Chapter 5

Tax and Spend or Spending Taxes—Economic Development in the States

Although legislators differ on issues pertaining to the means by which to finance government, they are united in their pursuit of enlarging tax bases via economic development. Since the 1970s, state officials have substantially increased their attention to economic development (Eisinger 1988; Brace 1993; Beyle 1983). Thirty of the legislators in this study (23 percent) either described themselves as specializing in economic development or considered economic development an important legislative priority. The half dozen representatives who resisted discussing economic development because they lacked expertise nonetheless described in detail their preferences for particular components of economic development policies.

There is considerable evidence detailing various state economic development efforts (Brace 1993; Dye 1990) and the efficacy of these policies (Courant 1994), yet less is known about how legislators and legislatures produce development policies and why they choose one set of development tools over others. Legislators share the goal of expanding their states' economies and creating new jobs and investment opportunities. They differ on how to pursue this collective goal. Two strategies exemplify legislators' choices between particular-benefits and public-goods strategies.

Economic development policy provides clear cases of representatives deciding between public goods and particular benefits in the pursuit of the same goals—growing economies and expanded tax bases. In addition to legislators' individual preferences for public-goods and particular-benefits strategies to enhance economic growth, state policy histories, citizen participation, and horizontal tax competition among states influence the development of state economic development policy.

The economic development case studies from Tennessee, Mississippi, New York, Colorado, and Washington and the individual interview data enhance the understanding of the variance among state development processes and illuminate the roles of state policy histories and policy interactions, opportunities for citizen participation, and intergovernmental relations. Despite empirical evidence that state development efforts may expend more marginal resources than they attract or generate (Courant 1994), most legislators believe these policies are worthwhile. This chapter offers an understanding of legislators' perceptions about interstate competition for employers. Although other studies have offered considerable evidence for interstate competition, few have reported directly on legislators' views about interstate competition and legislative responses to it (Eisinger 1988; Brace 1993).

Representatives are aware of and contend with the relationships and linkages among different policy areas. In the case studies of New Jersey, New York, and Washington, legislators expressed frustrations that general tax policies mitigated state development efforts. This "paradox of development" is not apparent if one views state economic development policy isolated from other state tax and spending policies.

Both public-goods and particular-benefits strategies provide political advantages for elected officials. Legislators can point to public goods such as community colleges and infrastructure improvements and claim credit for bringing the particular benefits, or positive externalities, of such goods to their districts. More directly, when particular benefits such as tax abatements or financial underwriting result in a state attracting a specific employer, legislators can claim credit for specific jobs in their districts.

The avenues of federalism available to state legislators for economic development are largely those between states and localities. And it is on these state and local avenues that the creative politics regarding development policies take place. State legislatures enact tax policies that circumscribe and preempt local tax policies. They rationalize that foregone local revenues can be offset by larger revenue bases. Alternatively, state governments may provide funding for employment and training at local or regional community colleges or funding for roads and infrastructure that will benefit municipalities. With respect to specific tax policies, state legislatures in Florida and Mississippi have used their incorporation powers either to create new special-district governments or to abate local taxes to lure employers.

To the extent that avenues of federalism run between the federal and state governments, they assume characteristics more akin to back alleys than to broad, clearly defined avenues. The lack of a national federal development policy has left states considerable latitude for developing their own policies (Eisinger 1988). In addition, federal spending, particularly defense spending, has implicitly influenced state development by funneling federal resources into specific states. The states have in turn used Department of Defense facilities and their contractors as anchor employers in their efforts to attract various high-technology firms (Schulman 1992; Mintz and Huang 1990; Leib 1992; Young 1993). Substantial federal spending and grants for education and infrastructure assist states in funding development policies (Brace 1993; Schulman 1992). Legislators in Washington, Colorado, Florida, and Massachusetts discussed defense spending's positive influence on their states' economies. In the 1980s their state governments relied on such spending as an economic stabilizer and as an avenue by which they could attract high-technology employers.

Scholars have argued that subnational politicians pursue economic development over and above redistributive policies (Dye 1990; Peterson 1981). For state governments to have sufficient resources to redistribute income or spend money on health and education programs, they must have sufficient tax bases. Consequently, politicians focus on development prior to turning their attention to other functions of government if only because development provides a basis for financing these other functions (Peterson 1981). The competition for employers discourages states from enacting large-scale redistributive tax-and-spending policies lest some states become "magnets" for the poor and other states havens for the wealthy (Peterson and Rom 1990; Dye 1990; Brace 1993; Peterson 1981). State representatives will attend to development because of an internal need to finance government and external competition for revenues.

Should economic development efforts succeed, legislators can increase benefit/tax ratios via two avenues. Enlarged tax bases and fiscal slack created by reduced demand for state services imply that legislators can raise equivalent amounts of revenue at lower tax rates. Legislatures can reduce taxes without decreasing services. Alternatively, legislators can increase funding for programs. Several legislators mentioned that one of the advantages of pursuing economic development was that the state could couple its development efforts with attempts to reduce spending on unpopular income-assistance programs. Both scenarios indicate unequivocal increases in aggregate benefit/tax ratios.

Legislators indicated an interest in three questions. First, what are the explicit costs to the state government from a particular development policy? These costs can be direct expenditures, tax expenditures, or, more implicitly, foregone revenues. Second, what are the implicit costs of a policy? These costs include additional services the state or localities may offer as a consequence of attracting new jobs and citizens. Such costs may include added educational costs or increased pollution-control costs. Third, does a policy enhance a state's comparative advantages or mitigate its relative disadvantages? About one-third of the legislators suggested that promoting relative advantages and lessening disadvantages created more cost-effective development strategies than did tax incentives or spending on education not tied to specific employment.

Representatives can calculate the political benefits of either a public-goods or a particular-benefits development strategy. With public goods, benefits may be more dispersed, but citizens can enjoy the same benefits, such as roads and infrastructure, as potential employers. With particular benefits, representatives can claim credit for specific jobs from specific employers, but the distribution of economic benefits may be much more concentrated than with a public-goods approach. For most states, economic development policies have incorporated elements of both public-goods and particular-benefits strategies, thereby providing legislators with access to benefits in either form.

States rarely initiate development policies contemporaneously. Legislators fine-tune their development efforts in response to changes in their economies and to the national macroeconomy (Brace 1993). The lack of a federal industrial policy, states' tax, education, and infrastructure policies, and states' incorporation powers and their abilities to limit or preempt local taxes create the politics surrounding economic development efforts (Eisinger 1988).

Three questions arise from legislators' proactive support for development policies and their strategic differences in how to pursue a collective goal. First, to what extent can different positions about development policy be accounted for? Second, how do preferences translate into policies? Finally, who stands to benefit from different policies, or what changes in benefit/tax ratios result from such policies?

Legislators' Development Preferences

Legislators divide into three groups with respect to economic development. The first group emphasizes public goods such as education, infrastructure, and, to a lesser extent, health care. The alternative group favors targeting particular benefits in various forms of tax incentives and credits to attract and retain employers. In the middle ground are legislators who emphasize some combination of particular benefits and public goods. These representatives stressed the advantages of having a good education system and adequate infrastructure and suggested that tax incentives for employers were necessary because of interstate competition for employers (Eisinger 1988).

Different development strategies imply different costs and benefits for citizens and employers. Public-goods strategies imply that citizens can take advantage of programs and goods offered by the state. Primary benefits flow not only to employers, who take advantage of new roads or a well-trained workforce, but also to citizens, who have access to infrastructure and education. With a particular-benefits strategy emphasizing employer tax incentives, employers enjoy primary benefits from tax abatements or interest subsidies. Citizens and firms whose tax rates are implicitly higher as a result of an employer tax abatement bear the costs of these benefits (Steuerle 1991; Eisinger 1988). Nonetheless, a particular-benefits strategy implies that primary benefits flow to citizens whose wages increase if a new employer comes to a state and that secondary benefits flow to all citizens as the tax base grows and the demand for state redistributive services declines.

Legislators emphasizing a public-goods strategy suggested that benefits would be available to citizens regardless of whether public goods succeeded in attracting new employers.[1] Citizens could increase their benefit/tax ratios by taking advantage of the educational programs or infrastructure offered—by increasing their consumption of government-provided benefits.

Representatives who focused on employer tax incentives emphasized a particular-benefits strategy. The advantage of this strategy is that the state expends resources only when an employer is attracted to the state. Supporters of this strategy argued that tax incentives were more efficient than education and transportation programs that may or may not produce dividends. In addition, the legislators did not have to worry that citizens would take advantage of education and training programs, only to leave the state for high-wage jobs elsewhere. By tying the benefits to employers, supporters of the tax-incentive strategy argued for an approach they perceived to be more efficient than strategies involving nonexclusionary public goods.

Preferences for economic development policies sort along party lines.

Twenty-three percent of the legislators listing a top priority for economic development emphasized state programs for education and training. Of these eighteen legislators, sixteen were Democrats and two were Republicans. Eighteen legislators (23 percent) said that tax incentives were the best way to foster economic development, and eleven of these legislators were Republicans. There is an important difference between legislators who promoted tax reform and those who promoted tax incentives. Tax incentives are particular tax credits or deductions for new or expanding firms. Employers qualify on an individual basis for these incentives. Tax reforms are broad-based changes in state taxes that affect many, if not all, individuals and businesses in the state. For example, Washington legislators promoted enacting an income tax and eliminating the state business and occupation tax. These legislators supported changes that focused on the totality of the state tax code. Conversely, representatives in Mississippi supported tax incentives, bills allowing ninety-nine-year abatements on county ad valorem taxes. Table 8 further details legislators' priorities for economic development strategies.

Legislators emphasizing education and infrastructure funding promoted a public-goods strategy for economic development, whereas those who emphasized tax incentives preferred a particular-benefits strategy for development (Levin 1987; Fitzgerald 1993). Although education confers particular benefits, I categorize it as a public good for several reasons.

TABLE 8. Legislators' Primary Emphasis for Economic Development

	Number Giving Policy First Priority		
Policy	Total	Democrats	Republicans
Education	18 (23%)	36%	8%
Tax incentives	18 (23%)	16%	42%
Tax reform	13 (16%)	20%	15%
Infrastructure	11 (14%)	18%	12%
Regulatory changes	10 (12%)	9%	23%
Other[a]	10 (12%)		

N = 80 (49 Democrats and 31 Republicans)

[a]Ten legislators gave individual responses, including quality of life, public-works jobs programs modeled on the WPA, spending reductions, advertising the state, port subsidies, reducing the national capital-gains tax, transforming state parks into golf courses, subsidized housing programs, and a state-sponsored minority set-aside program. Percentages in the second and third columns represent the distribution of responses among Democrats and Republicans who proffered one of the listed priorities.

Representatives indicated a need to finance education such that all citizens would enjoy access to training that would enable them to increase their earnings. No single citizen's use of education or training programs would inhibit another citizen from using similar services. Moreover, representatives in every state discussed offering educational opportunities and experiences to citizens and an increased state role in funding job training. To the extent that education confers particular benefits, legislators can enact policies whereby beneficiaries bear the cost of their particular benefits in tuition payments (i.e., the state can internalize the costs of particular benefits, or positive externalities). Such policies leave the state share of costs at a level consistent with the social benefits accruing from education and training. A well-educated populace may enjoy better health and thus demand fewer public-health services. Furthermore, legislators in nearly every state contended that a well-educated workforce attracted higher-paying employers.

Infrastructure is more clearly a public good than is education. Among legislators who promoted roads, sewers, and environmental projects for economic development, a division existed between those who believed that the state should develop a broad strategy for infrastructure and those who believed that infrastructure funds should be held until a potential employer identified the infrastructure enhancements that would make a site attractive. In the former category, legislators in Tennessee commented on a plan nicknamed the "roads to nowhere program" in which a former committee chairperson convinced his colleagues that if the state built roads and provided utility systems in rural areas, employers would find the state attractive and build plants and facilities. As one Democrat commented,

> You have to give the chairman credit—he had us building four-lane highways going through forests and pastures, and everybody thought he was crazy. At the time, we were so broke those programs were basically public works, but the chairman kept saying, "If we build it they will come" [laughs], like that movie that came out a few years later. And John was right, because ten years later we have Saturn, Nissan, GE, and all their suppliers around here. It was a strategy nobody would have really banked on, but it says, "We're willing to give you what you need to do business from here." What will a tax incentive do for you if you can't get to a rail line or . . . a loading dock?

In Michigan, Massachusetts, New Jersey, and New York, legislators emphasized spending money not on new roads but on existing, decaying infrastructure. Concerns about infrastructure investment emanated from threats that existing business would exit or close. Several representatives recognized a tension between assisting manufacturers, many of which are in declining industries, and helping newer high-technology firms in health care, financial services, and communications. The latter firms typically have required less traditional physical infrastructure and more employee training and education. When their economies declined, several legislators felt they were in a catch-22 situation: if they did not assist the remaining industry in their state, the tax bases would erode precipitously and impede the ability to invest in education and training programs necessary to attract new firms. Yet by investing in declining industries, representatives pursued a course that constrained their ability to attract new industry.

Many legislators discussed paradoxical or contradictory components of economic development strategies. Tax incentives, education, and infrastructure promoted growth, yet other policies impeded it. This problem became apparent when legislators argued that the best development policy for their states would be overall tax reform. Democrats in Tennessee, Washington, New Jersey, and New York argued that the state should shift from obscure regressive business, sales, and property taxes to income taxes. Republicans in Florida, Washington, and Colorado argued for fundamental tax reform but stressed cutting tax rates in conjunction with changing tax bases.[2]

A member of the Tennessee House Ways and Means Committee argued for tax reform as a fundamental element of an economic development policy this way:

> I offered a bill for a 4.5 percent income tax and a 4.5 percent sales tax and take [the sales tax] off food—a revenue-neutral bill, now. We could have had twenty thousand new jobs in Tennessee from what we're losing across the border in sales. . . . To give you a comparison, every $25 million we spend on infrastructure improvements provides 13,600 jobs, and here I can get you 20,000 jobs . . . by bringing people back into Tennessee to buy their groceries and some big-ticket items like a car. And I've gotten you these jobs without spending a dime on programs or tax incentives. . . . Our problem is that our tax system is inequitable, . . . and the current tax system costs us in terms of jobs here and tax reciprocity in other states.

Politicians promoting tax reform seek to change a collective good to benefit their constituents (Jackson and Hawthorne 1987). Issues of vertical transferability led legislators to view tax incidence broadly. They were concerned about the burdens imposed not just by state taxes but also by federal and local taxes. In New Jersey, Florida, and Michigan, legislators addressed issues of local property taxation in conjunction with economic development. Two New Jersey assembly members argued that the state would be at a disadvantage to contiguous states until it discontinued its reliance on local property taxes and shifted to income taxes. One of the assembly members made this argument:

Assembly Member: The best thing we could do for our development is reform our property tax system and get our property taxes on a par with especially Pennsylvania but also parts of New York, Connecticut, and maybe Maryland.

GB: How do you do that?

Assembly Member: The best way to tax is according to affluence. . . . I don't buy into some Neanderthal notion that if you buy things you should be taxed or that we need to have a system based on two-thirds property taxes and one-third sales taxes. That's ridiculous, especially when you consider that property taxes are the most regressive taxes. The better part, too, about a stable progressive income tax is that people pay income taxes, not business, and that will encourage development.

Among legislators supporting tax incentives, a division existed between those who believed incentives genuinely created jobs and those who felt incentives were a necessary competitive response to neighboring states' policies. Among legislators whose first priority was tax incentives, only one was in the latter group, and most sincerely believed that tax incentives created jobs. Several legislators who viewed incentives as a competitive response believed that if neighboring states abandoned incentives, employers could no longer be swayed from one location to another on the basis of taxes. Consequently, states could shift their development efforts to education, infrastructure, and general tax reform.

Although the economic benefits from targeted development programs may be less dispersed than with public-goods strategies, the potential for political benefits is probably higher. Citizens who work at employers attracted by development packages may credit individual politicians with attracting commerce and industry. In addition, politicians may solicit campaign resources from employers after they locate in a particular state or district.

Several legislators viewed the competitive nature of tax incentives as a healthy component of their overall philosophy to reduce the size of government. Some legislators were so enthusiastic about offering firms tax exemptions that they promoted increasing tax rates to increase the value of the exemptions to potential employers. These legislators believed that employers would respond to tax incentives with high dollar values and found no irony between their general position that government should reduce its spending but increase its tax rates. One New Jersey assembly member argued that Governor Whitman's effort to cut tax rates made sense as a long-run strategy but that in the short run she should have raised rates so the state could offer truly valuable exemptions to current and potential employers. This assembly member correctly noted that decreasing tax rates led to a decline in the value of tax exemptions (Steuerle 1991). When I asked about this irony, the assembly member responded that rates did not matter as long as the government was exempting firms from taxes. He argued that firms would find states with monetarily valuable exemptions more attractive than those where they could not receive the same tax break. Other legislators shared the view that tax incentives should form the core of any economic development program. One Mississippi legislator indicated that he believed no tax incentive too generous, saying,

> *Legislator:* The main thing we can do for a company is offer them the tax incentives they need to come here. . . . We've been able to help some with industrial-revenue bonds, and we can help you on the AV [ad valorem tax] and give you a long payback on it to do what needs to be done.
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> *GB:* Can you go too far?
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> *Legislator:* No, I don't see it. Everybody says Alabama did with Mercedes, but I'd say they went all the way, and it'll pay big dividends. . . . So no, I don't think you can ever go too far because these things, incentives, follow the basic economic laws of supply and demand, and if companies demand them, we should supply them.[3]

Of the seven Democrats who gave top priority to tax incentives, four were African-American or Hispanic legislators from economically distressed areas. They felt that targeted "enterprise zone" tax incentives were critical to revitalizing their districts. Two of these four represented portions of Harlem and the Bronx in New York City. One represented a densely populated, declining section of Denver. The fourth represented several rural counties on the Mississippi Delta. These members wanted tax credits not for employers but for specific geographic locations, so that employers could benefit only by locating in a designated area. Another Colorado representative who favored focusing on education and roads funding expressed his frustration with his state's enterprise zones:

> Sure, we have enterprise zones, and those help employers, but the problem is that now over 60 percent of the state is an enterprise zone. You mean to tell me that 85 percent of Coloradans live in economically distressed areas when we have the best economic growth in the nation. The problem is that [enterprise zones] were popular, but we should have targeted them to help the 'hood' that I represent. The problem is you can't get them passed unless you can get one for the folks in Aspen, too. Now, how does that make sense? We're giving tax breaks so skiers won't be economically distressed, I guess. And we offer an employer the same benefits or better for going to Vail or Aurora instead of east Denver.[4]

Among those who indicated support for tax incentives as a second or later priority, the majority considered incentives a competitive response. In Tennessee, Mississippi, and Washington, legislators discussed their reservations about the limited efficacy of employer tax incentives. These representatives viewed incentives as somewhat influential in encouraging a plant to locate in a state but pointed out that job location differed from job creation. Nonetheless, eleven of thirteen Tennessee representatives supported the 1993 franchise tax incentives as a response to incentives in other southeastern states. Legislators discussed tax breaks offered by Kentucky in attracting Toyota, South Carolina in attracting BMW, and Alabama in attracting Mercedes.[5]

These illustrations demonstrate that the incentives for particular benefits can be substantial, and legislators may respond to them. The "tangible" political benefits from a plant opening may be worth diverting state funds or foregoing state revenues, even when doing so implies providing a lower level of public goods. Although the public-goods strategy may provide better labor markets and more equitably dispersed public benefits, representatives may find it hard to resist the competitive policies of their neighbor states and the political capital created by claiming responsibility for creating specific jobs.

After tax incentives, legislators favoring particular benefits indicated preferences for regulatory reform and reduction.[6] Specific components of regulatory changes varied from state to state, but most legislators agreed that their states needed less complex permissions processes and adjustment in fees to reflect an employer's ability to pay. Republicans generally favored reducing the number of regulations and streamlining regulatory processes. Such regulatory changes offer particular benefits to various industries. Because such regulations often help produce various public goods, such as reductions in air or noise pollution, regulatory reductions would in general increase the consumer surpluses of particular employers, their employees, and their customers at the expense of those citizens who would be less well off because of increases in various pollutions or hazards.

Few legislators indicated support for a single-prong approach to economic development. Most indicated a second priority, and some indicated as many as five priorities in their development strategies. Table 9 is a cross-tabulation of legislators' first and second priorities for economic development strategies.[7]

Table 9 indicates a partisan breakdown in economic development strategies. Among legislators who identified both their first and second economic development priorities, 40 percent of the Democrats identified education and infrastructure spending among their top choices, whereas only a single Republican (6 percent of responding Republicans) did so. Conversely, Republicans placed far more emphasis on a combination of specific tax incentives, regulatory reductions, and broad-based tax reform. Eighty-two percent of Republicans identifying multiple economic development strategies emphasized these three mechanisms. In contrast, only 32 percent of Democrats gave high priority to specific tax incentives, regulatory changes, and tax reform.

For legislators, governing is an ongoing process where policy changes are typically marginal and where one set of policies may constrain legislators from enacting their preferences in a second policy area. In the following cases these constraints prevail. Legislators find themselves constrained in their endeavors to increase the benefit/tax ratios and overall incomes of their constituents via economic development policies.

Translating Preferences into Policies: Governing Principles and Federalism

Legislators cannot simply enact their individual preferences into a series of disjoint and contradictory policies. Representatives work to create policies that enjoy majority support among their colleagues, that governors will accept, that promote specific industries, and that comport with existing tax and spending policies. In this section, I detail how legislators enacted and implemented development policies. As with the examination of tax policies in the previous chapter, the primary units of analysis are the collective decisions of the legislatures for various development programs. Also similar to the investigation of tax policies is legislators' reliance on a subset of governing principles—obscurability, dependability, equity, and vertical transferability. Competition among states, a form of horizontal transferability, provided some motivation for the development policy and shaped the alternatives legislators debated.

TABLE 9. Legislators' First and Second Priorities for Economic Development (in percentages)

	First Priority				
Second Priority	Education	Infrastructure	Tax Incentives	Regulation Reduction	Tax Reform
A: Democrats					
Education		16	8		4
Infrastructure	24				
Tax Incentives		4			
Regulation Reduction			8		16
Tax Reform	24				8
B: Republicans					
Education		6		6	
Infrastructure					6
Tax Incentives	6		6		
Regulation Reduction			19		25
Tax Reform	6		6		32

Note: For Democrats, $N = 25$; for Republicans, $N = 16$.

Before moving to the specific cases, a few general points about the policy process are in order. A state's current economic climate and conditions shape its development goals (Laver 1981; Brace 1991, 1993) While Mississippi focuses on attracting manufacturers offering wages as low as five dollars per hour as a means of raising the incomes of its relatively poor residents, New York legislators worry about losing high-wage manufacturing jobs and retaining high-paying jobs in financial services. These professions provide a substantial income tax base but also contribute to growing income inequality in the state, which concerns many assembly members. Consequently, New York legislators coupled their 1994 corporate tax reduction with the introduction of an earned-income tax credit for families making less than thirty-seven thousand dollars annually. Second, overall tax systems and constitutional requirements shape governments' economic development strategies. A state's budget constraint is a general concern for legislators and offers parameters for what policies are viable (Kingdon 1990). Constitutional provisions in Florida and Mississippi enable the state legislature to offer tax abatements from local taxes.

Legislators in Mississippi and Tennessee placed considerable emphasis on economic development. Such emphasis may not be surprising given that the two states had the lowest per capita incomes among the eleven case-study states (Lilley, DeFranco, and Diefenderfer 1993). Despite similar economic profiles, the two states have chosen very different avenues by which to pursue economic development. Tennessee has increased its spending on education and infrastructure, while Mississippi has focused on tax incentives to employers (Tennessee 1994–95). Although differences in tax structures and constitutions explain some of this divergence, politics has also shaped the policy processes in both states.

Education and Infrastructure or Tax Incentives

Tennessee and Mississippi follow divergent strategies for economic development. In Tennessee, legislators focused on increasing funding for education and infrastructure, whereas Mississippi legislators directed more of their attention to tax incentives and tax reductions. In Tennessee, all but one legislator either questioned the economic efficacy of tax incentives or suggested that incentives had bounded benefits. In Mississippi, legislators from both political parties expressed support for incentives and other particular-benefits programs.

Tennessee. In 1993 Tennessee enacted an economic development policy that offered tax relief to new or expanding businesses by abating the state-imposed franchise tax. One of the architects of the plan explained its calculus:

> *Representative:* What knocks us out of competition . . . is the franchise tax, and that's why we now provide a break on that specific tax.
>
> When you look at incentives, . . . you can go overboard. Alabama gave away the store with Mercedes. . . . Kentucky has a plan that's supposed to benefit depressed counties, but I don't think they've done that because they just give up the incentives, and people are fighting for those benefits. But the beneficiaries are Owensboro and Bowling Green, not the depressed counties in eastern Kentucky outside of the Georgetown-Toyota area.
>
> *GB:* So what differentiates Tennessee?
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> *Representative:* We have a principle that we are willing to forgo a certain amount, portion, of marginal revenues. We won't forgo all revenues, and we won't go down from current revenues on a particular tax. Some states will say they absorb one incentive and a loss on a tax with a second tax, but you can never trace that. With an individual tax, you know whether you're below last year or not or how much you've given up. In our neighboring states, it's more an act of faith that the increased sales and income taxes offset franchise and property tax abatements.

Most Tennesseeans suggested that their need to respond to tax incentives from other states motivated their support for the 1993 tax incentives. Most noted that the 1993 plan followed a rule that the state would only forgo marginal future revenues. Fewer legislators admitted that constitutional and statutory provisions prevented property tax abatements and that the state's lack of gross-receipts and income taxes limited its ability to offer tax incentives paralleling those in Alabama, Kentucky, and Mississippi.

Tennessee's tax system influences its economic development in a second way. Several legislators suggested that the state's emphasis on providing infrastructure was a natural result of Tennessee's reliance on cyclical sales taxes and a historical tradition of using general revenues to pay for capital projects. Although legislators would have preferred shifting spending to education, they concluded that funding education generously one year and then cutting it dramatically the next would send a mixed signal to outside firms whose managers might expect a consistent, if not generous, education for their children. The one-time-appropriations nature of infrastructure projects with low maintenance costs relative to those of ongoing educational programs led the state to a policy whereby it invested revenue increases in flush years and cut back on these investments during recessions.

In Tennessee, representatives perceived that the benefits from education and infrastructure were more or less equally available to all citizens. Although they could not claim specific connections between tax incentives and new employers, the broader public-goods strategy appeared to have worked as Tennessee rejuvenated its economy through the 1980s by attracting two automobile assembly plants and then their component suppliers. In Mississippi, representatives could also point to attracting employers, but the benefits accrued largely to employers and even employees who worked in new plants, and facilities directly paid for some of the incentives offered to employers.

Mississippi. Although Mississippi has a limited tax base, its policymakers have offered a variety of tax incentives. In 1993 the legislature passed a law enabling new or expanding businesses to issue industrial-revenue bonds and to offset debt service by assessing all employees between 2 and 6 percent of their salaries.[8] In turn, employees could deduct assessments from their state personal income taxes. However, because Mississippi had a relatively high personal exemption and tax rates of only 3 to 5 percent, few of the employees could recoup their assessments via income tax abatements. Because the personal-income tax credit was not refundable and could not be carried forward to future tax liabilities, the likelihood that individual employees would recoup the bond assessments to their wages decreased substantially. None of the legislators or the relevant committee staff could estimate either the costs to the state in terms of foregone income from personal income taxes or the costs to individual employees for the bond assessment fees. In addition to the debt service provided by assessments on wages, employers receive further assistance from corporate income tax credits typically equal to or exceeding the total value of assessment on wages.[9] Thus, a firm with a payroll of $2 million, paying nine dollars an hour, and owing $500,000 in debt service annually could expect a $120,000 reduction in its debt service from a 6 percent payroll assessment and approximately $154,000 in corporate tax credits. Its debt service would fall from $500,000 to $226,000 (Condiff 1993). Several textile, small-appliance, and food-processing firms have taken advantage of this credit to build or renovate plants in Mississippi.

The second tax abatement authorized by the legislature comes at the immediate expense of local governments in the form of ad valorem tax abatements. Mississippi's ad valorem taxes are property taxes imposed on items such as manufacturing equipment. A new business can attain either a reduction in its ad valorem taxes or a deferral once it agrees to locate in a specific municipality or county. Although the county can define some of the terms of the abatements, the state maintains control over their broad parameters, such as how long they last. In this way, state legislators can offer tax incentives with costs absorbed by local governments. Some legislators defended this policy, suggesting that localities would benefit from economic growth and recoup any losses from increases in the stock of taxable residential and commercial real estate. Other members took a more critical view of the abatements and suggested that only localities with a healthy tax base could afford ad valorem abatements. Consequently, only areas of the state with relatively vibrant economies could bear development costs. This development distribution further exacerbated discrepancies in local resources and further disadvantaged some localities relative to others. Nonetheless the ad valorem abatements illustrate how legislators promoted economic growth through an avenue created by vertical transferability. No similar avenue was available to legislators in Tennessee, thus partially explaining the different development strategies.

Mississippi county governments and the legislature have made wide use of ad valorem tax abatements. The generosity of these abatements was such that in 1992 the Mississippi Supreme Court ruled abatements exceeding ten years violated the state constitution. (Abatements ranged from twenty to ninety-nine years.) In response to the court's decision, the Mississippi legislature enacted a law, SB 3013, which attempted to reinstate the ad valorem abatements. In cases where county tax assessors ignored the legislature's actions and placed manufacturing property on the tax rolls, it was assessed below its market value.

One final factor discouraged several Mississippi representatives from promoting a public-goods strategy: what four representatives called the "brain drain." House members feared that spending money for education would produce a workforce whose talents would find no market in Mississippi. Educated Mississippians would leave the state after having received the benefits of its educational services. One conservative legislator cited this problem as the rationale for concentrating on bringing employers to Mississippi as opposed to training workers for jobs in a larger marketplace. He stated that much funding for education was simply too nebulous for Mississippi's very specific, often low-skilled, employment needs. At one point he strongly criticized the state's effort to increase education spending, saying,

> *Representative:* Last year we passed a resolution saying we wanted to get to the Southeast average on teacher pay. Now, there is the argument that that's the way to get better people, but, meanwhile, we have to pay a lot more for current teachers who are satisfied with what they have. The second problem with it is statistical.
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> *GB:* I don't understand.
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> *Representative:* Well, if we raise our pay to the southeastern thirteen-state average, then that's going to raise that average, so we've got to go even higher. It's a goal we can never attain, so why start such a cycle?

Three Mississippi Democrats countered this argument by suggesting that the state needed to spend more on education and training but do so in a strategic manner. They argued that Mississippi needed to stop offering itself as the last bastion of cheap, low-skilled workers. Instead, they promoted state programs that would increase the skills of a large number of Mississippians so that the state could attract higher-wage employers. These legislators recommended focusing state resources on technical and vocational programs as opposed to offering more tax incentives or funneling money to the state universities and graduate schools.

The overall difference in strategies between Tennessee and Mississippi is striking. The differences existed in part because of basic differences in tax structure. Having no income tax, Tennessee has no opportunity to offer an assessment/credit program paralleling Mississippi's. A second reason for the differences is that Mississippi's governor enthusiastically proposed a variety of tax incentives, whereas the previous two Tennessee governors emphasized increasing funding for education and infrastructure.

Legislative leadership played a role in forming development policies in both states. In Tennessee, a chairperson of the House Ways and Means Committee enthusiastically supported Governors Lamar Alexander and Ned McWherter in their efforts to increase education and infrastructure funding. The chairperson resisted developing and presenting a tax-incentive package to the legislature and eventually did so only to placate colleagues and development officials who argued that one was necessary as a competitive response to neighboring states' policies. Once convinced, the chairperson asked a colleague who shared his skepticism to develop a tax package that would address the competitiveness issue but would not decrease the state's current revenues.

In Mississippi, the Speaker of the House enjoys the power to appoint committee chairs and has done so irrespective of party. Consequently, two Republicans who were enthusiastic supporters of tax incentives assumed committee positions that enabled them to present tax-incentive packages to the House. Both legislators proudly pointed out that once they presented an economic development package on the floor, most of their colleagues found it hard to oppose policies designed to enhance growth. Although several Democrats and a few Republicans argued that the state was underinvesting in education, they reported that they really could not garner sufficient support to defeat the development packages that had been offered in the early 1990s.

Colorado. Like Mississippi, Colorado offered a variety of state income tax credits and local property tax deferments and abatements. However, Colorado representatives worried that a citizen-passed referendum, Amendment 1, would impede their ability to design and enact tax packages for particular employers. In 1992 the legislature failed to enact a tax-and-subsidy package designed to entice Ziff Publishing to relocate from New York and Massachusetts to Colorado. In response, the governor and legislature attempted to devise a second plan, only to find that Ziff was no longer interested in relocating. The president of the publishing firm based his lack of enthusiasm on Amendment 1, which subjects all tax measures, including development and revenue bonds, to a popular referendum vote (Leib 1993).

A bipartisan group of representatives opposed the original Ziff package, believing that the subsidies exceeded the benefits or the generosity of the package set a bad precedent for possible future tax packages. In the wake of Amendment 1, legislators suspected they could no longer design, consider, and enact tax-initiative development packages because any tax changes would be subjected to a statewide vote. Facing an antitax mood, representatives perceived that they could not wage sufficiently informative campaigns to win development-package ballots. Such campaigns would be costly in terms of both money and time and have at best uncertain, if any, political benefits.

House members concerned about Amendment 1 suspected that employers would shy away from Colorado simply because they would have to endure a relatively cumbersome and uncertain process to receive development incentives, and the experience with Ziff publishing offered preliminary evidence for this dilemma (Leib 1993).

Provisions in Amendment 1 placed Colorado at a disadvantage in attracting federal dollars. With the completion of Denver International Airport, several legislators expressed concerns that the state find jobs for those who had moved to Colorado to work on the airport's construction. One option was to transform the former Stapleton Airport into a Department of Defense finance and accounting center employing between four thousand and seven thousand people. Amendment 1 required Denver officials to place a financing plan on the ballot either to create a special tax district or to issue bonds. A Denver economic development advocate noted that the city and state were not competitive with other cities bidding for the center not because of a lack of potential facilities but because the federal officials would not have to wait for votes to locate in competing cities (Leib 1992).

General Tax Reforms and an Improved Image

Legislators in Mississippi and Tennessee liked to say that their states were open for business, and, indeed, such sentiments are consistent among both elected and administrative development officials (Eisinger 1988). In contrast, legislators in the industrial states of Michigan, New Jersey, New York, and Washington worried that complex regulations and certain tax disadvantages sent a negative message to potential employers. As with efforts to change general tax systems discussed in chapter 3, legislators responded to this dilemma symbolically.

In New York and Washington, legislators identified dependable but regressive business taxes as their primary target for development efforts. In New York, a 6 percent tax on utility receipts exacerbated the Empire State's relative disadvantage in energy costs. As the result of a budget surplus in 1994, legislators agreed to cut taxes. Despite the problems created by utility taxes, assembly members and senators targeted their tax cuts at the state's corporate profits tax and rather than at the utilities tax. An assembly member with expertise in energy taxes and their impact on utility costs explained his colleagues' decision this way:

> The best thing we could do to change the business climate is to cut our energy costs. . . . We should say, "Hey, what are the advantages and disadvantages of doing business in New York?" We have great natural resources, a relatively central demographic location . . . but we have to recognize that our energy costs are going to at best be relatively high and we need to lower them. . . .
>
> Our biggest problem with these costs is that we tax utilities. We have a gross-receipts tax on all commercially and industrially used energy, so it adds substantially to your operation costs. It makes starting a business in New York a bigger hurdle than other places would be, where not only are their energy costs lower but they don't tax them.

Several of this assembly member's colleagues agreed that as a matter of good public policy, they should address energy taxes, yet the assembly's Ways and Means Committee—and ultimately the assembly—passed a two-pronged approach to tax relief that included a reduction in the state's corporate income tax rate and the enactment of an earned-income tax credit for low-income families. Eight of the New York assembly members indicated that the mix of tax cuts resulted from a political compromise between the Democratic governor and House leadership and the Republican Senate leaders. Two of the assembly members took a somewhat cynical view of the bipartisan leadership's exclusion of the gross-receipts utility tax in favor of corporate income tax relief. One Upstate Democrat noted, "It's all image. While it would be helpful to a lot of struggling businesses with relief from utility taxes, we instead go for the headlines with a corporate tax cut—helping firms that are by definition profitable and can pay some taxes." A more conservative member suggested that the Republican leadership in the Senate had ulterior motives for concentrating on the corporate profits tax:

> The way it works in New York is that you can carry forward your [corporate] losses, so the five largest corporations in the state probably have paid no income taxes since '89. Now that means you pass a tax cut that gets a lot of attention and gives us a big probusiness image but

> in fact helps very few struggling businesses and is really fairly costless. If we had gone ahead with the energy tax reductions, we really would have seen a drop in revenues—revenues we very much depend on, and the Republicans know that. This was a cheap cut that gives them the appearance of helping their big friends in business.

In Washington, a bipartisan contingent of legislators argued that overall tax reform was the optimal development policy, yet in 1994 the legislature enacted a fairly modest set of tax incentives (proposed by Governor Mike Lowery) for high-technology industries. In contrast to New York, Washington Republicans accused their Democratic counterparts of having ulterior motives. Two Republicans suggested directly that Governor Lowery's proposal was a political payoff to executives at Microsoft who had openly supported the governor in his close 1992 election. Several Democrats either corroborated this scenario or suggested one of two alternative explanations. Some contended that the tax incentives were a critical component in refurbishing a probusiness, high-technology image, while others suggested that they would have preferred comprehensive tax reform but supported the governor's proposal either out of political loyalty or because it was part of an overall tax bill that the House voted to pass en bloc.

Both Washington and New York legislators concluded that the dependability of the utility taxes in New York and the business and occupation taxes in Washington discouraged the legislature from decreasing them. Legislators also perceived that the relative obscurability of these taxes further depressed any desire to change them. They suggested that the headlines would go to the corporate tax cut in New York or to high-technology tax credits in Washington.

As in Colorado, Washington representatives faced consequences from the recent passage of Initiative 602, which limits the growth of government spending.[10] Legislators did not have to submit development proposals to statewide votes, but representatives suggested they were less likely to enact tax abatements because revenue losses could become a problem if the state's economy declined. Under the provisions of Initiative 602, any tax increases must be approved by a three-fifths majority of the House. House members felt that surmounting this hurdle made them less likely to offer tax breaks to potential employers. With the constraints imposed by Initiative 602, legislators said they would not vote to divert funds from current programs for development programs because it would be very difficult to recover funding should demand for services later change.

Conclusion: Benefits and Changes in Benefit/Tax Ratios

For representatives, deriving benefits from economic development is an uncertain enterprise, but it is one to which many legislators devoted considerable energy. With particular-benefits strategies, representatives can target resources, and such targeting may create more opportunities for claiming credit for job creation and serve as a means for mobilizing other campaign resources. Conversely, legislatures that choose to facilitate economic growth via public-goods strategies ensure that they can claim credit for government-provided education and infrastructure, if not for specific jobs in their communities. As the cases also indicate, a state's broader tax-and-spending policies, particularly for education, direct its focus toward public-goods or particular-benefits means for economic development ends.

Different economic development strategies imply different changes in citizens' benefit/tax ratios. In Mississippi's incentive-based strategies, citizens with new jobs also pay directly for those jobs by subsidizing capital formation with wage assessments. In Tennessee, citizens can receive certain benefits from increased education and infrastructure spending and have seen concomitant employment growth, for which they pay mostly through a general sales tax. Although regressive, the sales tax spreads development costs over the entire population to a larger extent than does the Mississippi tax abatement/income tax credit program. Whereas all consumers in Tennessee fund the public goods, which are then available to Tennesseeans regardless of their employment, Mississippi lowers the benefit/tax ratios of workers who gain jobs from firms locating there. Essentially, Mississippi targets the cost of its development policies at workers by allowing employers to assess debt-service costs to their employees.

New York and Washington legislators indicated strong desires to change tax policies to mitigate their states' relative development disadvantages. In both cases, political obstacles to general reforms meant that legislators settled for development policies with benefits targeted at particular firms. Other firms and businesses continued to operate under the tax policies that legislators indicated hindered development. In these states, changes in benefit/tax ratios may be minimal, and a better analysis concerns the counterfactual of the changes that could occur. If legislators in Washington and New York could pass broad-scale tax reforms, then marginally profitable firms in both states would become more profitable as their payroll and utility taxes declined. Employers could then retain higher profits, pass these benefits on to their employees in the form of higher wages, or pass benefits on to consumers by lowering prices.

The creative politics in economic development tie into the politics of taxation in the previous chapter and education finance politics in the next chapter. Many legislators consider education a critical component of their development policies. However, these legislators are concerned that the policies used to fund education are inequitable and consequently disadvantage students and school districts relative to others. They explicitly connect the payment mechanisms or taxes they impose with the public goods they fund, such as education.