Advancing liberty with responsibility by promoting market solutions for Missouri public policy

TESTIMONY

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TAX CREDITS:
A POOR STRATEGY FOR ECONOMIC DEVELOPMENT

by Christine Harbin

To the members of the Tax Credit Review Commission:

Thank you for the opportunity to address you today. I commend your efforts to evaluate the appropriateness and the effectiveness of tax credit programs in Missouri. I want to use my time today to explain why targeted tax credit programs are a poor strategy for promoting economic development in Missouri.

These programs defeat the purposes that supporters usually cite in their favor: encouraging employment and helping Missouri compete. In short, tax credits are a form of wealth redistribution — we all bear the cost, but only special interests and favored industries benefit.

Tax credit programs are not as effective as advertised.

According a recent audit by the state auditor's office, tax credits have less of an impact than predicted and cost more than anticipated. Montee reviewed 15 major tax credit programs in Missouri, and found that the fiscal notes underestimated the total cost of the programs by $1.1 billion over a five-year period.

Tax credit programs have failed to deliver on their promises in other states, too. The Mackinac Center for Public Policy in Michigan released a study in which it compared job promises made in press releases issued by Michigan's economic development agency accompanying tax credit awards to the actual outcomes of those programs. Mackinac found that only 7.9 percent of projects were completed on time and produced the number of jobs promised. Missouri cannot afford that failure rate.

A particular program may provide some social benefits, but the state has to weigh this against the cost of a particular project.

As Gov. Jay Nixon said in his opening remarks to this committee, the state has already to made cuts in education and public safety. Whenever the state of Missouri awards a tax credit, that credit comes at the expense of other activities. This is because the state has a budget. A dollar spent

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on tax credits is a dollar that the state must cut from another program. This commission should consider whether the social benefits of, say, increased wine production or vacant land assemblage are worth cutting the budget of another state program. Are dollars spent on tax credits being used better than dollars spent on education?

Tax credit programs are an attempt by the government to pick winners and losers.

The government has no special ability to predict which businesses and industries will succeed. Yet tax credits are an attempt to identify and subsidize future successes.

Unfortunately, in the game of picking winners and losers, the government almost always picks losers. This is because tax credits are an attempt to protect companies and industries that the market has already rejected to some degree. If they were successful and viable on their own, these companies and industries wouldn't need to seek the favor of the government.

In addition, another recent state audit found that the Department of Economic Development (DED) had a 43-percent error rate just when *recording* estimated jobs and investment figures from businesses receiving enterprise zone tax credits. In one instance, the DED inflated a business' investment estimate by 333 percent.

Given this amount of misinformation, how can the state possibly have a chance at encouraging the right businesses and industries? Government officials should not have the role of deciding who wins and who loses in the marketplace. They should allow businesses to succeed or to fail as a result of their own efforts, and the preferences of consumers.

Tax credits often don't create economic activity, but instead merely shift it to another location.

When states compete over companies by offering increasingly generous incentive packages, taxpayers lose because they have to foot the bill. We experienced this in Missouri earlier this year with Ford. While the company lobbied for $150 million in tax incentives from Missouri, Ford also courted Kentucky, Michigan, Ohio, and Illinois for financial assistance, communicating the message that it would locate within the borders of the highest bidder. This is a very expensive game, and taxpayers everywhere would be better off if their state governments stopped playing.

Cutting the targeted tax credit programs does not imply that economic development will halt in Missouri. Wisconsin, for example, has scaled back its film tax credit program and it is able to attract blockbuster film productions all the same. American Express decided to build a $600 million data center in North Carolina without receiving a cent of subsidy.

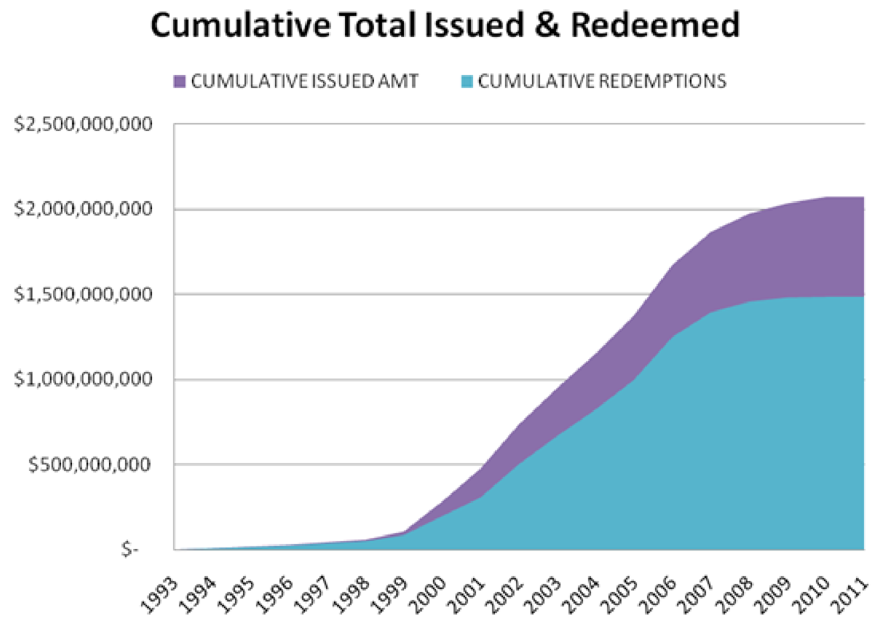
Even if other nations, states, or localities offer tax incentives to lure businesses, Missouri would be better off if we don't do the same — because we benefit from the lower prices that those subsidies create, without it costing Missouri's taxpayers a dime. It would be better for everyone if all states stopped providing these subsidies, but Missouri will still experience better economic growth if it unilaterally removes itself from the tax incentive bidding wars.

Tax credits represent a future financial liability for the state.

This is because many credits do not have to be redeemed in the year that they were issued. This negatively affects Missouri's ability to recover from difficult economic times, because officials will have to dole out money at unexpected intervals in the future. When these tax credits are redeemed in the future, it could cause the state to run a deficit, or exacerbate an existing deficit. Even if Missouri were to scale back or eliminate its incentive programs, it could still end up paying out credits in the future as they are redeemed. The uncertainty of when these tax credits will be redeemed makes it difficult for policymakers to forecast and plan future budgets. The tax credits will be redeemed at some point — just not necessarily during the same year that they were issued.

Missourians would be better off if the state government took a hands-off approach to economic development instead of providing subsidies to private companies.

Consumers would benefit because they would be able to purchase goods at a lower cost instead of subsidizing private firms with their tax dollars. Producers in other industries would also benefit, because they would not be forced to compete at an artificial competitive disadvantage. Missouri residents would be better off if the state government widened the tax base by reducing rates and eliminating targeted tax credits instead of continuing to subsidize specific industries in the market. The region would be better off if its resources — human and otherwise — were employed in activities that do not require subsidies. As a direct consequence, the region would have the capacity to produce more, and individuals in the market would be able to keep a greater percentage of their income.



Missouri's tax credit programs have not fulfilled their stated purposes, and spending more on them will not likely result in better outcomes. Missouri's tax dollars would be much better spent in the hands of individual Missourians than on enticements for companies like IBM and Ford.

If Missouri's state government officials are serious about promoting economic development, they will stop attempting to pick and choose the economic activities that occur within its borders. This strategy didn't work for the Soviet Union, and it won't work for Missouri, either.

For more of the Show-Me Institute's research about tax issues, visit www.showmeinstitute.org.

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SHOW-ME INSTITUTE POLICY AREAS

TAXES

Our economy works better when the tax system is simple, fair, and lets workers keep more of the money they earn. Show-Me Institute scholars study the impact of tax and spending policies, and develop reforms that will give us more for our tax dollars and spur faster economic growth.

EDUCATION

The latest education research confirms what common sense has always told us: Kids learn better when their parents have more choices. The Show-Me Institute studies how to empower parents by expanding educational options and providing them with better information, so that every child can attend a school that best meets his or her unique needs.

CORPORATE WELFARE

From eminent domain abuse to subsidies and tax breaks for the powerful and well-connected, government officials often try to pick winners and losers in the market. The Show-Me Institute develops policy recommendations to protect property rights and promote economic growth without caving in to demands for corporate welfare. Secure property rights encourage investment and entrepreneurship. Trying to create economic success through government intervention is a formula for failure.

HEALTH CARE

The standard employer-based model for health insurance leaves a remarkable number of people out. The Show-Me Institute highlights the ways that a consumer-driven, market-based model for coverage can help more people get the care they need while taking ownership for their own health and lifestyle decisions.

PRIVATIZATION

Many government services can be provided more effectively, and at a lower cost, by the private sector. When public services are provided by private industry, economic incentives and accountability provide a critical feedback loop that is largely absent in government bureaucracy. Show-Me Institute scholars analyze public programs to determine how taxpayers can benefit from market-based alternatives.

RED TAPE

One thing that government officials do well is establish barriers to market innovation and erect hurdles for entrepreneurs to clear. The Show-Me Institute is committed to showing how burdensome regulations stand in the way of economic growth and individual prosperity. Market solutions lose their strength when bound by red tape.

Show-Me Institute

ADVANCING LIBERTY WITH RESPONSIBILITY BY PROMOTING MARKET SOLUTIONS FOR MISSOURI PUBLIC POLICY

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