Another Tax Policy Lesson (Relearned)

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Eakinomics: Another Tax Policy Lesson (Relearned)

The Wall Street Journal (WSJ) is reporting on a new study by Columbia Business School economist Cailin Slattery and Princeton University economist Owen Zidar that indicates (in the words of the WSJ), "State and local governments across the U.S. spend at least $30 billion a year to attract and keep companies, but the biggest deals generate little in the way of economic benefits in return."

The research calls into question the common practice of using narrow, firm-specific tax breaks to attract businesses and boost employment. The most notable recent policy of this sort is the infamous competition for Amazon's HQ2, which my home county of Arlington "won" by handing Amazon a welcome-wagon present of $100,000 per job in state and local taxpayer funds.

If that feels a little like winning an economics Darwin Award, it is. The authors note that the basic strategy is highly biased against smaller firms, on average leads low-income areas to offer as much as four times as much of a subsidy for the same jobs as higher-income areas, and does little to generate broad economic growth in the region.

These conclusions really should not be a surprise for two reasons. First, this is the very definition of the government picking winners, and the empirical track record of governments doing so consistently well is thin to non-existent. Second, to attract, say, Amazon to an area and keep other government activities unchanged means that taxes will be higher on every other business (or household) to make up the difference. That discrepancy discriminates against the entrepreneurial start-up firm that might otherwise launch in the area, and against the maintenance of the infrastructure, education, and other attributes of the area that would make it a natural location choice.

The oldest lesson in tax policy remains fundamental: broad base, low rates. Preferential tax breaks narrow the base and raise the rates. Simple.