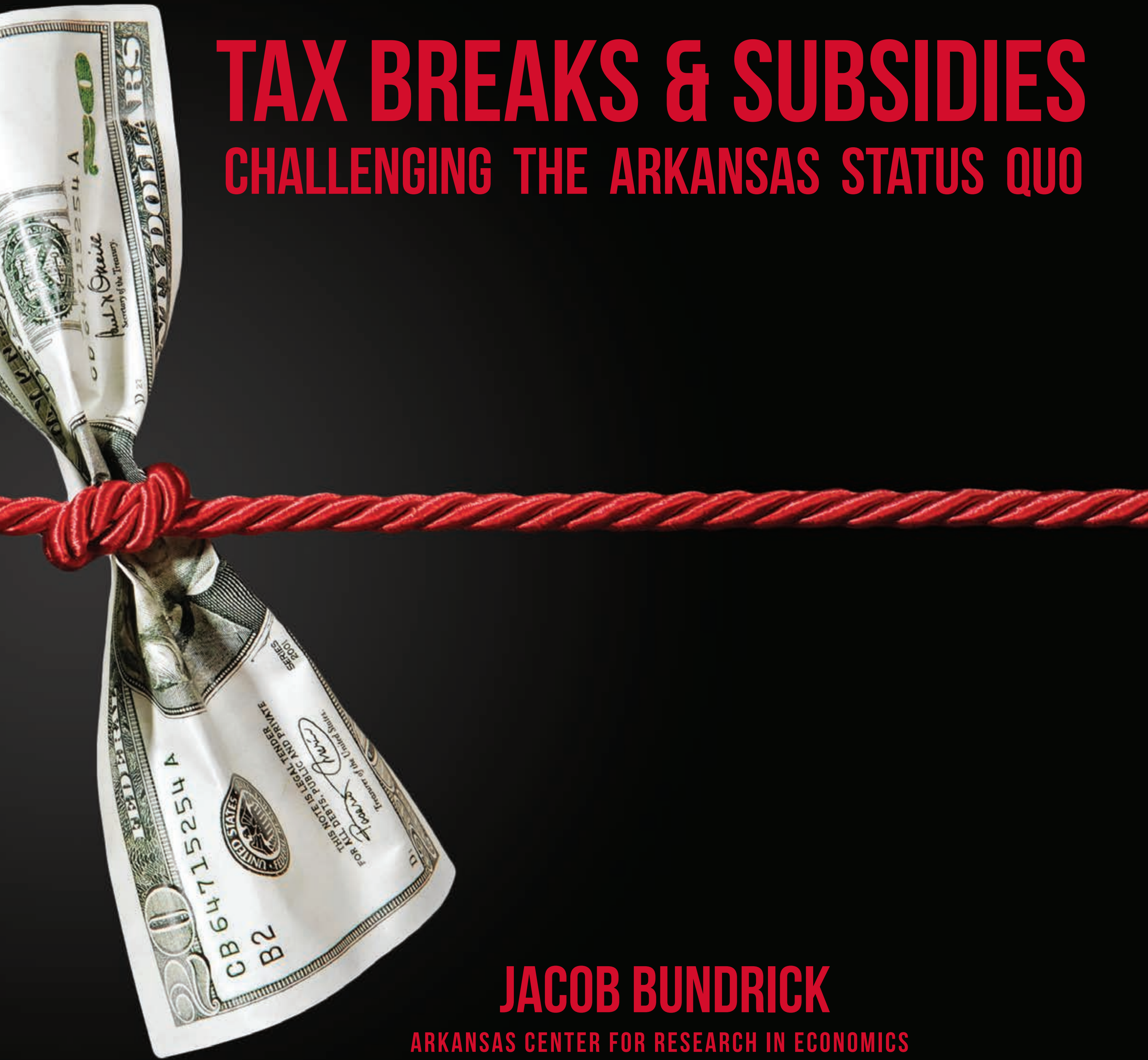
TAX BREAKS & SUBSIDIES

CHALLENGING THE ARKANSAS STATUS QUO



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TAX BREAKS & SUBSIDIES:
CHALLENGING THE ARKANSAS STATUS QUO

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TABLE OF CONTENTS

INTRODUCTION

Economic development is a constant focus of state and local governments. Government officials work to attract businesses, jobs, and investment to the area. They often do this by offering financial incentives, such as tax breaks and subsidies, to select firms. However, financial incentives used to entice businesses come at the taxpayers' expense. Trading tax dollars for a handful of jobs is frequently touted as remarkable progress, but it largely ignores the resulting economic costs.

Politicians continue to create new tax incentives and subsidies to attract firms, but the unintended consequences remain the same. Market distortions created by these incentives make residents worse off and leave them with less money in their pockets. Rather than focusing on developing the next special tax break or subsidy, government officials should focus on creating a better business environment to attract and retain businesses. Specifically, Arkansas should implement comprehensive tax reform that not only lowers taxes for all businesses, but creates a more simple, fair, and transparent system.

TWO STAPLES OF ECONOMIC DEVELOPMENT

When trying to improve economic development, politicians and government officials frequently use two carrots to recruit firms: tax incentives and subsidies. Let's examine how each one works.

TAX INCENTIVES

Tax incentives aim to attract more business to the state by making it less expensive for businesses to operate in Arkansas relative to other locations. Tax incentives come in many forms but are always designed to increase firm profitability by decreasing a firm's overall tax burden. Tax exemptions fully excuse firms from paying certain liabilities, while tax reductions partially offset the amount a firm is obligated to pay in taxes. Tax refunds and rebates repay a portion of the taxes a firm has already paid. Tax credits are more flexible: they allow a firm to offset a portion of its tax obligation, and they can often be carried forward to subsequent tax years or be sold in the secondary market.

To see how tax credits can impact a company's profitability, consider the sample profit and loss statement (**Figure 1**).

To receive tax incentives, firms must meet certain specifications the government lays before them. These vary depending on the tax incentive, but may include belonging to certain industries, investing so much in a particular project, creating a particular number of jobs, reaching a minimum payroll threshold, or a variety of other measures.

These qualifications often vary depending on the tax incentive's purpose. Some are aimed at creating new jobs, spurring private investment, increasing research and development, or other measures. An incentive encourages a specific activity by lowering the firm's cost of that activity, making the return on investment more attractive. For example, the Arkansas job creation tax

FIGURE 1

ARKANSAS COMPANY, INC.
Profit & Loss Statement

A. Without 5% Tax Credit for Payroll		B. With 5% Tax Credit for Payroll	
Operating Revenue	**$20,000**	**Operating Revenue**	**$20,000**
Operating Expenses		**Operating Expenses**	
Labor	$ 7,000	Labor	$ 7,000
Materials	$ 3,000	Materials	$ 3,000
Gross Profit	**$10,000**	**Gross Profit**	**$10,000**
Overhead Expenses	$ 4,000	**Overhead Expenses**	$ 4,000
Earnings Before Income Taxes	$ 6,000	**Earnings Before Income Taxes**	$ 6,000
Income Taxes	$ 600	**Income Taxes**	$ 600
Income Tax Credit	$ -	Income Tax Credit	$ 350
Net Earnings	$ 5,400	**Net Earnings**	$ 5,750

incentive known as Advantage Arkansas is an income tax credit given to qualifying firms based on the payroll of new, full-time, permanent employees. Because the tax credit lowers the firm's labor costs, the return on investment of hiring a new employee is greater and thus a more attractive option relative to other investments the firm could make.

Politicians commonly use tax incentives to target certain preferred businesses or industries in which they want to encourage the creation, expansion, or relocation of firms. This targeting is an attempt to steer the economy by lowering the cost of doing business in a desired industry. For example, Arkansas provides targeted incentives to six emerging technology sectors: advanced materials and manufacturing systems; agriculture, food, and environmental sciences; bio-based products; biotechnology, bioengineering, and life sciences; information technology; and transportation logistics.[1]

SUBSIDIES

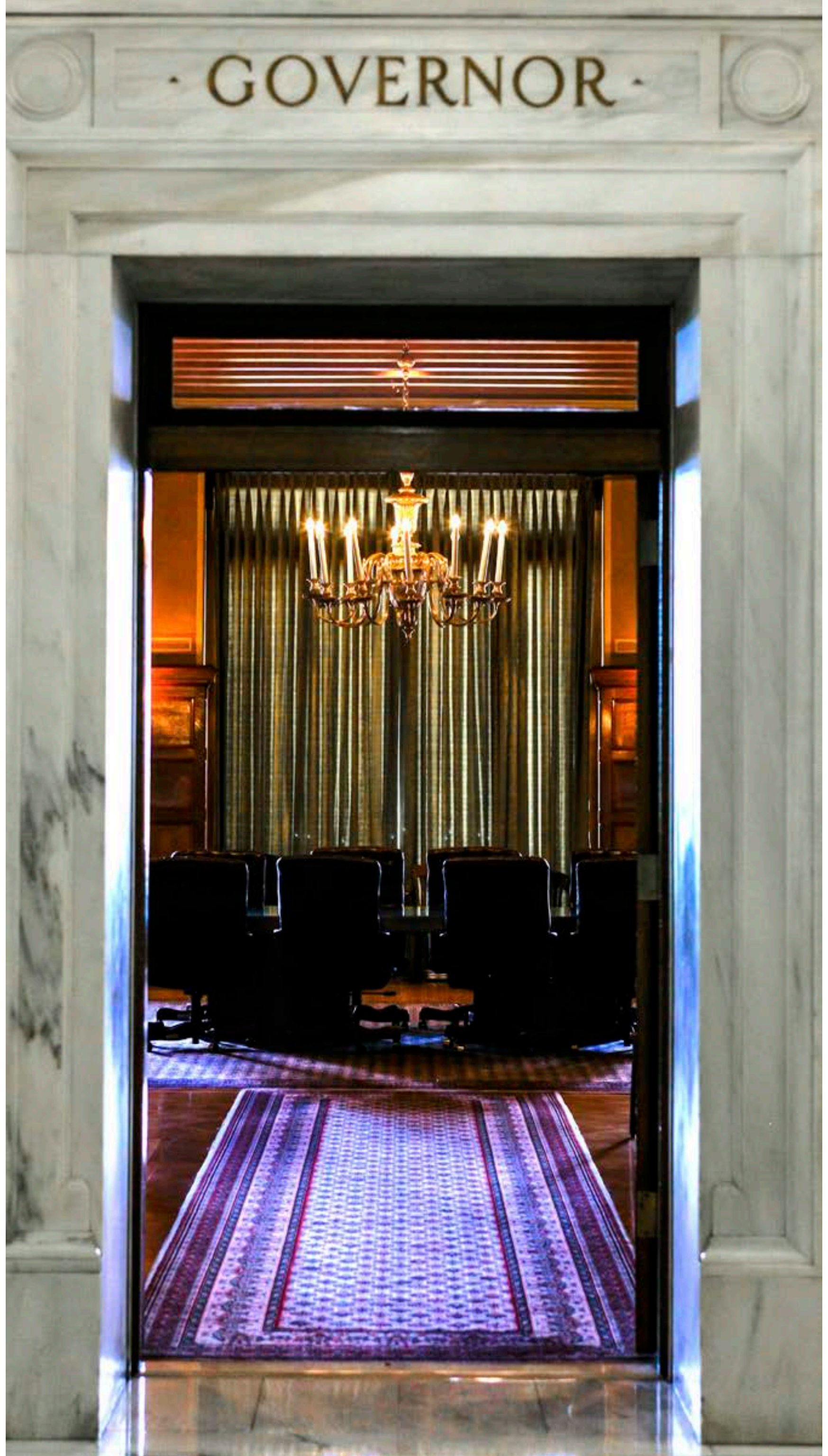
GRANTS, OR SUMS OF MONEY, THAT GOVERNMENT GIVES FIRMS TO ASSIST BUSINESS

SUBSIDIES

Subsidies are grants, or sums of money, that governments give firms in an effort to boost business. Often, governments issue subsidies under the premise that firms will create jobs or increase investment in the local economy. Subsidies, much like tax incentives, lower the cost of doing business and increase returns on investment. The potential for new jobs and investments to improve economic development makes subsidies an attractive tool for politicians.

Arkansas frequently provides subsidies through the Governor's Quick Action Closing Fund (QACF). The Arkansas Economic Development Commission's use of the QACF must be approved by both the governor and the legislative council. The QACF is funded with general revenues and, from its creation in 2007 through end of fiscal year 2015, has subsidized 73 entities. Some of the largest beneficiaries include Hewlett-Packard in Conway ($10 million), LM Windpower in Little Rock ($6.8 million), and Nordex in Jonesboro ($3.8 million).[2]

Arkansas's government also provides subsidies through Amendment 82 bonds. Amendment 82 of the Arkansas Constitution allows the Arkansas General Assembly to authorize the issuance of general obligation bonds of up to 5 percent of the state's general revenues collected during the most recent fiscal year. Amendment 82 bonds are generally reserved for "major economic development projects," such as the $125 million subsidy to Big River Steel in Osceola, and must be voted on by the general assembly.[3]



FINANCIAL INCENTIVES DO NOT SPUR ECONOMIC ACTIVITY

A common argument in favor of financial incentives is that they spur economic activity by encouraging firms to increase business investment. Tax breaks and subsidies incentivize firms to create new jobs and invest in new projects, which sparks demand for more products and services within the local economy. For example, if Hewlett-Packard builds a plant, construction workers get hired, computers get bought, employees eat at local restaurants, and so forth. As demand rises, more firms are attracted to the area and either establish new operations or expand existing operations, leading to further job creation, project investment, and an overall uptick in economic activity. This uptick increases public revenue as new businesses and employees pay taxes on their earnings and purchases. With increased public revenue, governments may be able to afford to decrease marginal tax rates on businesses or individuals or increase the number or quality of public goods and services. While these arguments seem sound, the reality is that financial incentives often fail to spur economic activity for several reasons.

NEGATIVE SPILLOVERS

Traditionally, incentive programs are evaluated only by their gross impacts: the jobs, local investment, and tax revenue directly created by the firm that receives the incentive package. For example, the annual report of the Governor's Quick Action Closing Fund only reports the direct number of jobs created or retained and the direct investments made by the companies receiving subsidies. But new and expanding firms create spillover effects that both positively and negatively affect surrounding businesses. Other firms migrating to the same location, labor pooling, technology spillovers, and knowledge sharing, for example, support economic growth. Labor pooling encourages economic growth by increasing the concentration of labor market participants with specialized skills and knowledge. Technology spillovers, or the exchange of technology among people and firms, increase efficiency and innovation. Likewise, knowledge sharing, or the exchange of thoughts, concepts, and ideas among people and firms, also leads to increased innovation.

But there are also several negative spillovers, such as increasing the cost of doing business. Increasing the number of firms in a location also increases the demand for a variety of inputs, such as labor and real estate, which increases the cost of labor and rents and raises the cost of doing business. There is also congestion of infrastructure. Increasing the number of firms in an area means that, unless infrastructure is expanded, more firms

POSITIVE SPILLOVERS AS A RESULT OF INCREASING THE NUMBER OF FIRMS IN A LOCATION

Labor pooling – The concentration of labor market participants with specialized skills and knowledge increases.

Technology spillovers – The exchange of technology among people and firms leads to increased efficiencies and innovation.

Knowledge sharing – The exchange of thoughts, concepts, and ideas among people and firms leads to increased innovation.

NEGATIVE SPILLOVERS AS A RESULT OF INCREASING THE NUMBER OF FIRMS IN A LOCATION

Increased costs – Higher demand for business inputs leads to higher costs of labor, real estate, and other expenses. The cost of doing business grows.

Infrastructure congestion – Without increasing the level of infrastructure, more firms are competing to use the same roads, railways, and other pieces of infrastructure. As the infrastructure becomes more congested, the movement of people and products slows and profits suffer.

Increased probability of tax hikes – With more businesses and people comes more demand for public goods. To pay for these public goods, the government must collect more revenue. Although the tax base will expand, there is an increased likelihood that tax rates will also rise to keep up with demand for public goods.

are competing to use the same level of infrastructure, such as roads. The resulting congestion can slow the movement of people and products, which hurts a company's profits. Furthermore, there is an increased probability of tax hikes. An influx of businesses and people means that demand for public goods such as roads, schools, and police will increase. Public money pays for these goods, which means that the government must collect more revenue. While more businesses and people mean that the tax base will expand, increasing the demand for public goods also increases the likelihood that taxes will rise to keep up with demand for public goods. Because of these spillovers, both positive and negative, incentive projects should be evaluated on their net, or total, impact on an economy—not just on the direct effects from the incentivized firm.

Much research considering net effects has found that large, new firm locations have a much smaller benefit on the local economy than advertised. Research examining the effect of new firm locations and existing firm expansions in Georgia found that the five-year net employment impact of the average new, large firm (300-plus employees) is much less than the gross employment impact over the same period.[4] In addition, research in the *Southern Economic Journal* found that "the location of a large firm has no measurable net economic effect on local economies when the entire dynamic of location effects is taken into account. Thus, the siting of large firms that are the target of aggressive recruitment efforts fails to create positive private sector gains and likely does not generate significant public revenue gains either."[5] In other words, these findings contradict the common argument that financial incentives increase economic activity. If new firms take employees and customers from existing firms, there are no positive spillovers.

RENT-SEEKING

THE USE OF RESOURCES TO GAIN FINANCIAL ADVANTAGES WITHOUT CREATING ANY VALUE IN THE ECONOMY

EXAMPLE: LOBBYING

RENT-SEEKING

Financial incentives also create artificial competitive advantages among firms. Because incentives reduce the cost of doing business, those who receive incentives have an advantage over similar firms that do not receive them. The government-granted competitive advantage gives incentivized firms a better chance of survival than those that do not receive aid. By providing advantages to select firms, the government is picking winners and losers rather than letting the market decide.

When governments pick and choose who receives financial incentives, they create an environment of rent-seeking: the use of resources to gain financial advantages without creating value in the overall economy. Firms use their resources to lobby for political favors that provide competitive advantages rather than creating a better product or service. In a study published by the Mercatus Center, economists Jeremy Horpedahl and Brandon Pizzola further explain that tax breaks "hinder economic growth by distorting individuals' and corporations' behavior toward qualifying for tax loopholes rather than making the best economic decisions."[6]

Rewarding rent-seeking encourages unproductive entrepreneurship, where businesses pursue activities such as lobbying rather than productive activities such as innovating. Entrepreneurs may decide that it is easier to spend their time asking governments for money instead of creating new products. When politicians increase the rewards, or financial incentives, for unproductive behavior, more entrepreneurs engage in unproductive entrepreneurship, which leads to a misallocation of talent and hurts the economy in the long run.[7]

SEEN AND UNSEEN EFFECTS

Policy makers need to consider both the seen and unseen effects of economic policies because policies do not have a single outcome, but a series of outcomes.[8] Only the initial outcome is immediately apparent; subsequent effects take time to develop. However, failing to consider the unanticipated outcomes of policy is dangerous. Policies that have short-run benefits often have negative long-run outcomes, and vice versa. Sound economic policy requires foresight to anticipate the future consequences of today's decisions.

Consider policies that provide financial incentives to select firms. The immediate, seen effect is the creation of new jobs by the firm benefiting from corporate welfare. This effect is often well documented in photo opportunities with politicians. What goes unseen are the jobs destroyed or lost to surrounding states from the unintended consequences of financial incentives. While a handful of firms may initially benefit from subsidies and tax breaks, the economy at large suffers in the long run from artificial competitive advantages, negative fiscal impacts, and the overall distortion of the marketplace.

FINANCIAL INCENTIVES HAVE FISCAL COSTS

Proponents of incentives argue that there is often no net fiscal cost associated with financial incentives. If Arkansas forgoes taxing a firm in some way, and that firm truly would not have located in the state without the tax break, there is no net fiscal cost. Arkansas does not forgo any tax revenue by issuing the tax break because taxing the firm would have led it to locate elsewhere, which means Arkansas would not receive tax revenue, anyway. If, however, the firm or its employees are not completely exempt and do pay at least some taxes, Arkansas would actually see a tax revenue increase. Tax breaks could potentially make the state better off.

This argument assumes that financial incentives are truly the deciding factor in where a firm locates. Arkansas officials assume that the jobs created in state-involved economic development projects would not have been created absent state intervention. The state thus assumes that these projects lead to net fiscal gains. But are these fair assumptions?

FISCAL COSTS

DIRECT COSTS TO THE GOVERNMENT'S BUDGET, WHICH MAKES LESS REVENUE AVAILABLE FOR OTHER FUNCTIONS

NONMARGINAL FIRMS

Anecdotal evidence suggests that incentives are frequently not the deciding factor in where firms locate. In a 2016 analysis, the *Arkansas Democrat-Gazette* revealed that some companies receiving state aid would have expanded regardless of whether they received incentives.[9] Bad Boy Mowers of Batesville is one such example. Scott Lancaster, general counsel for the company, said that Bad Boy Mowers would have expanded in Arkansas even without the nearly $4 million it received from the state from 2012 through 2014. Peco Foods of Independence County is another example. The state provided Peco Foods with $485,000 worth of incentives, but chief operating officer Benny Bishop said, "We would have chosen Arkansas for expansion even without state incentives."

When the state unnecessarily provides incentives to firms, it creates a fiscal cost. Issuing tax breaks and subsidies to firms that are going to expand or locate in Arkansas regardless of aid means that the state forgoes tax revenue that it would have otherwise received or sacrifices other, potentially more productive uses of its tax dollars. Incentives are merely a giveaway to politically favored firms when they are not the deciding factor in where a firm chooses to locate or expand. Not only do Arkansas officials create fiscal costs through unwarranted giveaways, but they inaccurately claim credit for creating jobs.

SELLING INCENTIVES

States also create fiscal costs when they allow firms that receive incentives to sell their incentives to other companies in the secondary market. Under the approval of the Arkansas Economic Development Commission, Arkansas companies are able to sell certain income tax credits, such as the Delta Geotourism Incentive, the In-House Research by Targeted Business Income Tax Credit, and the Targeted Business Payroll Income Tax Credit. To see how the selling of incentives creates fiscal costs, consider the following hypothetical scenario.

Company A receives $100,000 from the In-House Research by Targeted Business Income Tax Credit. However, Company A fails to turn a profit. Company A cannot use the $100,000 income tax credit because it does not owe any income taxes. But Company A knows it can sell the tax credit. Company A calls Business B, which does owe Arkansas income taxes, and sells the credit for $80,000. When filing taxes, Business B is able to reduce its income tax liability by $100,000. In the end, Company A is $80,000 better off because it was able to sell its useless incentive to Business B for $80,000. Business B is $20,000 better off. By buying Company A's tax credit for $80,000, Business B lowered its tax burden by $100,000, creating a net gain of $20,000. The state of Arkansas, however, is the big loser. By allowing Company A to sell its income tax credit to third-party Business B, Arkansas lost $100,000 of tax revenue that it otherwise would have received. In other words, the secondary sale of this tax credit created a fiscal cost to the state, making Arkansas worse off.

Furthermore, allowing the sale of incentives to third-party businesses means that the state is effectively subsidizing more than just the company it intended to aid. In our hypothetical scenario, Business B benefited from the state trying to aid Company A, even though the state had no intention of aiding Business B. Business B may or may not be in the industry the incentives were designed to target. In Arkansas, the Arkansas Economic Development Commission (AEDC) decides who can and cannot buy tax credits on the secondary market. Not only does the AEDC influence who buys tax credits, it also influences their price.

While the best solution is to eliminate tax credits, Arkansas should at least eliminate the ability to sell tax credits. Instead, Arkansas should make these transferable credits refundable credits. If the company cannot use the credits, the state will give the company cash. Company A would still receive $100,000 even if it had no taxable profits to offset. Refundable credits would prevent unintentional third-party subsidization that creates fiscal costs.

NEGATIVE FISCAL IMPACTS

The fiscal costs of financial incentives also likely lead to other negative fiscal outcomes. By nature, subsidies shift public money away from public goods. This shift of resources creates one of two outcomes. First, without increasing tax revenue, the city, county, or state issuing the subsidy decreases the amount of public goods in its jurisdiction. With less money to allocate to public goods, there will likely be a drop in the quality or quantity of infrastructure, a less developed workforce due to reductions in education, and a decrease in the quality or quantity of public goods like roads, education, parks, and bike paths that improve quality of life. The second possibility is that the government, wishing to maintain the current level of public goods, raises taxes.

Targeted tax breaks have a similar effect. Tax incentives likely lead to increases in marginal tax rates for those who do not receive tax incentives. When the government provides tax incentives to certain companies, it narrows the tax base and lowers the state's revenue. To make up for the lost revenue, all other taxpayers must pay more. Otherwise, the government must reduce spending on public goods.

Either scenario—reduced public goods or increased taxes—discourages firms from locating in the region. Firms become less attracted to a region as congestion of infrastructure increases and the quality of both the infrastructure and the workforce diminishes. Higher taxes and costs of doing business discourage firms, too. Federal Reserve Bank of San Francisco research shows that states with lower taxes enjoy faster economic and employment growth than high-tax states.[10]

PUBLIC GOODS

A GOOD OR SERVICE THAT MULTIPLE PEOPLE CAN CONSUME AT ONCE, AND IT IS DIFFICULT TO EXCLUDE USERS THAT DON'T PAY

USING FINANCIAL INCENTIVES TO STEER THE ECONOMY

An additional argument in favor of financial incentives is that they allow government officials to steer the economy. As the argument goes, governments can influence specific economic activities by designing and issuing incentives that address perceived needs such as job creation, project investment, or research and development. Furthermore, governments are supposedly able to influence industry composition, or the types of businesses in the state, by offering targeted business incentives. But steering the economy is counterproductive for two reasons.

REGIONAL UNREALISM

Regions prosper when they specialize in the industries where they have a comparative advantage, meaning they produce more efficiently than other regions. Specialization in comparative advantages often leads to industry clusters. The economic impacts of natural clusters, such as those in Silicon Valley, have led economic developers to attempt to create artificial clusters. Arkansas's targeted business incentives are one example.

REGIONAL UNREALISM

WHEN STATES DO NOT DO WHAT THEY ARE GOOD AT, BUT RATHER WHAT THEY DREAM THEY COULD BE GOOD AT

Incentives, however, are not necessary to attract firms that align with a region's comparative advantages. The comparative advantage alone, whether it is the workforce, technology, or location, is reason enough for firms in that industry to locate in the region. If Arkansas had a comparative advantage in "knowledge-based" industries, knowledge-based firms would locate in Arkansas regardless of the incentives the state provided. This phenomenon is evident in California, where Brook Taylor, spokesman for the Governor's Office of Business and Economic Development, said that data centers in Silicon Valley "are being built in spite of the fact that we don't have specific tax credits or incentives for them. Companies are just building them here because it makes sense."[11]

Steering the Arkansas economy into industries where it does not have a comparative advantage, however, makes Arkansas worse off. Mercatus Center economist Matthew Mitchell points out that Arkansas would actually "make itself poorer if it tried to specialize in ways that were inconsistent with its comparative advantage."[12] Market distortions lead to regional unrealism, the accumulation and use of resources in areas and activities in which they are not best used. When a state does not do what it is good at, but rather what it dreams it could be good at, its economy does not reach its production potential and the state is poorer as a result.

To see how regional unrealism harms states, consider Arkansas's comparative advantage in rice production. The state's water resources and topography allow Arkansas farmers to grow rice more efficiently than farmers in other states. Now imagine that the leaders of Arkansas thought that ski resorts were the key to a successful economy. By issuing enough subsidies and tax breaks, Arkansas could turn its rice fields into ski lodges. Instead of Arkansas farmers raising roughly half the nation's rice, tourists would be skiing down fake slopes. Would that be the best use of Arkansas's resources? Would it make the state wealthier or poorer?

LOCAL KNOWLEDGE

The argument that economies must be steered into clusters also has underlying assumptions. First, it assumes that the government is better than the market at allocating resources. However, Nobel Prize-winning economist F. A. Hayek pointed out that no single person or entity knows all the relevant information about the entire economy.[13] There is no omniscient wizard that knows exactly how many jackets need to be made, where they need to be sold, and at what price. Rather, people have specific, tacit knowledge about a business or industry, and the potential to earn a profit motivates them to react to market signals, such as prices. Governments, on the other hand, do not have the same profit incentive and are too far removed from market signals to behave in the same way. Individuals reacting to market signals lead the economy to focus on its comparative advantages better than government manipulation does.

More essential, however, is the assumption that the problem of economics is how to best allocate resources. Hayek disputes this, claiming that the problem of economics is instead how to best disburse information about the relative value of resources. Through attempts to steer the economy, the government is not improving the allocation of scarce resources; it is interfering with the market signals that could solve the problem.

INCENTIVES DON'T PROTECT TAXPAYERS

Supporters of financial incentives argue that incentives are designed to protect the taxpayers that pay for them. Tax incentives, for example, generally pay out only after a company makes a business investment. Governments will not award firms a job-creation tax credit if they do not create jobs, just as firms will not receive a research and development tax credit if they do not engage in research and development.

Subsidies differ in that they generally provide payments up front. Because of this, subsidies often come with clawback agreements, which allow governments to take back a portion of the granted money if a firm fails to create the agreed upon number of jobs or make the promised investment.

On the surface, clawbacks seem like a valuable protection mechanism that mitigates taxpayers' risk. However, clawbacks work only as well as they are enforced. If enforcement is lax, taxpayers have minimal protection from failed projects.

Consider the case of Hewlett-Packard (HP) in Conway. HP received a $10 million grant from the Quick Action Closing Fund in return for its promise to create 1,000 permanent, full-time jobs by the end of 2013. At the deadline, however, HP had failed to create approximately 40 percent of the jobs it promised.[14] Yet, Arkansas's government asked HP to pay back only 4.59 percent of the grant it received and negotiated an agreement that would "encourage the company

CLAWBACK AGREEMENTS

ALLOW THE GOVERNMENT TO RECOUP PORTIONS OF SUBSIDY PAYMENTS IF THE RECEIVING FIRM FAILS TO MEET ITS JOB-CREATION PROMISE

THE AMOUNT OF MONEY DEPENDS ON NEGOTIATIONS BETWEEN THE STATE AND FIRM

to continue hiring people."[15] But HP continued to underperform, as evidenced by a second clawback of $356,000 in early 2015.[16] As of the end of fiscal year 2015, HP has been allowed to keep 91.85 percent of the money it received for providing only 60 percent of the jobs it promised.[17]

Furthermore, clawbacks do not protect against bankruptcy. If a company receiving a subsidy with a clawback agreement goes bankrupt, there is little chance that taxpayers will see any money recouped. German manufacturer Beckmann Volmer in Osceola is a prime example. After receiving $1.5 million from the Quick Action Closing Fund, the company entered bankruptcy and has been unable to return any grant money to the fund.[18]

MORAL HAZARD

Financial incentives for businesses also create the problem of moral hazard. Moral hazard arises when people engage in risky activities that they otherwise would not because they share the risk with others. Put more simply, people tend to take more risk when using someone else's money instead of their own. Politicians are willing to provide incentives to riskier ventures, such as wind turbine manufacturer Nordex in Jonesboro or Beckmann Volmer in Osceola, because they are using

taxpayer money. Likewise, firms engage in riskier endeavors when they can use incentives to fund projects instead of making the investment with company capital. The risk of the politician's handout is spread among the taxpayers; it doesn't fall on the politician or the benefiting firm. A failed project does not lead to a loss for the government or for the business, but for the taxpayer.

MORAL HAZARD

THE WILLINGNESS TO ENGAGE IN RISKY ACTIVITIES AS A RESULT OF A PARTY'S ABILITY TO TRANSFER RISK TO A SEPARATE PARTY

OPPORTUNITY COSTS

Politicians also largely overlook the opportunity costs of financial incentives. Opportunity costs are the alternatives one forgoes when using resources in a particular manner. In other words, what could a state have done with the money if it did not provide financial incentives? One alternative use of incentive money would be to leave tax dollars in taxpayers' hands. Individuals would keep more of the money they earn and use it in a manner that best suits their interests.

Another alternative use of incentive money would be to make higher education more accessible. University of California, Berkeley, professor Enrico Moretti finds that cities with larger growth in their share of college graduates also experience larger growth in plant productivity.[19] This finding is important for Arkansas because only 21.4 percent of its population age 25 and older has attained a bachelor's degree or higher. Arkansas ranks eighth in this category among the nine neighboring states, which also include Alabama, Kansas, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, and Texas.[20]

A third alternative use for incentive money would be to hire K–12 teachers. Arkansas has eight critical academic licensure and endorsement shortage areas and 54 school districts with a critical shortage of teachers, according to the Arkansas Department of Education and the Arkansas Department of Higher Education.[21] The state is providing corporate welfare to a handful of firms while many of Arkansas's children are not receiving the education they deserve.

OPPORTUNITY COST

ALTERNATIVES ONE FORGOES WHEN USING RESOURCES IN A PARTICULAR MANNER

SPECIALIZED INCENTIVES: CASE STUDIES

States and localities also use a variety of specialized incentives in an attempt to spur economic growth. The following two case studies show how specialized incentives are supposed to work.

SPORTS VENUES

One example is the development of sports venues for professional franchises using public money. Stadiums such as Marlins Park in Miami, Florida, and AT&T Stadium in Arlington, Texas, were developed in part with public funding. In Arkansas, Arvest Ballpark in Springdale was built using $50 million in voter approved bonds.[22] The state also spends $849,500 managing War Memorial Stadium in Little Rock.[23]

Common arguments for using public money to build sports venues generally include establishing civic pride, increasing tax collections, and spurring secondary investment and indirect jobs. However, real-world evidence suggests that sports venues do little to boost economic activity. Temple University economist Michael Leeds says that “a baseball team has about the same impact on a community as a midsize department store.”[24] Further, a majority of economists agree that subsidizing sports venues is a poor use of taxpayer money. In fact, Harvard economist Greg Mankiw analyzed various polls of the economics profession and found that 85 percent of economists agree that state and local subsidies to professional sports franchises should be eliminated.[25]

ARVEST BALLPARK IN SPRINGDALE WAS FUNDED IN PART BY A $50 MILLION BOND REFERENDUM PASSED IN 2006.

Sports franchises generally do not spur new spending because households have a limited budget for entertainment. To attend a sporting event, households must refrain from spending money on other forms of entertainment, such as movie theaters or bowling alleys. Rather than creating new spending, sports venues merely shift spending from one entertainment venue to another, essentially robbing Peter to pay Paul.

Additionally, the congestion caused by sporting events can drive people who are not attending the event away from the area. This deterrent effect has a negative economic impact: the money these people would have spent at area restaurants, shops, and other businesses gets redirected. For example, a report from the Los Angeles city controller found that Inglewood, California, actually experienced increases in economic activity after the Lakers and Kings left Inglewood for Los Angeles.[26]

ARKANSAS SPENDS $849,500 MANAGING WAR MEMORIAL STADIUM. THE LITTLE ROCK STADIUM OCCASIONALLY HOSTS THE ARKANSAS RAZORBACKS FOOTBALL TEAM AMONG OTHER EVENTS.

FILM INCENTIVES

Film and motion picture incentives are other specialty incentives that have grown in popularity over the last decade. As of 2014, nearly 40 states offered motion picture incentives, according to the *Los Angeles Times*.[27] Arkansas belongs to this category, offering a rebate on all qualified production, with an additional rebate on the payroll of employees who are full-time Arkansas residents. These rebates reduce a firm's costs by repaying a portion of what it has already spent.

Proponents of film incentives argue that these specialty rebates and tax breaks boost the economy because production crews must stay in local hotels and eat in local restaurants. Advocates also argue that producing films in a particular state increases tourism because movie buffs want to see where films are made. However, evidence from other states shows that the return on motion picture incentives is very low.

Consider the cases of Massachusetts and Louisiana. Massachusetts saw just 13 cents in state revenue for every dollar it issued in tax credits from 2006 through 2012,[28] a loss of 87 percent. Louisiana's film production incentives had a negative impact of $168.2 million on the state budget in 2012 alone.[29] The negative fiscal impacts indicate that not only do film incentives not bring a return on investment, they do not even pay for themselves. States must increase taxes to pay for them or cut spending elsewhere.

Furthermore, evidence shows that the primary beneficiaries of film incentives are out-of-state companies and individuals. In written testimony to the finance committee of the Alaska House of Representatives, Joseph Henchman of the Tax Foundation testified that "while some benefits accrue to in-state filmmakers and suppliers, on the whole [film tax credits] are a net transfer from taxpayers to out-of-state production company beneficiaries."[30] For instance, total Massachusetts production spending that was eligible for film tax credits from 2006 through 2012 was more than $1.64 billion.[31] But only $556.3 million, or 33 percent, was spent on Massachusetts businesses or residents.[32]

IN 2012, NECKBONE PRODUCTIONS RECEIVED $2,245,206.23 FROM THE GOVERNOR'S QUICK ACTION CLOSING FUND FOR PAYMENT OF FILM REBATES FOR THE COMPANY'S PRODUCTION OF MUD. MUD WAS FILMED IN SOUTHEAST ARKANSAS ALONG THE MISSISSIPPI RIVER.

Moreover, the jobs created by film production are temporary. Catering companies, extras, local prop builders, and so forth are employed only as long as production lasts. Filmmaking is finite: a movie is not filmed forever. A film being produced along the Mississippi River may provide local jobs for a while, but when production ends, so do the local jobs.

ACHIEVING ECONOMIC GROWTH IN ARKANSAS

Rather than providing financial incentives for a select few companies, Arkansas should create an environment that is inviting to all firms, regardless of size and industry. Arkansas will achieve more economic growth if it focuses on reforming its regionally uncompetitive tax environment. A 2016 study from the Tax Foundation found that Arkansas has the highest overall state and local tax burden among the nine regional states.[33] And in a 2015 report, the Tax Foundation found that Arkansas has the nation's second highest combined state-local sales tax, behind only Tennessee.[34] Furthermore, data from the United States Census Bureau and from Texas Transparency, the comptroller's website for providing government spending information to the public, show that Arkansas has the third highest corporate income tax burden among the nine neighboring states.[35]

Arkansas could also attract and retain more firms by simplifying its tax code to make the system more fair and transparent. In a 2016 article in the Arkansas Democrat Gazette, economist Dr. Jeremy Horpedahl outlined several ways Arkansas can do this. Arkansas could reduce its number of corporate tax brackets as the state has the second most in the nation at six. This progressive tax structure "penalizes businesses for being successful and creates confusion for tax planning as businesses cannot always accurately forecast which bracket they will fall into."[36] Arkansas could also index its corporate tax brackets for inflation and use the same corporate tax base as the federal income tax code. By not doing either of these two, the state is again making it difficult for businesses to forecast their tax liabilities and creating two sets of incentives that pull firms in different directions. These reforms are some very easy things to start with, but are by no means the only reforms needed. Arkansas should always be looking for ways to lower the tax rate, such as closing loopholes in the tax code.

By eliminating tax incentives, lowering marginal tax rates, and simplifying the tax code, Arkansas would provide financial incentives to all firms by decreasing the overall tax burden. Establishing a regionally competitive tax environment would lead to a faster growing Arkansas economy. The jobs will not necessarily come with newspaper headlines and photo opportunities for politicians. But the citizens who are gainfully employed will appreciate them, along with the incentive money the state leaves in their pockets.

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