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“Was the Deal Worth it?”: The Dilemma of States with Ineffective Economic Incentives Programs

*Randle B. Pollard**

Federal subsidies to state and local governments have been substantially reduced due to public opinion prioritizing the reduction of the federal deficit, the recent “fiscal cliff” legislation, and the federal budget “sequester cuts.” In addition, in many states, revenue collection from individual and corporate income tax is below pre-recession levels. To address the reduction in federal funding and reduced revenue collections, state and local governments will increasingly rely on economic incentive programs to grow their economies through increased job creation and private capital investment within their jurisdictions. These economic incentive programs are no longer comprised of simple tax reductions for companies seeking expansion or relocation, but include financial incentives and direct investment programs. The cost of these incentives, both in expenditures and forgone tax revenue, represents a growing portion of state and local governments’ budgets and may subject them to steep budget deficits if the incentives do not produce net economic growth.

Because of the budgetary risk and the increased reliance on these economic incentives, there is a need for state and local governments to account for the cost of these incentives and to measure their

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effectiveness. Effective state economic development requires growth in state economic activity that results in a net increase of revenue in relation to the cost of the incentives. To measure effectiveness, state and local governments must maintain reliable information on the cost of incentives, institute mechanisms to limit or cap the costs of incentives, and hold businesses accountable for performing pursuant to incentive agreements.

I. INTRODUCTION

The United States' recession of 2007–2009 significantly reduced the revenues collected by state and local governments.¹ To address the reduction in federal funding and reduced revenue collections, state and local governments have increasingly relied on economic incentive programs to grow their economies through increased job creation and private capital investment within their jurisdictions. These economic incentive programs are no longer comprised of simple tax reductions for companies seeking expansion or relocation, but include financial incentives and direct investment programs. The cost of these incentives, both in expenditures and forgone tax revenue, represents a growing portion of state governments' budgets and may subject the state to steep budget deficits if the incentives do not produce net economic growth. Because of the budgetary risk and the increased reliance on these economic incentives, there is a need for state and local governments to account for the cost of these incentives and to measure their effectiveness. State and local governments should collect more reliable data that is more reflective of the performance of their economic incentives. In addition, to control the cost of incentives, state and local governments need to cap or limit the amount of incentives granted and hold businesses accountable for receipt of the incentives. Effective state economic development requires growth in state economic activity that results in a net increase of revenue in relation to the cost of the incentives. As discussed *infra* Section IV of this article, efficient and effective

1. Jean-Marc Lucas, *US State and Local Government Finances: from Recession to Austerity*, CONJONCTURE (BNP Paribas), Apr. 2011, at 3, available at http://s3.amazonaws.com/zanran_storage/economic-research.bnpparibas.com/ContentPages/2446749673.pdf.

incentive programs require reliable data, limits on costs, and accountability for businesses awarded the incentives.

Section II of this article will describe the history of state economic programs, the increased use of these programs since the United States recession of 2007–2009, the categories of economic programs, and the prevalent programs currently used. Next, Section III describes challenges to state and local economic incentive programs; the legality of such programs; the obstacles of measuring their effectiveness through data collection and methodologies used to analyze the data; the problems of “failed” incentive programs; and the fairness of incentive programs to the general public. Finally, Section IV will conclude with proposals to help states account for economic incentive programs and prevent the unwanted consequences of “failed” economic incentive programs.

II. GENERAL OVERVIEW OF STATE ECONOMIC INCENTIVES

A. HISTORICAL USE OF ECONOMIC INCENTIVES BY STATES

State and local economic incentive programs have been used by governments since near the inception of the United States.² Industrial parks created for developing business near cities were established in the late eighteenth century.³ In 1791, the New Jersey legislature created a private corporation for Alexander Hamilton named the Society for Establishing Useful Manufacturers, to help create economic development in the state.⁴ The New Jersey legislature also created an area of land solely for the development of business, the nation’s first industrial park.⁵ By 1844, Pennsylvania began an economic development strategy that involved one-hundred million dollars of public funds invested in private businesses, including the

2. See MICHAEL D. LAFAIVE & MICHAEL J. HICKS, MACKINAC CTR. FOR PUB. POLICY, MEGA: A RETROSPECTIVE ASSESSMENT app. E at 109 (2005), available at <http://www.mackinac.org/archives/2005/s2005-02.pdf>.

3. *Id.*

4. *Id.*; see also PETER K. EISINGER, THE RISE OF THE ENTREPRENEURIAL STATE: STATE AND LOCAL ECONOMIC DEVELOPMENT POLICY IN THE UNITED STATES 15 (Univ. of Wisconsin Press ed. 1988).

5. LAFAIVE & HICKS, *supra* note 2.

development of infrastructure to benefit such businesses.⁶ In the early twentieth century and at the beginning of after the Great Depression, one of the poorest states, Mississippi, created legislation to attract manufacturing businesses to the state by creating tax-exempt bonds.⁷ In 1929, the town of Columbia, Mississippi, assisted the Reliance Manufacturing Company, a manufacturer of garments, to obtain collateral from private citizens for a loan to build a new plant in the city that provided three-hundred new jobs.⁸ By 1949, Maine created the first statewide business development corporation.⁹ Mississippi's creation of tax-exempt financing and Maine's creation of a statewide business development corporation were soon duplicated by other states. In 1955, New Hampshire created the first state-created entities to issue state debt and guarantee the debt of private industry, also known as an industrial finance authority.¹⁰ By 1963, forty states had statewide business development corporations.¹¹ In the 1970s, counties, cities, towns, and other government entities had begun economic development programs. One of the earliest uses of an economic incentive program by a city was the creation of an Office of Economic Development by the city of New Haven, Connecticut in 1979.¹² In the twenty-first century and present day, the use of economic incentives is commonplace among all fifty states, the District of Columbia, and many local governments.¹³

6. Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature*, 15 ECON. DEV. Q. 90, 91 (2001), available at <http://edq.sagepub.com/content/15/1/90.abstract>.

7. See Connie Lester, *Economic Development in the 1930s: Balance Agriculture with Industry*, MISSISSIPPI HISTORY NOW (May 2004), <http://mshistorynow.mdah.state.ms.us/articles/224/economic-development-in-the-1930s-balance-agriculture-with-industry>.

8. Lester, *supra* note 7.

9. See Buss, *supra* note 6.

10. *Id.*

11. *Id.*

12. See EISINGER, *supra* note 4, at 17 (Detroit, Chicago, and Minneapolis also expanded or created economic incentives by the 1980s).

13. See *generally Frequently Asked Questions About Economic Development Tax Incentives*, THE PEW CHARITABLE TRUSTS (June 27, 2013), <http://www.pewstates.org/newsroom/press-releases/frequently-asked-questions-about-economic-development-tax-incentives-85899485601>.

B. THE RECESSION AND INCREASED USE OF STATE ECONOMIC INCENTIVES

By the end of the recession in 2009, state and local governments' revenues had declined 22.1 percent from the previous year.¹⁴ This decline was primarily due to a reduction in tax revenue collected from individual and corporate income taxes. In the second quarter of 2009, personal income tax revenue dropped by twenty-six percent.¹⁵ Tax revenue, including revenue from sales tax, personal and corporate income tax, property tax, and other taxes including inheritance and estate taxes, and excise taxes, is the primary revenue source for state and local governments.¹⁶ The next major source of revenue is from the federal government in the form of grants and subsidies. In 2009, 52.7 percent of local governments' revenue was from taxes, 22.2 percent from federal government support, and 16.1 percent from fees and charges to industry.¹⁷ Prior to 2009, the proportion of state and local government revenue attributed to federal aid averaged approximately twenty percent, but it was increased during the recession.¹⁸ Beginning in 2009, aid from the federal government accounted for over twenty-four percent of state and local government due to the actions of the U.S. Congress.¹⁹

Congress enacted legislation to address reduced tax revenue and provide fiscal relief for states for their participation in funding certain federal health care programs.²⁰ The most pivotal legislation enacted was the American Recovery and Reinvestment Act of 2009

14. See Lisa M. Blumberman & Jeffrey L. Barnett, *The Funding of our State and Local Governments*, RANDOM SAMPLINGS (Oct. 31, 2011), <http://blogs.census.gov/2011/10/31/the-funding-of-our-state-and-local-governments/> (The U.S. Census Bureau's 2009 Annual Surveys of State and Local Government Finances).

15. Lucas, *supra* note 1. However, sales tax dropped in the same time period by six percent.

16. *Id.* Seven states do not have a personal income tax—Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, and Wyoming. See 2014 STATE TAX HANDBOOK (Timothy Bjur et al. eds., 2013). Three states do not have a corporate income tax—Nevada, South Dakota, and Wyoming. Property taxes are assessed by local governments.

17. Blumberman & Barnett, *supra* note 14, at 1.

18. Lucas, *supra* note 1, at 4.

19. *Id.*

20. See also CHRIS L. PETERSON, CONG. RES. SERVICE, MEDICAID: THE FEDERAL MEDICAL ASSISTANCE PERCENTAGE (FMAP) 2 (2010), available at <http://www.ncsl.org/documents/health/MAFMAP.pdf> (discussing the federal medical assistance percentages that are used to determine the matching funds states must provide for certain medical and social services programs).

(“ARRA”), which provided federal aid to state and local governments to offset the effects of the recession.²¹ Federal aid provided through ARRA was meant to assist states for a limited time, some of which ended in December 2010.²² Federal aid provided through ARRA decreased from fifty-nine billion dollars in 2011 to six billion dollars in 2012.²³ In addition, since the 2012 Presidential campaign, federal aid to state and local governments has been reduced due to public pressure on Congress and the President to reduce the federal deficit.²⁴ The Budget Control Act of 2011 had already set a standard five percent cut to federal spending (the “Sequester Cuts”) that included a reduction of funding to state and local governments.²⁵ The Sequester Cuts were delayed two months by the enactment of the American Taxpayer Relief Act of 2012 on January 2, 2013 (known as the “Fiscal Cliff Act”).²⁶ The emphasis on reducing the federal deficit through the Sequester Cuts, along with the enactment of the Budget Control Act and the Fiscal Cliff Act, shows a clear trend of reducing federal funding to state and local governments.

In 2010, after the recession had officially ended, many states still

21. See American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 155; see also *The Recovery Act*, RECOVERY.GOV, http://www.recovery.gov/arra/About/Pages/The_Act.aspx (last updated May 1, 2014) (website provides details on the Act; \$288 billion in tax cuts, \$224 billion in extended unemployment benefits, education and health care; \$275 billion for job creation using federal contracts, grants and loans); *Recovery*, HHS.GOV, <http://www.HHS.gov/Recovery> (last visited Sept. 13, 2014) (ARRA provided approximately \$4.3 billion to states for assistance in FMAP).

22. See U.S. TREASURY DEP'T, TREASURY ANALYSIS OF BUILD AMERICA BONDS ISSUANCE AND SAVINGS 6 (May 16, 2011), available at http://www.treasury.gov/initiatives/recovery/Documents/BABs_20Report.pdf (discussing the Build America Bond Program, a taxable bond program used to assist state and local governments in financing capital projects at lower borrowing costs sunset on December 31, 2010). See also Phil Oliff et al., *States Continue to Feel Recession's Impact*, CTR. ON BUDGET AND POLICY PRIORITIES 6 (updated June 27, 2012), <http://www.cbpp.org/files/2-8-08sfp.pdf> (discussing reduction in federal aid from fifty-nine billion dollars in 2011 to six billion dollars in 2012).

23. Lucas, *supra* note 1, at 8. See also Oliff et al., *supra* note 22, at 7.

24. See generally THE PEW CTR. ON THE STATES, EVIDENCE COUNTS: EVALUATING STATE TAX INCENTIVES FOR JOBS AND GROWTH 14 (2012), available at http://www.pewtrusts.org/~media/legacy/uploadedfiles/wwwpewtrustsorg/reports/economic_mobility/PewEvaluatingStateTaxIncentivesReportpdf.pdf (discussing the study of the increased use of tax incentives after the recent recession).

25. Budget Control Act of 2011, Pub. L. No. 112-25, S. 365, 125 Stat. 240.

26. American Taxpayer Relief Act of 2012, Pub. L. 112-240, H.R. 8, 126 Stat. 2313 (2013) (addressing the expiring tax provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003).

had budget shortfalls because revenue from taxes and sources other than the federal government had not returned to their pre-recession levels.²⁷ In 2011, twenty-three states raised taxes and fourteen states cut their budgets a total of four billion dollars.²⁸ By 2012, several states had increased their revenue and had been able to balance their budgets with spending cuts and tax increases.²⁹ State income and collected sales tax revenue rebounded in 2012 and 2013.³⁰ State budget shortfalls continued but by the end of fiscal year 2013, state economies had slowly recovered.³¹ Several states have projected revenue growth for 2014, but the growth remains lower than at pre-recession levels.

In light of reduced federal funding, state and local governments continue to balance their budgets by reducing spending and seeking alternative revenue sources. States are emphasizing private investment in economic development within a state through economic incentive programs. The use of business tax incentives has increased substantially since the recession.³² The use of non-tax economic incentives, though not a new idea for increasing state and local revenue, is being expanded and redeveloped by many states to attract and retain new business. There is an increased reliance by state and local governments on economic incentive programs to grow their economies through increased job creation and private capital investment within their jurisdictions.³³ In 2012, it is estimated that 1,874 state and local governments nationwide spent over eighty billion dollars in economic incentives.³⁴ Since 1999, the number of

27. Oliff et al., *supra* note 22, at 1. Budget gaps existed for all fifty states for fiscal years 2010 and 2011 and are listed in tables in this report.

28. See Lucas, *supra* note 1, at 5.

29. *Id.*

30. *Summary: Fall 2013 Fiscal Survey of States*, THE NAT'L ASS'N OF ST. BUDGET OFFICERS, Dec. 14, 2013, available at http://www.nasbo.org/sites/default/files/Summary_Fall20201320Fiscal20Survey20of 20States.pdf.

31. *Id.*

32. Amy Hamilton, *NTA Panelists Say Recession Accelerated State Use of Business Tax Incentives*, ST. TAX NOTES (TA), May 20, 2013. The article reflects comments made by panelists at the Eleventh State Local Tax Program sponsored by the National Tax Association and the American Tax Policy Institute.

33. See Louise Story, *Firms Reap Tax Deals for Jobs*, PITTSBURGH POST-GAZETTE, Dec. 2, 2012, <http://www.post-gazette.com/news/nation/2012/12/02/Firms-reap-tax-deals-for-jobs/stories/201212020246>; Scott M. Susko, *In Defense of State Tax Incentives*, CFO.COM (Jan. 7, 2013), <http://ww2.cfo.com/tax/2013/01/in-defense-of-state-tax-incentives/>.

34. See Louise Story, *As Companies Seek Tax Deals, Governments Pay High Price*,

economic incentive programs nationwide has doubled.³⁵

C. TYPES OF ECONOMIC INCENTIVES

State economic incentives are essentially programs of state and local governments designed to increase business investment and job creation. Most economic incentive programs are focused on four industries: manufacturing, agriculture, energy, and film.³⁶ These incentives are grouped as tax incentives, financial incentives, and direct investment incentives.³⁷

1. *Tax Incentives*

Tax incentives are the reduction, deferral, exemption, or credits of property, sales and use, personal and corporate income taxes. Tax incentive programs, authorized and promulgated through state or local law, ordinance, or rule are designed to attract or retain businesses by reducing their tax liability in exchange for their investment in that state for anticipated increased economic growth and future increased tax revenue. Tax incentives for businesses are popular among state elected officials who generally believe that businesses will locate to their state because of tax incentives and targeted tax cuts to businesses.³⁸ There is also a common belief among state policymakers that lowering the tax burden of a business makes a

N.Y. TIMES, Dec. 1, 2012, <http://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html>. The article was a part of a three-part series of articles examining subsidies and economic incentives granted to private business by state and local governments. The New York Times created a searchable database that was comprised of information from state governments, Investment Consulting Associates, Good Jobs First's Subsidy Tracker Database, company financial filings, and Equilar.

35. THE COUNCIL FOR CMTY. AND ECON. RES., 2012 STATE ECONOMIC DEVELOPMENT INCENTIVES SURVEY REPORT (2013), *available at* http://members.c2er.org/download/2012_Economic_Development_Program_Survey_Report.pdf.

36. *See* Story, *supra* note 34, at 3.

37. JOHN E. SILVA ET AL., WELLS FARGO SEC. & RES., THE STATE OF ECONOMIC DEVELOPMENT INCENTIVES (2011), *available at* <http://media.mclatchydc.com/static/pdf/StateEconomicIncentives.pdf> (discussing all three types of incentives).

38. Soledad Artiz Prillaman & Kenneth J. Meier, *Taxes, Incentives, and Economic Growth: Assessing the Impact of Pro-Business Taxes on U.S. State Economies*, 76 S. POL. SCI. ASS'N J. POL. 364, 364–79 (2014) (addressing the National Meeting of the American Political Science Association (Aug. 30-Sept. 2, 2012, New Orleans, Louisiana)).

state more attractive for business expansion and job creation.³⁹ However, few empirical studies have documented the relationship between low taxes as an incentive for a business to relocate or expand in a state.⁴⁰ Regardless of empirical support, tax incentives remain an important part of many states' economic incentive packages.⁴¹

Billions are spent by states every year on tax incentives, and every state has at least one tax incentive program in the form of tax credits, exemptions, or deductions.⁴² Tax credits are a direct reduction of businesses' tax liability in income, sales and use, property, or other business taxes. These credits may be granted for investments in equipment and machinery;⁴³ economic development within a targeted area;⁴⁴ job creation and hiring of employees in specific areas and salary levels;⁴⁵ use of alternative or renewable energy;⁴⁶ and research and development activities.⁴⁷ Exemptions and deductions typically exclude or reduce income generated from specific business activities encouraged by the state such as the acquisition of land or expenditures and are commonly in the form of tax exemptions for raw materials, sales and use taxes, and inventory taxes.⁴⁸ A popular type of exemption is a temporary exclusion from property tax liability, also known as property tax abatement.⁴⁹ A government entity, generally a municipality or county, offers to "abate" or delay

39. Prillaman & Meier, *supra* note 38, at 368.

40. *Id.* (providing a recent empirical study, using data from fifty U.S. states from 1977 to 2005, examining the impact of state business taxes on the economy of a state).

41. See PEW CTR. ON THE STATES, *supra* note 24.

42. PEW CTR. ON THE STATES, *supra* note 24, at 6.

43. See *Investment Credit*, BLOOMBERG BNA, ST. TAX PORTFOLIOS: BUS. CREDITS AND INCENTIVES, available at Portfolio 1450-2nd: 1450.02.A (describing state credits for businesses investing in tangible personal property essential to their business).

44. See *Targeted Economic Development Area Credit*, BLOOMBERG BNA, ST. TAX PORTFOLIOS: BUS. CREDITS AND INCENTIVES, available at Portfolio 1450-2nd: 1450.02.E (describing the use of this type of credit in 35 states).

45. See *Job Credit*, BLOOMBERG BNA, ST. TAX PORTFOLIOS: BUS. CREDITS AND INCENTIVES, available at Portfolio 1450-2nd: 1450.02. B.

46. See *Energy Credit*, BLOOMBERG BNA, ST. TAX PORTFOLIOS: BUS. CREDITS AND INCENTIVES, available at Portfolio 1450-2nd: 1450.02.D.

47. See *Research and Development Credits*, BLOOMBERG BNA, ST. TAX PORTFOLIOS: BUS. CREDITS AND INCENTIVES, available at Portfolio 1450-2nd: 1450.02.C. (states generally model their credit after the federal research and development credit in I.R.C. § 41 (1986)).

48. See *State Incentive Programs*, SITE SELECTION (Nov. 2010), <http://www.siteselection.com/issues/2010/nov/upload/1011IncentiveChartswNotes.pdf>.

49. See STEVEN G. KOVAN & THOMAS S. LYONS, *ECONOMIC DEVELOPMENT: WHAT LOCAL GOVERNMENTS DO* (IMCA Publications 2006). Many local governments nationwide use property tax abatements for economic incentives.

the collection of property tax on new real and personal property for a certain period of time, in exchange for a business investment project in its jurisdiction.⁵⁰ The abatement is attractive to the business because it reduces their tax liability for a certain period of time, usually in the project's first years of operation in the jurisdiction. The government entity makes a determination that projected revenue in the form of property tax, local income tax, and other economic benefits such as job creation generated by the project are well worth the temporary abatement of property tax. Typically, the business must report the progress of the project annually to the government entity. Once the project is complete, meaning the real property is ready for its intended business use or the personal property such as equipment is acquired and installed, the business must notify the government entity and the abatement period begins.

2. *Financial Incentives*

Financial incentives provide economic value to a business without a reduction of tax liability.⁵¹ These incentives may be grants and other nonrecourse revenue, direct or subsidized loans, financing funded by tax revenue generated from a particular geographic area, known as tax increment financing ("TIF"), municipal bond financing, public utilities reduction, and infrastructure improvements.⁵² Grants and other nonrecourse revenue are simply funds from state or local government or quasi-government entities given directly to private businesses while direct and subsidized loans provide private businesses with loans at interest rates at or below market rates. TIF uses the anticipated future tax revenue generated by new private business development within a specific geographic area for economic

50. *See, e.g.*, ALA. CODE § 40-9B-4 (2014) (abatement for non-educational real and personal property taxes assessed and not previously placed in service, for a private business conducting manufacturing, warehousing or research); *see also* IC § 6-1.1-12 (2010) (abatement of new real property improvements or new personal property such as manufacturing equipment research and development equipment for maximum of ten years granted by a local government to a privately owned business).

51. SILVA ET AL., *supra* note 37, at 2.

52. *See, e.g.*, N.C. GEN. STAT. § 143B-437.01 and § 143B-437.04 (2014) (North Carolina's statute authorizing local governments to grant financial incentives in the form of grants and development funding).

development.⁵³ A state or local government designates a specific geographic area for economic development known as a TIF district. The TIF district typically is a geographic area that suffers from economic blight or an area that lacks significant private investment.⁵⁴ The tax revenue from property or sales taxes collected before any development occurs in the TIF district is the base rate of tax revenue. As an enticement to locate in the TIF district, private businesses are offered financial incentives financed by the increased property or sales tax revenue, known as a tax increment, resulting from the economic development.⁵⁵ The financial incentive financed by TIF funds may include infrastructure improvements and the repayment of municipal debt used to fund the development within the TIF district.⁵⁶

Probably the most common financial incentive is loaning the proceeds of the sale of state and local debt known as municipal bonds.⁵⁷ The interest earned on the bonds is excluded from gross income of the bondholder.⁵⁸ The federal tax exemption reduces the cost of borrowing money for state and local governments because it increases the after-tax yield on the bonds, allowing state and local bond issuers to pay lower interest rates to bondholders.⁵⁹ State and local governments may transfer the benefits of the lower interest rates in the form of a loan to private businesses through bonds called revenue bonds.⁶⁰ The revenues used to secure the bonds are generated from the activity or project financed by the bonds.⁶¹ The proceeds from the sale of the bonds are used to help private businesses finance the purchase of supplies, equipment, and land, as

53. See generally *Tax Increment Financing*, GOOD JOBS FIRST (2010), <http://www.goodjobsfirst.org/accountable-development/tax-increment-financing>.

54. See ALYSSA TALANKER ET AL., GOOD JOBS FIRST, STRAYING FROM GOOD INTENTIONS: HOW STATES ARE WEAKENING ENTERPRISE ZONE AND TAX INCREMENT FINANCING PROGRAMS 1 (2003), available at <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/straying.pdf>. However, the Good Jobs First organization has cited a trend of state and local governments designating geographic areas that are non-blighted and affluent areas.

55. TALANKER ET AL., *supra* note 54.

56. See SYLVAN G. FELDSTEIN & FRANK J. FABOZZI, *THE HANDBOOK OF MUNICIPAL BONDS* 1296 (Wiley, 1st ed. 2008) (defining a tax increment bond).

57. See generally *id.* (general description of how municipal bonds are used and issued by state and local governments).

58. 26 U.S.C.A § 103 (West 1986).

59. JUDY WESALO TEMEL, *THE FUNDAMENTALS OF MUNICIPAL BONDS* 27–29 (5th ed. 2001).

60. See *id.* at 33.

61. See FELDSTEIN & FABOZZI, *supra* note 56, at 809.

well as the cost of construction of improvements.⁶²

Finally, there are financial incentives that help reduce operating costs of private businesses. These incentives include reduced public utility rates, and direct expenditures by state and local governments by providing private businesses with free land, buildings, exemptions from local and state regulations, and other customized services for agreeing to develop or relocate their operations to a specific area.⁶³

State and local governments do not reduce tax revenue by using these incentives, but they incur risk of the loss for a poor investment of their financial incentives.⁶⁴ Grant and loan funds could be wasted if economic development promised by private businesses is not accomplished. State and local governments are burdened with an obligation to repay debt created by a TIF or municipal bond issuance if a business fails to repay the obligation. Moreover, state and local governments may have to repay utility companies for a public utility reduction or public funds used for infrastructure improvements.

3. Direct Investment Incentives

State and local governments with direct investment incentive programs use public funds to make equity investments into privately owned businesses.⁶⁵ Quintessentially, state and local governments become owners of a private business.⁶⁶ The risk is inherent because there is a direct relationship with the success of the business and the state and local government receiving a return on their investment.⁶⁷

62. See FELDSTEIN & FABOZZI, *supra* note 56, at 809.

63. See Lauren Murphree, *A Window of Opportunity: Why Texas is in the Best Position to Develop Offshore Wind Energy*, 45 TEX. TECH L. REV. 73, 77 (2013) (discussing Texas' use of financial incentives in its efforts to lead the renewable energy market for offshore wind energy); see also Robert A. Reiley, *Financial Incentives and the Leadership Role Taken by Pennsylvania and Other States to Bring Green Energy to the Free Market*, 18 WIDENER L.J. 897, 909 (2009) (discussing incentives adopted by Pennsylvania including its financial incentives to the green energy market and the impact these program and funding sources have had).

64. See *infra* Section III (a "poor investment" equating to a failed incentive program is discussed in more detail).

65. SILVA ET AL., *supra* note 37, at 4.

66. See *Programs and Services*, BEN FRANKLIN TECHNOLOGY PARTNERS, <http://benfranklin.org/programs-services> (last visited Feb. 21, 2014) (the Advanced Technology Centers of the Ben Franklin Partnership in Pennsylvania is a state-sponsored direct investment program in technology businesses that began in 1983).

67. In some circumstances it may be reasonable for state and local governments to risk potential loss for the sake of enabling a private business that but for the government investment

D. GOALS OF ECONOMIC DEVELOPMENT

The primary goal of state economic development appears obvious—attract or retain business to increase capital investment and job creation to ultimately increase tax revenue. This increased revenue then becomes available for use in the state’s overall budget. However, is the goal of the state to increase the number of jobs for its residents or to increase the per capita income of its residents?⁶⁸ Critics of state economic development programs frequently state that mere job creation of an incentive program does not justify the effectiveness and economic worth of the program.⁶⁹ Advocacy groups such as Good Jobs First, a national advocacy group promoting more effective and accountable economic incentive programs, monitor state economic development programs nationwide and provide the public and government officials with data and resources to help these programs be more accountable and effective.⁷⁰ Good Jobs First and other thought leaders on state economic development believe states should not look to the quantity of the jobs created but the quality—whether the jobs are increasing the per capita income of the residents of the state.⁷¹

would not be developed. This article does not examine the criteria for a government to make such a risk assessment.

68. See, e.g., Timothy J. Bartik, *What Should Michigan Be Doing to Promote Long-Run Economic Development?* 1 (W.E. Upjohn Inst. for Emp. Res., Working Paper No. 09-160, 2009), available at http://research.upjohn.org/up_workingpapers/160 (discussing the state of Michigan’s goal of economic development).

69. See generally GOOD JOBS FIRST, <http://www.goodjobsfirst.org> (last visited Oct. 19, 2014) (describing Good Jobs First’s purposes and activities); see also Timothy J. Bartik, Senior Economist, Estimating the Costs per Job Created of Employer Subsidy Programs, Presentation at Upjohn Institute Conference on Labor Markets in Recession and Recovery (Oct. 22-23, 2010) (discussing the need for state job-creation policies that are more cost effective); THE PEW CHARITABLE TRUSTS, AVOIDING BLANK CHECKS: CREATING FISCALLY SOUND STATE TAX INCENTIVES (2012), available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_tax_incentives_report.pdf (providing an overview of how unexpected costs of state economic incentive programs, including job creation programs, can negatively impact state budgets); Peter Fisher & Alan Peters, *The Failures of Economic Development Incentives*, 70 J. OF THE AM. PLAN. ASS’N 27, 32 (2004), available at <https://www.mackinac.org/archives/2009/nr043009-petersfisher.pdf> (stating on average state economic development incentives create an average of one in ten new jobs).

70. See generally GOOD JOBS FIRST, <http://www.goodjobsfirst.org> (last visited Oct. 19, 2014).

71. *Id.*; see, e.g., Robert C. Dauffenbach & Larkin Warner, *Oklahoma’s Ad Valorem Tax Exemptions and the Quality Jobs Act*, in STATE POLICY AND ECONOMIC DEVELOPMENT IN OKLAHOMA 13–27 (Oklahoma 21st Century, Inc., 2004); Dan Gorin, *State Economic Growth*

III. CHALLENGES TO ECONOMIC INCENTIVE PROGRAMS

A. LEGAL CHALLENGES

State and local economic incentives have been challenged on state constitutional and federal constitutional grounds. On the state level, petitioners have unsuccessfully argued that economic incentives to private businesses did not serve a public purpose and thus violated the state constitution.⁷² On state constitutional grounds, state and local economic incentives are constitutional and remain enforceable if they serve a public purpose.⁷³ The federal claim has been that state and local economic incentives violated the “dormant” or “negative” Commerce Clause of the U.S. Constitution, which prohibits states from discriminating against interstate commerce.⁷⁴ The primary argument is that state and local incentives discriminate against out-of-state economic activities or interstate enterprises.⁷⁵ This was the essential claim by a taxpayer in *DaimlerChrysler Corp. v. Cuno*.⁷⁶ In *Cuno*, a taxpayer claimed economic incentives, an investment tax credit, given to the car manufacturer to locate to the state violated the Commerce Clause.⁷⁷ The U.S. Supreme Court dismissed the case on procedural grounds, stating the taxpayer did not have standing to sue and thus did not address the substantive issue.⁷⁸

Incentives and the Oklahoma Quality Jobs Program, 1 OKLA. POL'Y STUD. REV. 1, 7–12 (2000).

72. *Maready v. City of Winston-Salem*, 342 N.C. 708, 727 (1996) (North Carolina Supreme Court upheld twenty-four economic development incentive projects as constitutional because they were directly aimed at furthering the general economic welfare); see also Jeanette K. Doran, *The People versus Corporate Welfare: North Carolina's Forsaken Opportunity to Reverse Perversion of the Commerce Clause and to Reinvigorate the Public Purpose Doctrine*, 33 CAMPBELL L. REV. 381, 403 (2000).

73. *Id.*

74. The analysis of the Dormant Commerce Clause is beyond scope of this Article. Congress has the power “To regulate Commerce with foreign Nations, and among the several States, . . . with the implication that states cannot discriminate against or unduly burden interstate commerce.” U.S. CONST. Art. I, § 8, cl. 3.

75. See Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 382 (1996) (providing a detailed analysis of Commerce Clause challenges to the use of state tax incentives).

76. *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 332 (2006).

77. See S. Mohsin Reza, *DaimlerChrysler v. Cuno: An Escape From The Dormant Commerce Clause Quagmire?*, 40 U. RICH. L. REV. 1229 (2006) (discussing whether the granting of an investment tax credit to a taxpayer based on whether the taxpayer installed new equipment in the state violated the dormant Commerce Clause).

78. *Cuno*, 547 U.S. at 322.

B. EFFECTIVENESS OF INCENTIVE PROGRAMS

1. Measuring Effectiveness

Assessing the effectiveness of incentive programs is difficult because there are so many different ways to measure the effectiveness.⁷⁹ Statistical models have been used to measure the growth due to incentive programs, which measure certain factors such as changes in employment, personal income, gross state and local product, and formation of new companies.⁸⁰ However, these factors may not truly reflect effectiveness without accounting for the time period in which the incentives are measured and the impact of business cycle fluctuations in the economy.⁸¹ Some indeterminate factors of measuring incentive programs include: time period used; tracking of data state; rationale for lack of data; and determining if results of incentives are attributed to the incentive or the economic climate.⁸² Economic growth may only be maintained for a specific period of time before outside economic factors may cause a downturn in economic growth. An increase in jobs or an increase of personal income may be due to other economic factors such as tourism or economic growth in a specific industry that are not associated with or a direct result of the incentive program. For these reasons, it is important to determine a specific period of time to measure effectiveness and to account for outside economic factors.

Scholars in economics and tax, relocation consultants, government officials, and economic public policy organizations have not agreed on a sole standard to determine the overall effects of state economic incentives on the general economic growth of a state or local government.⁸³ However, most economists, consultants, and government and public policy officials will agree that data collected and relied on is the beginning of the process of evaluating an incentive program. In a 2012 State Economic Development Incentives Survey Report (the “Survey Report”) conducted by the Council for

79. See SILVA ET AL., *supra* note 37, at 5.

80. *Id.*

81. *Id.* at 6.

82. *Id.*

83. See *generally* Fisher & Peters *supra* note 69.

Community and Economic Research, state and local government agencies that administered economic incentive programs were asked how economic incentive programs were evaluated.⁸⁴ The Survey Report separated non-tax and tax incentive programs and indicated that seventy percent of the responding state agencies collect quantified program information or performance data occasionally or on a regular basis. From 1999–2012, the collection of data for evaluation of programs increased by almost nine percent.⁸⁵ Factors used by state agencies to evaluate the performance of incentives included: number of jobs created; number of jobs retained; investment made by company assisted; average wages paid; increased or new sales; tax revenues generated; and value of cost savings for business. For both tax and non-tax programs, the most common factor used to evaluate the outcome of a program was the number of jobs created, used for sixty-one percent of non-tax programs and 31.9 percent of tax programs.⁸⁶ Other key factors included number of jobs retained, investments made by company assisted, and average wages paid.⁸⁷

Once data is collected, a method for conducting a quantitative analysis is needed to complete the evaluation. The Survey Report determined that state agencies used the following methods to analyze their data: Economic Impact Analysis, Return on Investment Analysis, Ratio of “Public Benefit” Analysis, and Net Fiscal Impacts Analysis.⁸⁸ A substantial percentage of the state agencies did not analyze the data collected (17.8 percent) or used another methodology (4.1 percent). The most used methodology was the Economic Impact Analysis at 60.6 percent, followed by the Return on Investment at 16.2 percent, Ratio of “Public Benefit” Analysis at 11.6 percent, and Net Fiscal Impacts Analysis at 10.4 percent.⁸⁹ Each methodology focuses on different factors to evaluate effectiveness.

84. See COUNCIL FOR CMTY. & ECON. RESEARCH, *supra* note 35. The survey included 576 tax incentive programs and 696 non-tax incentive programs. The response rate for both tax and non-tax programs was 29.7 percent.

85. *Id.* at 20–21.

86. See *id.* at 21, Figure 26.

87. *Id.*

88. *Id.* at 27.

89. *Id.* The percentage of use of methodologies differed between the non-tax and tax programs. See *id.* at 28, Figure 32.

a. Economic Impact Analysis

The economic impact analysis estimates how economic activity is affected by a new business locating in that community.⁹⁰ For instance, a new business locating to a community will have various economic effects on that community through its direct spending to build or lease new facilities, the hiring personnel, and the purchasing of supplies and equipment to operate the business. These expenditures are easily tabulated and recorded as direct effects on the local community. However, these direct expenditures may cause a chain reaction of other economic effects on the community and broader regional economy.⁹¹ For example, the direct spending on goods and services from local vendors and suppliers may cause them to hire more workers. The salaries of those new workers will be used on local goods and services and help expand the local and regional economies. Thus, the total economic impact of the one new business can be measured in layers.⁹² An economic impact analysis accounts for the effects on three different levels: direct effects, indirect effects, and induced effects.⁹³ The direct effects are the changes to employment and income that are the result of the initial spending of the new business or economic development project. The spending of suppliers, vendors and manufacturers that provides goods and services essential to the new business' or project's operations makes up the indirect effects.⁹⁴ Lastly, induced effects on the economy are the changes in and spending of the wages and salaries of the direct and indirect employees on goods and services for common household expenses such as food, housing, transportation, and medical services.⁹⁵ Together, the indirect and induced impacts create a "ripple effect" of economic activity that results from the initial direct expenditures.⁹⁶ The additional impacts are estimated by "multipliers"—a numerical

90. *See generally* Jonathan Q. Morgan, *Analyzing the Benefits and Costs of Economic Development Projects*, CMTY. & ECON. DEV. BULL. (Univ. of N.C., Sch. of Gov't), April 2010.

91. *Id.* at 2.

92. *Id.*

93. *Id.* at 3.

94. *Id.*; *see also* PEW CTR. ON THE STATES, *supra* note 24, at 19.

95. *See* Morgan, *supra* note 90, at 3.

96. *Id.*

factor by which the value of the direct effects is multiplied.⁹⁷ These multipliers vary by industry and provide a simplistic estimate of the total increase in employment, economic output per each job created or per each dollar increase in the earnings of business sales in the local and regional community.⁹⁸ More sophisticated input/output estimates are made through impact model and software applications.⁹⁹

b. Other Methodologies

The other three methodologies—Return on Investment, Ratio of “Public Benefit” Analysis, and the Fiscal Impact Analysis—are more simplistic analyses than the Economic Impact Analysis. Each is the process of comparing the costs, in the form of tax concessions and revenue outlays, to the revenues that have been generated by the economic development project.¹⁰⁰ The forgone tax revenue and infrastructure improvement costs are compared with the revenue returns due to job creation and other sources of state income.¹⁰¹ The fiscal impact analysis may provide a more detailed prediction of the net financial impact on the jurisdiction where the development occurs.¹⁰²

2. “Failed” Economic Incentive Programs

Whether an incentive program is successful or unsuccessful will depend on the data relied upon and the methodology used to evaluate the program. If the goals are not met, has the incentive program failed? There are numerous examples of incentive programs

97. See Morgan, *supra* note 90, at 3.

98. *Id.*

99. The most commonly used modeling software includes the Regional Input-Output Modeling System (“RIMS II”), Impact Analysis For Planning (“IMPLAN”), and Regional Economic Models Inc. (“REMI”). *Id.* This Article is not attempting to provide an economic analysis of which methodology is the best in measuring net financial impact.

100. *Id.*; see also SILVA ET AL., *supra* note 37, at 6.

101. *Id.* The fiscal impact analysis focuses on the net effect of the project on the state or local budget. The forgone tax revenue and infrastructure improvement costs are compared with the revenue returns due to job creation and other sources of state income.

102. See MICHAEL J. MUCHA, GOV’T FIN. OFFICERS ASS’N, AN INTRODUCTION TO FISCAL IMPACT ANALYSIS FOR DEVELOPMENT PROJECTS (2007), available at <http://www.gfoa.org/downloads/FinanicalImpactAnalysis.pdf>.

throughout the country that did not meet the projected goals promised by private business.¹⁰³ To better illustrate examples of failed incentive programs, this article focuses on two states with significant highly publicized failed incentive programs.

a. Florida

The state of Florida, through Enterprise Florida, Inc., its public-private economic development organization, has invested over \$1.7 billion in incentives in 1,600 job creation programs since 1995.¹⁰⁴ Collectively, private companies receiving these incentives promised to generate 224,000 jobs, yet only 80,000 jobs were created.¹⁰⁵ The Florida Department of Economic Opportunity (“DEO”) was created in the fall of 2011 to help monitor state incentive programs and recover money from businesses that failed to produce promised jobs.¹⁰⁶ The DEO created a database listing more than 1,500 subsidy deals dating back to 1995.¹⁰⁷ Most incentives granted by the state are paid to companies with after-tax credits; however, some incentives are paid up front to companies from a Quick Action Closing Fund.¹⁰⁸ This fund is meant to provide companies with upfront cash to encourage them to locate or expand in Florida. Seven companies that were granted over twenty-three million dollars from the Quick Action Closing Fund failed to meet their promised job creation goals.¹⁰⁹ One of the seven companies was Redpine Healthcare Technologies, a company that developed cloud-based software to help chiropractors manage their billing systems. Redpine received \$750,000 from the

103. See PEW CTR. ON THE STATES, *supra* note 24.

104. Beth Kassab, *Public Money Doesn't Guarantee Jobs*, ORLANDO SENTINEL, Oct. 30, 2011, http://articles.orlandosentinel.com/2011-10-30/business/os-cfb-kassab-job-incentives-20111030_1_new-jobs-tax-incentives-gray-swoope.

105. *Id.*

106. Aaron Deslatte, *Florida Gave \$750,000 Tax Deal to Company That Went Bankrupt*, ORLANDO SENTINEL, Mar. 7, 2012, *available at* http://articles.orlandosentinel.com/2012-03-07/news/os-state-wants-economic-development-money-back-20120307_1_economic-incentives-prograqm-gray-swoope-incentive-deals.

107. See *Database: Florida Business Incentives*, ORLANDO SENTINEL, http://databases.sun-sentinel.com/Orlando/ftlaudoincentives/ftlaudBusinessInventives_list.php.

108. FLA STAT. § 288.1088 (2014); see also *State of Florida Job Creation Plan*, FLORIDAJOBS.COM, http://www.floridajobs.org/docs/business-resources/state_of_florida_job_creation_plan.pdf (a description of Florida's economic incentive programs).

109. Dauffenbach & Warner, *supra* note 71.

Quick Action Closing Fund and \$1.6 million in other incentives to relocate from Spokane, Washington, to Panama City, Florida. Redpine committed to create a minimum of 123 jobs with an average salary of \$49,155 by the end of 2012. Five months after Redpine relocated to Panama City, the company went bankrupt. The Florida Attorney General has filed a lawsuit to recover the money, and the litigation is ongoing.¹¹⁰ Florida governor Rick Scott disputes the characterization by Florida newspapers that the DEO is not fully disclosing the state's economic incentives and that it is not enforcing the incentive agreements.

b. North Carolina

In 2005, to lure Dell, Inc. from the state of Texas, the state of North Carolina offered Dell, Inc. an economic incentive package totaling approximately \$260 million. The incentive package was the largest granted to date and consisted of \$243 million in tax breaks on corporate income and state franchise taxes.¹¹¹ Tax breaks were based on the number of jobs to be created. Incentives also included a \$14.1 million Job Development Investment Grant and a \$2.8 million grant from Golden LEAF Foundation to Forsyth Technical Community College for a Dell Training Initiative for job training associated with the new facility.¹¹² In October 2009, Dell announced it was closing its facility in Winston-Salem, laying off more than nine hundred employees.¹¹³

110. Chris Olwell, *Lawsuit Claims Redpine Exec Misused Funds*, THE NEWS HERALD, Nov. 9, 2012, <http://www.newsherald.com/news/business/lawsuit-claims-redpine-exec-misused-funds-documents-1.47373>; Amended Complaint, State of Florida, Dept. of Economic Opportunity v. Redpine Health Care Technologies, Inc., No. 2012CA 000645 (June 2013).

111. Brian Balfour, *Top Ten North Carolina Economic Incentive Deals*, CIVITAS INSTITUTE (Jan. 25, 2010), https://www.nccivitas.org/2010/top-ten-north-carolina-economic-incentive-deals/#_edn3.

112. The incentives were part of the Economic Development Partnership of North Carolina, a non profit corporation that led the state's efforts to attract and retain businesses. *See generally* ECONOMIC DEVELOPMENT PARTNERSHIP OF NORTH CAROLINA, <http://www.edpnc.com/> (last visited Oct. 23, 2014). The Job Development Grant, which is part of the state's economic development program, is a discretionary grant given to new businesses. *See Job Development Grants*, THRIVE IN NORTH CAROLINA, <http://www.thrivenc.com/incentives/financial/discretionary-programs/job-development-investment-grant> (last visited Oct. 23, 2014). The Golden Leaf Foundation is a non profit entity providing funding for job training in North Carolina. *See* THE GOLDEN LEAF, <http://www.goldenleaf.org> (last visited Oct. 23, 2014).

113. Adam Owens, *Dell to close N.C. plant. Eliminate 905 Jobs*, WRAL, Oct. 8, 2009,

3. *Recourse for Failed Economic Incentive Programs*

State and local governments have recourse against businesses that received economic incentives but did not produce the promised economic results. The state and local government can seek the reimbursement of the incentives based on repayment or “clawback” provisions in the agreement with the business.¹¹⁴ The forgone tax revenue resulting from the granting of tax incentives by the state and local government is lost unless the agreement provides that the business pay for the forgone tax revenue. With financial or direct investment incentives, provisions in the agreement may require the business to pay back all the funds it received.¹¹⁵ In order to enforce the promises made by a business, there must be a contractual agreement. Statements made by a business in its solicitations and negotiations for economic incentives are not considered enforceable promises. The process of distinguishing mere statements and enforceable promises was addressed in the case of *Ypsilanti Township v. General Motors Corporation* (“GM”).¹¹⁶ The town of Ypsilanti, Michigan, had granted GM several million dollars of personal property tax abatement in 1984 and 1988 for the expansion of its manufacturing plant in the town.¹¹⁷ Ypsilanti claimed GM breached its agreement with the town when it announced in December 1991 that it was closing the plant and moving its operations to Arlington, Texas.¹¹⁸ Ypsilanti’s lawsuit alleged that GM breached a

available at <http://www.wral.com/business/story/6156112/>; Nanette Byrnes, *Dell's Plant Closure Raises Anger Over Incentives*, BLOOMBERG BUSINESSWEEK, Oct. 9, 2009, available at http://www.businessweek.com/careers/managementiq/archives/2009/10/dells_plant_closure_raise_s_anger_over_incentives.html.

114. See generally PEW CTR. ON THE STATES, *supra* note 24.

115. See Ben Weisfuse, *Sealing the Deal: Why states are incorporating deal closing funds into economic development strategy*; SITE SELECTION (May 10, 2012), <http://www.siteselection.com/onlineInsider/sealing-the-deal.cfm> (This article describes the use discretionary cash grants, usually ranging from several hundred thousand to ten million dollars, given to business up front to make businesses commit to expansion or relocation in the state. Twenty-three states currently use these types of incentives).

116. *Charter Twp. of Ypsilanti v. Gen. Motors Corp.*, 506 N.W.2d 556, 557 (Mich. Ct. App. 1993).

117. *Id.* at 558. GM was granted a twelve-year fifty percent personal property tax abatement at its Willow Run facility in Ypsilanti on its 1984 planned investment of \$175 million and its 1988 planned investment of seventy-five million dollars.

118. *Id.* GM claimed that moving the facility to Arlington, Texas to consolidate the production of its Chevrolet Caprice was necessary due to record losses on sales of the car.

contract created by the state tax abatement statute and based on its conduct, unjust enrichment, misrepresentation, and promissory estoppel.¹¹⁹ The Washtenaw County Circuit Court ruled that the abatement state statute and application for abatement did not create a contract.¹²⁰ However, the court ruled in favor of Ypsilanti on the grounds that GM had made a promise to continue production at the Willow Run plant and was bound to the promise by promissory estoppel.¹²¹ Based on the ruling, GM was enjoined from moving the plant to Texas. On appeal, the Michigan Court of Appeals reversed the lower court's ruling that GM was obligated to maintain the plant in Ypsilanti under the theory of promissory estoppel.¹²² The Court of Appeals held that GM's statements of continuing use of the plant in obtaining the tax abatement were not promises and such statements were required in the tax abatement application process.¹²³ In addition, even if there had been a promise created by such statements, reliance on them was unreasonable.¹²⁴ The *Ypsilanti* case encouraged state and local governments to create enforceable and binding contracts with businesses requiring business to remain in the jurisdiction for a certain specified time period.¹²⁵

C. EFFICIENCY OF INCENTIVE PROGRAMS

To attract businesses to their jurisdictions, state and local governments may find that they are competing with several other jurisdictions. Some critics claim that competition results in an economic war among the states where there is a “‘zero-sum game’—

119. *Charter Twp.*, 506 N.W.2d at 557.

120. *Id.*

121. *Id.* The town claimed that the statements by GM's plant manager at a public hearing constituted a promise to produce the Caprice automobile at the Willow Run facility on the approval of the abatements.

122. *Id.* at 559. The Court of Appeals refers to the elements of promissory estoppel, “[a] promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee.” (quoting the RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981)).

123. *Charter Twp.*, 506 N.W.2d at 560. Receiving the tax abatement required that a business make representations of job creation as required by state statute.

124. *Id.* at 559–61. The Court of Appeals also noted that there was no evidence that the Ypsilanti Township board approval of the tax abatement was conditioned on a commitment by GM to stay in the town for a specific period of time.

125. Krystal Miller & Edward Felsenthal, *GM Can't be Forced Into Keeping Plant Open*, *Appeals Court Says*, WALL ST. J., Aug. 5, 1993.

one jurisdiction gains at the loss of another.”¹²⁶ Nationally, this competition does not produce a net economic gain because capital is relocating from one state to another.¹²⁷ The competition has also caused an increase in the cost of incentives used to attract business, resulting in less tax revenue, which may affect a jurisdiction’s tax base and education and infrastructure funding.¹²⁸ Businesses also help increase the cost of incentives by causing costly “bidding wars” between and among states to obtain the most favorable deals.¹²⁹ Some businesses threaten to relocate in order to receive retention incentives to stay in the state, increasing the cost of incentives in that state.¹³⁰

Another problem caused by the increased competition among the states is interstate job fraud—the “shell game” of treating existing jobs of a newly relocated business as “new jobs.”¹³¹ An example of the job “shell game” is the 2012 relocation of the company Freightquote from Lenexa, Kansas twelve miles away to Kansas City, Missouri.¹³² The relocation of 1,225 jobs did not add jobs to the metro Kansas City area, but cost the state and local governments in Missouri \$64.3 million in incentives.¹³³ Recent studies in Minnesota and Nebraska show that job growth would occur without the help of incentives.¹³⁴ Overall, the economic war among the states has increased the cost of incentives and called into question the efficiency of incentives.

126. Jonathan Q. Morgan, *Using Economic Development Incentives: For Better or for Worse*, 70 *POPULAR GOV'T* 23 n. 2 (2009).

127. *Id.* at 23.

128. Greg LeRoy et al., *The Job-Creation Shell Game: Ending the Wasteful Practice of Subsidizing Companies that Move Jobs From One State to Another*, GOOD JOBS FIRST (Jan. 2013), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/shellgame.pdf>.

129. Gorin, *supra* note 71.

130. LeRoy et al., *supra* note 128, at i.

131. *Id.*

132. Karen Mracek, *States Reviving Incentives for Firms to Relocate*, KIPLINGER (Apr. 1, 2013), <http://www.kiplinger.com/article/business/T019-C021-S005-state-economic-development-incentives.html>.

133. *Id.*

134. *Id.* In Minnesota, eighty percent of jobs created by companies receiving state employment incentives would have occurred without the incentives. The Nebraska report stated that each job created through its job incentive program cost \$235,000. *Id.*

IV. MORE EFFECTIVE AND EFFICIENT USE OF ECONOMIC INCENTIVES

A. RELIABLE DATA ON INCENTIVES

A common barrier to the collection of data is the reluctance of state policymakers to review the effectiveness of incentive programs for political reasons.¹³⁵ In several states, data on incentive programs is nonexistent.¹³⁶ Without accurate and measurable data on past incentives, state and local officials cannot make informed decisions on future incentive programs.¹³⁷ The need for accurate data collection and public disclosure of data on state economic incentives is not a recent development. On May 21–22, 1996, the Minnesota Public Radio’s Civic Journalism Initiative held “The Economic War Among the States” conference at the National Academy of Sciences in Washington D.C.¹³⁸ The conference, attended by economists, lawyers, state legislators, policymakers, tax administrators, and business leaders, addressed several issues including the need for state governments and their agencies to more accurately report the costs and benefits of economic incentives and provide better disclosure of this information to the public. Policy groups such as Good Jobs First encourage states to make information on incentives more transparent and readily available to the public.

There is no national database to account and access state and local incentive programs. However, in a 2012 *New York Times* series of articles on state and local government economic incentives, columnists Louse Story, Tiff Fehr, and Derek Watkins created a database of state and local economic incentives by using multiple sources that included: research of government agency reports; financial reporting of individual companies; data from Good Jobs First and the Investment Consulting Associates; and budgetary information from the Center on Budget and Policy Priorities and the

135. PEW CHARITABLE TRUSTS, *supra* note 69, at 7.

136. *Id.*

137. See SILVA ET AL., *supra* note 37, at 7.

138. See Chris Farrell, *The Economic War Among the States: An Overview*, THE REGION, June 1, 1996, available at http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3659.

National Association of State Budget Officers.¹³⁹ The database reviewed 1,874 incentive programs nationwide.¹⁴⁰ Last January, Good Jobs First produced a study reviewing the online reporting of incentive programs by states.¹⁴¹ The study showed forty-six states and the District of Columbia provided online disclosure of at least one major incentive program, an increase from twenty-three that provided such disclosure in Good Jobs First's similar study in 2007.¹⁴² States were rated on data available online that included the name of the recipient of the incentive, amount of the incentive, the number of jobs created by the incentive, and the ease of obtaining the information online—focusing on whether the online disclosure provided transparency of incentive program data to the public.¹⁴³ Overall, states were providing more information about their incentive programs online. However, four states, Arkansas, Delaware, Idaho, and Kansas, do not make data on their incentive programs available online.¹⁴⁴

A solution to the data problem is state and local governments statutorily requiring the collection of economic data and providing standards for the collection of the data. In the authorization of an economic incentive program, the state or local government is required to maintain data on all incentives granted to private businesses. Support for this mandate could come from the Center on Budget and Policy Priorities and the National Association of State Budget Officers. The data would be of public record and could be used in the assessment of the success of an economic incentive.

139. See Story, *supra* note 34. The Investment Consulting Associates is an association that assists companies with relocation analysis and incentive negotiation. See also ICAINCENTIVES.COM, <http://www.icaincentives.com/> (last visited Oct. 18, 2014); *Subsidy Tracker 2.0*, GOOD JOBS FIRST, <http://www.goodjobsfirst.org/subsidy-tracker> (last visited Oct. 18, 2014).

140. *Id.* It took the *New York Times* reporters ten months to collect and tabulate the database.

141. Philip Mattera et al., *Show Us the Subsidized Jobs—An Evaluation of State Government Online Disclosure of Economic Development Subsidy Awards and Outcomes*, GOOD JOBS FIRST (Jan. 2014), <http://www.goodjobsfirst.org/showusthesubsidies>. The study reviewed four to five economic development programs in all fifty states and the District of Columbia. The total cost of the programs was twelve billion dollars annually.

142. *Id.*

143. *Id.*

144. *Id.*

B. LIMITS ON FUNDING OF INCENTIVES

Government officials tend not to be motivated in accurately estimating the projected impact of incentive programs when attempting to pass economic incentive legislation.¹⁴⁵ The emphasis is on getting the incentive legislation passed and not accurately estimating the cost of the incentive and its effect on the state and local budgets. An appropriation of funds to incentives would limit their cost. Appropriation of funding of economic incentives to state or local government budgets has not been widely done nationwide. However, legislators are more frequently setting annual caps to the costs expended for incentives.¹⁴⁶

C. ACCOUNTABILITY ON BUSINESSES FOR PERFORMANCE

As stated in Section III(b)(3) of this article, states have recourse against businesses that fail to meet their projected employment or investment goals. States will frequently include “clawback” or recapture language in the contractual agreements that provides the incentives. However, in the case of Quick Action Closing Funds that provide businesses with upfront money for economic development, there is a need to curtail or limit the amount of money provided before the business has begun its expansion or relocation. As in Florida’s failed incentive program with the company Redpine, there is a risk that upfront money granted may be unrecoverable due to embezzlement, fraud, or an insolvent or bankrupt company.¹⁴⁷ To avoid this risk, state and local governments should monitor the incentive programs annually rather than wait until a project is completed, which may be over a several-year period. A state could avoid clawback enforcement by basing the amount of incentives granted on the amount of employment and earnings achieved by the business within the first two to three years.¹⁴⁸ In addition, state and

145. PEW CHARITABLE TRUSTS, *supra* note 69, at 7.

146. *Id.* at 14. In 2012, Minnesota’s Small Business Investment Tax Credit was capped at twelve million dollars per calendar year. Massachusetts’ Life Sciences Center tax incentives program has a twenty-five million dollars-a-year cap. *Id.*

147. See Dauffenbach & Warner, *supra* note 71; see also Bartik, *supra* note 68, at 9–10.

148. Bartik, *supra* note 69, at 12.

local governments conducting more rigorous cost-benefit analysis before granting the incentives would avoid the clawback issue all together.¹⁴⁹ In addition to the recourse of retrieving allocated or granted incentive funds, state and local governments should consider creating accountability standards for recipients of incentives. The state could create accountability standards as a part of its statutes creating incentive programs. Requiring a business to post bonds in the amounts of the incentives granted would also create accountability for the business and protect state and local governments. Any restriction of the granting of incentives, accountability standards or the posting of bonds must be nationwide standards applied by all state and local governments to be effective. Without a national standard of accountability, state and local governments that implemented them would be at a competitive disadvantage to other state and local governments. Businesses would simply avoid the accountability standards by expanding or relocating in those jurisdictions without the standards.

V. CONCLUSION

Despite the risks of inefficiencies and accountability, state and local governments should continue to use economic incentives to attract business to their jurisdiction to increase job creation and private capital investment. However, the cost of these incentives, both in expenditures and forgone tax revenue, represents a growing portion of state governments' budgets and may subject the state to steep budget deficits if the incentives do not produce net economic growth. There is a need for state and local governments to account for the cost of these incentives and to measure their effectiveness. To measure effectiveness, state and local governments must be able to collect reliable information on the cost of incentives, institute mechanisms to limit or cap the costs of incentives, and hold businesses accountable for compliance of performance covenants made in incentive agreements. The collection of reliable information to measure the effectiveness of economic incentives will require public availability of data and guidelines on maintaining the data. To

149. *See* Morgan, *supra* note 126, at 28.

limit costs of incentives, limits and caps on funding, annual reviews of funding, and direct appropriation of funding of incentives should be connected to state or local government budgets. Lastly, placing the burden of compliance of incentive agreements on businesses will help save unnecessary expenditures and forgone tax revenue of state and local governments.