



ADVANCING LIBERTY
WITH RESPONSIBILITY
BY PROMOTING
MARKET SOLUTIONS
FOR MISSOURI
PUBLIC POLICY

TESTIMONY

APRIL 20, 2011

AEROTROPOLIS TAX CREDIT BILL LACKS EMPIRICAL SUPPORT, FRAUGHT WITH HIDDEN COSTS

By Audrey Spalding and Christine Harbin

*Presented Before the Missouri Senate Jobs, Economic
Development and Local Government Committee
considering House Bill 840, the Aerotropolis
Trade Incentive and Tax Credit Act*

Thank you for the opportunity to address you today. My name is Audrey Spalding, and I am here with Christine Harbin. We are policy analysts for the Show-Me Institute, a nonprofit, nonpartisan Missouri-based think tank that supports free-market solutions for state policy. The ideas presented here are our own.

Our testimony today is intended to provide an explanation of House Bill 840, the Aerotropolis Trade Incentive and Tax Credit Act, and the probable damaging effect that it would have on the Missouri economy. This legislation is fraught with hidden costs, no study has been published that quantifies its supposed benefits, and tax credits in general have been a poor strategy for economic growth in Missouri.

*Audrey Spalding and
Christine Harbin are
policy analysts for the
Show-Me Institute.*

COSTS OF AEROTROPOLIS LEGISLATION WILL LIKELY BE GREATER THAN ADVERTISED

There are three major cost components of the proposed legislation:

- **\$60 million:** The Aerotropolis bill would award \$60 million in tax credits to freight companies for shipping cargo out of the state. The state will give more money to companies shipping perishable freight.¹
- **\$120 million:** The bill would award \$120 million in tax credits to help pay off interest costs

It appears that there is no firm commitment in place that freight traffic to and from Missouri will increase if the Aerotropolis subsidies are awarded.

associated with debt incurred to build cargo warehouses and other facilities.²

- **\$300 million:** The bill would award \$300 million in tax credits to owners of cargo warehouses. The amount of the credit is tied to property purchases and construction costs, as well as brokerage fees, attorney fees, and other such expenditures.³

All of the above adds up to the \$480 million figure that legislators and the media cite as the total cost of the Aerotropolis tax credit bill. That amounts to about \$80 for every man, woman and child in the state. There's more. A closer read of the proposed legislation reveals that the bill would likely be even *more expensive for Missouri*.

- **Tax exemptions:** In addition to the tax credits awarded, any tenant or entity operating an eligible facility would be exempt from the state income tax and the state corporation franchise tax.⁴ The legislation doesn't include a limit on these costs. Furthermore, the state fiscal note, which was supposed to estimate costs associated with this legislation, has not attempted to estimate these costs either, noting only that these exemptions "will reduce general and total state revenues an unknown amount."⁵
- **Keeping employee-paid taxes:** Not only will cargo warehouse operators be exempt from the state income tax, but they could also keep half of the income taxes withheld from their employees. Again, the proposed legislation

doesn't limit this amount, and the state fiscal note doesn't estimate this lost revenue.

Incidentally, this particular provision within the Aerotropolis bill appears to match up with state tax increment financing that was awarded to the Lambert Eastern Perimeter Redevelopment Project in 2006, meaning that development in this area is already subsidized.⁶

THERE IS NO FIRM COMMITMENT FOR INCREASED FREIGHT TRAFFIC

Officials cite the potential increase in trade with China as the justification for awarding more than \$480 million in subsidies. It is troubling, then, that the Aerotropolis bill does not specify that those subsidies will be void if there is no commitment from China to increase air freight traffic to and from Missouri. In fact, the word "China" isn't used even once in the legislation itself.

From media accounts and public statements made by proponents of this legislation, it appears that there is no concrete commitment in place that freight traffic to and from Missouri will increase if the Aerotropolis subsidies are awarded.

If this bundle of subsidies is written into state law, a more prudent action would be to protect Missouri taxpayers — either by obtaining a firm commitment from Chinese representatives, or by adding safeguards to the Aerotropolis legislation that would render the subsidies void if negotiations with China fall through.

NO STUDY HAS BEEN PUBLISHED TO MAKE THE 'BUSINESS CASE'

In August 2010, Mike Jones, chairman of the Midwest China Hub Commission, told the *St. Louis Post-Dispatch* that a key study making the “business case” for the China Hub idea was halfway completed.⁷

However, when the Show-Me Institute requested a copy of the study promised by Jones, we were told that the study “is still underway but very close to completion,” and that we could expect “possible completion and release of findings to come at the end of next month or June.”⁸

This means that despite statements indicating that subsidizing freight traffic is a good idea for Missouri, **no study has been published that backs up those statements.**

As an example of the depth of analysis that such a study can provide, I have brought along a copy of the 144-page feasibility report for the Cleveland International Airport, which is considering Aerotropolis-style economic development. Ohio took the time to produce this study before proposing any related tax credits.

If no similar study has demonstrated that this project and related incentives would result in new jobs or an increased international demand for Missouri agricultural products, the prudent policy action would be for the state to wait. A substantive analysis of the costs and benefits of the China Hub dream and related subsidies could enable this legislature to make a better-informed decision.

TAX CREDITS ARE NOT FREE MONEY

Supporters of this project argue that it won't cost taxpayers a dime, but this is far from the truth. Tax credits are real money, and they do not appear out of thin air — they come from the pockets of taxpayers. Even though the recipients of tax credits will pay less in taxes, everybody else will bear the burden of their benefit. Unless every tax credit is offset by real spending cuts of the same amount, every dollar that the government spends on tax credits has to be raised through higher taxes, debt, or a reduction in services. It means that everybody other than the tax credit recipient is getting less or paying more.

Think of it this way: When the state gives a company tax credits, that company won't be paying those taxes. *This means that less revenues will flow to the state Treasury.* The government therefore has fewer dollars to pay for schools, fix roads, and build bridges.

One way in which Missourians would pay for this program is through lost activity in the private sector. This is a concept that economists refer to as “crowding out.” If the Aerotropolis subsidies pass, the average Missourian would effectively pay at least \$80 for this legislation. This means that the average family of four in Missouri would pay at least \$320 primarily to subsidize warehouse construction and operation in the Saint Louis area. If Missourians were able to keep more of their earnings, if the family of four could keep their \$320, they would eat at more restaurants, spend more nights in hotels, buy a newer car, make upgrades to their home, etc. With a higher tax burden, Missourians inevitably scale back their

One way in which Missouri would pay for this program is through lost activity in the private sector. This is a concept that economists refer to as “crowding out.”

If tax credits generate economic activity, they do so only at the expense of other forms of economic activity.

spending and this economic activity is lost.

If tax credits generate economic activity, they do so only at the expense of other forms of economic activity. The money that is spent in this program could otherwise benefit Missourians through a tax reduction or another form of state spending.

RURAL TAXPAYERS WILL PAY MOST OF THE BILL

Because the China Hub project will be located in Saint Louis, people living near Saint Louis will receive more of the benefits, but the other taxpayers in Missouri will have to help shoulder the cost. Even though 65 percent of Missourians do not live in the Saint Louis region, they will still have to pay for this program with their tax monies. A taxpayer in Joplin or Sedalia will pay proportionately the same as a taxpayer in Saint Louis, despite the fact that he doesn't directly benefit from the policy. This is an unfortunate case of concentrated benefits and diffused costs — an important concept that lawmakers too often overlook.

Currently, almost 4 million Missourians live outside of the Saint Louis region. Given that each of them would pay at least \$80 more in taxes because of this policy, **Missourians living outside of Saint Louis will be forced to spend \$310 million on the project.** In other words, this policy would remove \$310 million from the economy in the rest of the state, and funnel it into Saint Louis.

The editorial board at the *St. Louis Business Journal* certainly seems to get

this idea.⁹ Earlier this month, they wrote:

That this is essentially a St. Louis-only measure is an insult to the rest of the state, making us look like the greedy urban jerks the outstate legislators love to hate. Not to mention our colleagues in Kansas City.

Speaking of our friends in Kansas City, they in particular will see more costs than benefits. **Kansas City residents will collectively pay \$37 million for this policy.** However, they are unlikely to receive direct benefits from the policy because they live 235 miles away from Lambert Airport. Is sending \$37 million to Saint Louis the best use for their money? Could it perhaps be better spent on schools and roads in Kansas City, or returned to Kansas City residents to spend and invest in the private sector?

CONCLUSION

Don't get us wrong: Audrey and I are enthusiastic supporters of foreign trade — we just do not believe that this plan is the best way to go about it. Providing nearly half a billion dollars in tax incentives to subsidize debt and warehouse construction without a concrete commitment from a foreign firm or a comprehensive study is misguided. This policy will likely do more harm than good to the Missouri economy. What's the rush? Where's the guarantee? Where's the study that shows that this project will be successful?

Tax credits are out of control in Missouri. They are increasing faster than state revenues, and studies repeatedly show that they fail to produce the results that they promise. Most recently, the East-West Gateway Council of Government

concluded that local government has provided \$5.8 billion in subsidies to private development in Saint Louis, but doesn't have much to show for it.

Both the Tax Credit Review Commission and the state auditor's office have recommended changes that would limit tax credits, but so far lawmakers have adopted none. The legislature should implement measures that limit — not expand — tax credits in Missouri.

We have a shared goal: an economy that is thriving and attractive to new businesses. If we are serious about growing the economy, we should abandon the failed policies of the past and investigate different strategies.

For more of the Show-Me Institute's research about tax credits, visit www.showmeinstitute.org.

NOTES

- ¹ HB 840, 135.1511.
- ² HB 840, 135.1511.
- ³ HB 840, 135.1517.1.
- ⁴ HB 840, 135.1513.1.
- ⁵ Committee on Legislative Research, Fiscal Note for SB 390, March 14, 2011. Online here: tinyurl.com/3pw9hcg
- ⁶ State Supplemental Tax Increment Financing Program, Second Amended Certificate of Approval for the Lambert Airport Eastern Perimeter Redevelopment Project, effective Oct. 5, 2006.
- ⁷ Logan, Tim, "Decision time looming on China Hub project," *St. Louis Post-Dispatch*, Aug. 12, 2010. Online here: tinyurl.com/3r92xmj
- ⁸ From an email sent by Douglas A. Potts, project manager of the Midwest-China Hub Commission, on April 13, 2011.
- ⁹ "Digging a Hole to China," *St. Louis Business Journal*, April 8, 2011. Online here: tinyurl.com/3mdolz
- ¹⁰ Stoller, Gary, "St. Louis' airports aren't too loud: They're too quiet," *USA Today*, Jan. 9, 2007. Online here: tinyurl.com/3l4hdyn

Both the Tax Credit Review Commission and the state auditor's office have recommended changes that would limit tax credits, but so far lawmakers have adopted none.





Audrey Spalding
Policy Analyst, Show-Me Institute

Audrey Spalding graduated in 2009 from the University of Missouri with dual degrees in journalism and economics. She became fascinated with local government issues while working as an education reporter at the *Columbia Missourian*, and realized the importance of holding elected officials accountable. Her coverage of the Columbia Public School District's tax levy increase election won a Hearst Journalism Award. Before joining the Show-Me Institute, Audrey worked for the institute as a research intern for a year, and during that time filed more than 500 requests for public information. She is originally from Michigan.



Christine Harbin
Policy Analyst, Show-Me Institute

Christine Harbin, a recent transplant from Wisconsin, joined the Show-Me Institute as a research analyst in July 2009. She holds undergraduate degrees in economics, mathematics, and French from the University of Wisconsin–Madison, and an MBA with an emphasis in operations management from the University of Wisconsin–Eau Claire. She interned with the National Economic Council at the White House in Washington, D.C., during spring 2007. Prior to joining the Show-Me Institute, she worked as an advance planning analyst for hospitals and health care systems.

SHOW-ME INSTITUTE POLICY AREAS

TAXES

Our economy works better when the tax system is simple, fair, and lets workers keep more of the money they earn. Show-Me Institute scholars study the impact of tax and spending policies, and develop reforms that will give us more for our tax dollars and spur faster economic growth.

EDUCATION

The latest education research confirms what common sense has always told us: Kids learn better when their parents have more choices. The Show-Me Institute studies how to empower parents by expanding educational options and providing them with better information, so that every child can attend a school that best meets his or her unique needs.

CORPORATE WELFARE

From eminent domain abuse to subsidies and tax breaks for the powerful and well-connected, government officials often try to pick winners and losers in the market. The Show-Me Institute develops policy recommendations to protect property rights and promote economic growth without caving in to demands for corporate welfare. Secure property rights encourage investment and entrepreneurship. Trying to create economic success through government intervention is a formula for failure.

HEALTH CARE

The standard employer-based model for health insurance leaves a remarkable number of people out. The Show-Me Institute highlights the ways that a consumer-driven, market-based model for coverage can help more people get the care they need while taking ownership for their own health and lifestyle decisions.

PRIVATIZATION

Many government services can be provided more effectively, and at a lower cost, by the private sector. When public services are provided by private industry, economic incentives and accountability provide a critical feedback loop that is largely absent in government bureaucracy. Show-Me Institute scholars analyze public programs to determine how taxpayers can benefit from market-based alternatives.

RED TAPE

One thing that government officials do well is establish barriers to market innovation and erect hurdles for entrepreneurs to clear. The Show-Me Institute is committed to showing how burdensome regulations stand in the way of economic growth and individual prosperity. Market solutions lose their strength when bound by red tape.



**ADVANCING LIBERTY WITH RESPONSIBILITY
BY PROMOTING MARKET SOLUTIONS
FOR MISSOURI PUBLIC POLICY**