REMAPPING DEBATE
Asking "Why" and "Why Not"

It's like signing a blank check

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

ept. 26, 2012 — In the early 1990's, while Robert Lynch was teaching economics at the State University of New York at Cortlandt, he became interested in one of the state's most-touted economic development programs, known as Industrial Development Agencies (IDAs). In 1969, New York state lawmakers had allowed local governments to set up these kinds of agencies, which functioned as quasi-governmental corporations with the responsibility of attracting and retaining business investment and the power to give incentives — such as free land, low-cost financing, and exemption from state and local taxes — to accomplish that result.

HOW CAN WE KNOW WHAT WORKS?

This is the second 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."

The first article in this series can be found here.

— Editor

"They were issuing these press releases where they claimed that the IDAs were remarkably successful," Lynch said recently. "They claimed that they had created hundreds of thousands of jobs and cost local governments almost nothing."

It was widely reported at the time that the IDAs had created 270,000 jobs between 1970 and 1991, at very little cost to taxpayers. "I thought, 'If that's true, then this is a great success story,' and I wanted to document it," Lynch said.

When he began to investigate those claims, however, Lynch found that reliable data was hard to come by. There were few rules governing what IDAs were required to report to state and local officials. In the reports that were filed, Lynch quickly found discrepancies: "They were claiming that a certain company had created 200 jobs," he said, "but when I looked into it, that company only had 100 employees."

Lynch spent the next four years collecting data from individual firms, the IDAs themselves, and various state and local agencies. When he published his results in 1992, they came as a shock to many lawmakers. Lynch found that, rather than being nearly cost-free, IDAs had cost taxpayers about $1.4 billion between 1987 and 1991 alone (about $2.8 billion in today's dollars).

Where officials had claimed that the incentives offered by IDAs had lured hundreds of firms to New York from other states and abroad, Lynch found a grand total of 23 relocated firms, only two of which said that the incentives had played a part in their decision to move. And as for the 2,700 jobs those firms were said to have created, Lynch found that the IDAs had created no more than one third of that number, and probably far fewer.

“I was disappointed, to say the least,” Lynch said. “This was not the success story it had been promoted as.”

The program, which still exists, was reformed following Lynch’s study to restrict the types of incentives that IDAs can offer and to make some modest improvements in transparency requirements. But there are still problems with disclosure, and the program remains the object of much criticism, coming even from state officials charged with overseeing it. A report this year from the office of New York State Comptroller Thomas DiNapoli, for example, found several instances where IDAs had misused funds or misreported data, and recommended legislative changes to increase transparency and accountability.

“Essentially the same as writing checks”

The IDA program in New York is just one of countless programs across the United States through which states grant various kinds of incentives — such as tax credits, grants, low-cost loans, and free property — to businesses with the goal of encouraging economic development. Most states and numerous localities have several ongoing programs, and also offer one-time, company-specific incentive packages to some businesses. Kenneth Thomas, a political scientist at the University of Missouri-St. Louis has estimated, conservatively, that the total value of economic development incentives in 2010 was $70 billion.

“We are talking about billions of dollars of taxpayer money every year, and the workings of a lot of these programs are about as clear as mud.” — Philip Mattera, Good Jobs First

Despite the high cost, basic facts about many of the programs remain opaque: “We are talking about billions of dollars of taxpayer money every year, and the workings of a lot of these programs are about as clear as mud,” said Philip Mattera, the research director for the D.C. organization Good Jobs First, which advocates for increased transparency in economic development incentives. While an increasing number of states have begun posting some information on their incentive programs online, Mattera said that such information is often unreliable or incomplete, and many programs simply “fly completely under the radar.” (See bottom box on state-level disclosure on page five.)

“If you found out that one of your elected officials had written a bunch of checks to some companies out of the general fund, you would want to know which ones, how much they got paid, and what you as a citizen got out of it,” Mattera said. “Many of these subsidy programs are essentially the same as writing checks.” (See bottom box, below.)

What we know and what we don’t

States are not alone in the subsidy-granting business. Most municipal governments also offer both company-specific subsidies and incentive programs that are available to all companies that meet the profile that the municipality is trying to attract. Thomas estimates that at least half of his $70 billion estimate comes from local governments. Most of those incentives come in the form of tax abatements and specialized financing for projects through bond sales.

But disclosure of those incentives is extremely patchy, at best. Only a few large cities, like New York City and Chicago, provide details online about the costs and recipients of their incentive programs.

The secrecy at the local level is especially galling to good government advocates. “Transparency at the local level is extremely important,” said Phineas Baxandall, a senior tax and budget policy analyst for the United States Public Interest Research Group (U.S. PIRG). “That’s the level where decisions about tax and spending policy has the most direct impact on residents, so it’s especially important that localities disclose where their revenue goes.”

Call it what you will, it costs the taxpayers money

Only a fraction of the money that is spent on incentives for businesses constitutes what is described as “direct spending” in which states and local governments transfer assets directly to companies, usually in the form of monetary grants or land.

A larger portion of the total is made up of “indirect spending,” through which states and localities reduce what would otherwise have been the companies’ tax liability. Most commonly this is acheived by offering the companies a tax credit.

Part of the reason that business subsidies are so opaque is because, while direct spending is reflected in the budget of a state or local government, indirect spending often is not.

Several economists noted that indirect spending has exactly the same impact on state and local budgets as direct spending: they point out that, in both cases, money that would have otherwise been used for public functions is lost to public use.

In some cases, localities do not even track the recipients of their incentives. In 2011, the East-West Gateway Council of Governments, which represents the local governments in the St. Louis area, published an evaluation of all non-cash incentives offered in the St. Louis metropolitan area, which comprises all of the municipalities in seven counties in both Missouri and Illinois.

"If states really wanted to improve transparency, they would require detailed reports from all local governments, and they would have enforcement mechanisms in place and audit them regularly." — Phineas Baxandall, U.S. PIRG

"It took us more than three years to put that information together, and even now there are big gaps," said Mary Rocchio, one of the report's main authors. Rocchio said that while local governments in both states are required to report some data to the state governments, there are no enforcement provisions in place that can require them to do so, and many of the reports that are filed are incomplete.

"Even when we could get a dollar amount, often there was no way of knowing why that money was diverted in the first place, what the context was," Rocchio said. "That makes a comprehensive economic analysis pretty much impossible."

For the most part, Baxandall said, tracking local incentives should be the role of state governments. "Trying to convince tens of thousands of towns to put this information on their website would be very difficult," he said. "If states really wanted to improve transparency, they would require detailed reports from all local governments, and they would have enforcement mechanisms in place and audit them regularly."

Where's the evidence?

Many good-government advocates say that the disclosure of information regarding economic development incentives is important because without it, voters cannot make informed decisions about the policies that affect them. But there is also another argument for transparency: without detailed reporting on subsidies and incentive programs, it is difficult for researchers to evaluate their effectiveness, meaning that lawmakers often cannot make informed decisions, either.

Earlier this year, the Pew Center on the States published a report entitled "Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth." The report ranked states on the quality and consistency of the internal evaluations of their incentive programs, and found that only four states — Washington, Oregon, Iowa, and Arizona — undertake regular, rigorous assessments of all major tax incentives.

“Tax incentives are a decision about what the state’s priorities are,” said Jeff Chapman, a research manager for the Center and one of the report’s authors. “If they are deciding to lower taxes for some businesses then that will require either cutting spending or raising taxes elsewhere, and that’s a decision that’s important to assess.”

Because tax incentives for businesses are not automatically subject to annual or bi-annual legislative review through the budget process, like spending programs, Chapman said that there are incentive programs in some states that have been on the books for years without ever having been evaluated for effectiveness or cost.

In a story reminiscent of Robert Lynch’s independent study of New York’s IDA program, the North Carolina legislature in 2007 commissioned the first comprehensive study of the state’s incentive programs. Confidentiality agreements with companies had previously made an independent, detailed cost-benefit analysis nearly impossible. The report concluded that the recipients of the state’s largest tax incentive program were actually creating jobs at a slower rate than companies that had not received the incentives, and recommended several policy changes.

State-level disclosure

Most states do disclose the recipients of cash grants, though there are exceptions. Delaware, for example, maintains a special “deal closing” fund called the Delaware Strategic Fund that provides grants and loans to companies for major relocations and expansions. The state makes an annual appropriation to the Fund, which amounted to more than $30 million in 2011. But when Remapping Debate requested a list of the recipients of Strategic Fund grants and the amount each was ultimately paid, the Economic Development Office said that the only way to obtain that information was by filing a formal Freedom of Information Law request.

When it comes to less direct forms of spending on subsidies, like tax credits, there is even less disclosure. Only a few states — such as Ohio, Missouri, North Carolina, and Wisconsin — disclose the recipients of all of their major tax credit programs online, while many more disclose none, according to Good Jobs First.

California, for example, offers tax abatements to companies in designated areas called Enterprise Zones. The program is controversial, and it had an estimated total cost of $270 million in the last fiscal year. The state does not disclose any of the program’s recipients, nor the recipients of any of the state’s other tax incentive programs. Idaho, a much smaller state, doled out $130.4 million last year on a sales tax exemption for manufacturers, miners, and farmers, representing nearly six percent of the state’s entire budget; it does not disclose the recipients of those subsidies, either.

Voting blind

In some cases, lawmakers are asked to enact incentive programs without even being given the most rudimentary information about the proposals.

When the South Carolina legislature voted, in 2009, to offer Boeing a subsidy package to locate a factory in North Charleston, lawmakers were not presented with any detailed cost-benefit analysis beforehand, nor did they demand to see one. While the package was initially reported to be worth $450 million, it was later estimated that the full cost was at least twice that amount, far more than the $750 million that Boeing had agreed to invest.

Another example concerns a complicated instrument called Tax Increment Financing (TIF). The mechanism was born in California in the 1950s as a way to bring investment into underserved and impoverished communities. In general, municipal officials divert a portion of present or future revenue that would normally be destined for the municipality's general fund into a dedicated fund that can only be used in and for the TIF district itself. In some cases, the diverted revenue is used for projects that benefit the TIF district as a whole, such as road repair. In others, however, the revenue is used to benefit a specific company, including direct payments to real estate developers and the financing of infrastructure to serve a particular corporation.

When the South Carolina legislature voted, in 2009, to offer Boeing a subsidy package to locate a factory in North Charleston, lawmakers were not presented with any detailed cost-benefit analysis beforehand, nor did they demand to see one.

"TIFs are probably the most-used economic development incentive at the local level," said Baxandall, "but in most places it's almost impossible to figure out what they're being used for."

From 2007 to 2009, for example, a series of investigative reports on Chicago's TIF districts found that the administration of former Mayor Richard Daley had for years produced a secret budget of TIF revenue and spending. Not only was that budget not released to the public, it was not even shared with all of Chicago's Aldermen. When that budget was finally examined, it showed that nearly a third of the city's land had been designated as TIF districts, and that a significant amount of money was used to subsidize private developers in the most affluent neighborhoods.

"If the politicians don't even know what it is they're voting for, then clearly we are doing something wrong," said Mattera of Good Jobs First.

This content originally appeared at http://www.remappingdebate.org/node/1444