

## **CARS FELL ON ALABAMA: HOW TO REGULATE BUSINESS**

### **TAX INCENTIVE PROGRAMS SO THEY BENEFIT**

### **THE STATE AND DON'T JEOPARDIZE EDUCATION**

#### **A. ALABAMA: THE CENTER OF CORPORATE WELFARE OR DETROIT SOUTH?**

During past administrations, Mercedes, Honda and Hyundai were attracted to Alabama by large tax and other incentives, with the Mercedes package costing the State \$253 million, the Honda deal equaling \$248 million and the Hyundai offer totaling \$118 million. Such incentives include large tax abatements, regulatory relief, training programs, and payment for highway and utility costs.

Does this constitute sound economic development for Alabama or a raid on our tax coffers? In this article, we examine a sound procedure to analyze the pros and cons of tax benefit incentive programs. We commend them to Governor Riley, as he looks at developing the Black Belt and other depressed areas of Alabama by attracting new business, while, hopefully, encouraging our incumbent businesses to stay in Alabama and prosper.

When large car manufacturers come calling, Alabama has entered a bidding war with its neighboring states. The tax incentives go up and up, and there has never been public scrutiny of the package before its implementation or a publicly disclosed economic impact study to compare what Alabama has given up to bring these manufacturers with what Alabama receives. Clearly, jobs have been created, and the car industry with its spin-off suppliers, has prospered. But, does this economic development justify the tax incentives provided to these manufacturers? The only sound answer is for Alabama, not the manufacturer prospect, to do an economic analysis, in which the costs of bringing the business to our State are weighed against the benefits.

Below is a summary of recent auto relocation incentive packages. As you can see, Alabama has been the highest bidder.

<u>Company/State</u>	<u>Total Incentive Package</u>	<u>Cost per Job</u>
Mercedes/Alabama	\$253 Million	\$169,000
Hyundai/Alabama	\$253 Million	\$126,000
Honda/Alabama	\$158 Million	\$105,000
Honda Expansion/Alabama	\$90 Million	\$45,000

Nissan/Mississippi	\$300 Million	\$75,000
DiamondStar/Tennessee	\$33 Million	\$40,700
Saturn/Tennessee	\$70 Million	\$23,000
Mazda/Michigan	\$49 Million	\$14,000
Nissan/Tennessee	\$33 Million	\$8,000
Toyota/Kentucky	\$150 Million	\$8,000

Alabama may be likened to a borrower with poor credit, as we struggle to make ends meet and keep the schoolhouse lights on. When you have bad credit, you pay too high an interest rate. Is it prudent to give millions of tax dollars to new businesses while public services and education are being cut?

Based upon its incentive package, Mercedes Benz only paid \$100 for its Vance, Alabama, site when all the tax abatements and other incentives are included. That's a little more than the cost of an oil change on one of the company's luxury SUV's.

Local Alabama governments have also done their share to attract new business. One Vance resident sums up the Mercedes transaction: "We probably gave away half the State, but it's probably

worth it." Despite all the enthusiasm, experts have questioned the true economic value to the area.

The City of Tuscaloosa, which provides water and fire protection, land and sewage disposal for the Mercedes site, expects it may take ten years or more to get its money back.

When will Alabama give away so much of its treasure that it now jeopardizes our fiscal health - our ability to educate the children, keep up the roads, and protect the environment? Is that moment now? Is Alabama the fiercest aggressor in the industrial war among the states? In this process, have we hollowed out our tax base so deeply that our future has come into question?

Arguably, the winners are not cities and states. It's the company and entrepreneur who wins.

Is this is just a corporate subsidy, business welfare?

**B. BUSINESS BIDDING WARS ARE DRIVING INCENTIVE PACKAGES HIGHER.**

Alabama is not alone. Other states have offered a number of high profile economic incentive packages to obtain new business. Often, each state's highest officials play a key role in designing, promoting, and negotiating incentive packages. Businesses engage in bargaining with states and encourage the bidding spiral for the best package of incentives. Every time Alabama lands an

automotive plant, our state has outbid and shown a willingness to outspend more than 20 other states in the competition.

Perhaps, our license plates have it wrong: It's not stars falling on Alabama right now. It's cars.

Incentives don't last forever. Corporations will be looking to find new ways to make up for lack of production or efficiency once the the incentives have expired. The impact of tax breaks on the bottom line is significant enough that missing incentive opportunities can result in a serious blow to the facility's profitability. Once the honeymoon period is over, the jobs could also come to an end. Just look at auto plants that have closed in neighboring states.

From a company's point of view, incentives lower the cost of doing business, allowing it to increase the return on its investment. Incentives given for a business to move to Alabama should not be the most important factor in economic development, however. Workforce, quality of life, infrastructure and education are more important.

Incentive packages have cemented Alabama's reputation as one of the South's hottest auto-making center, but are we giving away too much?

### **C. ARE THE INCENTIVES WORTH THE ECONOMIC GAIN?**

Competition for big business is nothing new. There is, however, a difference between building infrastructure such as an airport or a college and eroding the State and local tax base. As the policy has grown in popularity, the typical local tax load has shifted from business to homeowners. As discussed in previous articles, this does not lead to tax fairness.

Based upon results through 2001, Alabama business income taxes have dropped drastically, falling from \$300 million in 1999 to \$166 million in 2001. We are losing revenue not only because of the tax loopholes reviewed in earlier articles but due to large tax incentives given to companies who relocated operations to Alabama. This decline will continue if government officials refuse to scale back incentive packages.

Arguably, existing Alabama businesses, which should share incentive programs with new entrants in fairness, are losing employees due to quality workers seeking employment with our new auto manufacturers. Alabama's manufacturing jobs are shrinking because of increasing reliance on foreign factories. Existing manufacturing businesses pay corporate income taxes to fund education. New business should do the same.

Despite the new business in Alabama, we will continue to see corporate income taxes decline unless these giveaways are curbed. Our new auto manufacturers stay rent free and tax free with a variety of tax incentives that are inequitable, poorly constructed, and harmful to Alabama's corporate income tax base. Tax that companies don't pay will be paid by our existing corporations or not at all.

It is just as important to have programs that keep existing businesses here. Businesses that contribute to the Alabama tax base, not take from it.

Since 1997, more than 13,000 of the State's 60,000 textile and apparel-production jobs have disappeared, with large corporations going out of business, moving out of state, or relocating operations to other countries like Mexico.

#### **D. REFORM: HOW TO REGULATE THE INCENTIVES**

For tax incentives, like many Government programs, sunshine is the best antiseptic. Alabama should establish an Incentives Review Commission that has its own expert compare the costs and benefits of tax incentive payments before their approval. The Commission should be made

up not only of the Governor's and the Legislature's appointees, but representatives of education and business. It should have all tax incentives presented and voted on at a public meeting.

Following this model, Kentucky has an Economic Development Cabinet that reviews and monitors business tax incentive programs. It is comprised of appointees of the Legislature and representatives of private groups. Kentucky also offers more balance to its tax incentive program than Alabama. It provides a comprehensive package of performance tax-based incentives to help attract new jobs and investments. They allow Kentucky corporations to keep income tax and some of the Kentucky individual income tax of employees to help pay for the business investment. Kentucky considers up-front incentives "giveaways". Kentucky businesses must first generate the tax revenue before they get the tax breaks, which is a form of allowing corporations to amortize this investment.

Alabama could also borrow from Maryland and New York, who have invested in economic incentive evaluation programs. Too many other states either rely on economic impact estimates from the companies or do not collect data at all.



We should also keep in mind that some businesses asking to relocate are in financial trouble, such as the airlines. Indianapolis regrets the \$300 million in tax incentives it spent on a United Airlines now teetering on insolvency. Review of a tax incentive prospect, be it local or coming from out-of-state, must require a sound financial outside audit.

Frankly, business incentives reform will not come until we change our attitude toward new business development. Local and State officials need to understand that some jobs aren't worth having. A new company could bring a thousand jobs to your community but the majority of the jobs may be low paying. A household consuming State provided services, such as education, needs to make a fair amount of income before it pays for itself.

Also, business tax incentives are not the best way to get new business. Permanent business incentives are the key. By enhancing the quality of our education, the desirability of our workforce will be improved. Business transportation and various other costs may be lowered by investing in our State's infrastructure, such as highways and airports.

A business should want to locate in Alabama because it has a well-educated workforce and a good tax structure, and not based on the short term fix of who offers the biggest bucks.

