

Commentary

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On Tax Credits and Economic Development, or: What SB 1234 Does Poorly

By Joseph Haslag

Senate Bill 1234 is currently rolling through the Senate. It expands the enterprise enhancement zone, and by identifying “mega-projects” that consist of capital investment of at least \$300 million over an eight-year span, it is intended to create more than 1,000 jobs that pay higher-than-county-average wages. Under the new law, mega-projects would receive tax credits applied to the project’s wage bill over 22 years. Proponents tout the bill as a tool to spur economic development.

Summary

Officials who use tax credits as a plan to spur economic development tend to rely on discredited economic models. SB 1234 is one such bill, designed to attract “mega-projects” and spur related job creation. Such tax credits will cost taxpayers millions of dollars, without any reliable way of predicting relevant economic growth.

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In a March 25 article, the *Kansas City Star* reported that Bombardier Aerospace is considering land near Kansas City International Airport for a possible \$375 million aircraft assembly plant that would eventually employ 2,100 people. According to Missouri’s Department of Economic Development (DED), up to 5,200 additional related jobs would be attracted. (More on the DED estimate of spillover jobs later.)

These two events are related. Bombardier’s qualification as a mega-project would make it eligible for a tax credit applied to its workers’ wages for the next 22 years — not exceeding 80 percent of the wages for the first three years and up to 25 percent for years nine through 22 after the project is initiated.

Bombardier Aerospace is a welcome addition to Missouri. But because tax credits — reductions to taxes collected by the Department of Revenue — are involved, it is worth asking two questions: Is this a good deal for Missouri taxpayers? Is this the best deal for Missouri taxpayers? I analyze the impact on Missouri’s revenue two ways: In one case, I accept DED’s measure of spillover jobs, and in the other case focus on just the additions from Bombardier alone. In both cases, I find that Missouri tax receipts will suffer a shortfall.

I will start by examining the question on the deal for Missouri and its taxpayers. Assuming the plant is fully operational in 2014, I have computed the present value of the tax credits that would be received by Bombardier Aerospace, assuming that it used the maximum eligible value of credits and found that the tax credits total \$377 million. In other words, Missouri would see \$377 million fewer dollars collected by its Department of Revenue if Bombardier took advantage of the enhanced enterprise zone tax credit.

Obviously, Missouri economy — its tax base — would expand.

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Suppose that the Department of Economic Development is right and that 7,300 jobs would be added, in the form of Bombardier Aerospace workers and other jobs, also taking into account the additional Gross Domestic Product within Missouri's borders from the plant and equipment income — so-called “capital income.” I use the state historical average for Missouri — that is, 3.8 cents of each dollar of state GDP becomes Net General Revenue collected by Missouri's Department of Revenue. As such, I have considered individual income, sales taxes, liquor taxes, etc. Given the expanded state GDP, the present value of taxes collected would be \$355 million. Thus, even granting the Department of Economic Development's opaque measure of related job creation, the Bombardier Aerospace project would cost Missouri taxpayers about \$22 million.

One big problem with this analysis is that the DED's measure of related job creation is the output of a discredited economic model. Typically, this model exhibits a multiplier of between 2 and 2.5, meaning that every job attracted into the state generates an additional 2 to 2.5 spillover jobs. Note that in the absence of these unidentified spillover jobs, the cost to Missouri taxpayers rises from \$22 million to \$110 million. The multiplier approach, if correct, would support widespread government hiring; the Missouri economy could magically expand with each new government hire at least with the range of several thousand workers. Markets do not work this way, however, and the DED unfortunately does not have the resources to update its economic model. Missouri taxpayers should not have to pay for such backward thinking.

There is an escape clause, though. The enhanced enterprise zone law permits the mega-project to make commission payments to the state. The idea is that these payments would offset the state's “excess” tax credits, so that the costs to Missouri taxpayers would be, on balance, zero. The commission payment feature is a little worrisome insofar as the payment plan is not very specific.

Now, for the second question: Is this the best deal for Missouri taxpayers? We have no way of knowing. The value of the tax credits was not offered to every possible business venture. Instead, lawmakers and unelected officials in the DED are choosing recipients for us. In the marketplaces for ideas and business projects, people operating in their own best interest vet lots of options, and eventually buyers and sellers of the projects pass economic judgment. In this case, though, taxpayer money is being spent on a single project, vetted only by elected officials and bureaucrats.

Perhaps our elected officials can do just as well as those whose livelihood depends on careful analysis. I would prefer for officials and bureaucrats to stay out of the vetting process, despite their good intentions. I appreciate their effort to do something for the Missouri economy, but I urge them to stay out of the business of trying to pick winners and instead consider policies aimed at leveling the playing field for all Missourians. If they want to hand out tax breaks, they should give them to all of us — not just a mega-project.

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