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COMMENTARY

CORPORATE WELFARE:

IF BUSINESS LOCATION INCENTIVES DO NOT WORK, WHY DO LOCALITIES CONTINUE TO OFFER THEM?

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The state of Minnesota offered Northwest Airlines a financial package worth nearly $838 million as an incentive to build two new aircraft maintenance facilities intended to create one thousand five-hundred new jobs in late 1991.[221] Northwest has since put the project on hold and no new jobs have yet been created.[222] In 1993, Alabama assembled a $300 million incentive package to attract a Mercedes-Benz plant which would employ one thousand five-hundred workers.[223] The tax breaks and other subsidies provided by the state of Alabama amount to $200,000.00 per job.[224] These are but two high profile examples of a practice frequently used by localities that has become known as "corporate welfare."

State and local governments provide a variety of inducements to persuade private industries to locate in their areas. Corporate welfare takes the form of property and sales tax abatements or exemptions, low interest loans, grants, utility credits, and other financial incentives given to companies by states and localities with the expectation that these companies will bring with them more jobs and increased revenue for the residents of those communities. Because these programs are largely promise- based rather than performance based, they often fail to meet expectations. Despite the overall inefficiencies of business location incentives, other factors assure their continued use.

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[221] David Phelps, *Northwest Deal Approved*, Star Trib. (Minneapolis-St.Paul), Dec. 17, 1991, at 1A.
[222] Phil Bereano & Todd Fedorenko, *Hooking High-Tech – For a Price – Corporate Welfare in Washington – Subsidies, Incentives Don't Always Pay Off*, Seattle Times, Mar. 23, 1997, at B7.
[223] E.S. Browning & Helene Cooper, *Alabama Won The Business, But Some Wonder If It Also Gave Away the Farm; Will Image Now Improve?*, Wall St. J., Nov. 24, 1993, at A1.
[224] Allen R. Myerson, *Alabama Paying Dearly to Have Mercedes Plant*, Greensboro News & Record, Sep. 8, 1996, at E1.

Local economic development plans including location incentives are not only used to attract new industries, but also to keep existing businesses from relocating. In 1993, New York City revised its tax apportionment formula for corporations to encourage Dreyfus and other financial companies to stay in the city.[225] Similarly, Illinois taxpayers gave Sears a land package and cash worth $240 million to help Sears move its corporate headquarters thirteen miles as an alternative to relocation out of state.[226] Surprisingly, economic development programs are generally not based on corporate financial need. Incentive programs are often offered to financially stable corporations and yield almost no benefit to localities.[227] An extreme example occurred in Baton Rouge, Louisiana where the Exxon Corporation received more than $14 million in tax abatements and was expected to create only one new permanent job.[228]

Additionally, such programs are not offered exclusively on the state and local level. The federal government too has been criticized for using millions of taxpayer dollars to promote sales of American products overseas.[229] In 1992, the Federal Agricultural Department gave $465,000 in tax money to subsidize McDonald Corporation's commercials advertising Chicken McNuggets and $450,000 to the Campbell Soup Co. to promote the sales of V8 juice overseas.[230] The advertisements were part of a Market Promotion Program funded with $200 million in taxpayers' money.[231]

Despite what seem astronomical costs, municipal officials continue to offer subsidy programs in the hope that they will create employment opportunities and expand the local tax base, thereby stimulating and promoting a healthier overall economy. One commentator notes that the advantages of local economic development programs fall into two general categories - local autonomy and economic competitiveness.[232]

The power to grant location incentives and subsidies designed to attract corporate investment may be construed as an exercise of local

[225] Paul R. Kahan, *State Economic Development Initiatives*, Tax Executive, Nov. 21, 1996; *available in* 1996 WL 9885182.
[226] Bereano, *supra*note 2, at B7.
[227] *See, e.g.*, Mike Meyers, *Government Subsidies for Private Businesses Ought to Be Stopped*, Star Trib. (Minneapolis-St.Paul), Dec. 1, 1995, at 2D.
[228] *See* Kary L. Moss, *The Privatizing of Public Wealth*, 23 Fordham Urb. L.J. 101, at 108 (1995).
[229] *See* Catherine S. Manegold, *Labor Secretary Urges Cuts for Corporate Welfare Too*, N.Y. Times, Nov. 23, 1994, at A19.
[230] Jennifer Dixon, *$200 Million From Taxpayers Help Finance Ads*, Orange County Register, Feb. 3, 1992, at A1.
[231] *See id.*
[232] Mark Taylor, Note, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 Tex. L. Rev. 669, 691 (1994).

autonomy and this serves as a powerful justification for such incentives.[233] Offering attractive investment incentive packages gives municipalities the power and the freedom to shape their own destinies. Supporters argue that economic incentive programs are selective by nature and that this allows localities to target companies that meet essential criteria including job creation, construction control, neighborhood improvement, tax income, and economic diversification.[234]

Furthermore, by offering incentives, state governments show their desire to create a pro-business environment.[235] Many states and localities offer incentive programs to project an economically competitive community image. Others feel they have no choice but to offer incentives or lose coveted businesses and industries to other locations.[236] There is substantial competition between states and municipalities to attract economic opportunities.[237] Proponents of incentive programs contend that local incentive programs are solid public investments and are vital to the creation of new jobs.[238] But are they?

Many studies have attempted to measure the effectiveness of incentive packages in promoting economic development and creating job opportunities for local residents.[239] The consensus is that corporate location determinations turn on a number of factors, the majority of which cannot be altered by localities.[240] One commentator has summarized the primary factors cited by companies regarding site selection decisions to include "(1) location of suppliers and markets, (2) the costs and quality of available energy and land, (3) the cost of capital, (4) the availability and cost of housing for management and employees, and (5) security and other amenities."[241] Additionally, there is evidence that intangible psychological pressures, described as the "herd instinct" play a role in location determinations.[242]

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[233] *See id.*
[234] *An Attractive Idea Offering Hewitt Associates $500,000 in Incentives to Move to Orange County is Not Corporate Welfare. It's a Smart Business Move*, Orlando Sentinel, Jan. 3, 1997, at A8 [hereinafter *Attractive Idea*].
[235] Taylor, *supra* note 12, at 691.
[236] Matthew T. Furton, Note, *The Use of Penalty Clauses in Location Incentive Agreements*, 70 Ind. L.J. 1009, 1017 (1995).
[237] Martin Gold, *Economic Development Projects: A Perspective*, 19 Urb. Law. 198, 198 (1987).
[238] Edward P. Lazarus, Note, *The Commerce Clause Limitation on the Power to Condemn a Relocating Business*, 96 Yale L.J. 1343, 1361 n.91 (1987); *see also* Furton, *supra* note 16, at 1017.
[239] *See* Furton, *supra* note 16, at ---; *see also* Lazarus, *supra* note 18, at ---.
[240] Gold, *supra* note 17, at 198.
[241] *See id.*
[242] *See id.*

Researchers generally agree that firms initially satisfy their expansion needs by expanding existing sites or building satellites nearby.[243] When companies do relocate, research suggests that businesses first select a geographic region then compare communities based on factors significant to the type of venture involved.[244] Commentators characterize corporate investment as a long-term profit-oriented decision.[245] Areas failing to offer long-term profitability criteria such as infrastructure quality, fiscal stability and general business climate will not be able to offer enough special incentives to attract and retain businesses.[246] However, supporters contend that incentives "can and do make a difference in tilting a business toward picking a given community."[247]

Setting aside the debatable effectiveness of incentives in enticing corporations to choose a particular location, how effective are they once a company gets there? Critics challenge the ultimate effectiveness of local incentive programs on several grounds.[248] Financial incentives are often attacked as disguised government spending frequently offered with no analysis or accountability.[249] Tax incentives are often not considered expenditures and therefore are frequently not budgeted prior to being offered or evaluated to determine their effectiveness.[250]

Critics also charge that the provision of municipal incentives directly reduces the public resources available for other investments essential to economic development such as education and infrastructure improvements.[251] Alabama was driven to spend beyond its means to attract Mercedes.[252] To keep its $300 million dollar promise to Mercedes, Alabama raided its education fund, borrowed from its state pension fund, and called out the National Guard for a "training mission" to clear the land for the plant site.[253] Critics contend that attracting businesses with a community's solid assets such as a well-developed infrastructure and an educated, skilled work force is far better than using incentives.[254] Not only would dollars invested in the local infrastructure be more likely to

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[243] Jennifer L. Gilbert, *Selling the City Without Selling Out: New Legislation on Development Incentives Emphasizes Accountability*, 27 Urb. Law. 427, 434 (1995).
[244] *Id.*
[245] Moss, *supra* note 8, at 108.
[246] *Id.*
[247] *Attractive Idea*, *supra* note 14, at A8.
[248] *See* Furton, *supra* note 16, at 1016-17.
[249] *See id.* at 1016; *see also* Richard D. Pomp et al., *Can Tax Policy Be Used to Stimulate Economic Development*, 29 Am. U. L. Rev. 207, 218 (1980).
[250] Richard D. Pomp et al., *Can Tax Policy Be Used to Stimulate Economic Development*, 29 Am. U. L. Rev. 207, 218 (1980).
[251] Furton, *supra* note 17, at 1016.
[252] Myerson, *supra* note 4, at E1.
[253] *See id.*
[254] Larry Hufford, *Recruit Only Businesses That Benefit Cities*, San Antonio Express-News, Dec. 4, 1996, at 5B.

substantively influence a corporation's decision to relocate, but those investments are guaranteed to serve the community in the long term.

Additionally, authorities argue that incentive programs benefit new businesses at the expense of existing businesses.[255] "The principal inequity may be that they place other businesses, which do not qualify for tax abatement at a competitive disadvantage."[256] For instance, Iowa gave $738,000 in tax abatements to Iowa Beef Processors, a subsidiary of Occidental Petroleum Corporation.[257] Critics contend this assistance may drive many smaller meatpackers out of business.[258] An extension of this criticism is the claim that assistance to one business amounts to discrimination or favoritism by the government toward that entity.[259]

Others have argued further that incentives are actually detrimental because they distort free-market competition and misallocate resources.[260] Incentive programs are perceived as an interference with the market in its natural form which will produce negative consequences which override any benefits they may yield.[261] This view "emphasizes that when government induces businesses and jobs to move, it does so at the expense of another location. Thus, government assistance merely moves jobs from one location to another, with a zero sum game nationally."[262]

Economists argue that competitive markets lead to the most economically efficient allocation of resources and determine how much of each good will be produced.[263] Critics counter that interference with naturally competitive efficient markets leads to a misallocation of resources.[264] If a locality grants a subsidy to a business already enjoying a competitive advantage over the rest of its industry, the subsidy leads to an "underallocation of productive resources to that industry."[265] The subsidy may give the business enough market power to restrict output and drive up its profits by increasing prices.[266] "[S]ociety loses the net benefit of the production that would have occurred in the competitive market."[267]

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[255] Furton, *supra* note 16, at 1016.
[256] Andrew L. Kolesar, Note, *Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development*, 44 Tax Law. 285, 296 (1990).
[257] *See id.*
[258] *See id.*
[259] Gold, *supra* note 17, at 229.
[260] *See*, *e.g.*, Furton, *supra* note 16, at nn. 46-49 and accompanying text.
[261] Gold, *supra* note 17, at 229.
[262] *See id.* at 199.
[263] Taylor, *supra* note 12, at 680-81.
[264] *See id.* at 681.
[265] *See id.*
[266] *See id.*
[267] Taylor, *supra* note 12, at 680-81.

If a locality manages to persuade a business to locate in its area, how likely is it that they will stay? Some companies threaten to relocate to pressure localities into offering incentive programs.[268] Businesses that relocate primarily because of investment incentives are likely to move on again when they get a better offer.[269] In 1991, General Motors Corporation announced that the company would cease operating at its Willow Run Plant in Ypsilanti, Michigan and would relocate in Arlington, Texas.[270] Only four years earlier, GM had promised to maintain nearly five thousand jobs at its Willow Run plant for twelve years after receiving significant tax abatements.[271] Texas offered an incentive package designed to induce General Motors to close the Michigan plant rather than the one in Texas.

Furthermore, there is a human cost to location incentives rarely considered by municipalities. Critics argue that location incentives encourage corporations to change locations frequently without regard for the disruption of the lives of their employees that results.[272] Others believe that large corporations which expand into small communities draw the most talented workers in the area preventing them from developing entrepreneurial enterprises which may be of greater long term value to the community.[273]

However, even as ineffective as such local incentive programs may appear, municipalities continue to clamor for the attention of corporations and compete with each other by offering them. The widespread use of subsidies and local incentive programs and the trend toward escalation of these programs "illustrates a belief by public administrators that they are sound public policy."[274] Critics charge that incentive programs exploit localities' fears that businesses will move elsewhere forcing states into competition with one another.

In an attempt to counteract this trend, some regions have attempted to formulate agreements to address the problems that stem from competitiveness among states. In late 1991, New Jersey, Connecticut, New York State, and New York City signed a "non-aggression" pact designed to reduce the competition among them.[275] The agreement was designed to set limits on the subsidies and incentives each was offering to

[268] Furton, *supra* note 16, at 1016-17.
[269] Hufford, *supra* note 34, at 5B.
[270] Charter Township of Tpsilanti v. General Motors Corp., 506 N.W.2d 556, 558 (Mich. 1993).
[271] *See id.* at 557-58.
[272] Furton, *supra* note 16, at 1017.
[273] Taylor, *supra* note 12, at 685.
[274] Furton, *supra* note 16, at 1018.
[275] Furton, *supra* note 16, at 1014.

attract and retain businesses.[276] Within the first year of the pact's signing, all four participants had "essentially disregarded the voluntary agreement and returned to their earlier practice of raiding each others' businesses."[277] In fact, the incentives and subsidies offered after the collapse of the non-aggression pact were more complex than the ones offered before the signing of the compact.[278]

Furthermore, political forces have become important motivators for local officials to increase their use of location incentive programs.[279] The survival instincts of political incumbents combined with campaign promises of job creation and increased economic development lead communities to offer incentive packages that are not justified based on their cost and projected return.[280] "Moreover, elected representatives perceive financial inducements to be a low cost method of job creation, at least when compared to public works programs."[281] It is contended that another common reason that governors and mayors continue to offer incentive packages is to simply create the appearance for their constituents that they are creating jobs.[282] "By taking visible steps to encourage economic growth, they can take credit for subsequent economic successes, whatever their actual causes...."[283] Political pressures make it difficult for mayors and governors to eliminate the use of incentive programs. Because they appear to work, the risk is too high that the companies will locate elsewhere.[284]

Local officials faced intense political pressures when Toyota Motor Manufacturing USA, Inc. ("Toyota") selected Scott County, Kentucky as a potential site for a new facility.[285] Kentucky had, just months earlier, lost a bidding war for a Saturn facility to the state of Tennessee.[286] Kentucky's state pride was at stake and the governor was facing increasing pressure to bring an industrial 'success' to the state.[287] These factors are cited as contributing to the size of the incentive package Kentucky offered.[288] Similarly, in the midst of the bidding war preceding the eventual deal between Sears and the State of Illinois, a state official commented, "'We

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[276] *See id.*
[277] *See id.*
[278] *See id.*
[279] Furton, *supra* note 16, at 1012.
[280] *See id.*
[281] *See id.*
[282] *See* Furton, *supra* note 16, at 1012-13.
[283] Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Restraints on State Tax Incentives for Business*, 110 Harv. L. Rev. 377, 394 (1996).
[284] *Getting the Job Done*, Cap. Dist. Bus. Rev. (Albany, N.Y.), June 24, 1996, *available in* 1996 WL 10010654.
[285] Furton, *supra* note 16, at 1012.
[286] *See id.* at 1012-13.
[287] *See id.* at 1012-13.
[288] *See id.* at 1013.

think it's important for the city's image to keep an important corporate citizen."[289]

If incentives are successful, or at least are perceived as a successful means of attracting and retaining business, then states will continue to use them.[290] Location incentive programs, including tax incentives, will continue to be offered, primarily because "the political rewards are still tempting."[291] State and local officials find themselves trapped in a prisoners dilemma.[292] Competing localities would enjoy the greatest economic benefit if no incentives were offered.[293] However while states and localities may communicate their desires to one another, they have no means to enforce an agreement not to grant subsidies.[294] "Faced with the likelihood that some governments will cheat and enact incentives, other governments will follow suit to ensure they are not placed at a competitive disadvantage."[295]

Ultimately, the effects of incentive programs may not be realized, analyzed or documented, until years later, if at all.[296] This gives governments and local officials all the freedom and incentives they need to continue to compete for new businesses.[297] Although substantial evidence demonstrates the costliness and inefficiency of business location incentives, because of their apparent effectiveness and the highly competitive nature of today's market, their use continues to increase.

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[289] Lindsey Tanner, *Illinois Scrambles to Keel the Sears Address in Chicago*, Wash. Post, Feb. 21, 1989, at D1.
[290] Kolesar, *supra* note 36, at 297.
[291] *See id.* at 307.
[292] Taylor, *supra* note 12, at 693.
[293] *See id.*
[294] *See id.*
[295] *See id.*
[296] Kolesar, *supra* note 36, at 307.
[297] *See id.*