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Reforming Incentives through Federal Action

By Congressman David Minge

States and cities across the country are competing against one another to lure companies that will provide jobs to local residents. This has been happening for years, and it probably always will, given our country's commitment to the free market economy and rigorous competition. Some localities simply do a better job of ensuring that their area has an educated workforce, efficient transportation infrastructure, and is generally more attractive to employers. That's one of the tenets of good government--create an environment that promotes economic growth and jobs.

But in the last several years we have seen an increase in competition between the states based on something other than the quality of the roads, schools, or available labor force. Local governments are being forced to spend scarce taxpayer dollars for incentives to attract specific companies looking for a new home, or even more discouraging, just to keep a business from packing up and leaving town.

State and local government across the country provide more than $15 billion annually in tax rebates and other subsidies, according to Kenneth Thomas of the University of Missouri, St. Louis. That price is staggering. Those funds could educate 3 million elementary school students, hire 300,000 police officers, or construct 6,000 miles of four-lane highway.

It gets worse. Some of these distorting subsidies are financed through federal tax dollars. The U.S. General Accounting Office (GAO) reports that federal block grant funds are being used not only to create jobs, but subsidize the movement of jobs from one state to another. Why should the nation's taxpayers finance these deals that benefits job growth of one state to the detriment of another?

We must start considering how to stop the use of tax subsidies that squander limited public resources and distort economic decision-making. I have introduced legislation, HR 1060, the Distorting Subsidies Limitation Act, to reduce the incentive for firms to solicit subsidies from states and cities. The bill discourages firms from seeking tax breaks and special grants, and encourages healthy economic competition among states based on factors such as quality of services, reasonable and efficient regulatory policies, and fair tax structures.

HR 1060 would create a federal excise tax on these special targeted economic subsidies, including grants, loans with below normal rates, tax deferrals, or reductions in any fees or charges paid by the firm to the government. The proposed tax should be viewed as a "sin tax" meant to stop an undesirable activity. The less tax collected, the better. Businesses would be taxed on the value of the subsidies at the same rates as currently applied in the federal corporate tax structure. For example, the minimum tax rate on a subsidy would be 15%, but the rate increases to as much as 35% for subsidies over $10 million.

Businesses would be subject to the tax only on subsidies targeted to that one specific business. Tax breaks or economic development incentives generally available to several businesses and meant to improve the overall economic climate would not be subject to the excise tax. The tax would not apply to expenditures for job training and other educational purposes

In addition, the bill denies the exemption from tax for interest on bonds providing targeted state or local government development subsidies for a specific business entity and prohibits the use of federal funds by a state or local governmental unit for any targeted subsidies. If it is determined that federal funds have been used for targeted subsidies, the bill provides for recovery of those funds. However, federal program dollars that are available to all businesses or that are used for an established federal economic development program such as enterprise zones, will not be affected.

This legislation will attempt to combat the practice of a company shuttling back and forth between local governments, playing the auction game, looking for the sweetest deal. To be clear, the local jurisdictions are not to blame for the current bidding war for jobs. Communities, working within the current system, cannot be blamed for trying to attract or retain business. At the same time, businesses cannot be blamed for wanting to move into a community that offers the best incentive package. The system itself is flawed, and we are due for a tune up. Only Congressional action can address the problem.

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