Corporate Welfare

We use the inflammatory term "corporate welfare" to draw attention to a proposal for a significant rethinking of policy executed at the State level. It is likely to bring together liberals and progressives doubtful about direct subsidies to business with fiscal conservatives and libertarians.

Many elected leaders have pushed for government to contribute tax dollars to private businesses. The newest vision is that of Governor Ritter to create a "green energy" industry in Colorado. The intent of such redistribution programs is for government to intervene in the economy so that new jobs are created where otherwise none would be. These jobs then supposedly will multiply through the economy as wages from the jobs and purchases of materials and other inputs provide new income to supporting businesses. It is the dream, vision and expressed intent behind the Obama administration's American Recovery and Reinvestment Act (ARRA) stimulus funding, and the hope of governments at all levels. Yet it is increasingly understood that such programs actually result in a lower general standard of living.

Policy makers often overlook that resources given to a business must come from somewhere else where they could have been better used in alternate ways. Economists observe that "the real cost of something is what you have to give up to get it." The real costs of the Ritter administration's green energy jobs are all the lost opportunities to use the labor, resources and capital for other, more productive things in the economy. Misunderstanding this crucial point is the fallacy of the broken window writ large. [1]

A person will decide what to purchase based on an opinion of what will make him or her better off. When government steps in with a prohibition, a regulation or an incentive, it adversely changes the decision and prevents the actor from taking that best step. If a state-provided incentive is used, the cost is lowered for the decision-maker by forcing someone else to pay the difference.

The cost of competing with other states to win the favor of firms wastes resources. Studies going back decades call the practice into question. A comprehensive paper on the practice found:

> Some evidence exists that incentives have the potential to move jobs from one state to another intraregionally; but no evidence exists that incentives actually create new jobs. This intraregional job heist has been dubbed 'begger (*sic*) thy neighbor' strategy by Timothy Schellhardt of the Wall Street Journal (1983).
>
> The fact that states continue to compete among themselves through business inducements despite the evidence that the competition is generally counterproductive is an obvious anomaly for students of state government and policy. Furthermore, this competition is more than a theoretical concern since these inducements

The "broken window fallacy" is an allegory of a young hoodlum breaking a baker's window. The townspeople are happy that the glass maker is now employed and that the moneys will invariably filter into the local economy. The young hoodlum is viewed as a benefactor to the town's economy. The fallacy is in "what is not seen." The baker would have used the money on something that would make him happier, such as buying a new suit. The tailor in turn is deprived of an income, the baker is worse off for buying something he already possessed, and the townspeople are deprived of a tangible good in their economy. The "young hoodlum" can serve as a metaphor for governmental manipulation of the economy.

> represent a substantial investment of state resources.[2]

Others' research has led to a call for terminating the programs:

> Some economists claim that so long as incentives are directing firms to areas with high unemployment, these policies are wonderful. In fact, the free market already does this, directing resources to where they are in greatest demand and cheapest to employ. State financial packages can only distort prices and resource allocation.
>
> The whole institution of the state development agency needs to be scrapped as a futile and frequently corrupt effort in economic planning that only ends up redistributing other people's money. What we need is a free market within the states and economic competition among states, not a war among state government agencies.[3]

The progressive Economic Policy Institute has come to similar conclusions, based on the research of Robert Lynch of Washington College, who has studied the issue of corporate welfare for 20 years. Lynch argues that these incentive packages "rarely cause firms to expand in geographic areas that they would not have otherwise expanded to without state incentives."[4]

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There are instances when a state can buy the favor of a firm with a large incentive package. Milwaukee bought 200 Frontier Airline maintenance jobs, wooing them from Colorado by offering $27 million in incentives compared to the $16.5 million Colorado offered.[5] Milwaukee now has 200 jobs it may have gained in any case, but arguably it is not 200 jobs richer. Paying $135,000 for each new job is likely to have caused net damage to the City's economy.[6]

In the words of economist Russ Roberts, "it's like taking a bucket of water from the deep end of a pool and dumping it into the shallow end. Funny thing—the water in the shallow end doesn't get any deeper." [7] To make things even worse, there are economic "leakages" that take place—the inefficiencies, false starts and mistakes that occur when someone in charge does not have his own money at risk. It is like moving swimming pool water with a bucket that has holes poked in it. The faster you try to move the water, the faster resources are depleted and wasted, and the more our standard of living declines.

Local and state economic development agencies have been too silent about failures. Projects and businesses financed with tax dollars occasionally fail or do not permanently relocate to Colorado.

Local and state economic development agencies have been too silent about failures. Projects and businesses financed with tax dollars occasionally fail or do not permanently relocate to Colorado. The Intel plant in Colorado Springs was a high priority for people looking to secure a "basic industry" for the state and generous tax incentives were used to lure the company. When the market for computer chips changed soon thereafter, Intel closed the plant and moved its operations out of state. First Data Corporation moved its headquarters from Greenwood Village to Atlanta in 2009; economic incentives did not matter when the new C.E.O. decided that Atlanta was closer to the company's customers.[8]

The central justification for making the incentive decisions is that the elected officials and the government employees who serve them are expert, knowledgeable people who know better than the citizen or individual investor about what business is best suited to be wooed. The economist Hayek calls this justification the "fatal conceit" that hands over unwarranted power to people who cannot possibly have all the information that resides in the millions of actors who make up a market.

We believe the entire "green energy" effort is slowing economic recovery and very likely does not represent the strongest investment. The state legislature[9] has mandated that fossil fuel-based energy sources be curtailed and that 30 percent of the energy consumed in Colorado by 2020 be generated from solar and wind power.[10] Direct costs paid by energy consumers to a utility provider act as a new tax, but the focus here is only on the economic development part of the equation.

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From 2005 to 2009 the legislatively-created and politically-appointed Economic Development Commission and local governments spent just under $13 million in direct subsidies. Matching funds from local agencies and governments more than double the cost to $27 million. Tax credits undoubtedly were a far larger part of subsidizing businesses. The Economic Development function, housed within the Governor's budget, will spend $3.4 million of General Fund moneys in the current fiscal year, and an additional $2.7 million for job training.[11] Money over the past four years went to directly support about 57 companies. About half of them are large, publicly-traded international and national companies. Seven are dedicated to "green" activities such as wind and solar power.[12]

Colorado has paid for bioscience grants.[13] The theoretical justification for the state's funding of bioscience is the alleged existence of a "market failure" and the inability to serve the public good at optimal levels without the state's intervention. The cost to the taxpayer was also that the free market would have employed researchers to pursue alternatives with higher potential. By contrast, computer technology also benefits society, but the state was not central in the development of the computer industry. Even without state intervention, rapid advancement of technological efficiency continues as computers become faster and cost less.

Another unstated assumption has to be that the target company does not know and cannot accurately predict the extent of its contribution. If a company understands the cost-benefit analysis for each community under consideration, it can continue to negotiate increasingly higher subsidies. A rational economic development agency will stop only when the analysis shows the additional costs of bringing in the new company begin to exceed the benefits.[14] At that point, there is no net gain to the town or state that attracted the new company. Instead, the agency must hope the target company has inept negotiators or is unable to quantify on its own how much net value a subsidy is worth—usually not a good bet. Where negotiations are successful for the agency, look to the strong possibility that the investing private firm had already decided to move into the community, but was looking for a hand-out to sweeten the deal.

When it comes to economic development, citizens should demand that governments at all levels enforce contracts, protect property rights and curtail "externalities." Individuals should be left to function unimpeded by bureaucrats, undirected by politicians and left to enjoy their work rather than have it spread around by agents who neither started the enterprises nor contributed to the value the enterprises created. In 1680 the powerful French finance minister Jean-Baptiste Colbert asked a delegation of merchants and other men of commerce what the state could do to help them. Their answer was simple and resonates today: "Leave us alone."[15]

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Colorado benefits from the reminder that the state constitution strictly prohibits taking on public debt for companies and very explicitly prohibits any appropriation to be made "for charitable, industrial, educational or benevolent purposes to any person, corporation or community not under absolute control of the state … ."[16] "Corporate welfare" on its face is a violation of the state constitution.

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Sam Beck assisted in the research. Mr. Beck is an economics major with Senior credits at the University of Colorado at Boulder. He is working as an intern at the Independence Institute in the summer and fall of 2010. He will pursue a career in government after his anticipated graduation in May 2011.

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Sean Paige provided historical insights for economic development failures. He is a City Councilman in Colorado Springs and the Director of Local Liberty Action. He also is the Executive Director of the Limited Government Forum. His career included work as the editorial page editor of the ***Colorado Springs Gazette.*** He received his education at Arizona State University.

We appreciate the review of this material by **Paul Prentice**, a Senior Fellow in at the Independence Institute and an Adjunct Scholar at the Ludwig von Mises Institute. Dr. Prentice owns a consulting practice, Farm Sector Economics, Inc., which analyzes macroeconomic developments and their implications for agriculture. He also teaches at The Vanguard School in Colorado Springs. Dr. Prentice's career included work as the Chief Macroeconomist at the Department of Agriculture's Economics Research Service under both the Carter and Reagan administrations, and as a Visiting Scholar at the U.S. Department of Treasury under the Clinton Administration. He obtained his doctorate in agricultural economics from the University of Connecticut.

Eric Wilson performed a great deal of the research in this section. He is a 2010 graduate of the University of Colorado at Denver, with a degree in history. Mr. Wilson worked as an intern at the Independence Institute during the summer 2010. He is preparing for a graduate degree in economic policy at the London School of Economics external studies program.

ENDNOTES

1 See Henry Hazlitt, *Economics In One Lesson* (New York: Arlington House Publishers, 1979), pgs. 23-24.

2 Dennis O. Grady, "State Economic Development Incentives: Why Do States Compete?" *State & Local Government Review* 19, no.3 (Autumn 1987), pg. 87.

3 Peter T. Calcagno, "Can States Buy Businesses?" *The Free Market: Mises Institute Monthly* 17, no. 4 (April 1999), http://mises.org/freemarket_detail.aspx?control=30.

4 Robert G. Lynch, *Rethinking Growth Strategies:*

How State and Local Taxes and Services Affect Economic Development (Washington D.C.: Economic Policy Institute, 2004).

[5] Renee McGraw and Ed Sealover, "Can Colorado Do More To Keep Company Headquarters?" *Denver Business Journal*, April 30, 2010.

[6] Stacey Vogel Davis, "People Speak Poll," *The Business Journal Serving Great Milwaukee*, June 25, 2010.

[7] Russell Roberts, "Presidential Economics: What Leaders Can And Cannot Do About The State of the Economy," Library Of Economics And Liberty, http://www.econlib.org/library/Columns/y2004/Robertsleaders.html.

[8] McGraw and Sealover.

[9] Before the legislative mandate, a plebiscite started the trend. In 2004, then-Speaker of the House Lola Spradley led an initiative that demanded 10 percent of alternative forms of energy constitute citizens' energy consumption on or before 2015. Amendment 37 passed by 52-48.

[10] Other options include nuclear-generated steam, hydroelectric plants, or geothermal plants. These options suffer from one or more impossibly large regulatory burdens, and/or rare few workable locations, or other deficiencies that drive per unit costs into stratospheric heights.

[11] Appropriations legislation for 2010 budget, House Bill 1376.

[12] Colorado Office of Economic Development and International Trade, *Annual Reports*, 2006 through 2009.

[13] Colorado Office of Economic Development and International Trade, *Bioscience Discovery Evaluation Grant Program*, http://www.colorado.gov/cs/Satellite/OEDIT/OEDIT/1167928017742.

[14] Although, as discussed above, the economic development agency first must ignore the information created by the producers and consumers in the polity who have found through the trial and error of the market what the best investment would be.

[15] "*Laissez-nous faire*," from which the term "laissez-faire capitalism" is derived. Compare with the interventionist policies of public-private partnerships and other government direction of the economy. The French economist and statesman Anne-Robert-Jacques Turgot writes of this episode in *Eloge de Vincent de Gournay* (1759). Quoted in Murray N. Rothbard, "Biography of A.R.J. Turgot," http://www.Mises.org/resources/3244.

[16] Article XI, Section 1. "Pledging credit of state, county, city, town or school district forbidden," and Article XI, Section 2. "No aid to corporations - no joint ownership by state, county, city, town, or school district," and Article V, Section 34. "Appropriations to private institutions forbidden."