; and Slattery, Cailin and Owen Zidar, "Evaluating State and Local Business Tax Incentives," Journal of Economic Perspectives 34.2, Spring 2020, https://scholar.princeton.edu/zidar/publications/evaluating-state-and-local-business-tax-incentives, among many works.

4 Florida, "The Uselessness of Economic Development Incentives."

5 Bartik, Timothy J., "'But For' Percentages for Economic Development Incentives: What percentage estimates are plausible based on the research literature?," Upjohn Institute Working Paper 18-289, July 1, 2018 https://doi.org/10.17848/wp18-289

revenue changes. In 2018, corporate tax reductions cost U.S. schools a collective $1.8 billion—and that's only accounting for what was disclosed.[6]

Incentives can also exacerbate economic inequities.[7] In Kansas City, for example, officials were granting more incentives—and therefore taking more money out of schools—in predominantly minority neighborhoods.[8] In and around Chicago, an investigation revealed that leaders in communities with higher numbers of minority residents were giving Amazon far more than those in predominantly white neighborhoods for similar facilities.[9]

Finally, these giveaways disproportionately benefit big corporations, giving them an advantage over small, local businesses that don't receive the same level of state support.[10] A 2015 study of incentives in 14 states by Good Jobs First found that 90 percent of the money went to large corporations.[11]

5. THAT SEEMS BAD. HOW PREVALENT ARE THESE INCENTIVES?

It's hard to get an exact number because many states and municipalities aren't good about disclosing how much they spend on incentives, but estimates put the total amount at about $30-40 billion per year.[12] Some have even put it as high as nearly $90 billion.[13] That's tens of billions of dollars each year that can't go to support schools, infrastructure, or other public services. Every state participates in one way or another.

6. THAT SEEMS LIKE A LOT! HOW DID THAT HAPPEN?

Corporate tax breaks date back to the earliest days of the U.S. The first recorded one went to Alexander Hamilton for a failed manufacturing campus in 1791.[14] The modern era of corporate tax break competition, though, can be traced back to the post-World

6 "The New Math on School Finance," Good Jobs First, Decembe 2018, https://www.goodjobsfirst.org/sites/default/files/docs/pdfs/newmath3.pdf

7 Maciag, Mike, "Big Business Tax Breaks May Worsen Income Inequality," *Governing*, May 2018, https://www.governing.com/archive/gov-tax-breaks-cities-affluent.html; Parilla, Joseph and Sifan Liu, "Examining the local value of economic development incentives: Evidence from four US cities," Brookings Institution, March 2018, https://www.brookings.edu/research/examining-the-local-value-of-economic-development-incentives/

8 Kite, Allison, "'This is systemic racism': Kansas City school leader criticizes tax incentive plan," *Kansas City Star*, June 24, 202, https://www.kansascity.com/article243758907.html

9 Lippert, John and Natalie Moore, "Amazon's Massive Chicago-Area Expansion Was Fueled By $741 Million From Taxpayers," WBEZ, October 26, 2020 https://www.wbez.org/stories/amazons-massive-chicago-area-expansion-was-fueled-by-741-million-from-taxpayers/300fa829-1b71-4d9e-a2f4-1776e88d4cb3

10 Garofalo, Pat, "Why are local governments paying Amazon to destroy Main Street?," *Fortune*, August 23, 2020, https://fortune.com/2020/08/23/amazon-coronavirus-taxes-local-governments/

11 LeRoy, Greg, Carolyn Fryberger, Kasia Tarczynska, Thomas Cafcas, Elizabeth Bird, and Philip Mattera, "Shortchanging Small Business: How Big Businesses Dominate State Economic Development Incentives," Good Jobs First, October 2015, https://www.goodjobsfirst.org/sites/default/files/docs/pdf/shortchanging.pdf

12 Slattery and Zidar, "Evaluating State and Local Business Tax Incentives."

13 Story, Louise, "As Companies Seek Tax Deals, Governments Pay High Price," *The New York Times*, December 1, 2012, https://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html

14 "CHARTER OF THE SUM," November 22, 1791, accessed via the Hamilton Partnership for Paterson, https://www.hamiltonpartnership.org/node/225

War II era, when southern states wanted to diversify their economies. In a tactic pioneered by Mississippi Gov. Hugh White, southern states would use tax incentives to entice northern manufacturing plants to move south, a strategy known as "smokestack chasing."[15] This strategy has proliferated across the country.

7. WHAT ARE SOME RECENT EXAMPLES?

Amazon's search for subsidies to open a new division headquarters, dubbed HQ2, and the subsidies the Taiwanese manufacturer Foxconn received and Wisconsin's subsidies for Taiwanese manufacturer Foxconn received the most press attention, but these deals are everywhere. In terms of the direct poaching of companies from other states that the compact would initially outlaw, a recent example is Goldman Sachs exploring "tax advantages" with local officials in return for moving a division from New York to Florida.[16]

8. SO WHY DO THESE ARRANGEMENTS KEEP OCCURRING?

Because they're very good for politicians. Political scientist Nathan Jensen, currently at the University of Texas–Austin, and his colleagues found that governors receive a "vote bonus" for engaging in dealmaking with corporate incentives. "We find strong evidence that voters, especially independents, are more likely to vote for incumbent politicians who use tax incentives to attract investment," they wrote in a 2013 study.[17]

The same holds true at the local level, as Jensen found that elected mayors use more incentives than unelected city managers, because they thought it was good politically.[18]

Incentives allow political leaders to accrue useful electoral capital: positive local press coverage, talking points for speeches about the economy, and campaign contributions. Consequently, governors' use of incentives increases during years in which they are up for re-election.[19] This is a political problem, not an economic one.

15 Garofalo, *The Billionaire Boondoggle*, Chapter 3.

16 Natarajan, Sridhar, "Goldman Plots Florida Base for Asset Management in a Blow to New York," *Bloomberg,* December 6, 2020 https://www.bloomberg.com/news/articles/2020-12-06/goldman-plots-florida-base-for-asset-management-in-a-blow-to-nyc?sref=ZvMMMOkz

17 Jensen, Nathan M. and Edmund Malesky, Mariana Medina, and Ugur Ozdemir, "Pass the Bucks: Credit, Blame, and the Global Competition for Investment," *International Studies Quarterly* (2013) 1–15, https://sites.duke.edu/malesky/files/2014/07/Pass-the-Bucks.pdf

18 Jensen, Nathan, "Business Location Incentives Are Ineffective – So Why Do They Persist in American States and Cities?," Scholar Strategy Network, September 27, 2016, https://scholars.org/contribution/business-location-incentives-are-ineffective-so-why-do-they-persist-american-states

19 Slattery and Zidar, "Evaluating State and Local Business Tax Incentives."

9. HOW DOES THE COMPACT GET AROUND THOSE ISSUES?

By removing the potential political penalty for any one state ending its programs unilaterally. Since states agree to mutual cease-fires, no single elected leader has to sit idly by while other states engage in dealmaking around her. Kansas and Missouri implemented a version of this in 2019 to prevent corporations from moving across the greater Kansas City metro area—which straddles both states—in order to claim incentives.[20] The compact aims to bring that solution nationwide.

10. HOW DOES THE COMPACT GO INTO EFFECT?

It depends on the specific bill in each state, but generally there is a trigger in the legislation, whether that is every other state, a subset of states in a particular region, or any one other individual state joining the compact. Importantly, though, the terms of the compact only apply to states that have joined. States do not have to refrain from using incentives to entice businesses from non-compact states.

11. HAVE THERE EVER BEEN OTHER INTERSTATE COMPACTS?

Many! Though the most well-known compact is the National Popular Vote Compact for abolishing the Electoral College, which hasn't gone into effect, there are currently more than 200 active interstate compacts. States belong to an average of 25 apiece, and they cover a range of topics, from water and flood management to crime control to common licensing regimes for lawyers and doctors.[21]

12. SOUNDS GREAT! HOW DO I GET INVOLVED?

Contact your state legislators and ask them to introduce a bill to have your state join the compact. And then lobby your state legislature and your governor to pass it and sign it into law.

20 Garofalo, Pat, "What's the Matter With Kansas City?," *Boondoggle,* August 15, 2019 https://boondoggle.substack.com/p/whats-the-matter-with-kansas-city

21 "10 Frequently Asked Questions," National Center for Interstate Compacts, https://www.csg.org/knowledgecenter/docs/ncic/CompactFAQ.pdf

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