Pittsburgh Post-Gazette
post-gazette.com

Stop the corporate extortion

'Job creators' wring tax breaks from states at the expense of everyone else

September 21, 2014 12:00 AM

By Richard Florida

They say the house always wins, but the state of Nevada is letting Tesla walk away with the store.

Back in June, the electric car company and its partner Panasonic broke ground outside Reno for a multibillion-dollar "gigafactory." As the company described it to its shareholders, "processed ore from mines will enter by rail car on one side, and finished battery packs will exit on the other." But then it held out the possibility that it might break ground at other sites in California, Arizona, New Mexico and Texas too — and that the factory's ultimate location would depend on what kind of "relevant incentives" states put on the table. The ante, Tesla said, would start at $500 million.

California is the real winner here, since it gets to keep Tesla's key operations without having to pay for the privilege.

Instead of calling Tesla's bluff, Nevada shelled out $1.25 billion in so-called economic development incentives, and a grateful Tesla agreed to make its batteries in the factory that it was already building. "The gigafactory will mean nearly $100 billion in economic impact over the next 20 years," Gov. Brian Sandoval said when announcing the deal. The state's director of economic development, Steve Hill, added exuberantly that the deal would "allow every under-employed person to reach full employment. It will lift up everyone in the region. Property values will go up. The prosperity of the region will be materially changed."

The reality is that incentives play little if any role in companies' location decisions, which are based on more fundamental factors like labor costs, the quality of the workforce, proximity to markets and access to suppliers. But companies have learned to game the process. Once they have decided on the best location, some even create a fictitious competition to extract whatever incentives they can from overzealous governments.

Political scientist Kenneth Thomas, a leading expert on incentives, points out that “companies have learned that the site location decision is a great opportunity to extract rents from immobile governments, and invest considerable resources into doing just that.”

The Nevada deal is just the tip of the iceberg. California recently doled out more than $400 million apiece in tax credits to Lockheed Martin and Northrop Grumman, while increasing its incentives to the film and media industries from $100 million to $400 million. In 2012, the state ranked second only to Texas, handing out an estimated $3.8 billion in incentives.

According to the watchdog group, Good Jobs First, economic development megadeals (packages topping $75 million each) hit a sky-high $16 billion in 2013, on the heels of Washington state’s eye-popping $8.7 billion in incentives to Boeing. So far this year, states have given away another $7 billion, including the $2 billion Oregon handed over to Intel. Pennsylvania has offered up to $1.7 billion to encourage gas companies to build ethane-processing plants in the state. Mr. Thomas estimates that state and local incentives doubled from about $25 billion annually in the mid-1990s to more than $50 billion in recent years.

The $1.25 billion Nevada is shelling out is a lot of money, but that’s not the worst of it. Even more disturbing is the costs per job created.

Under even the very best scenario — in which Nevada ends up with 6,500 jobs at the gigafactory and another 16,000 or so jobs that the plant stimulates across the economy — the state will end up having doled out more than $55,000 per job created.

If the plant creates and stimulates fewer jobs, say 9,750 of them based on a more realistic multiplier for a battery plant, the state’s bill jumps to more than $130,000 a job. The payout out climbs to just under $200,000 per job if we just consider the 6,500 or so jobs inside the gigafactory. But if Tesla’s projections prove over-optimistic and the plant ends up employing only half that number (which some experts suspect will happen), the subsidy could be as high as a whopping $400,000 per job.

And for all that, there’s little holding Tesla to Reno. Its headquarters is in Palo Alto, and its vehicle assembly plant is still in nearby Fremont. If the market for batteries expands and the technology becomes more mature, what’s to stop it from opening new plants elsewhere instead of expanding in Nevada — or picking up stakes and moving someplace cheaper, like Mexico?

If incentives are gravy for the companies that receive them, they are a hardship for the locations that pay for them. The $725 million in sales tax abatements that Nevada will be giving to Tesla over the next two decades is equal to 80 percent of the state’s current annual sales tax revenue. The $332 million in property tax abatements that Tesla will receive over the next 10 years amounts to 250 percent of Washoe County’s annual property tax revenue.

Virtually all of the published research on the subject shows that most economic development incentives are a senseless waste of taxpayer money. The Lincoln Institute of Land Policy, for example, studied the issue and found that "instead of creating new jobs or spurring employment, the main effect of incentives is simply to deplete a community's tax base."

Poorer, less advantaged communities often take the biggest hit, being more likely to gamble public funds on the hope of new factory jobs. My own analysis found no connection between incentive dollars spent per capita and such measures of economic success as wages, incomes, human capital levels or unemployment.

It's time to put an end to incentive madness once and for all.

Richard Florida, a former professor at Carnegie Mellon University, is director of the Martin Prosperity Institute at the University of Toronto, a global research professor at New York University and senior editor at the Atlantic, where he co-founded CityLab. A version of this article first appeared in the Los Angeles Times.