AMERICAN ECONOMIC LIBERTIES PROJECT

House Committee on Finance
Rhode Island House of Representatives
82 Smith Street
Providence, RI 02903

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Testimony in Support of H5316 – Pat Garofalo, Director of State and Local Policy, American Economic Liberties Project

I write today in strong support of H5316, the Agreement to Phase Out Corporate Giveaways Act. Forming an interstate compact to curb and eventually eliminate the use of company-specific tax incentives, thereby creating a legally-binding agreement with like-minded states to abandon decades of failed economic development strategies, will help save Rhode Island taxpayers money, level the playing field for small businesses, and allow elected officials to focus state resources on policies that boost overall economic growth and quality of life for Rhode Island residents.

States across the country spend tens of billions of dollars on company-specific corporate tax incentives annually. Rhode Island, according to disclosed records, has spent more than half a billion dollars on such incentives, most of that since 2011.[1]

According to the vast bulk of the research done on this policy area, that money is buying next to nothing, as corporate tax incentives have a negligible effect on economic growth, job creation, or incomes.[2] As Prof. Richard Florida, one of America's foremost experts on urban studies, put it, "there is virtually no association between economic development incentives and any measure of economic performance."[3]

There are several reasons why that is the case, but one of the most important is that the vast majority of the time, incentives don't entice corporate leaders to do anything they wouldn't have done anyway, in the absence of incentives, because location decisions are based on several other business factors, such as workforce requirements, supply chains, access to transportation and other infrastructure, and other local laws. According to Tim Bartik of the Upjohn Institute,

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[1] Good Jobs First, Subsidy Tracker, Accessed March 1, 2021

[2] See: Garofalo, Pat, "The Billionaire Boondoggle: How Our Politicians Let Corporations and Bigwigs Steal Our Money and Jobs," Thomas Dunne Books, March 2019; LeRoy, Greg, "The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation," Berrett-Koehler Publishers July 2005; Florida, Richard, "The Uselessness of Economic Development Incentives," CityLab, Dec. 7, 2012 https://www.bloomberg.com/news/articles/2012-12-07/the-uselessness-of-economic-development-incentives; and Slattery, Cailin, and Owen Zidar, "Evaluating State and Local Business Tax Incentives," Journal of Economic Perspectives 34.2. Spring 2020, among many works. https://scholar.princeton.edu/zidar/publications/evaluating-state-and-local-business-tax-incentives

[3] Florida, "The Uselessness of Economic Development Incentives."

between 75 and 98 percent of granted incentives have no bearing on where a firm ultimately chooses to locate.[4]

So that means, at best, incentives are influencing location decisions a quarter of the time. Every other incentive given out is quite simply wasted taxpayer money.

As former U.S. Treasury Secretary and Alcoa CEO Paul O'Neill once said, "If you're giving money away, I'll take it. If you want to give me inducements for something I'm going to do anyway, I'll take it. But good businesspeople don't do things because of inducements."[5]

Why, then, do incentives persist, not just in Rhode Island, but across the country, perpetuating a race to the bottom in which better development strategies are eschewed in favor of never-ending rounds of corporate giveaways? Because there is a prisoner's dilemma at work: No state, understandably, wants to unilaterally disarm while every other state continues to use incentives. No officeholder wants to appear to be doing nothing for their constituents, while those in the next state over are announcing deal after deal, even if the promised benefits of those deals don't actually materialize once the ink is dry. Research has shown that governors' use of incentives increases during the years in which they are up for re-election, because there is political capital to be gained by engaging in giveaways to corporations, even if actual capital doesn't follow in their wake.[6]

This is, at its core, a political problem, not an economic one.

The interstate compact aims to solve this issue by having states multi-laterally disarm, together. By instituting a cease-fire amongst the states, the compact can short-circuit the political attractiveness of incentives and, in the long term, foster the development of more impactful, equitable, and cost-effective economic policies that focus on small businesses and the concrete needs of communities. Because the compact's terms only apply to other compact states, there's no danger of Rhode Island having to go it alone.

Kansas and Missouri implemented a version of this in 2019 in order to prevent corporations from moving across the greater Kansas City metro area — which straddles the border — to claim incentives. That solution deserves to go national, with more robust enforcement mechanisms.

Instituting an incentive cease-fire was a good idea before the current pandemic struck. But it's an even better one now. The pandemic is crushing state budgets and disproportionately harming small businesses, while corporate incentives provide little return for taxpayers and disproportionately go to larger companies. States are paying for the privilege of putting their own small businesses at a disadvantage vis-a-vis larger, national chains, and making their budget situations worse while doing so.

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[4] Bartik, Timothy J., "'But For' Percentages for Economic Development Incentives: What percentage estimates are plausible based on the research literature?" Upjohn Institute Working Paper 18-289. July 1, 2018 https://doi.org/10.17848/wp18-289

[5] Treasury Secretary Nomination Hearing, Jan. 17, 2001. https://www.c-span.org/video/?161899-1/treasury-secretary-nomination-hearing

[6] Slattery and Zidar, "Evaluating State and Local Business Tax Incentives."

At the American Economic Liberties Project, we've seen up uptick in interest in incentive reform since the pandemic for that very reason – there's no money to spare on failed initiatives in a moment of such acute economic distress. With at least 10 other states having introduced versions of the same legislation, the moment is now to begin to make the compact a reality.

Entering a compact is also good for democratic accountability. Too often, incentive deals are cloaked in secrecy, with corporate leaders having more information about what states are promising in terms of public resources than elected leaders themselves, or the general public. By facilitating information sharing and the development of best practices, the compact can foster the introduction of transparency and accountability to a policy area desperately lacking both.

There will be pushback to this idea, of course. Business leaders and trade associations always say that cutting corporate incentives will lead to job losses. But Rhode Island's own experience shows that to be false: When incentives from the state's Jobs Development Act shrank between fiscal year 2016 and 2017, and individual beneficiaries such as CVS and Citizen's Bank saw their total incentives shrink by more than that, those corporations still added jobs in the state.[7]

Ideally, the debate about economic development should be about what builds the best overall economic climate: That means trying to figure out the optimal levels of overall taxation, the right amount of social spending, the proper education and infrastructure investments, and the best policies for promoting quality of life and workplace protections. Instituting the interstate compact would help move the debate there, instead of the problematic place in which it resides today.

Rhode Island should be the first to approve the compact, and lead the charge toward a brighter economic future, not just for Rhode Island's residents, but for all Americans.

[7] Anderson, Patrick, "Cost to R.I. for corporate tax breaks shrinks," Providence Journal, Jan. 26, 2018 https://www.providencejournal.com/news/20180126/cost-to-ri-for-corporate-tax-breaks-shrinks