Competition, Not Corporate Welfare: 3 Ways to Help All Businesses Flourish

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Key Takeaways

- In 2020-21, Pennsylvania will spend roughly $958 million on corporate welfare.
- More than half of this spending is allocated to just four programs.
- If the state eliminated all corporate welfare, we could reduce the CNIT by more than two percentage points bringing the rate down to 7.22% while remaining revenue neutral.

Background

For every economic problem, there is no shortage of ill-advised "solutions." The latest comes from presidential hopeful Joe Biden, who is touting his plan of government protectionism and favoritism as a solution to the COVID-19 health and economic crisis. But stricter government regulation will only make our economic problems worse.

One timely example is Paycheck Protection Program (PPP) loans. Despite being touted as a lifeline to help businesses stay afloat during the crisis, the *Washington Post* reported that many of these loans went to politically connected businesses. Additionally, billion-dollar companies—such as Kanye West's Yeezy—received millions of dollars of loans through PPP.

As of April, over 60% of Pennsylvania's small businesses were at risk of closing if COVID-19–-related disruptions continued. Given that small businesses make up over 98% of all businesses and are responsible for 47% of job creation in Pennsylvania, the state can't ignore their survival and still hope for economic recovery. While government-directed investment might reach ***some*** of its intended recipients, there are better solutions that will benefit ***all*** businesses.

Corporate Welfare's Good Intentions and Poor Results

Corporate welfare is an amalgamation of two distinct economic ideas. On one front, these programs embrace the economic reality that business growth creates jobs and opportunity. However, the targeted distribution of these incentives results in government favoritism for selected businesses or industries. This favoritism comes at the expense of other businesses, who are left to compete on a now-uneven playing field.

Corporate welfare encompasses multiple programs, including subsidies, grants, loans, tax credits, or tax breaks. It's not "stimulus"—it's favoritism for one industry, company, or region over others. And it doesn't lead to lasting job growth.

In fact, these government handouts often reward firms for decisions they would have made even without the handouts. Additionally, any job growth that does occur comes at a high cost. For example, a 2020 paper in the *Journal of Economic Perspectives* found that the average subsidized job cost Pennsylvania taxpayers over $93,000, well above the state average household income of less than $60,000.

Corporate Handouts in the State Budget, Fiscal Year 2019-20

Program	Amount
Agricultural Excellence	$ 2,800,000.00
Alternative Fuels Funding	$ 8,795,000.00
Ben Franklin Tech Development Authority Transfer	$ 19,500,000.00
City Revitalization and Improvement Fund	$ 9,000,000.00
Commonwealth Financing Authority Transfer**	$ 156,583,290.00
Computer Data Center Equipment Incentive Program	$ 7,000,000.00
Council on the Arts	$ 971,000.00
Grants to the Arts	$ 11,090,000.00
Industry Partnerships	$ 2,813,000.00
Infrastructure and Facilities Improvement Grants	$ 10,000,000.00
Keystone Communities	$ 6,365,000.00
Life Sciences Greenhouses	$ 3,000,000.00
Machinery and Equipment Loan Fund	$ 11,778,000.00
Marketing to Attract Business	$ 2,027,000.00
Marketing to Attract Tourists	$ 4,071,000.00
Municipalities Financial Recovery Revolving Fund Transfer	$ 4,500,000.00
Neighborhood Improvement Zone Fund	$ 63,520,000.00
New Choices/New Options	$ 750,000.00
Partnerships for Regional Economic Performance	$ 9,880,000.00
Pennsylvania First	$ 12,000,000.00
Pennsylvania Race Horse Development Fund	$ 234,759,000.00
Transfer to the Nutrient Management Fund	$ 6,200,000.00
Office of International Business Development	$ 5,936,000.00
Youth Shows	$ 169,000.00
WEDnetPA	$ 10,000,000.00
Brewer's Tax Credit	$ 5,000,000.00
Entertainment Production Tax Credit*	$ 79,000,000.00
Innovate in PA Tax Credit	$ 20,000,000.00
Keystone Opportunity Zone	$ 95,200,000.00
Keystone Innovation Zone	$ 15,000,000.00
Manufacturing and Investment Tax Credit*	$ 10,000,000.00
Mobile Telecommunications Broadband Investment Tax Credit	$ 5,000,000.00
Neighborhood assistance Tax Credit	$ 36,000,000.00
Pennsylvania Resource Manufacturing Tax Credit	$ 17,100,000.00
Research and Development Tax Credit	$ 55,000,000.00
Resource Enhancement and Protection Tax Credit	$ 13,000,000.00
Tax Credits for Beginning Farmers	$ 5,000,000.00
Total	$ 958,807,290.00

Source: Office of the Budget, Commonwealth Budget, 2020-21, *Governor's Executive Budget*.

**Treasurer's Status of Appropriations using #60414, https://www.patreasury.gov/tabs/.

*total of different components.

In 2020-21, Pennsylvania will spend $958 million on corporate welfare, according to initial estimates from the Governor's Executive Budget. This spending encompasses 37 different

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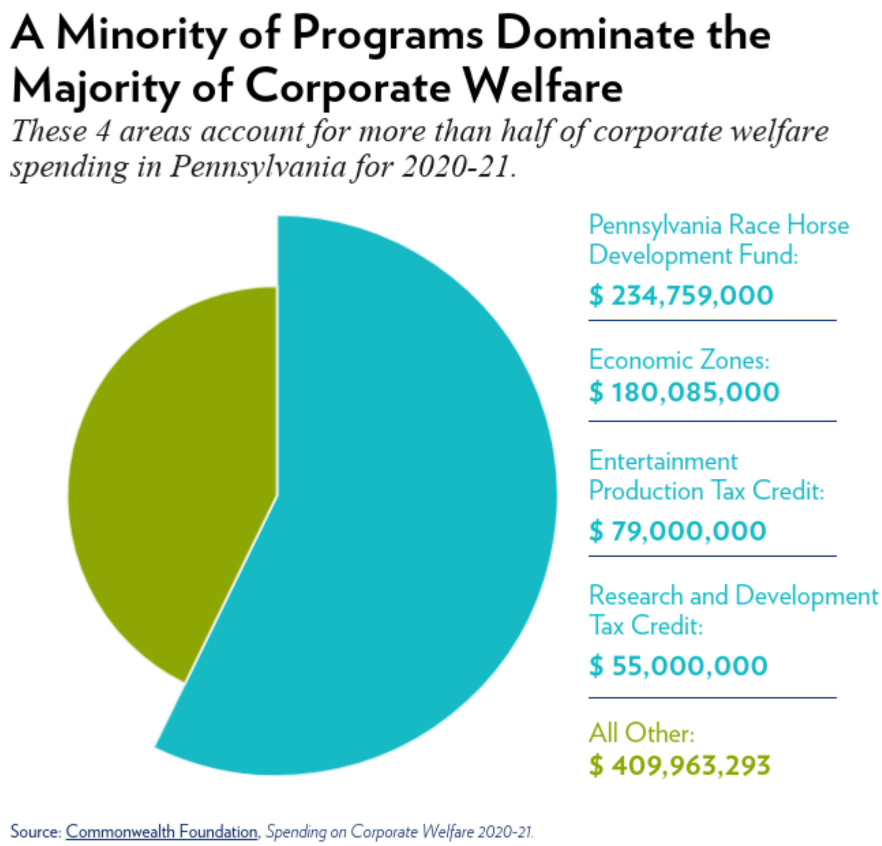
programs, making it impossible to evaluate the expenditures as a whole. However, more than half of this spending is allocated to just four areas.



Entertainment Production and R&D Tax Credits

Tax credits are incentives that allow individuals and businesses to subtract qualifying amounts of income from their tax liability. Not all credits qualify as corporate welfare. The largest tax credits that do qualify[1] are for Entertainment Production and Research and Development (R&D). The largest portion of the entertainment production program is the Film Production Tax Credit, which totals $70 million and isn't worth the price tag. A report by the Independent Fiscal Office (IFO) found that every dollar in credit produces only 13 cents in economic activity. Put another way, this tax credit is projected to cost the commonwealth over $60 million for every year it's in place.

The next largest credit program is for R&D, first instituted in Pennsylvania in 1997. The program was intended to encourage investment in R&D that would spur long-term innovation and economic growth. Many of these benefits go to society or a particular industry as a whole,

[1] Not all tax credits are considered corporate welfare. The largest tax credit program is the Educational Tax Credits, which amounts to $240 million this year and encompasses the Educational Improvement Tax Credit (EITC) and the Opportunity Scholarship Tax Credit (OSTC). These programs don't qualify as corporate welfare because they are directed toward public education and are not designed to support a specific industry or to create jobs.

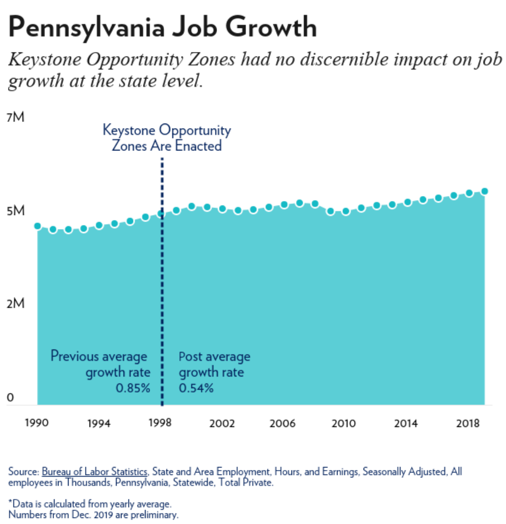
and therefore may not serve as adequate motivation for investing firms, hence the program. Like the Film Production Tax Credit, the IFO report found the R&D Tax Credit to have a low return on investment of only 16 cents on the dollar. This means that with over $55 million dedicated to the program, about $46 million of that is useless spending.

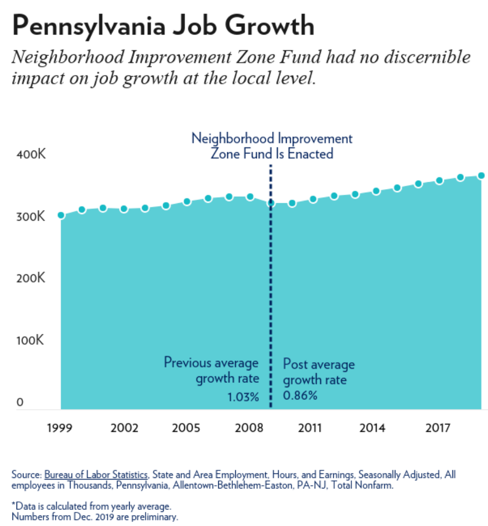
Accounting for other states' programs, R&D incentives were found to be zero-sum, with increases in one state offset by decreases in another. Overall, they have a minimal impact on total R&D spending. After the federal enactment of the tax credit in 1981, 55 percent of companies said the credit didn't impact their overall spending on R&D.

Economic Zones Don't Create Jobs

Targeted Economic Zones (EZ) refer to specific geographical areas that offer specialized tax climates and/or business incentives. In Pennsylvania, these zones impact almost every county.[2]

However, EZs generally show no measurable influence on a business's location decision and barely any influence on the creation of new jobs. Since EZs are in virtually every county, it is difficult to compare county-level impacts. When measured at the state and regional level, there has been no discernible difference in employment growth before the two largest EZ programs and after.





Like all government favoritism, these programs have winners and losers. A 2018 paper from the Upjohn Institute found that incentive programs influenced location decisions in firms between only 2 to 25% of the time. In other words, the other 75 to 98% of the time, these tax incentives acted as rewards for decisions the business would have made regardless of the program.

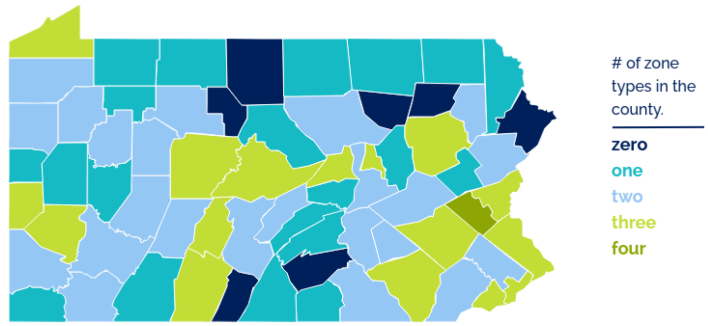
A 2019 report in *The Philadelphia Inquirer* makes this very point with the story about David Waxman, who runs a development company. David is primed to take advantage of federal opportunity zones, but his project of transforming a former brewery into luxury apartments in Philadelphia was planned well in advance of the program and would have occurred without it.

[2] These zones don't encompass the entirety of the county and are in smaller targeted areas.

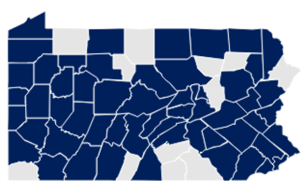
Missing from *The Inquirer's* report are the stories of all the businesses that existed in the area prior to the opportunity zone designation that aren't allotted the same benefits. They now have to compete with David's new business and its unfair tax advantage.

Counties with Economic Zones

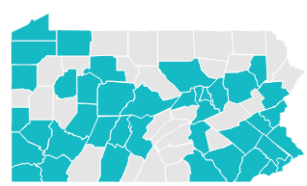
*Most counties have at least one economic zone, while only 7 counties in PA don't have one.**



Keystone Opportunity Zones

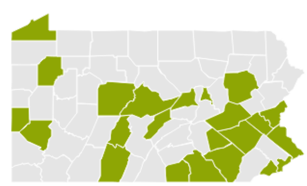


Keystone Innovation Zones



Neighborhood Improvement Zones

Keystone Communities



Sources: Keystone Opportunity Zones
Pennsylvania Department of Community and Economic Development, *Keystone Opportunity Zones*, Keystone Opportunity Zone Interactive Map.

Keystone Innovation Zones
Pennsylvania Department of Community and Economic Development, Business Assistance, *Keystone Innovation Zone (KIZ) Coordinator Location*.

Neighborhood Improvement Zones
AllentownPA.gov, Work, *Neighborhood Improvement Zone.*

Keystone Communities
Pennsylvania Department of Community and Economic Development, Programs, *Keystone Communities Program, Keystone Communities – Elm Street Designations.*
Pennsylvania Department of Community and Economic Development, Programs, *Keystone Communities Program*, Keystone Communities – Main Street Designations.
Pennsylvania Department of Community and Economic Development, Programs, Keystone Communities Program, Keystone Communities – Keystone Communities Designations.
Pennsylvania Department of Community and Economic Development, Programs, Keystone Communities Program, Keystone Communities – Enterprise Zone Designations.

*This only includes Keystone Opportunity Zones, Keystone Innovation Zones, Neighborhood Improvement Zones, and Keystone Communities

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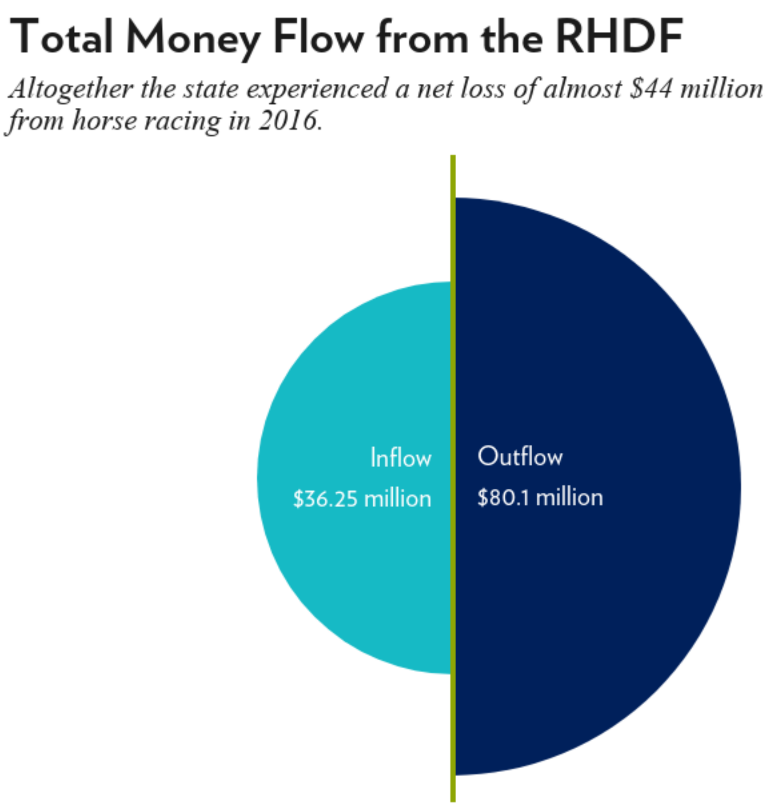
Race Horse Development Fund and Similar Handouts

The most blatant examples of government favoritism are industry-specific handouts. In Pennsylvania, these industry handouts total almost $250 million.[3] While they clearly violate fairness principles by favoring one industry over another, there are also economic reasons to end the practice. These handouts put Pennsylvanians on the hook for benefits that flow to other states and even other countries. One example is Pennsylvania's Race Horse Development Fund (RHDF). Although most disbursements from the RHDF go to Pennsylvanians, the state is not gaining revenue from the program. According to a 2017 IFO report, the state operates at a net loss of about $44 million, with about $80 million leaving the state and only about $36 million coming in.



Source: Independent Ficsal Office, *Horse Racing Analysis*, (Februrary 28,2017).

3 Includes Agriculture Excellence, Council on the Arts, Grants to the Arts, and the Pennsylvania Race Horse Development Fund. Tax credits for brewers and beginning farmers are excluded since they are included in the tax credit spending numbers.

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Solutions That Help All Businesses

1. **Pass legislation to automatically sunset underperforming tax credit programs.** Pennsylvania has 12 programs that fall into this category of corporate welfare and cost over $245 million a year.[4] Fortunately, the passage of Act 48 in 2017 mandates that the IFO conduct evaluations of existing tax credit programs. In its first year, the IFO reviewed the New Jobs Tax Credit and the Film Production Tax Credit. Following the review of the New Jobs Tax Credit, the program was eliminated.

   Legislators should continue to use the evaluations from the IFO in order to make smart decisions about budgeting. Last year's evaluations included the Research and Development Tax Credit, the Keystone Innovation Zone Tax Credit, and the Mobile Telecommunications Broadband Investment Tax Credit. By IFO estimates, these programs wasted $60 million last year. Passing legislation to automatically sunset underperforming programs with less than a dollar-for-dollar return will reduce wasteful spending.

2. **Eliminate corporate welfare entirely and use the savings to dramatically reduce the corporate net income tax (CNIT) for all businesses.** Pennsylvania's CNIT[5] is third highest in the nation at 9.99%. Instead of picking favorites through targeted handouts, reducing this tax would benefit all Pennsylvanians by increasing investment and spurring economic growth. If the state eliminated all corporate welfare, we could save $958 million per year, which is enough to reduce the CNIT by more than two percentage points,[6] bringing the 9.99% rate down to 7.22% while remaining revenue neutral.

3. **Reduce corporate welfare and use the money to reduce the CNIT for all businesses.** Alternatively, by redirecting the resources used in industry-specific handouts and economic zones, Pennsylvania can cut the CNIT by over a full percentage point. Combined with sunsetting tax credits, Pennsylvania could reduce its CNIT considerably and save up to $245 million. Remaining programs would include but are not limited to marketing to attract businesses, regional partnerships, and machinery improvement incentives.

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[4] This excludes two tax credit programs that are part of the Economic Zone calculations as well as non-corporate welfare credits.
[5] Increases in the corporate tax rate are linked to business closures, and reductions are linked to business increases.
[6] Based on pre-COVID-19 revenue estimates from June 2019. Pre-COVID-19 numbers were used so as to not distort the likely impact of this policy.

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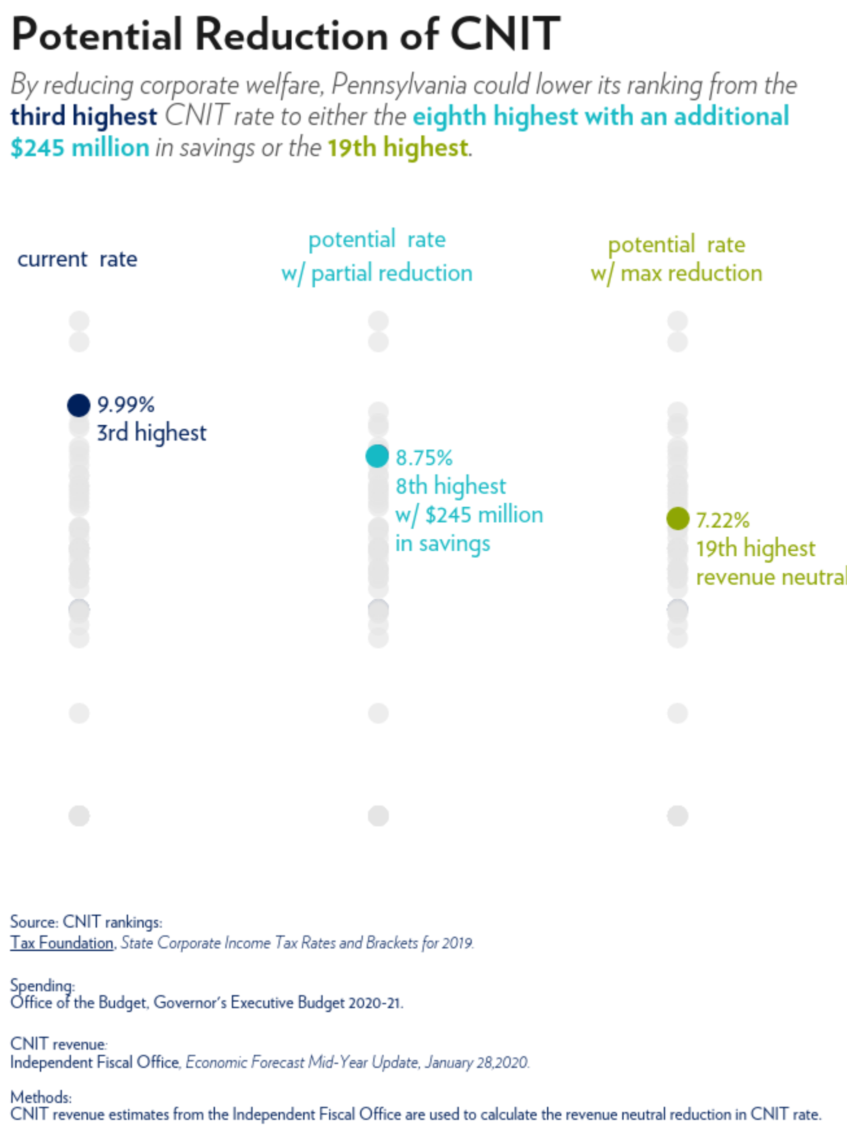

Conclusion

To effectively promote economic growth and job creation, policymakers need to stop investing tax dollars in failed programs and start enacting policies that benefit a wide range of job creators, like reducing the CNIT. In just two years, IFO reports have identified $120 million[7] that the state wasted on underperforming tax credits each year.[8] Spending on failed programs is not only wasteful, it is wrong for the government to pick economic winners and losers. By implementing these changes, Pennsylvania can give all businesses a needed hand up.

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[7] This calculation is based on spending projections from the Governor's Executive Budget, 2020-21, and the return on investment estimates from the IFO reports.

[8] Includes the Film Production Tax Credit, Research & Development Tax Credit, Keystone Innovation Zone Tax Credit, and the Mobile Telecommunications Broadband Investment Tax Credit. It excludes the New Jobs Tax Credits which was defunded following the report.