In a Healthy Democracy, Facts Matter

20 Major Studies Showing Taxpayer Subsidies to Businesses Don't Work

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New York State spends roughly five billion dollars every year subsidizing big businesses. Unfortunately for New Yorkers, there is overwhelming evidence that government subsidies to businesses are a very poor way to create good jobs and local economic growth.

Worse yet, taxpayer handouts to businesses in New York – and elsewhere – are often hidden from public view, highly politicized, and pose a corruption risk.

Reinvent Albany advocates for government decision-making based on facts and good sense. We have compiled 20 of the most important studies done by reputable independent researchers to help our elected officials better understand business subsidies.

The facts are in: taxpayer subsidies to businesses are a bad investment

There is extensive independent research assessing whether subsidies to businesses, often in the form of tax abatements, spur local economic development. Three major approaches have been used to study this question: 1) surveys of businesses examining the influence of state and local policies on investment decisions; 2) case studies assessing how changes in policies might influence behavior, including siting, expansion, or new firm start-up decisions; and 3) econometric analyses that study how state and local policies influence state and local economic growth, as well as firm decisions (Bartik 1991, Lynch 2004). The evidence from these studies shows that tax incentives and direct subsidies are relatively poor mechanisms for job creation and other economic development indicators. Specifically, studies show that subsidies have little effect on the number of new firm establishments, job growth, firm location decisions, and overall economic growth.

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Gabe and Kraybill (2002) evaluate firm-level tax abatements from a sample of more than 350 firms. The authors asked whether abatements contributed to job growth and whether recipient firms overstated expected employment gains. They find no evidence that the abatements promoted employment growth. They state that **abatements "have very little effect on actual growth of establishments**." Further, they determine that firms receiving certain tax abatements also overstate the number of jobs they expect to create to a greater extent than firms that do not receive them.

In his review of survey and econometric studies concerning the effectiveness of business subsidies, Lynch (2004) finds that there is near unanimity in concluding that "**state and local tax incentives fail to attract a significant number of new businesses, create numerous jobs, or substantially enhance state economic performance**" (25). This study shows that tax cuts and incentives do not create jobs in a cost-effective manner and further, that spending on state and local services does not undermine growth.

Jensen (2017) studies a state subsidy program in Kansas, Promoting Employment Across Kansas (PEAK). Jensen creates a control group for each firm that received a PEAK subsidy and then compares employment generation between the two groups. Jensen additionally surveys managers about the impact of the PEAK program on firm decisions. His analysis concludes that the PEAK program, while popular, is ineffective. He says that his findings "indicate that **incentive programmes have no discernible impact on firm expansion, measured by job creation**" (85).

Donegan et al. (2018) take a similar approach to Jensen and compare the performance of firms that received subsidies against a group of firms who did not receive subsidies. Through a difference-in-differences approach, they conclude that "**[w]hen we examine the overall effectiveness of state incentive grants on firm-level performance, we find little evidence that they generate new jobs or other direct economic benefits to the states that employ them"** (14).

Scholars from the University of Illinois at Chicago (2019) study whether subsidies helped municipalities in the Midwest recover from the Great Recession. Using a unique dataset that combines data on tax increment financing districts and tax abatements together with socioeconomic, geographic, fiscal, and spatial competitive characteristics for six municipalities in Illinois, Michigan, and Wisconsin, the authors measure employment growth, establishment formation, and business relocation. **They "find little evidence that economic development subsidies helped municipalities recover from the crisis"** (895).

When it comes to who gets jobs created by firms receiving subsidies, a significant portion do not serve existing residents. According to Bartik (2019), for every 10 jobs created, 4 jobs go to in-migrants in the short run. After 5-6 years, that portion shifts, and **for every 10 new jobs, 7-9 jobs go to in-migrants**. This pattern persists through at least 15-20 years after a firm has received subsidies, suggesting that firm subsidies might do little for existing residents of any state or locality.

As to whether business subsidies actually influence a firm's location, Bartik (1991) highlights the complexity of business location decision-making, noting that **businesses are concerned with more than just maximizing profits**. Most studies ignore other factors that might influence business decision-making processes. These studies also often assume that profits are heavily impacted by state and local tax policies. Other factors that should be considered include existing durable capital investments, wages, and public services.

Similarly, Jolley et al. (2015) survey North Carolina firms that received subsidies and those that did not. Both groups report **that the availability of skilled labor is the primary factor influencing business climate**. Further, contrary to the belief that tax credits motivate firm location decisions, only 30% of executives at companies receiving subsidies were actually aware that their company received a subsidy.

Jensen (2017) examines the same question: do business incentives actually influence firm decisions? By focusing on a single business subsidy program in Texas, Jensen documents whether firms receiving a subsidy would have stayed in state regardless of subsidies. In many cases, firms openly indicated that they were not considering any locations outside the state, while others had already started facility construction before even applying for the subsidy. Jensen concludes that "**only 15% of the firms...would have invested in another state without this incentive.**"

A 2018 meta-analysis by Bartik reviews research on the effectiveness of local business subsidies, including grants provided by state or local governments to individual firms. Based on 30 studies, the author derives 34 estimates of what proportion of business location, expansion, or retention decisions would not have occurred "but for" the incentive. He concludes that the average incentive package might tip somewhere between 2 and 25 percent of business location/expansion/retention decisions, which means that **for at least 75 percent of firms receiving subsidies, the firm would have made a similar decision to locate, expand, or remain in a place without the incentive.** These findings are consistent with other studies examining the effects of state and local business taxes, as well as studies examining the impacts of business subsidies in foreign countries.

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Rubin and Boyd (2013) candidly state: "**There is … no conclusive evidence from research studies conducted since the mid-1950s to show that business tax incentives have an impact on net economic gains to the states** above and beyond the level that would have been attained absent the incentives" (1). Further, there is no evidence that state and local taxes have an impact on business location and expansion decisions.

Their study, which specifically analyzes New York State business tax credits, lists a common set of flaws across all tax credit programs, including those in New York. First, they may reward activity that would have been undertaken even without the credit. Second, they are similar to direct spending programs but are not subject to public scrutiny or legislative oversight. Third, they require no annual appropriation, thus remaining on the budget indefinitely with little or no evaluation of their costs and benefits. Finally, it is difficult to evaluate their impacts on jobs and the economy because information about beneficiaries is so limited, if disclosed at all.

Concerning the spillover effects of business subsidies to other parts of the economy, Slattery and Zidar (2020) evaluate state and local business tax incentives in the U.S. While they find some evidence of direct employment gains, they find **no evidence that "firm-specific tax incentives increase broader economic growth at the state and local level**" (91). The authors note that, instead, reforms that direct resources to where efficiency and equity gains are largest would likely be a better use of resources.

Business subsidies are not only ineffective, they also harm a state's fiscal health. Using data from 32 states and covering the years 1990-2015, McDonald, Decker, and Johnson (2020) find that **"when a state uses financial incentives, the fiscal health of the state diminishes."** The authors carefully account for different types of government, political party control, economic conditions, and demographics. State fiscal health is defined in terms of dependence on federal intergovernmental revenue, a state's efficiency ratio (a ratio of total expenditures to total revenue), and a state's debt ratio.

In addition to harming state fiscal health, business subsidies also contribute to increased inequality. Jansa (2021) uses data on business subsidy spending and inequality from 50 states from 1999 through 2014 and finds that increased incentive spending leads to increased inequality. Jansa concludes that **business subsidies "serve to redistribute resources to the relatively wealthy and reduce the capacity of the state to redistribute to the relatively poor over the long term."**

Taxpayer subsidies often escape transparency and pose a corruption risk

Not only are business subsidies a totally ineffective way to encourage economic growth, they also escape transparency and pose a corruption risk. For instance, Aobdia et al. (2021) find that US state governments give more subsidies to politically connected firms. In fact, **a firm is nearly four times more likely to receive an award, and the award is 63% larger, when they make a campaign contribution to a state politician**. Even more worryingly, politically connected awards generate less local job growth and less aggregate economic growth.

Sobel et al. (2021) explore how offering business subsidies affects campaign contributions and electoral outcomes for politicians. The authors leverage a difference-in-differences design that adjusts for the timing of subsidy awards. They find that when a state starts to offer large business subsidies, "**annual campaign contributions increase by approximately 38.4% (or $738,100) in the average state from construction and labor unions, 20.5% (or $158,600) from lobbyists and lawyers who represent large firms in the political process, and 106.8% (or $122,000) from large business advocacy and trade organizations**" (3).

Raghunandan (2021), leveraged a nationwide dataset on business subsidies provided by Good Jobs First, a national advocacy group, and found that **firms receiving state-level subsidies are more likely to engage in corporate misconduct**, reflecting an increase in the underlying rate of misconduct and the fact that states are often lenient when it comes to misconduct enforcement.

Felix and Hines (2011) examine characteristics of cities and counties that offer business subsidies. Among their findings, they discover that **"cities and counties in states with troubled political cultures demonstrate the greatest willingness to offer business development incentives**." Specifically, they find that increasing the rate at which government officials are convicted of federal corruption crimes by 1 per 100,000 residents over a 13-year period is associated with a 2.9 percent greater chance that a community will offer business subsidies.

Jensen et al. (2015) explore how electoral institutions impact business subsidy allocation. Specifically, they study the form of government across municipalities providing business subsidies, and find that municipalities with council-manager systems (where a city council oversees the general administration of city government, makes budgets and policies, and appoints a professional city manager to carry out operations, as opposed to a mayor-council form, where the mayor is elected separately from the council) provide less generous incentives and have more oversight over their subsidy programs. This is even more pronounced during election years. Their results indicate that electoral pressures, not the effectiveness of subsidies, encourage local executives to "**provide overly generous incentives to firms, which is also driven by limited oversight of these programs."**

Concerning transparency in economic development deals, Jensen and Thrall (2021) examine legal challenges to public records requests for deal-specific, company-specific information in a Texas discretionary business subsidy program. They focus on two potential explanations: 1) firms may be more likely to challenge a request if they were subject to clawback provisions for noncompliance, and 2) they renegotiated subsidy contracts to reduce or delay job commitments (and thus avoid clawbacks). They find that the latter case is more likely and conclude that **"a company is more likely to challenge a formal public records request if it has renegotiated the terms of the award to reduce its job-creation obligations."** This finding highlights the importance of transparency in business subsidy transactions.

Recommendations for New York

Despite the extensive literature highlighting the myriad problems with business subsidies as a tool for economic development, New York and local governments continue to use them. Government officials rationalize that subsidies are necessary to keep businesses from moving out of state, rescue failing firms, and attract outside firms and start-up businesses. Business subsidies are also good politics; decisions about them are relatively isolated from political processes and interference, and they give the appearance that elected leaders are "getting stuff done."

In light of the empirical research cited above, state officials should take action now to curb wasteful, corrupt spending. We recommend:

1. Do no harm: Create no new tax abatement programs and stop providing state and local grants to businesses. Freeze or reduce the total tax abatements and direct subsidies provided by the state.
2. Create a more robust "Database of Deals" that goes beyond what is mandated in the FY 2023 budget and includes a uniform definition of "job" that applies to all state subsidy programs, which would enable apples-to-apples comparisons among all subsidy programs and deals.
3. Freeze all state subsidy mega-deals, including the Penn Station Vornado deal, until the extent of the subsidy to Vornado and potential loss of NYC tax revenue is made public.

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