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As incentives boom, states wage bigger battles for jobs

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By Tyler Dukes

RALEIGH, N.C. — On an early summer morning in 1993, Gov. Jim Hunt boarded a private plane bound for New York City.

It was a last-minute trip, and its purpose was so high-stakes it required the presence of an unlikely ally — Republican U.S. Sen. Jesse Helms.

Not 10 years earlier, the two political heavyweights were locked in a bitter, no-holds-barred battle for North Carolina's open Senate seat. Helms triumphed, and eight years later Hunt won a second stint as governor.

Now both Democrat and Republican dropped everything to join state Commerce Secretary Dave Phillips on a mission to midtown Manhattan, where top executives at Mercedes-Benz gathered to discuss the eventual location of a massive new manufacturing facility.

With competition fierce between North Carolina and the two other states still in the running for the plant, state leaders hoped the united front would be enough to swing the decision.

"It was a show of force for North Carolina," Phillips said. "It was very important for those two gentlemen to show up at the same time."

It wasn't enough.

North Carolina lost the plant and its 1,500 jobs to Alabama. It was a turning point for the state, and in the two decades since, North Carolina leaders have created an arsenal of programs they say are necessary to compete for jobs with the rest of the South.

DO JOB PROMISES PAY OFF?

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EXPLORE THE DATA
Search our incentives database app to see whether, how and where the promise of jobs is paying off across the state.

As southern states increase the use of tax incentives to lure companies, criticism over the spending on these programs has grown as well. But even those who agree with the dissent are reluctant to unilaterally disarm, fearing the toll any lost opportunity will take on the state's economic development.

"If you want to be in the recruiting game today, incentives are part of the deal. If you don't have incentives, you are going to lose opportunities," Norris Tolson, who served as the state's commerce secretary in 1997, said. "Some of the opportunities you lose you may not even know about."

North Carolina's incentives take shape

Whether in the form of low-cost loans, direct subsidies or tax rebates, states in the southeast have used incentive strategies to lure industry inside their borders since at least the 1930s. That's when, according to *The Selling of the South* by James Cobb, Mississippi rolled out a plan to offer voter-approved bonds for the construction of hosiery, fabric and tire plants officials hoped would jumpstart an ailing economy.

Even then, the program sparked controversy over claims of corporate welfare.

"The thing was outright socialism and should never have been attempted, much less held constitutional," Cobb quoted one Mississippi businessman.

States experimented with similar programs for the next few decades. But toward the end of the century, more states found ways to sweeten the pot.

Phillips said that put North Carolina, which had traditionally relied on its infrastructure, geography and education system to entice businesses, at a disadvantage with Mercedes.

"Very few states have what North Carolina has," Phillips said. "Other states, to try to level the playing field, started this major incentive escalation competition because they were not being as successful as North Carolina."

After the car company narrowed its options to three – North Carolina, South Carolina and Alabama – Tar Heels echoed the criticism that came nearly 60 years earlier in Mississippi.

"Today, the 'bribes' to ever bolder and more demanding prospects grow by the week," Hans Wanders, a Winston-Salem banker, wrote in a letter to Hunt dated Aug. 25, 1993. "In the end, it's a zero-sum game with a minority of companies profiting at the expense of the majority of existing industry and taxpayers."

"Very few states have what North Carolina has. Other states, to try to level the playing field, started this major incentive escalation competition because they were not being as successful as North Carolina."
Dave Phillips, former NC commerce secretary

As state officials grappled for the luxury car plant behind the scenes, legislators publicly set about augmenting the state's competitive ability. In the 1993 state budget, lawmakers pumped $5 million into a newly created Governor's Industrial Recruitment Competitiveness Fund.

In 1996, the General Assembly began offering a system of tax credits that would eventually dwarf the recruitment fund. Over the decade from 1996 to 2006, it generated about $2 billion for 3,000 companies, according to a study from researchers at UNC-Chapel Hill.

But by 2002, state officials decided those efforts weren't paying off in the jobs North Carolina needed.

"In all candor, they didn't move the needle that much," Jim Fain, Gov. Mike Easley's commerce secretary from 2001 to 2008, said. "We began to see we were losing deals that probably would have made more sense in North Carolina."

The legislature added more money to the governor's recruitment program, now known as the One North Carolina Fund. A new initiative called the Job Development Investment Grant program also allowed much larger cash grants to companies for expanding or relocating in North Carolina.

Again, the rationale from political leaders was that competition was getting fiercer — especially amid the post dot-com recession and North Carolina's rapidly declining manufacturing sector, which was shedding jobs to facilities overseas.

"We put JDIG in place when we were getting our butt kicked competitively, and it was at the time of the perfect economic storm," Fain said. "There were fewer projects, more competition and more urgency to build."

Both JDIG and One North Carolina provide no money up front and pay only for performance, meaning only companies that hire in the state can get taxpayer money.

With larger grants, Fain said, the commerce department was able to target clusters of industries with the potential to boost the state's economy – industries like health care, biotechnology and microelectronics. And he said it allowed North Carolina to get back into the game again when it came to competition for big projects.

"You could begin to see, in my view, the impact of a souped up governor's competitive fund and the arrival of the JDIG program," Fain said.

When playing field levels, incentives become deal closers

While North Carolina caught up to the tactics of its southeast neighbors, those same states added to their own offerings.

Texas in 2003 started up its Enterprise Fund, which it bills as the country's largest deal-closing war chest. South Carolina established its own closing fund, as did Georgia.

"In the old days, you were tied to a market or a raw material or low-cost electric power, and you built your strategy around that. Once you start to take all of those things out, what's left? The differentiator is incentives."
Don Schjeldahl, site location consultant

Although business leaders say incentives like these are just part of the calculation when deciding where to hire new workers, they began to grow in importance for many industries as the differences in the cost of doing business flattened out among states.

"In the old days, you were tied to a market or a raw material or low-cost electric power, and you built your strategy around that," said Don Schjeldahl, a consultant who for 35 years has worked with companies to find locations for new projects. "Once you start to take all of those things out, what's left? The differentiator is incentives."

For their part, companies saw benefits to their bottom lines – and the practice of using incentives has soared as a result.

A recent paper by Joshua Jansa, a fourth-year political science Ph.D. student at UNC-CH, analyzed data from the non-partisan Good Jobs First, which tracks the value of corporate subsidies across the country.

From 2000 to 2012, Jansa found the number of projects granted incentives nationally went from about 2,000 to more than 48,000. And of the top 50 recipients of these tax rebates and grants, 30 were Fortune 500 firms.

"We found states are spending more and more every year to attract businesses to their states," Jansa said. "The real winners in this process are the biggest businesses."

And to Tim Bartik, senior economist at the Michigan-based nonprofit W.E. Upjohn Institute for Employment Research, the growing use of incentives gives corporations an advantage over states who don't always know what their competition is offering.

"They have the upper hand and the bargaining position because they know the alternatives better than the state does," Bartik said. "The state has no idea, and there's no way the state can get the information."

In North Carolina, the stepped-up incentives game has come with a price tag.

The state in 2014 ended its tax rebate system, which accounted for the majority of its incentive spending. That makes JDIG and One North Carolina the largest programs the state uses to entice economic development.

Although not all these performance-based grants will fully pay out, the legislature's fiscal research division says the state has committed to paying out nearly $800 million through 2027.

And across the country, according to a 2012 New York Times investigation, state and local municipalities pay out more than $80 billion annually for incentive programs.

State leaders deride use of incentives, but use continues

For critics like Sarah Curry, that's too high a cost.

The director of fiscal policy studies at the conservative John Locke Foundation says the group advocates for the end of both JDIG and One North Carolina. Instead of "picking winners and losers," she said the state can become much more competitive with a lower tax rate and more targeted infrastructure improvements.

"This is a corporate handout," Curry said. "The money would be better spent on citizens of North Carolina and investing in infrastructure than giving to corporations."

> *"The governors get together and they rant and they rave. The answer always seems to be, 'Great, you go first.'"*
> *Kate McEnroe, site location consultant*

Some North Carolina officials, both past and present, seem to agree.

In a statement after losing the Mercedes deal, Hunt said he didn't think the state should have offered similar incentives to those of Alabama, "and I cannot envision that we would ever need to."

"Now the competition is getting stiffer, and we've got to work harder to stay ahead," Hunt said on Sept. 29, 1993. "But we do not need to risk the future of the franchise to recruit star players."

More modern state leaders have gone so far as to quip wistfully about a federal moratorium on the practice of incentives.

"I'd love to see the federal government say we're not going to deal with this any more. We'd like all that money to go into infrastructure and education and all those things," current Commerce Secretary Sharon Decker said. "Until that happens, we really can't afford not to be in the game."

Full interview: Decker discusses future of economic incentives

Gov. Pat McCrory, who appointed Decker, has made similar comments at job announcements across the state.

Such a move might look similar to the ban in the European Union, where member countries are prohibited in most cases from offering up cash for jobs.

But long-time observers like Kate McEnroe, a consultant who's worked with companies on site location for 30 years, doubt the sincerity of comments like these from leaders across the country.

"The governors get together and they rant and they rave," McEnroe said. "The answer always seems to be, 'Great, you go first.'"

More incentives could be coming for state

No ones sees North Carolina taking that first step.

Although the job incentive programs are largely used at the discretion of the governor and the executive's appointed boards, the legislature set caps for total spending. For JDIG, it's $15 million a year, while One North Carolina can dole out $28 million during every two-year budget cycle.

Decker, the state's current commerce secretary, has called on lawmakers to raise that cap and extend JDIG, which is set to expire at the end of 2015. Her department is working on a separate proposal for a "catalyst fund" to quickly close large projects.

The future incentives already have support from economic development experts across the aisle.

"She basically is having to operate at this point without a full quiver of arrows," said Tolson, one of the commerce secretaries who served under Democratic Gov. Hunt. "She needs incentives, because that's what she's competing with."

Explore the data: Job Promise Explorer

When she took the job, Decker said she wasn't sure about incentives. More critical, she said, was the 2013 reduction in the state's corporate tax rate that had long been a Republican priority.

But with that effort accomplished, Decker says she's now sure these grants help the state keep its edge.

"The incentives are critical for us to be competitive, and I'm convinced of that as I'm the one sitting at the table and I know what I've won and what I've lost," Decker said. "They're essential tools in larger projects."

Decker said every incentive the state uses has to be responsible with taxpayer money, pointing to the state's performance-based payouts and clawback provisions, which allow officials to recoup money from bad deals. That was the case after 2009, when the state sought repayment from Dell Inc. after the firm shuttered its Forsyth County plant after committing to an incentive deal.

Jansa, the UNC researcher, has noticed a related trend in his study of incentive growth across the country. As public scrutiny increases, more governments are retooling programs that once offered cash with little evidence of benefits.

"What you're starting to see is a move away from that," Jansa said. "There's a wellspring of citizens and activists who want to know more about whether these programs are working."

Read more at http://www.wral.com/as-incentives-boom-states-wage-bigger-battles-for-jobs/14052608/#tmGlPEWSrI5zRB3v.99

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