GOVERNING
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Tax Incentives' Bipartisan Folly

William Ruger and Jason Sorens

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Tax rates are a critical factor that businesses pay attention to when deciding where to invest. That may sound like a conservative belief, but when it comes to attracting investment and jobs to their states, Democratic governors use corporate tax incentives and economic development zones at least as much as their Republican counterparts.

Consider the example of New York Gov. Andrew Cuomo. Promoting one of New York's many tax incentive programs, Cuomo argued earlier this summer that "businesses do not come to New York state without government incentives. Businesses literally shop states. ... It literally takes money to make money."

Cuomo is right, to some extent. States and cities are bending backward to provide incentives for companies such as Amazon to set up shop, yet the fact that these incentive programs attract particular businesses does not mean they are conducive to economic growth in general. States are better served through broad-based tax cuts rather than incentive programs. Just like direct subsidies, tax incentives and economic development zones, with their preferential tax and development policies, distort sound business decisions, place government in the role of picking winners and losers, and undermine the rule of law.

New York is one of the worst offenders. According to Good Jobs First, since 1980 the Empire State has offered more than $34 billion in 127,154 different subsidy programs, far more than any other state. In subsidy dollars per capita, only five states exceed New York, three of them blue (New Mexico, Oregon and Washington state) and two red (Kentucky and Louisiana). Apart from blue Hawaii, states with the lowest subsidies per person are red or purple: the Dakotas, New Hampshire and Wyoming.

New York is a typical blue state, with high taxes and regulations on business, but Albany tries to compensate for those disadvantages with targeted incentives. How well does this model work compared to the red-state model of deregulation, right-to-work laws and low taxes on labor and investment? In our biennial Cato Institute study, *Freedom in the 50 States*, we have found year after year that states with lower tax and regulatory burdens -- more economic freedom -- see faster income growth.

To be sure, red states indulge in corporate welfare as well, but these states are less likely to have broad-based income and sales taxes, which mitigates some of their ability to dole out special favors using narrow exemptions and credits. But regardless of who is adopting incentive programs -- conservative or progressive governments -- they rarely make sense.

Why don't tax incentives offset the disadvantages of high tax rates? There's a clear opportunity cost. The more generous the tax incentives are, the higher tax rates have to be elsewhere to collect the same amount of revenue. Moreover, narrow, placed-based tax incentives, such as the "opportunity zones" in the otherwise beneficial federal Tax Cuts and Jobs Act of 2017, encourage businesses to locate in places that aren't the most efficient for production.

Politicians will tend to overuse targeted tax incentives because they create a clientele of voters (the "ribbon-cutting" phenomenon). Broad-based low tax rates do not create a committed political constituency in the same way. But a state-by-state comparison shows that low taxes and other pro-market policies are the best way to grow jobs and economies.

New York has the highest tax burden in the country and the most incentive programs. Florida, by comparison, is a right-to-work state with no personal income tax. Florida and New York are about the same on land-use regulation, although Florida has no rent control. Yet Florida is doing better economically and is the biggest destination for New Yorkers moving out of state. And we aren't just talking about retirees: The biggest five-year age group of New York-to-Florida migrants is 20-to-24-year-olds.

Of course, Florida also has room to improve. It gives out a vast number of special sales-tax exemptions, but low and declining tax and debt burdens and competitive labor laws have helped Florida build the third-fastest-growing economy in the South since 2008, after similarly economically free Texas and South Carolina.

Overuse of tax incentives is a problem for all states. One way to stop the subsidy war is to create an interstate compact that restricts the ability of states to compete for investment with targeted subsidies. As the researchers at the Mercatus Center at George Mason University put it, think of it like multilateral disarmament -- against bad economic policy.

The problem with tax incentives is not that they don't work to attract business. They do, but at often unseen costs. Those costs aren't worth it.

William Ruger is a research fellow in foreign policy studies at Cato Institute. He is also vice president for research and policy at the Charles Koch Institute and vice president for research at the Charles Koch Foundation.

Jason Sorens is an adjunct scholar at Cato Institute. He is also a lecturer in the Department of Government and Program Director of the Political Economy Project at Dartmouth College. His research focuses on fiscal federalism, U.S. state politics, and worldwide movements for regional autonomy and independence.