

Bacon's Rebellion

Reinventing Virginia for the 21st Century

Tax Incentive Disease

By James A. Bacon - Posted on October 9, 2012

The Cato Institute and I share a pet peeve: business tax incentives. In its “Fiscal Report Card on America’s Governors 2012,” author Chris Edwards chastises a practice that is prevalent in Virginia: the granting of special-interest tax breaks to favored businesses under the guise of economic development. States the report:

While some governors are pursuing broad-based tax reforms, others are trying to micromanage their states’ economies with “tax incentives.” These narrow, special-interest tax breaks have spread like a contagious disease over the last decade or so. Most states now offer dozens of tax incentives targeting favored types of businesses and activities.

Tax incentives are bad policy for several reasons, writes Edwards. They create unequal treatment between different companies and industries. They favor businesses that have good lobbyists or pander to the economic-development fad of the day. Incentives also create compliance burdens because bureaucrats need to audit companies to see if companies delivered on the investment and job creation they promised as a condition for getting the taxbreaks. (Furthermore, I would add, tax incentives are not transparent. They don’t appear in state budgets as line-item expenditures.)

The misuse of tax breaks is a nonpartisan affliction, highlighting the hypocrisy of both political parties. “Republican governors often claim allegiance to free markets, but their support of tax incentives amounts to support of central planning,” says Edwards. Likewise, Democrats rail against special treatment for the rich and powerful, and then turn right around and shower them with tax benefits.

I totally agree with Edwards’ conclusion: “The spread of state tax incentives represents a troubling move away from free markets and toward crony capitalism, similar to what we have seen at the federal level in recent years. ... Policymakers at all levels of government need to understand that we will achieve the strongest economic growth if we have low and neutral taxation that treats all industries equally.”