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Avi Green [00:00:08] Hi, I'm Avi Green. Welcome to No Jargon from the Scholars Strategy Network. Each week we discuss an important policy issue or social problem with one of America's top researchers with no jargon. This week we're going to talk about tax incentives -- those special tax packages and government payments that sweeten the deal for businesses to try to bring them to town and keep them in town creating jobs. Sounds like a really good idea, right? Maybe not. Here to tell us more is Nathan Jensen. Professor Jensen is at the University of Texas at Austin and he has a new brief with the Scholars Strategy Network entitled "Business Location Incentives Are Ineffective. So Why Do They Persist in American States and Localities?" Professor Jensen, thanks so much for being with us on No Jargon.

Nathan Jensen [00:01:01] Thank you for having me.

Avi Green [00:01:03] Why did you decide to study tax incentives in the first place?

Nathan Jensen [00:01:07] Boy, it's a good question. I actually started analyzing international development looking at countries attraction of investment in job creation and actually looking in the United States. United States, ironically has some of the largest tax incentive programs. So despite sort of the belief that the US is in some sense the most free market, there -- actually the United States, at least at the state and local level, offers 50, 60, 70 billion dollars in incentives to companies every year. And this could be anything from a tax incentive, meaning a reduction in your tax rates, to outright cash grants or other forms -- other forms of support. So it's -- it's big money but also tells us a lot about the political process, allows us to understand what politicians are doing to try to both attract investment and generate jobs but also how they like to try to take credit for what's happening in their districts.

Avi Green [00:02:06] So I want to tell you the general case for tax incentives as I see it. And then I want you to tell me like with this, ideally with a specific example, what's -- what's wrong with that case. So here -- here I'm going to lay it out as a non-expert. So businesses could go anywhere. They could move around. I am running the government of a local town, like I'm the mayor or something like that. I really want businesses to come and if I maybe lower the property tax or provide some sort of a tax credit or some other type of way to kind of help the business with their profits then they'll come to my town. They'll hire a lot of people because those people now have more jobs. They'll spend more in taxes and our economy will be bigger locally and everyone will be better off. What's wrong with that?

Nathan Jensen [00:03:01] Right, right. Well, you know the way you tell that story there's nothing wrong with that specific story especially in the context of perhaps a business that really wouldn't have come to your location without that support. And you know a great example is there's a program in Texas called the Chapter 313 program which gives really large tax incentives specifically to manufacturing but also there's a large program that provides wind farms. And the idea is that you abate the taxes, meaning rather than being a billion dollars that you're going to be taxed on, which is the real cost of your capital and equipment, they'll tax you on one hundred million dollars and you know that the great news for the company is you have a lower tax rate for the community. The idea is,while you still get a nice slice of something you wouldn't have got it otherwise the problem with that story is that most of the research suggests that the majority of companies were coming anyways. And again, to give concrete examples, there's a bunch of oil and gas production facilities that are not really going to leave Texas without getting support. So they were probably coming here anyways. And if you're incentivizing them by reducing the amount of taxes you're getting by 90 percent and even if it's just a small number of those companies, that has a huge impact on your ability to collect taxes. So the research shows that about two-thirds of companies to three-quarters of companies were kind of coming anyways or going to expand anyways. And in the end, you end up giving this a large percentage of the tax revenues that you were going to collect without the incentive program to the company.

Avi Green [00:04:39] Well, how do you know that? I mean, how did you study what businesses do, you know if they get an incentive versus businesses that don't?

Nathan Jensen [00:04:51] Sure, sure. Well a couple ways you can -- you can do this. The way that I did it was starting by thinking hard about the companies that were in a state and I did a project in Kansas and a project in Missouri and I'm rolling out a project in Maryland and in Virginia. And essentially what I tried to do is look at the companies that received incentives and look for a matched group, a control group -- a similar set of firms that didn't receive incentive.

Avi Green [00:05:17] And I guess what you'd figure is that the companies that receive the incentives grew -- grew faster, hired more people, contributed more to the -- to the economy didn't go out of business. That sort of thing.

Nathan Jensen [00:05:33] That's exactly right. You would hope that they are performing better with the support, you know, relative to a control set of firms. So that's the first starting point and I did this in Kansas and Missouri and I found that the firms that received incentives essentially didn't create any more jobs than the firms that didn't. In Kansas, there was literally a zero effect. And in Missouri, for every one and a half million dollars in incentives, there was one job created.

Avi Green [00:06:03] Wait, wait. One and a half million? This is becoming one of the more outrageous episodes of No Jargon very quickly. One and a half million dollars per job?

Nathan Jensen [00:06:14] Per job. And the reason why that number is probably higher than any other number you've seen, is often the assumption is all those jobs that were generated under the program were caused by the program, meaning a program that brings in a thousand jobs, you look at how much that costs per job. What I'm saying is that, you know, 75 percent to 66 percent of those jobs were coming anyways. So the cost of most of these programs that are often reported are probably two to three times more than the cost. Again, that's an average but what I tried to do specifically -- look at Kansas and Missouri -- and what I did in Kansas is I actually emailed the companies that received incentives and surveyed them. And again, I wasn't quite sure what kind of responses I would get from them. I asked them, "Would you have generated the same amount of jobs even if you wouldn't have gotten the incentive," and the numbers matched up again. About two-thirds of the companies said "No, we would have gotten the same thing we did anyways. The job numbers would not look any different if you were to cancel this program."

Avi Green [00:07:21] You know, it's interesting because I think that this goes to a general thing that's come up in No Jargon which is that sometimes government policymakers both on the positive side and on the negative side kind of overestimate the impacts of government policies. We had another podcast on the idea of a 15 dollar minimum wage and what an economist was on No Jargon said was that you know, if you had a higher minimum wage and you run a fast food restaurant, the first thing that you would not do is stop selling burgers, right? You would still have a restaurant. The basic fundamentals -- you have burgers, you have to sell them -- you know, are unchanged and you're just trying to kind of do your same thing regardless of that situation. And in this case, whether it is something which might suddenly raise the cost of business or suddenly decrease the cost of business or give you sort of a rebate on the back-end -- the impacts on business might be less either way.

Nathan Jensen [00:08:26] And I think what's interesting, there's so much controversy about companies amassing billions of dollars overseas, for example. So you have Google and a number of tech companies and what's what's interesting to me is that these are not capital-constrained companies. So they're not, you know, it's one thing to talk about a little incubator. It's a tiny startup firm that can't get a loan and you have a government program that helps fund these kind of -- these kind of projects. I mean, that -- there is much more of a sort of logical rationale why this incentive is important versus a really large company that has cash in the bank, has access to capital, has the ability to borrow. They have sort of all the things they need to move forward and then the claim is that you have to swing them with a little bit extra. There are clearly a few cases where it does matter. But you know, as the research suggests, the majority it doesn't matter. So you're throwing extra money at companies that are coming anyways.

Avi Green [00:09:25] Well, let's go back to that first example that you gave of oil wells or drilling companies in Texas getting tax incentives to drill for oil. I have to say you know, here in Massachusetts I wonder if we could set up our own tax incentive program for oil and gas drilling. Somehow, I suspect that that would not bring those Texas companies to Massachusetts because we, I think are missing something in the earth that is kind of important.

Nathan Jensen [00:09:59] Right, right. Well you know, I mean but what's funny is I've spent a lot of time in -- you know the natural resource seems like an obvious one. Of course, there's only certain locations but a lot of tech companies have come to Austin because of the highly skilled workforce and that Austin is both kind of inexpensive enough to get people to move here and you're not competing with as many firms as you are in New York or San Francisco. So, the human capital is here. So that startup tech company might very well choose Austin as a location. So, it's not just natural resources or an auto producer might want to be near its suppliers. So there are a number of reasons why firms choose to locate somewhere and there are very few firms that are going to say, "We could go anywhere in the country. Let's see the bid of the 50 states and we'll pick the one that gives us the biggest deal." That is -- that is really rare with the exception of maybe a couple of the server farms where they could go anywhere. For the most part, yeah, I mean there's companies that have -- they're going somewhere for a reason and it's anything from the infrastructure to the people to the natural resources.

Avi Green [00:11:04] So it actually sounds like businesses understand something, you know, that real estate agents do. You know, location, location, location. That -- that there are basically more or less fundamentals about a location that not just, you know, whether or not there's oil in the ground but the human resources that kind of thing that determine whether or not a location is really good for a specific type of a business. And that those fundamentals are not altered so much by the policy landscape. And I'm not saying of course, that you know, at the extremes that you couldn't with very, very, very low taxes and very, very low amounts of public services or on the other extreme with very, very high taxes and you know that that kind of environment either that you couldn't have an impact through policy. But you know, with these like little one-off policies on individual business incentives, you're not really going to have the impact that's going to make the difference about whether a business comes and grows or not. But why don't policymakers understand what you do?

Nathan Jensen [00:12:25] Well, you know, I mean so there are some cases that it's hard not to see what's going on. And I think the most extreme is in the Kansas City area or some of the other regions of the country where you have a metro spanning multiple -- multiple states. So you can think of areas around New York, Washington D.C. and you actually literally have in Kansas City, we saw a number of companies that moved from the Kansas City side -- Kansas side of Kansas City to the Missouri side of Kansas City and counted as a new investment in the state which opened them up to a whole bunch of incentives as a new company. And then they moved 10 years later back across the line and got new incentives from Kansas. And this is what they call the economic border war. And it really is companies shifting back and forth, but the workers aren't moving. The impact on the local area obviously doesn't vary. I mean, they're moving six miles. So there are some of these extreme cases where the politicians have noticed and there's been discussions in Kansas and Missouri saying "OK, this is silly." What's much harder I think, is the case of a program, like these Texas programs. The Texas program where I said oil and gas attracted Toyota and Samsung and these are two big manufacturing facilities that generate a lot of jobs. They do a lot for the community. And it's hard for a politician to really know whether or not they would have come, right? And I think that's the hard part and there's obviously every reason the company is going to say we needed this. We needed this. And it's actually the economic developers who helped attract it, want to take credit as well saying "Yeah, Samsung was not coming but it's because I pulled off this deal. We now have this beautiful production and R & D facility." So -- So I don't know if that makes sense that you know, the idea is that maybe in some cases the politicians don't know. And in other cases you know, maybe there's no real incentive to call people out for it. You're a politician and Samsung's here and that's good enough for you. And whether or not an incentive brought it or caused it, you still get the same amount of credit.

Avi Green [00:14:36] Yeah, well let's -- let's talk about that -- that credit or seeking that credit. One thing that you pointed to is that different types of decisionmakers and I'm talking about elected mayors versus city managers are -- are more or less likely to use these -- these tax incentives for businesses. Explain that.

Nathan Jensen [00:15:01] Sure, sure. And this goes back to you know, sort of a longer literature thinking you know, what's -- what's great about democracy? And what's great about democracy is that we get you know regular elections. We get political competition. We get people who get to make decisions about who their leaders are. One of the biggest problems or the criticized -- criticisms of democratic rules: One is that you can get these really short time horizons meaning a politician is up for re-election every two years or four years or six years. So you've got to get stuff immediately. And then secondly you want to be visible about what you do. So by you know, being really good about climate change and there's no natural disasters because of what you did, is harder to see than building a new bridge or new road or getting a new manufacturing facility. So part of what I look at is looking at the city level. You have real variation in cities in the United States that have either appointed city managers and they are, you know, beholden to elected officials but they're not directly elected versus elected mayors. And the finding is that these elected mayors because of political competition and pressures to show that they've generated economic development provide more incentives and specifically larger incentives to firms than the appointed -- appointed officials.

Avi Green [00:16:21] The city manager basically, you know, working on maybe a five year contract or something like that wants to show steady city finances, you know, good city revenues, and good city spending on -- on public services over time. And the mayor kind of wants to run around and cut a bunch of ribbons before Election Day.

Nathan Jensen [00:16:46] The ribbon cutting ceremony with incentives is very important. And you actually see this when a company gets incentives that the political officials are there and rather than hiding that they gave this money to the to the firm, they make it part of their press statements. They talk about it and say, "Because of the Massachusetts program or the Kansas program or because of our city council's vote, we could deliver this and that's what brought the firm." That's -- that's exactly the mechanism. They're not hiding what they're doing. In some sense they're using it to show how much they had to do, how much effort they put in to get the firm.

Avi Green [00:17:20] Professor Jensen, this is actually terrifying to me, right? Because this is sort of an example of how a bunch of bad things happen in in our democracy, right? So one is, it's sort of an example of the power of lobbying. Two is, you know, you've got a situation where different municipalities are competing and -- and as opposed to when you want to have an economy where there's sort of uniform public policies for everybody and the small businesses are treated like the big businesses. This is sort of the opposite. You're creating like a Swiss cheese of different policies for different -- for different businesses, right? And you've got this race to the bottom going where business -- big businesses are sort of getting more and more sweetheart deals and that means that regardless of the merits of whether or not they should pay X or Y in taxes, those taxes end up either on small businesses or they end up on individuals, not because we decided it was the right thing to do but it just sort of happened. So how does democracy handle a challenge like this?

Nathan Jensen [00:18:30] Well, you know I mean so we're not the only, right, democratic country in the world and we're not the only country trying to attract investment. The hard part is given kind of domestic politics but also interstate commerce, it's much more difficult for the United States to impose some of the same solutions that other countries have. So there's major competition across states in the European Union for investment and what they instituted are what's called state aid rules, the idea that we understand that governments are going to give big, big incentives and we're going to police that. Regulations in Brazil trying to limit competition across cities. A number of Canadian provinces essentially getting rid of incentives or clamping down the type of incentives that can be offered. So often it is kind of a central agency saying, "This really is a prisoner's dilemma. This is a competition where no one's winning the same amount of investments coming. We're just getting a lot less." It's much more difficult to do in the United States context. There was an attempt between Missouri and Kansas to kind of sign an agreement that they would limit this competition. And it didn't work. They didn't actually agree to a detente or agree to a peace treaty in the Kansas City area.

Avi Green [00:19:45] Although Kansas and Missouri failed, states could enter into these agreements not to race to the bottom or perhaps a state could limit competition between cities within that state or in theory, Congress could limit competition between -- between all the states?

Nathan Jensen [00:20:07] I'm not sure that Congress actually has the authority to do that because of the Interstate Commerce Clause. I'm -- You'd have to ask a legal expert on that and you know, I think that would be a difficult question and it would be difficult to pull off. Especially there are some states that have been very effective, Texas being one of them, at attracting investment and I'm not sure that they would be willing to sign the same sort of agreement. In terms of cities, I mean, this is plausible. The other proposal that some people have made is that there is such an asymmetry between the companies and the cities that plausibly the cities could communicate with each other about what the offers being made are because there's sometimes, you know, a company will come and say, "I'm looking at your city. What can you offer me?" And it's not even clear that they have offers from any other cities. So this asymmetry of the company kind of holding all the cards and if cities just share data and information about incentives they were offered -- that would be at least a step towards -- But I think the underlying political logic is that politicians see a benefit to this, that they get to take credit for the investment that's coming. So it's not clear that they're so pro-reform on many of these programs.

Avi Green [00:21:19] Right. And that brings us I think, to sort of the public aspect of your work. You make the argument at the end of your brief that there's sort of a possibility here that states could formulate their defense in another way. That they could say, "Well, we're not doing these incentives because if we do that -- these incentives it means less money for our schools. It means less money for our roads. It means less money for our budget which we need to make up someplace else in taxes." Do you think there's any, any hope to initiatives along those lines?

Nathan Jensen [00:22:00] What's -- what's interesting is the biggest critics of these programs are the right, specifically Tea Party members of Texas legislature, but also of other state legislatures and the left. And it's sort of a criticism of you know, on the right it's government picking winners and losers and on the left it's crony capitalism. And there's this weird coalition you know, essentially saying that you know, we both agree. One of the few things that you'll see the far right and far left agree on is that this is, you know, an ineffective strategy and problematic both from ethical but also practical standpoint. What you do see and sort of the answer to the finance -- I mean, these -- these programs don't pay for themselves and often there's a claim is that in the long run they'll generate revenues and these revenues will eventually make it so that these incentives are a positive impact. But in Texas, for example, they raise the sales tax to pay for these. And as you know, a sales tax is regressive, meaning you know, Bill Gates pays very little of his income and sales tax. But a poor person who spends all their income. pays a lot more as a proportion in sales tax. So, it's a very regressive system of -- of taxing essentially consumption and then piling that together and then sending it to a very select set of companies. So, in some sense I think voters don't understand that aspect that they are paying and the aspect that this can affect school finance in many states. That this affects the ability of the government to raise money. This is why some teachers' unions and education associations have come out very much against these tax incentives and firefighter unions, police unions, in many cases have asked for better disclosure of these tax abatements because of cannibalizes public finance. I think that voters in general don't understand that and when that tradeoff becomes made more clear, that's when you can see, I think, some -- some sort of education. Just hitting people with the costs of these programs don't really affects their decisions as much as it shows what the costs are in terms of tradeoffs for the programs.

Avi Green [00:24:08] Well, when the Tea Party and the teachers union agree on something, I think that we all need to pay pay some attention. Professor Nathan Jensen, I hope that every mayor in the United States reads your brief. Thank you so much for coming on no jargon.

[00:24:24] Thank you so much for having me.

[00:24:26] And thanks for listening. No jargon is the podcast of the Scholars Strategy Network.

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