Ending the Economic War among the States: A Strategic Proposal

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Executive Summary

Many Americans are rightly aghast at the “economic war among the states” as so plainly revealed by Amazon.com, Inc.’s HQ2 auction. And now they are also emboldened to challenge the system underlying this corrosive war by the enormous community organizing victory in New York City that caused Amazon to cancel its plan for one new headquarters in Queens.

By “economic war among the states,” we mean the costly competitions between states, as well as localities, when corporations (often represented by secretive site location consultants) stage auctions for economic development projects, compelling governments to offer huge tax breaks and other subsidies. Public officials in the competing locations are placed in a “prisoners’ dilemma,” forbidden by decades of practice from communicating with each other, lest they be blacklisted on future auctions.

Worse than zero-sum, this is a net-loss game in which governments everywhere overspend, losing revenue that would otherwise support education, infrastructure and other public goods and services that benefit all employers. The problem of nine- and ten-figure “megadeals” has become especially acute and persistent since the Great Recession. Large, multistate or multinational corporations are grossly favored over small, local and entrepreneurial firms.

While positive intrastate solutions have emerged, and there are numerous safeguards against federal dollars making things worse, past efforts to curb the state-versus-state problem have yet to succeed. However, these efforts offer lessons. Based on our many years of research and advocacy on this issue, Good Jobs First proposes here five ways to rein in the problem of governments over-spending for economic development deals—so they can better focus on strategies that work.

1) State “cease-fire” pacts, like the one Missouri and Kansas are again considering, would stop paying corporations to relocate very short distances, but across state lines. These pacts hold great promise in those many labor markets that straddle state lines.

2) Subsidy caps can help keep spending in check, and they can be imposed by federal and state governments, which in turn would rein in localities. They can be set as dollars per project, per job, per program, and/or per company. They can also be structured to limit subsidy spending as a percentage of a government’s tax base.
3) A reinvigorated federal commitment against interstate job piracy is necessary to counter President Trump’s green light on “job wars” that brought us the $4.8 billion Foxconn debacle. While most major federal economic development programs have regulations that prohibit their use in moving jobs across state lines, these rules are obscure and seem only to be contested or enforced when an investigator knows about such fine print. Congress should review these far-flung rules, combine them into a new umbrella law drawn upon the best existing standards, apply one high standard to all federal incentive programs (including federally tax-advantaged deals), and loudly message its intent.

4) Building on examples as recent as the 2009 Recovery Act stimulus, we recommend a federal “carrot” to give states a positive incentive to not actively pirate jobs from each other, to stop legally designating existing jobs “new” for purposes of qualifying for incentives, and to embrace process reforms and best disclosure practices.

5) Process reforms, though little-studied, also hold great promise, especially advance notice of deals so that taxpayers can weigh a proposed deal’s costs and benefits. Neighborhood-friendly hearings and systemic public engagement are also critical. Finally, robust disclosure is necessary, so that records about the deals are not shielded by nondisclosure agreements, privatized or partially-privatized economic development functions, or faulty state Open Records Acts.
Introduction: A Rare Teachable Moment

The recent auction staged by Amazon.com, Inc. for its second headquarters, or “HQ2” location, has rightly outraged many Americans. How is it, many ask, that a company valued at almost $1 trillion and led by the world’s richest person could be allowed to stage a public relations blitz that caused hundreds of politicians—Democrats and Republicans alike—to publicly grovel, many of them offering undisclosed, multibillion-dollar subsidy packages?3

The truth is, such auctions happen hundreds of times per year, though to be sure the HQ2 trophy deal was exceptional for its size. But mainly it was unusual for being public: corporate site location searches are almost always conducted in secret; this was only the sixth major public auction in U.S. history.

Why Amazon CEO Jeff Bezos chose to stage the auction publicly is not yet known. Perhaps he was influenced by Tesla Motors’ five-state auction in 2014 for its “giga-factory” now operating in Nevada. Perhaps he noticed that Boeing, formerly headquartered in Seattle, staged three public auctions: for its 787 line (in 2003), its headquarters (in 2005) and its 777 line (in 2013-2014). Those three auctions landed Boeing subsidy packages totaling $12 billion.

No matter why it happened, it is objectively true that the Amazon HQ2 auction has created a powerfully teachable moment in how the U.S. tax break-industrial complex works. Most of the American public did not previously understand how corporate-dominated our nation’s economic development system is: how incentive bids are negotiated secretly, how many cities outsource recruitment functions to Chambers of Commerce (which can mean that records will never be disclosed), how constrained public officials are (in the “prisoners’ dilemma”) from cooperating with each other, and how long-standing secretive norms make it impossible for community groups to have any meaningful input at the critical formative stages of a deal.4 And they had no idea now irrelevant subsidies are to companies’ site location decisions until Amazon didn’t choose DFW International Airport (with its $22.7 billion bid), Pittsburgh ($9.7 billion), Montgomery County, Md. ($8.5 billion), St. Louis ($7.2 billion) or Newark ($7 billion).

The other fresh textbook we have now is the faltering Foxconn deal in Wisconsin. Call it the failed “Trump Effect.” Never before has a president weighed in for or against the “economic war among the states.” But President-elect Donald Trump robustly endorsed it in a December 2016 speech at Carrier Corp. Then in 2017, he actively aided and abetted Foxconn chairman Terry Gou in staging a multi-state auction that landed the Taiwanese corporation the largest subsidy megadeal ever awarded a foreign-based multinational ($4.8 billion). However, since it was
announced, this supposedly 13,000 factory-job deal has repeatedly failed to meet its stated goals and may end up never manufacturing anything.

The “Second War among the States:” A Festering Policy Blight

The issue of ruinous over-spending by state and local politicians, because they are disempowered by this corporate-dominated system, is not new. *Business Week* magazine coined the quotation-phrase in our subtitle here 43 years ago. Over those decades, states have only upped the ante, enacting more subsidy programs that further reduce corporate income, property and sales tax contributions to the public fisc. What was originally a Southern-states job-luring device has spread like kudzu to every state. Tax breaks have become so overgrown that today, a third of the states even allow some corporations to keep *their employees’ state personal income taxes*. Cities and state spend an estimated $70 billion per year on economic development subsidies.⁵

Occasionally, an elected official decries this war and a few have even proposed to “unilaterally disarm.” However, absent broad support, such calls are Quixotic. Indeed, a long series of events has caused some to despair if there will ever be meaningful progress. The National Governors Association last debated the issue in 1993, merely issuing a non-binding statement (with a two-year expiration date). No regional or partisan governors’ association has weighed in either. Various professional associations such as the International Economic Development Council and the Government Finance Officers Association grappled with the issue in the late 1980s and early 1990s, but to no avail.

A Blue Dog Democrat from Minnesota, Congressman David Minge, introduced a federal bill in 2000 to tax away incentives. That is, he proposed a confiscatory federal tax of 100 percent on state and local subsidies. The reasoning here was that companies would stop seeking tax-break packages because they could not keep them, that incentives would be mooted. Minge’s bill was never heard, and to our knowledge did not attract co-sponsors. He served only one term.

A lawsuit from Toledo, Ohio reached the U.S. Supreme Court in 2005: *Cuno v. DaimlerChrysler* (with the names reversed on appeal). The case was premised on the Commerce Clause of the U.S. Constitution, arguing (in very simplified terms here, we are not lawyers) that Ohio interfered with Michigan’s commerce by paying the auto company to build a new, replacement plant in Toledo rather than relocate. Some of the plaintiffs lost their homes or businesses to the plant’s footprint; named plaintiff Charlotte Cuno argued that she and her grandchildren were harmed by an
impoverished tax base that froze teachers’ salaries for seven years and meant schools had virtually no computers.

The *Cuno* case drew enormous corporate and political blowback, much of it orchestrated by the Council on State Taxation (COST, an association of large corporations that advocates against state tax reforms) and by Ernst & Young. Thirty-seven states, numerous associations of state and local elected officials, trade associations and corporations filed amicus briefs in favor of DaimlerChrysler and the State of Ohio.

Congress also was prepared to act, *adversely*. Against the possibility that the Court might rule for Cuno et al, then-Senator George Voinovich (who, as the governor of Ohio, had previously negotiated the deal) introduced legislation to explicitly legalize the economic war among the states (per the Commerce Clause, which grants Congress the power to regulate commerce among the states). The bill gained bipartisan sponsorship from all eight senators in the states of the U.S. Sixth Circuit Court of Appeals, which had ruled for the citizen plaintiffs (Ohio, Michigan, Tennessee, and Kentucky).

But Voinovich found his legislation unnecessary: in 2006, the Court dismissed the *Cuno* case on standing, saying that the plaintiffs had not been sufficiently harmed to be able to bring the case. Besides failing to resolve the Commerce Clause issue, the case created adverse case law on standing: *Cuno* set a new, worse precedent in the interpretation of federal standing rules, making it harder for everyday citizens to seek relief via the U.S. court system.

We place our greatest hopes in five approaches: pacts to prohibit “interstate job fraud” between neighboring states; caps, or spending ceilings, to prevent multi-billion-dollar “megadeals” like HQ2; a reinvigorated federal commitment against interstate job piracy; a federal “carrot” to incentivize positive state reforms; and economic development process reforms to empower more public engagement.

State Pacts against “Interstate Job Fraud”

In 2011, a group of 17 business leaders in the Kansas City metro area began publicly agitating over an intolerable situation: companies were locating short distances in both directions across the Missouri-Kansas state line to be declared “new job creators” and awarded eight-figure tax-break packages. In truth, the companies were only changing their employees’ commuting routes. The 17 executives rightly argued that the two states were allowing a tiny subset of area employers to game a loophole, creating transactions in which one state lost its tax base, the other state abated its tax base—and all other employers got stuck with higher tax rates and impoverished public services.6

By 2014, the business leaders succeeded in convincing the Republican-led Missouri legislature and the state’s then-Democratic governor to enact a legally binding offer to Kansas Gov. Sam Brownback (who had the power to act administratively). If Kansas would reciprocate, Missouri offered to stop paying companies to jump the state line in the Kansas City metro area.7

Tragically, Brownback failed to agree and the proposed deal expired in mid-2016. It would have been the first such formal agreement; various “handshake” deals among Midwestern and Northeastern governors in the 1980s and ’90s all quickly failed.

With new leadership in Topeka, the 17 business leaders now seek to revive the pact. If the two states were to agree to a “cease-fire,” it would set a powerful precedent for the many other bi-state and tri-state metro areas, large and small, that suffer the same “interstate job fraud” problem. These include: Memphis (which grossly overspends due to pressures from bordering Mississippi and Arkansas); New York; Chicago (Indiana and Wisconsin); and Charlotte (South Carolina suburbs).8

Such pacts will also go a long ways towards solving the related problem of “job blackmail,” in which a company demands “retention incentives” by threatening to relocate. New York City has suffered dozens of “job blackmail” cases involving
Connecticut and New Jersey, compelled to give eight-figure subsidy packages to dozens of corporations after they merely created the appearance of being footloose.

Already, there are numerous precedents of successful anti-piracy models within given metro areas of a state. The two best are in the Denver and Dayton regions. For more than a quarter-century in each area, local governments have agreed, as a condition of belonging to region-promoting networks, to not actively recruit companies from each other. Disrupting the prisoners’ dilemma and the modus operandi of site location consultants, the localities also agree that if a company approaches City A saying it might be interested in abandoning City B, City A is obligated to promptly notify City B of the company’s approach. While employers remain free to move, and sometimes need to for legitimate business reasons (e.g., expansion they cannot achieve in their current locale), it is understood that the norm in the Denver and Dayton areas is to favor retention by incumbent locations.

**Subsidy Caps**

There are ample precedents in the U.S. and Europe of ways in which governments cap the cost of deals, so that projects like HQ2 simply no longer could cost billions. Deals can be capped by “aid intensity,” or the ratio of subsidies to total investment (with many European Union deals capped at 25 percent or less, and then only in areas that are truly distressed, with top rates sharply reduced for projects beyond 50 million and 100 million Euros; had HQ2 been placed in London and Brussels, it would have been eligible for $0 in incentives).

Deals can be capped by cost per job (with federal and state program limits of between $5,000 and $35,000 common, versus $112,000+ per job awarded Amazon in New York). Deals can be capped, with, for example, a limit of no more than $25 million per project (from all subsidy programs) over its entire life. Entire programs can (and should) be capped by their total annual cost (some state programs are). Good Jobs First has also proposed that individual companies be subject to caps within an entire state.9

Subsidies can also simply be “means tested.” That is, their eligibility rules can be structured so that large corporations simply don’t qualify. In a detailed study examining more than 4,000 deals in 14 states, Good Jobs First found that large, multistate or multinational corporations got 70 percent of the awards and 90 percent of the dollars—even from programs that are facially available to companies of any size. Small and entrepreneurial businesses—which in past decades were often disproportionate new-job creators, but which for the past two decades have struggled—are being severely shortchanged.10
One of the subsidies granted to Amazon in New York City is a glaring example of how necessary caps are. Based on its projected hiring numbers, Amazon will be automatically entitled to $897 million under the Relocation and Employment Assistance Program (REAP). New York City Comptroller Scott Stringer estimates that Amazon will receive $75 million per year from that REAP award, compared to 205 corporations currently receiving a total of $32 million annually from the program.

It is inconceivable that the original sponsors of REAP ever expected one project to so dominate the program’s spending. Capping any one project or company at no more than two percent of a program’s annual cost would prevent such over-spending and promote “eggs in many baskets,” a prudent risk-management strategy.

Caps can be pegged to municipal-finance metrics as well. We recommend that local governments be limited (by states) to foregoing no more than two percent of their property and/or sales tax base to tax abatements, TIF districts and/or sales tax exemptions or diversions. Having limits on such tax expenditures will help local governments maintain discipline to target their economic development resources where they are most clearly needed; it will also enable them say “no” to developers who, when spending is not limited, expect tax breaks to be effectively automatic.

Finally, per our “federal carrot” discussion below, we would urge policymakers to consider how federal program rules and funding formulas could be leveraged to encourage the use of municipal finance-driven caps as well as those measured by job, deal, program and/or corporation.

A Loud Federal Commitment against Interstate Job Piracy

There is an obscure body of rules, sprinkled among the regulations of most major federal economic development incentive programs (e.g., from the departments of Labor, Commerce, Agriculture and Housing and Urban Development) that prohibit the use of federal dollars to subsidize the relocation of existing jobs from one state to another. In some cases, they even apply to relocations within a state, but from one labor market to another. (Good Jobs First drafted a summary of these rules for the Cuno plaintiffs; it helped them convince the U.S. Solicitor General to sit the case out.)

However, it has been our experience that these rules are contested or enforced only when an investigator knows about such fine print. As well, there are likely gaps in coverage: for example, we believe that federally tax-exempt Industrial Revenue Bonds are sometimes structured into deals which involve job piracy.
Congress should review these far-flung rules, identify those which are strongest, and find any programs lacking coverage. Then it should enact a new umbrella law that would apply across the board to all federal incentive programs—including federally tax-advantaged transactions. Congress should apply one high standard and loudly announce its intent.

We think such an umbrella law is highly consistent with and supportive of a pro-U.S. manufacturing policy. It is also a necessary antidote to Pres. Trump’s green light on job wars. If putting our nation's jobs first is a consensus goal, why on earth would we let states and cities undermine each other, playing shell games with taxpayer dollars that could be far better spent on skills, infrastructure and entrepreneurship?

A Federal “Carrot”

History provides useful examples of how federal program rules and spending formulas have been used to “nudge” states to adopt smart policy reforms. Rather than a “silver bullet” approach like a Commerce Clause lawsuit or a confiscatory tax, we believe that a “race to the top” approach is more politically viable and holds the most promise against possible legal challenges.

For example, to convince the states to raise their legal drinking age to 21, the federal government withheld a small portion of federal highway funding until each state conformed. The reform has saved thousands of lives by reducing traffic accidents and was upheld by the U.S. Supreme Court in 1987. More recently, states were incentivized to modernize their Unemployment Insurance (UI) programs (making them more reflective of today’s labor market and thereby benefiting more workers), by provisions of the 2009 federal stimulus. Drawing from a specific menu of reforms expanding access to UI for low-wage, part-time (and hence mostly women) workers, 39 states claimed $4.4 billion in Recovery Act funding benefiting more than 200,000 workers who otherwise would not have qualified for assistance.

Applied to economic development subsidies, Uncle Sam could hold back 10 percent of a common federal appropriation (such as HUD Community Development Block Grants) until a state signs a pledge, affirming that: it will not actively pirate jobs from other states; it will not fund “interstate job fraud” (i.e., it will not fraudulently call existing jobs “new” for purposes of qualifying for incentives); it will adopt process reforms including advance disclosure; and it will provide robust online post-award disclosure of every deal’s costs and benefits (including actual jobs created and actual wages and benefits paid over the life of the deal).
Finally, as long as Congress is revisiting major federal incentive programs, there is the problem we dubbed “Uncle Sam’s Rusty Toolkit.” In an analysis we performed of five commonly-used programs, each overseen by a different cabinet agency, we found that they often lacked basic accountability safeguards that long ago became best practices among states and cities. None, for example, requires the permanent jobs subsidized to adhere to any job quality standards such as market-based wages, full-time hours, health care or paid leave. Three of the five lack clawbacks, or money-back guarantees if a company fails to deliver, and the two others have limited protection.14

Yet it is clear from the experience of the American Recovery and Reinvestment Act— with its robust recovery.gov portal that generated detailed data four times per year on hundreds of thousands of projects— that the federal government can modernize its own subsidy program rules and oversight systems.

**Process Reforms**

These are some of the least-studied yet potentially most powerful areas for reform. Although certain forms of federally tax-exempt financing require advance public notice, it is our belief that few if any states require safeguards such as, for example, 90 days’ advance disclosure of proposed incentive packages prior to their being enacted. Such rules are needed for subsidies that involve state spending, and especially for subsidies granted by local governments (including property tax abatements, tax increment financing districts, etc.). Such local awards are enabled and regulated by state law, so ultimately states need to attach process reforms to those local powers.

Advance disclosure of each deal’s application, cost-benefit analysis and so on is necessary but not sufficient. Residents, NGOs and journalists should be able to sign up for email alerts about each new proposed deal. Hearings within the project site during non-working hours should be publicized. More systematically, localities should structure public engagement systems to bring community groups into the planning process.

Also critical is full disclosure, under state Freedom of Information or Open Records Acts, of materials surrounding those negotiations and incentive offers, also 90 days prior to enactment. Such records must not be hidden by non-disclosure agreements (NDAs). And if local or state governments outsource recruitment or related functions to Chambers of Commerce or public-private partnerships, all of those contractors’ records should be covered by state FOIA laws.
Summary: This is a Bi-Partisan Issue with Broad Public Support

Our proposals are rooted not only in lessons learned from the episodes cited here, but also in the challenges inherent in taking on a bi-partisan dogma. They teach us that it is critical to break things down into easily-understood, facially outrageous problems (of which incentives provide many) and then offer positive, common-sense solutions to them. That approach is also necessary because the tax break-industrial complex has intentionally made incentives arcane, so as to actively discourage taxpayers from trying to understand them.

At their core, our solutions are common-sense, good-government reforms. They make it clear: we are for positive economic development. We are for transparency and public engagement. We are for honesty in what a “new job” actually is. We are for a more equitable distribution of assistance to small businesses. And we are for protecting public treasuries to ensure we have great schools and infrastructure and other public goods and services necessary for all employers to thrive.

We know these ideas enjoy a broad spectrum of support among grassroots groups, small business leaders, academics, policy advocates, elected officials and corporate social responsibility experts. We also know that many economic development practitioners—who feel trapped within a game whose rules they would never have written—would welcome the liberty to focus on proven investments like skills, business “clusters,” entrepreneurship and infrastructure.

Finally, we would cite the broad outpouring of formal, written support for what would become Governmental Accounting Standards Board (GASB) Statement No. 77 on Tax Abatement Disclosures as evidence of how many kinds of constituencies see the need for subsidy reform.15
Notes

1. This net-loss distinction was laid out in 1995 by two officers of the Minneapolis Federal Reserve, at: https://www.minneapolisfed.org/publications/annualreports/congress-should-end-the-economic-war-among-the-states


3. See our writings and link to various resources on Amazon at: http://www.goodjobsfirst.org/amazon

4. In a recent New York Daily News op-ed, we summarize this corporate-dominated history dating back to the 1930s, including secretive site location consultants and “business climate” studies, at: https://www.nydailynews.com/opinion/ny-opedend-the-subsidy-wars-20181121-story.html. For a more detailed recounting of that history, see chapters 2 and 3 of The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation (Berrett-Koehler, 2005), at: http://www.goodjobsfirst.org/gajs

5. See “Paying Taxes to the Boss: How a Growing Number of States Subsidize Companies with the Withholding Taxes of Workers,” Good Jobs First, 2012, at: https://www.goodjobsfirst.org/taxestotheboss

6. See the powerful text of the business leaders’ appeal at: https://clawback.org/2011/04/15/1746/

7. For more detail, see: https://clawback.org/2014/07/02/missouri-seeks-ceasefire-in-kansas-city-border-war/

8. For case studies on “interstate job fraud,” see ‘The Job Creation Shell Game: Ending the Wasteful Practice of Subsidizing Companies that Move Jobs from One State to Another,” Good Jobs First, 2013, at http://www.goodjobsfirst.org/shellgame


11 The law is Title 23 U.S.C. 158 and the Supreme Court decision upholding it was South Dakota v. Dole, 483 U.S. 203 (1987).

12 The National Employment Law Project was central to this Unemployment Insurance modernization success story; see more at: https://nelp.org/wpcontent/uploads/2015/03/ARRA_UI_Modernization_Report.pdf


15 See our resources on Statement 77 here: https://www.goodjobsfirst.org/gasbstatement-no-77 and see the 2014-2015 comment file here (Good Jobs First’s are numbers 193 and 193-A): https://www.gasb.org/jsp/GASB/CommentLetter_C/GASBCommentLetterPage&cid=1176157116776&project_id=19-20E