



Bombardier: A Postmortem

By Joseph Haslag

Bombardier Aerospace has announced that it will produce its new jets in Canada rather than in Missouri. For Bombardier's shareholders, this location decision rests on where the directors believe its share prices will be highest. In announcing its decision, Bombardier indicated that it received repayable investments from Canada and the Province of Quebec, as well as Northern Ireland and the British government. With Bombardier's announcement, an appropriate post mortem would ask: What lessons should we take away from Missouri's efforts to attract Bombardier?

Summary

Now that Bombardier has decided to build in Canada rather than Missouri, it's worth examining whether tax incentives are a worthwhile strategy for economic growth. While legislators certainly had Missouri's best interests at heart, both economic theory and hard data show us that real growth stems from lower tax rates across the board.

Main text word count: 730

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First, it is important to distinguish between what is in Bombardier's best interest and what is most beneficial to Missouri's citizens. Some will be frustrated because Bombardier played Missouri against Canada. No one can blame Bombardier's directors for seeking the best deal. They want as many governments offering tax incentives as possible. Suppose we are talking about two suppliers negotiating with Bombardier to supply their rivets. If the rivets are identical, we would expect Bombardier to choose the lower cost. Similarly, tax payments are a significant expense. When governments offer to lower taxes, Bombardier's shareholders want their directors to listen. So, the lesson here — which is hardly surprising to anyone — is that companies can lower their expenses through competitive negotiations. In each case, one supplier wins. From Bombardier's or any company's perspective, they want to encourage this type of competition because their shareholders are the direct beneficiaries.

Second, we must ask whether the tax incentive package is most beneficial to Missourians, and whether it makes sense to continue using these tools to attract business in Missouri. Missouri legislators will continue to make the argument that their offer to Bombardier demonstrated that Missouri is "open for business." If I took this assertion literally, the statement is extraordinarily hurtful. Hard-working Missourians should ask: When was the state *not* open for business? Did I miss some announcement that Missourians were not working hard to improve their productivity and compete with others living in states that are open for business?

I realize that this takes the legislators' claims to their illogical

extreme, and that the "open for business" claim is a sound byte standing for a deeper point. But it is important to note that Missouri's total income is falling relative to other states. Therefore, Missouri state government is competing for new business to locate within our state's borders. Tax incentive tools are the state's way to signal this new, more aggressive stance. But the critical question is this: Are tax incentives the best way for Missouri to indicate that it is open for business? What is the best way for Missouri to indicate that it is open for business? The answer depends crucially on the engines that drive economic growth.

First, it is important to understand that tax credits reduce the revenues received by state government, resulting in either fewer services like roads, schools, etc. — or higher tax burdens for everyone else. The bottom line: Tax rates matter for Missouri's future economic growth.

With the deal that state officials offered to Bombardier, and with other economic tax credits for business development and expansion, this approach assumes that economic growth stems from big plants. In fact, the evidence from economic research is that big plants typically drive other businesses out. Employees leave small businesses for the large ones, resulting in unchanged total economic activity.

New technologies are developed at research centers and businesses across Missouri that are seeking to lower production costs. Historically, we owe improved living standards to such technological progress. Because new technologies are mobile, developers look for production sites where the "after tax return" is the greatest. Sometimes it is best to stay in Missouri; sometimes it is best to move production elsewhere.

If legislators recognized that economic growth owes more to the idea-generating process than to expansion via tax credits, and trusted their constituents to generate those ideas, spurred by high after-tax returns, the state could realize accelerating living standards. Economic development is not an exact, predictable outcome. I know that Missouri's officials, such as Department of Economic Development Director Greg Steinhoff, Rep. Ron Richard, Sen. Charlie Shields, and others, had nothing but good intentions in pursuing Bombardier — but I wish I could convince them that the economic model they use is flawed. With their passion for improving their fellow citizens' lives, and a sound economic model, I am confident that Missouri's long-term economic future would brighten.

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