POLICY POINTS
FROM THE COMMONWEALTH FOUNDATION

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Corporate Welfare's Record of Failure

In a free market economy, entrepreneurs succeed or fail based on their ability to meet their customers' needs. Yet all too often, government disrupts this process by conferring tax credits, loans, and grants to favored individuals or businesses. These privileges—also known as corporate welfare—are intended to promote economic development, but a large body of evidence suggests they don't work.

The Evidence Against Corporate Welfare

- A review of 30 different studies on the relationship between economic development incentives and a firm's decision to relocate, expand, or retain jobs found incentives had little impact in *75 to 98 percent* of cases.
- According to a Martin Prosperity Institute analysis, there is no relationship between the amount of state incentives offered and key economic performance metrics, like economic output or growth in wages and income.
- Michael LaFaive of the Mackinac Center examined nearly forty years of tourism incentives and the recent academic literature on a variety of economic development incentives. Of the studies he reviewed and authored, the overwhelming majority failed to justify the costs associated with the incentives.
- Businesses that receive incentives grow slower than those that do not. About 10.5 *fewer* jobs per establishment existed at businesses that received incentives in the form of tax credits or grants in a study of 366 Ohio businesses by the *Journal of Regional Science*.
- The average delinquency rate is almost three times higher for government loan programs (8 percent) than for commercial lenders (3 percent). In other words, the government cannot adequately assess risk and market value.
- There is a negative relationship between economic incentives and economic freedom, according to a 2018 study published in *The Review of Regional Studies*. Economic freedom is critical to improving the standard of living for people off all income levels.
    - Additionally, the authors note findings from a 2018 study, which found targeted incentives offered to privileged firms exacerbate income inequality.

Why Corporate Welfare Fails

- *Vulnerable to Manipulation:* Governments do not possess any special knowledge that allows them to efficiently allocate resources.
    - This knowledge problem leads to arbitrary, poorly designed, and even unethical decisions.
    - The knowledge problem also allows businesses to manipulate incentives. For example, as one study demonstrates, the ineffectiveness of job creation tax credits is primarily the result of "rolling basis" enrollment.

This allows firms to initially decrease employment prior to applying for a job creation tax credit, leading to what researchers term the "anticipatory dip."

- *Reduces Productivity:* Stephen Moore and Dean Stansel articulate another problem with economic development: "Corporate welfare converts the American businessman into a lobbyist."
  - As entrepreneurs focus on lobbying for economic development funds, they devote less time to maximizing the efficiency of their businesses.
- *Too Complex:* The complexity of economic development programs can also dissuade businesses from utilizing them. The *Public Performance & Management Review* demonstrated that corporate executives were often unwilling to claim the tax credit because the administrative expense was too great.
- *Wastes Resources:* Finally, the administrative and funding costs associated with corporate welfare requires higher taxes. These are resources that cannot be directed to provide meaningful tax relief, which is necessary for robust economic growth.

Pennsylvania's Recent Experience with Corporate Welfare

- In 2014, the Auditor General's Office reviewed Department of Community and Economic Development (DCED) records for 600 businesses receiving more than $212 million in grants. The AG's office found only 56 percent of these businesses created or retained all the jobs they promised in exchange for taxpayer subsidies.
- The Aker Philadelphia Shipyard, which has been bailed out by taxpayers twice in the last two decades, announced 275 layoffs earlier this year.
- Hyundai Rotem recently announced its decision to leave Philadelphia after 10 years in the city. The company has received $2.2 million in state financial incentives.
- The bidding war to become the location of Amazon's second headquarters has led some state and local governments to hide their taxpayer-subsidized incentive offers.
  - The Office of Open Records (OOR) recently ordered DCED to make its offer to Amazon public. DCED has argued the financial incentive package represents a "trade secret" and "proprietary information." But OOR ruled there is no economic value to the information, and therefore no justification for government secrecy.
- Corporate welfare incentives have failed to prevent the bankruptcy of Aquion Energy and the closings of Unilife, American Eagle, Railroad Terminal, and Kraft Heinz—all businesses located in Pennsylvania.

Corporate Welfare in Pennsylvania Today

Unfortunately, according to the Governor's Executive Budget and final budget agreement, Pennsylvania is projected to spend at least $847 million in corporate welfare during the 2018–19 fiscal year. This includes funding for several programs with a poor record of results.

  - *Race Horse Development Fund*: This fund subsidizes prizes for wealthy horse owners. Yet since 2006, approximately $2.7 billion in subsidies have failed to revitalize the horse racing industry, while sending millions of dollars out-of-state annually.
  - *Film Tax Credit*: This tax credit is better categorized as a subsidy for out-of-state businesses. And according to the Independent Fiscal Office, it provides an abysmal return for taxpayers of just 14 cents on every dollar.
  - *Pennsylvania First*: This program helped finance a Kraft plant in the Lehigh area. Yet the $200,000 Pennsylvania First grant couldn't keep the plant from closing—a decision that cost 415 people their jobs.

CORPORATE WELFARE IN THE 2018-19 BUDGET

PROGRAM	2018-19 BUDGET (in thousands)
Agricultural Excellence	$1,331
Agricultural Research	$2,187
Agricultural Promotion, Education and Exports	$303
Alternative Fuels Funding	$6,645
Ben Franklin Tech Development Authority Transfer	$14,500
City Revitalization and Improvement Fund	$12,500
Commonwealth Financing Authority Transfer	$142,088
Council on the Arts	$839
Food Marketing and Research	$494
Grants to the Arts	$9,590
Hardwoods Research and Promotion	$424
Industry Partnerships	$4,813
Infrastructure and Facilities Improvement Grants	$16,000
Keystone Communities	$16,707
Life Sciences Greenhouses	$3,000
Livestock Show	$215
Machinery and Equipment Loan Fund	$11,778
Marketing to Attract Business	$2,007
Marketing to Attract Tourists	$17,839
Municipalities Financial Recovery Revolving Fund Transfer	$1,000
Neighborhood Improvement Zone Fund	$59,806
New Choices/New Options	$500
Open Dairy Show	$215
Partnerships for Regional Economic Performance	$9,880
Pennsylvania First	$15,000
Pennsylvania Race Horse Development Fund	$238,065
Tourism-Accredited Zoos	$800
Transfer to the Nutrient Management Fund	$2,714
Office of International Business Development	$5,871
Youth Shows	$169
Film Production Tax Credit	$65,000
Job Creation Tax Credit	$10,100
Research and Development Tax Credit	$55,000
Keystone Opportunity Zone	$95,100
Keystone Innovation Zone	$15,000
Resource Enhancement and Protection Tax Credit	$10,000
TOTAL	$847,480

Free Market Reforms to Encourage Economic Development

- *Eliminate corporate welfare to reduce taxes*. Policymakers should eliminate the approximately $847 million of corporate welfare in the budget and use the savings to reduce Pennsylvanians' tax burden. These savings would allow for a reduction in the state's corporate tax rate from 9.99 percent to 7.04 percent. Instead of having one of the highest corporate tax rates in the country, Pennsylvania's rate would rank as the 19th highest.
- *Reduce Pennsylvania's regulatory burden*. The *Pennsylvania Code* contains more than 153,000 restrictions, including 208 regarding the use of a ladder. Lawmakers can begin to address these restrictions by requiring the repeal of two ineffective regulations for every one authorized by the General Assembly.
- *Repeal onerous licensure laws.* Pennsylvania needlessly requires permission to work in too many fields, including low-income occupations. Lawmakers should eliminate licenses for these occupations, making it easier for budding entrepreneurs to serve their communities and provide for their families.
- *Expand school choice.* Businesses can't succeed unless they can hire from a skilled workforce. This is why an educational system that prepares students for the 21st-century economy through high quality education options—like tax credit scholarships and Education Savings Accounts—is critical to equipping students and businesses for success.