

"OUTSIDE THE BOX": THOUGHTS ON UTAH'S CORPORATE INCENTIVE PROGRAM

RESPONSIBLE CITIZEN SUMMARY

Background

- The Governor's Office of Economic Development (GOED) selects a few businesses every year for millions of dollars in tax breaks as an "incentive" to produce jobs
- These government handouts are patently unfair and weaken the state's economy
- Incentive programs are unnecessary in Utah, where the most important attractive factors to businesses exist in abundance
- Incentive programs invite corrupt and unethical practices

What's at stake?

- The meaning of the free-market and the state's entrepreneurial heritage
- Utah's economic strength and Utahns' job stability

What's next?

- The state should encourage diversity in K-12 education to develop "outside-the-box" minds that can take advantage of 21st-Century economic opportunities
- The state should repeal the corporate income tax, establish a level playing field, and create an inviting environment for free-market entrepreneurs

Responsible *Citizenship*[™]

The state needs to adopt a new vision of economic development and end the practice of arbitrarily giving handouts to a few favored businesses.

Every month or two we see essentially the same photo and story in the newspaper. Prominent elected officials stand with gold shovels in hand, hard hats on head, in a line with corporate bigwigs similarly adorned: Utah's Office of Economic Development has just handed out another basket of promised cash and tax credits to (as they say) lure a corporation into Utah or to keep one here. In September 2009, for example, the state approved another \$27.3 million for the financial firm Goldman Sachs, bringing its total haul of state incentives to \$47.3 million.¹ In mid-October, the favored corporation was Edwards Lifesciences, which graciously "accepted" an unspecified package of grants and tax credits to expand its manufacturing presence in Utah.²

Tad DeHaven of The Cato Institute calls such behavior "press release economics," allowing state governors and key legislators to focus on the dramatic announcement, rather than the more difficult tasks of broadly lowering taxes and reducing regulation. When critics complain, the governors respond: "Everyone else does it; so must I." Or as the Economic Development Corporation of Utah puts it, "Companies interested in relocating or expanding expect to be courted by local, regional and state development agencies."³

However, as every parent of a teenager knows, the "everyone else does it" argument is immediately suspicious. Questions need to be asked: Are such incentive programs fair? Do they work? Are they really necessary?

The easiest to answer is the first: **State economic incentive programs are patently unfair.** At the most obvious level, such narrowly-cast special favors give advantages to a few firms, often at the expense of their competitors – companies which pay the full state corporate tax and otherwise play by the rules of a free market. Advocates of incentive packages respond that these companies could also seek special aid. Yet this merely politicizes more jobs and turns market entrepreneurs into political “rent seekers,” currying the favor of state officials. The human energy and time spent by businesses searching for government cash and special tax breaks are time and resources not spent developing, improving, and introducing new products to market.⁴

Indeed, state incentive packages allow corporations operating in multiple states to “work the system.” As Peter Fisher of the University of Iowa reports, companies carefully analyze apportionment formulas for allocating revenues to these several states, manipulating them in ways that leave some portion of corporate income untaxed anywhere.⁵ Again, this time-consuming, accountant-heavy process diverts firms from more useful research tasks and – in the aggregate – damages all the states affected.

Second, these state economic incentive programs do more harm than good. Such efforts, whether tax credit- or subsidy-based, are at best “job stealers, not job creators.” States cannot create private-sector jobs; they can only move them around.⁶ The cost for each “new job” can actually be quite staggering. When Alabama won the 2003 contest for a new, 2000-employee, Hyundai auto plant, the cost was a staggering \$117,500 in government incentives per job. This paled in comparison, though, to the \$170,000 per job paid by the same state to Mercedes-Benz, a decade earlier.⁷

While these numbers are at the extreme, the evidence is strong that states rarely, if ever, generate enough new revenue from the new plant or facility to offset costs. Professor Fisher has carefully analyzed the effects of incentive programs in 17 states. He found that, on average, only nine percent of the new jobs in affected factories or offices could be attributed to incentives. The balance would have come or stayed anyway. When comparing lost revenues to state income later gained, the results were also sobering: “Cost per induced job of these incentive entitlements... averaged about \$46,000 among the various manufacturing sectors.... Furthermore, the fiscal effect never turned positive; even by year 20 the annual revenue loss was still \$6,500 per job.”⁸ Examining data from all 48 contiguous states, Harold J. Brumm, an economist with the General Accounting Office in Washington, DC, concluded that state incentive programs actually had a “relatively large negative effect on the rate of state economic growth.”⁹

Moreover, “incentive-driven” state economies prove to be fragile. Some projects actually blow up in the “winning” state’s face. Indiana, for example, celebrated when Indianapolis landed a new, billion-dollar maintenance facility for United Airlines. State, county, and city incentives totaled \$320 million; United promised 7,500 new jobs. Yet subsequent turmoil in the airline industry, including United’s own bankruptcy, brought disappointment. Jobs peaked at only 3000; by 2003, the number was down to 1000. The airline paid certain penalties, but dodged others. Meanwhile, city and state taxpayers were left paying off \$300 million in bonds issued to fund the facility’s construction.

Utah’s “performance-driven” incentives may avoid some of these potential disasters, but not all. The case of Ireland looms large here. Starting in the mid-1990s, Ireland

showered generous incentive packages on companies, with apparent success. Boosters claimed that “if incentives were all that mattered, Ireland would have *all* the attractive corporate facilities in the world gathered on its island nation.”¹⁰ Alas, the current global crisis has hit the Irish economy especially hard. “Incentivized” companies are fleeing the land. And Ireland’s unemployment rate has soared to 12.4 per cent, second worst in the Euro zone, “as the economy continues to unravel amid the recession, a property market depression and runaway debts.”¹¹ The lesson may be that an economy built on state incentives is an economy resting on sand.

Third, state economic incentive programs are unnecessary, especially in Utah. As even cheerleaders for state incentives on the business side will candidly admit, while schemes of this sort may seem important, the “traditional location factors still take precedence.”¹² As in real estate, the bottom line remains “location, location, location.”

And on these terms, Utah will usually win. The state offers a [magnificent physical setting](#), the nation’s [youngest workforce](#), the nation’s [best educated workforce](#), the nation’s [highest level of active religiosity](#) (which predictably would raise levels of honesty, integrity, and hard work), the [most livable and affordable cities](#) (according to several independent surveys), and a [valuable geographic location](#) at the center of the growing intermountain West. With these real advantages already in place, state corporate incentives are simply a waste of money.

Finally, such programs are both politically-suspect and backward-looking. Officials in the Office of Economic Development have a “targeted cluster” of favored industries, including “software and information technology,” “aviation and aerospace,” and “life sciences.” They

get preference when government largesse is handed out. However, viewed both in terms of history and political science, this is merely another version of central economic planning, a “soft” form of socialism which Friedrich Hayek warned about in his classic work, *The Road to Serfdom*. Central state planning poses a host of dangers, ranging from cronyism (“deals among friends”) to varied forms of corruption (such as direct and indirect bribes).

Even if those pitfalls are avoided, state economic planners *always* get the future wrong. Like generals facing new circumstances who still fight the last war, government planners will safely invest in last year’s technology. Throughout Utah, there are young people dreaming of new forms of communication and knowledge enhancement that could quickly make Facebook, Google, and Microsoft as obsolete as the VCR tape. There are others, young and old, tinkering in garages who could produce a pollution-free fuel out of waste water, or invent science fiction’s “transporter” and “warp drive.” And there are still others, unbound by conventional thinking, who may develop a cure for cancer. While they will – if successful – eventually be taxed by the state, these true innovators would never receive a state incentive package when it might have done some good. To begin with, they cannot afford the public relations specialists, the fancy proposals, and the creative accountants that impress the state’s Office of Economic Development. Moreover, these sorts of innovations involve a high degree of risk. For every transformative economic success, there will be a thousand or more incompletes and failures. The clumsy hand of government should stay out of the process.

Can the State of Utah do *anything* to encourage a real culture of enterprise and innovation – that *will actually produce new jobs*? Yes, two approaches stand out.

- 1. The state should encourage educational pluralism.** Learning how to “think outside the box” is difficult in the bureaucratized, unionized, standardized-test-driven entities known as public schools. Whatever the claims, such schools excel at regimentation, predictability, and inertia: all good for old-style factory and office jobs, but poor at sparking fresh thinking. Indeed, real student creativity gets in the way of a well-managed school day. Instead, the state should favor schools that are open to eccentricities, peculiarities, and innovations among the young. Charter schools, informal cooperative schools, home schools, private academies, church schools: because of their very variety, these learning places are more likely to nurture the creative geniuses that will shape Utah’s economic future. Home-schooled students, for example, constitute only less than four percent of all American school children, yet they regularly dominate state and national science fairs and engineering, spelling, and geography competitions. Truly new ideas are more likely to come from them.
- 2. If Utah really wants to be fair, effective, and business-friendly, the state should abolish both its corporate incentive program and its corporate income tax.** Eliminating the former would actually help pay for the latter. Meanwhile, ending the corporate income tax would make Utah truly business-friendly and encourage all private businesses, not just those favored by a state committee. In this way, Utah’s inherent advantages – youth, basic education, landscape, livability, religiosity, and location – would be substantially enhanced.

Indeed, I predict that the entire economic world would quickly beat a path to Utah’s splendid mountains, valleys, plains, and people.

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ENDNOTES

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