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We need an accurate picture of North Carolina's business incentives budget (1/31/2008)
by William Schweke

Few government expenditures are more controversial these days than "business incentives." With incentives, of course, government provides direct cash payments and/or tax breaks to a private business in order to get it to move to (or stay in) a particular community. Some see incentives as little more than corporate welfare for favored companies. Others see them as a necessary evil and a critical part of any modern economic development program. And indeed, there are occasional cases in which incentives can lure foreign investors who likely would not have relocated otherwise.

Recently, the controversy has been reignited by a new draft report from the Fiscal Research Division staff of the North Carolina General Assembly that attempts to take stock of the state's incentive programs. While some have even criticized the report's very title ("North Carolina Economic Development Inventory") as indicative of a bias in favor of incentives, most of the harshest criticism has come from defenders of the current system who charge that the report's calculation of $1.2 billion a year was overstated and misleading.

If North Carolina is to make the most of the report and the hard work that went into producing it, it is essential that we not get bogged down in a philosophical debate. What is needed now is to make the purpose of the research more transparent. The report was not an exercise to support or call into question the state's business incentive strategies, but an effort to get the facts on the fiscal "out-go" – something on which nobody in or out of state government had any reliable data.

The report is an inventory of all economic development spending, direct expenditures and tax-based measures. Thus, the report's goal is to count money, not to criticize programmatic use. If the program makes this list, it does not mean that it is unworthy. The legislature and the study staff wanted to come up with a ball park estimate of total development spending, view the trends over time, and determine what the implicit funding priorities are (or have been) in recent history.

Republicans (RealClearPolitics.com)

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Critics have attacked the report as being over-inclusive. They claim the report counts a number of long ago adopted tax exemptions and other well-accepted measures and lumps them in with more controversial modern programs like the so-called William S. Lee Act and the recent subsidies to Dell and Goodyear.

While the critics have a point – there are important differences in the various programs – this is no reason not to count them all. All the programs – cash grants, tax measures, free land, low interest loans, loan guarantees, management and business planning advice, etc. – constitute subsidies. In return for the government assistance, the private sector is supposed to provide a good, service, or investment as either a *quid pro quo* or part of a commercial transaction and exchange relationship.

So, for the purpose of clarity, let's better define our terms. Use the term "business incentive" only to designate a subsidy whose chief intent is to affect the location of a business. Such location incentives include a broad spectrum of fiscal aid. Other subsidies (whether it's the so-called "double weighted sales tax" that benefits manufacturing interests or long ago established tax breaks for farmers or insurance companies) may not have been adopted in order to impact the location of a particular business, but they are still used as economic development tools to improve "business climate." As such, they should still be counted.

The report should address this confusion by simply disaggregating its "tax incentive" category and its "general spending" line and distinguishing between location subsidies and other economic development programs and goals.

Defenders of incentives have also attacked the report on the grounds that incentives can "pay for themselves" by raising new tax revenues from new businesses. Unfortunately, this is not always the case. While some incentives deals make fairly tough performance demands from businesses, (the so-called Job Development Investment Grant program, for instance), many do not.

In many instances, it's clear that the state has miscalculated the benefits of a particular business and "overbid" in bringing it to North Carolina. In some instances, the business would have come without the incentives. In others, the state might well have generated a larger "return on its investment" if it had spent the money in another way. In short, despite the claims of some defenders, incentives are rarely costless.

It is due to the controversial nature of incentives that greater transparency of the kind provided by the new legislative report (especially if it is improved) is so needed. There are many promising tactics for improving our business incentives efforts (local hiring preferences, better investments in worker training and other business preservation tactics, for example), but before the state can improve the system, it needs to have a much clearer idea of what it is doing now. Let's hope all sides of the incentives debate can come together on this critical point.

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