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The Honorable Janet Yellen
Secretary
Department of Treasury
1500 Pennsylvania Avenue NW
Washington D.C. 20220

July 16, 2021

**Re: Coronavirus State and Local Fiscal Recovery Funds Interim Final Rule Comments**

Dear Secretary Yellen,

The following are the comments of the Center for Economic Accountability on the Coronavirus State and Local Fiscal Recovery Funds Interim Final Rule.

## Executive Summary:

1. **Use of Coronavirus State and Local Fiscal Recovery Funds to offset tax abatements under existing state "economic development" incentive mechanisms violates the spirit and letter of Section 602(c).**
    a. Allowing states and their subsidiary entities to use ARPA funding to offset targeted tax abatements for purposes of "economic development" conflicts with legislative intent, and in some cases will work directly counter to the purposes for which Congress has appropriated these funds.
    b. State and local tax agencies that manage tax abatement programs regularly fail to comply with basic transparency and oversight requirements, making them poor potential stewards of ARPA funds and calling their ability to meet Section 602(d) certification and reporting requirements into question.
2. **The Final Rule must clarify that the vote of a public body established under state law to award a tax abatement for economic development purposes that would trigger a reduction in net tax revenues is a "final legislative or regulatory action" under Section 602(c)(2)(A).**
    a. Since state "economic development" tax abatements are designed to lure jobs or investment across state lines, such a prohibition is squarely within Congress's Commerce Clause power to regulate commerce among the states.

## Introduction:

The Center for Economic Accountability is an independent and non-partisan 501(c)(3) nonprofit organization that works to advance opportunity for all by promoting transparency, accountability and free-market-based reform of state and local economic development initiatives across America.

Our position is that the Department of Treasury must ensure that the Coronavirus State and Local Fiscal Recovery Funds Final Rule does not create a dangerous environment of unintended consequences by allowing state and local governments to use Section 602 funding to offset new "economic development" tax abatements offered under existing statutory authority. As the Interim Final Rule stands now, states would arguably be free to use Section 602 funding to offset millions, if not billions, of dollars in new tax abatements so long as those abatements were offered under existing state statute.

This clearly works counter to both the letter and the intent of Congress in establishing the Coronavirus State and Local Fiscal Recovery Funds, and the Final Rule can simply and cleanly solve this problem by clarifying that any vote of a public body established under state law to award such a tax abatement is a "final legislative or regulatory action" under Section 602(c)(2)(A).

Such a rule limiting the use of ARPA funding to fund a tax subsidy "race to the bottom" between the states would be clearly in line with Congress's legislative intent, as well as squarely within Congress's Article I powers to regulate interstate commerce. It would also be good public policy, fiscally responsible and consistent with existing public accounting standards.

## Discussion:

## 1: Use of Coronavirus State and Local Fiscal Recovery Funds to offset tax abatements under existing state "economic development" incentive mechanisms violates the spirit and letter of Section 602(c) 602(c).

Congress created the Coronavirus State and Local Fiscal Recovery Funds "to mitigate the fiscal effects stemming from the public health emergency with respect to the Coronavirus Disease (COVID–19)." Using those funds to offset new tax abatements for "economic development" purposes would work counter to that legislative intent by failing to generate net new jobs or economic growth, placing more stress on states' long-term fiscal stability and discouraging new business creation and entrepreneurship.

The evidence was clear even before the pandemic that tax abatements by state and local governments had reached a scale that placed severe strains on budgets, leading to lower spending on public services in the long term.[1] This is one reason that researchers at North Carolina State University found that financial incentives such as tax abatements "come with a high cost to the state's financial sustainability" and "negatively affect the overall fiscal health of a state."[2]

[1] Wang Jia, 2016. "Do Economic Development Incentives Crowd Out Public Expenditures in U.S. States?," The B.E. Journal of Economic Analysis & Policy, De Gruyter, vol. 16(1), pages 513-538, January. https://doi.org/10.1515/bejeap-2015-0042

[2] McDonald, B.D., III, Decker, J.W. and Johnson, B.A.M. (2021), You Don't Always Get What You Want: The Effect of Financial Incentives on State Fiscal Health. Public Admin Rev, 81: 365-374. https://doi.org/10.1111/puar.13163

In 2012, The New York Times estimated the total cost of targeted state and local economic development subsidies at $80.1 billion.[3] With adjustments for inflation and with the rise in recent years of "megadeals" such as Foxconn's Wisconsin LCD factory or Amazon's "HQ2" project, we now estimate the cost at $95 billion. By way of comparison, that is enough money to fully fund the 11 smallest state budgets, combined.[4]

For context of how this plays out at the state and local level, consider two examples of very different entities facing budget challenges thanks to existing tax abatement bills:

- Iowa projects a total FY2021 tax credit cost of $431.6 million.[5] That is more lost revenue than the state's FY2020 General Fund appropriations to operate its Department of Agriculture, Department of Natural Resources and Department of Public Health; Iowa Economic Development Authority; Iowa Workforce Development and Iowa Vocational Rehabilitation Services. In addition, the revenues lost to existing tax credits could also cover Iowa's FY20 General Fund appropriations for the Child Development, College Student Aid Commission, Community College State General Aid and Secondary Career & Technical Education programs within its Department of Education.[6]
- In New York City's 2019 annual financial report, the city reported losing roughly $3.8 billion in various forms of tax abatements.[7] That's more money than the $3.4 billion in revenue the Department of Finance collected from the General Corporation Tax (GCT) on "S" corporations doing business in the city; or alternatively more than the city budgeted in its November 2019 financial plan to run both the New York Fire Department ($2.1 billion) and Department of Corrections ($1.3 billion).[8]

The fungibility of government revenues means that Coronavirus State and Local Fiscal Recovery Fund appropriations will inherently be used to offset these and other existing tax abatements by states and their subsidiary entities. But there is no need for the Final Rule to encourage more and larger abatements under existing statute.

Section 602(c)(1)(A) allows for use of funds to respond to "negative economic impacts, including assistance to households, small businesses, and nonprofits, or aid to impacted industries such as tourism, travel, and hospitality." Allowing these funds to be used to offset tax abatements in the name of "economic development" would run counter to this intent, as the clear consensus of both research and real-world evidence shows that they do not accomplish such goals:

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[3] Story, Louise. "As Companies Seek Tax Deals, Governments Pay High Price." The New York Times, December 1, 2012. https://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html

[4] "2020 State Expenditure Report" National Association of State Budget Officers, November 20, 2020 https://www.nasbo.org/reports-data/state-expenditure-report

[5] Iowa Department of Revenue Tax Credits Contingent Liabilities Report, March 19, 2021: https://tax.iowa.gov/sites/default/files/2021-03/ContingentLiabilitiesReport0321.pdf

[6] Iowa Budget Report FY2021, https://dom.iowa.gov/sites/default/files/documents/2020/01/fy2021bbb_final_book.pdf

[7] The City of New York Notes to Financial Statements, June 30 2020 and 2019. https://comptroller.nyc.gov/wp-content/uploads/2020/10/5-Notes-to-Financial-Statements-and-Required-Supplementary-Information-2020.pdf

[8] New York City Comptroller Scott M. Stringer, "The State of the City's Economy and Finances." December 13, 2019. https://comptroller.nyc.gov/wp-content/uploads/documents/The-State-of-the-Citys-Economy-and-Finances-2019.pdf

- **Targeted economic development subsidies do not aid and may even discourage net new job creation.**
    - In an assessment of economic development incentives across the country, researchers at the University of Connecticut and University of North Carolina at Chapel Hill found that incentivized companies actually had lower employment gains than their nonincentivized peers.[9] "This simple but direct finding—that incentives do not create jobs—should prove critical to policymakers," they concluded.
    - Other researchers have found subsidized job growth, but at horrific cost. In Michigan, a comparison of employment growth at subsidized companies versus their nonsubsidized competitors found that subsidized companies created jobs, but at an average per-job cost of $593,913 per year.[10]
- **Targeted economic development subsidies do not contribute to economic recovery.**
    - Researchers at the University of Illinois-Chicago investigated the efficacy of economic development incentives in the last recovery in Illinois, Michigan and Wisconsin and found them to be ineffective: "[W]e do not find compelling evidence that economic development subsidies created or retained jobs to help municipalities recover from the Great Recession."[11]
- **Targeted economic development subsidies harm new business creation.**
    - Congress recognized the critical importance of small business to local economies and the broader national economic recovery in its construction of the Coronavirus State and Local Fiscal Recovery Funds. However, the research evidence shows that allowing states to use ARPA funds to offset targeted tax abatements would conflict both with the specific intent of supporting small business growth and with the broader intent of improving long-term economic growth nationwide. For instance, researchers at The Ohio State University, Organization for Economic Cooperation and Development and Georgia State University found that state and local economic development incentives "have a statistically significant, negative relationship with start-up rates in total and for some industries including export-based and others that often receive incentives."[12] "Our findings support critics who contend that incentives crowd out other economic activity, potentially reducing long-term growth," they added.
- **Targeted economic development subsidies reduce innovation.**
    - Researchers at Southern Methodist University found "a negative and statistically significant relationship between economic development incentives and patent activity. Our results suggest that development incentives can at best help large businesses over

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[9] Donegan, Mary, T. William Lester, and Nichola Lowe. 2018. "Striking a Balance: A National Assessment of Economic Development Incentives." Upjohn Institute Working Paper 18-291. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research. https://doi.org/10.17848/wp18-291

[10] LaFaive, Michael D., Devaraj, Srikant and Hicks, Michael. (2020) "Economic Development? State Handouts and Jobs: A New Look at the Evidence in Michigan." Mackinac Center for Public Policy. https://www.mackinac.org/archives/2020/s2020-05.pdf

[11] Drucker, J, Kim, G, Weber, R. Did incentives help municipalities recover from the Great Recession? Evidence from Midwestern cities. Growth and Change. 2019; 50: 894– 925. https://doi.org/10.1111/grow.12318

[12] Partridge, Mark D. and Tsvetkova, Alexandra and Schreiner, Sydney and Patrick, Carlianne, The Effects of State and Local Economic Incentives on Business Start-Ups in the U.S.: County-Level Evidence (March 2019). Andrew Young School of Policy Studies Research Paper Series No. 19-02, http://dx.doi.org/10.2139/ssrn.3376166

> the short run, and at worst harm small businesses in the short run and slow innovation (as measured by patents per 100,000 residents)."[13]

This is not to say that no tax abatement has ever generated economic benefits for a state, but as researchers at the University of Iowa wrote in the Journal of the American Planning Association, "…the best case is that incentives work about 10% of the time, and are simply a waste of money the other 90%."[14] Congress did not appropriate this money for 90 percent of it to be wasted by ineffective and inefficient tax abatements that impose a variety of negative unintended consequences on the very communities it was intended to aid.

**State and local tax agencies that manage tax abatement programs regularly fail to comply with basic transparency and oversight requirements, making them poor potential stewards of ARPA funds and calling their ability to meet Section 602(d) certification and reporting requirements into question.**

Across the country, state and local economic development authorities frequently violate both state statute and fundamental principles of good government by operating with insufficient transparency and ineffective oversight. It is common for official audits to discover targeted economic development subsidies going to ineligible companies or being used for ineligible purposes. As a 2020 report from the National Freedom of Information Coalition documented, the endemic lack of transparency in these programs impedes evaluation and accountability and makes them hotbeds of fraud, waste and abuse.[15]

Some relevant examples include:

- A 2019 report by Wisconsin's Legislative Audit Bureau found that projects subsidized by the Wisconsin Economic Development Corporation (WEDC) were only meeting 34.9% of job creation targets.[16] Additionally, the audit found that companies were only meeting 58.8% of their contracted "retention" targets to keep jobs in the state. Furthermore, the WEDC was also violating state statute (as well as basic common sense) by knowingly subsidizing hundreds of employees who neither lived nor worked in Wisconsin. These problems were not new, as state auditors had identified many of them in 2013[17] and again in 2015.[18]
- A 2013 state audit of the Michigan Strategic Fund (MSF) found a wide array of incorrect reporting and failures to comply with state statutes.[19] Among other issues, the MSF had reported a 75% job creation success rate for its "Centers of Energy Excellence" program. However, the state Auditor General found that the actual figure was just 19%, as the MSF had

[13] Tuszynski, Meg and Stansel, Dean, Targeted State Economic Development Incentives and Entrepreneurship (July 11, 2018). Forthcoming, Journal of Entrepreneurship and Public Policy, https://ssrn.com/abstract=3212411

[14] Peters, Alan & Fisher, Peter. (2004). The Failures of Economic Development Incentives. Journal of The American Planning Association - J AMER PLANN ASSN. 70. 27-37. https://doi.org/10.1080/01944360408976336

[15] Miller, Steve. "Invisible Incentives: How Secrecy Impedes Evaluation and Accountability of Economic Development Subsidies." National Freedom of Information Coalition, November 2020 https://www.nfoic.org/wp-content/uploads/2020-11/Invisible_Incentives_Nov2020%282%29.pdf

[16] "Wisconsin Economic Development Corporation" State of Wisconsin Legislative Audit Bureau. May, 2019. https://legis.wisconsin.gov/lab/media/2861/19-6full.pdf

[17] "Wisconsin Economic Development Corporation" State of Wisconsin Legislative Audit Bureau. May, 2013 https://legis.wisconsin.gov/lab/media/1496/13-7highlights_m.pdf

[18] "Wisconsin Economic Development Corporation" State of Wisconsin Legislative Audit Bureau. May, 2015 https://legis.wisconsin.gov/lab/media/1214/15-3highlights.pdf

[19] "Performance Audit of the 21st Century Jobs Trust Fund Programs." Michigan Office of the Auditor General. September, 2013 https://audgen.michigan.gov/finalpdfs/12_13/r271041013.pdf

artificially chosen a reporting date before a major recipient declared bankruptcy. As with the Wisconsin example above, an audit three years earlier had already uncovered many of the same issues.[20]

- The Missouri State Auditor's 2020 report on Tax Increment Finance (TIF) districts in St. Louis uncovered fundamental flaws and delivered the lowest possible grade to the city's management of $656 million worth of incentives.[21] The report found that the city's TIF district oversight "does not include specific program goals or strategic preferences, does not clearly define the evaluation process or criteria to be used in project selection, and does not include effective project cost limits or overall program cost controls." The audit also warned of a failure to meet accounting and transparency standards, excessive waivers of cost control policies and "an appearance of a conflict of interest" in the program's financial structure.
- In New York State, a 2020 State Comptroller audit of the "Buffalo Billion" subsidy program found a lack of up-front oversight and cost-benefit analyses, insufficient measurement and evaluation of project performance and poor reporting to the public.[22] Federal prosecutors would go on to secure convictions against multiple public officials and corporate executives in connection to corruption within the program.[23] [24]
- A 2019 legislative audit of the Kansas Job Creation Program Fund found that the $25.6 million program did not have written procedures to guide decisions for subsidy awards and frequently did not require subsidy recipients to commit to job creation or investment targets. Some companies were not even required to submit a formal application to receive state funding.[25]

The above examples and concerns are only a sampling of the evidence against the use of new economic development tax abatements in the recovery from the pandemic. The Final Rule must be clarified to clearly prohibit states from using ARPA funding to offset revenue reductions from such abatements.

## 2: The Final Rule must clarify that the vote of a public body established under state law to award a tax abatement for economic development purposes that would trigger a reduction in net tax revenues is a "final legislative or regulatory action" under Section 602(c)(2)(A).

While the definition of "covered change" in § 35.3 plausibly includes any tax abatement awarded during the Covered Period under existing state law as such abatements would not be "prescribed prior to the start of the covered period" and included in state baseline budgeting, the Final Rule must remove any

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[20] "Performance Audit of the 21st Century Jobs Trust Fund Programs." Michigan Office of the Auditor General. October 2010 https://audgen.michigan.gov/finalpdfs/10_11/r271041010.pdf

[21] "Report No. 2020-075: City of St. Louis Tax Increment Financing." Missouri State Auditor. September, 2020. https://app.auditor.mo.gov/Repository/Press/2020076701653.pdf

[22] "Report 2017-S-60: Empire State Development Oversight of Select High-Technology Projects." Office of the New York State Comptroller, August 2020 https://www.osc.state.ny.us/files/state-agencies/audits/pdf/2017-S-60_0.pdf

[23] Ramey, Corrine. "Four Convicted in 'Buffalo Billion' Corruption Trial." *The Wall Street Journal*, July 12 2018 https://www.wsj.com/articles/four-convicted-in-buffalo-billion-corruption-trial-1531429595

[24] DeGregory, Patricia and Golding, Bruce. "Ex-Cuomo aide convicted on corruption charges." The New York Post, March 13, 2018 https://nypost.com/2018/03/13/ex-cuomo-aide-convicted-on-corruption-charges/

[25] "Limited-Scope Performance Audit Report – Kansas Department of Commerce: Evaluating the Department's Administration of the Job Creation Program Fund." Legislative Division of Post Audit, State of Kansas. July, 2019. https://www.kslpa.org/wp-content/uploads/2019/07/3-Final-Report-PDFA.pdf

potential ambiguity by clearly defining the vote of any public body established under state law to award such a revenue-reducing tax abatement as a “final legislative or regulatory action” as specified in Section 602(c)(2)(A).

This could and should be interpreted to include state economic development authorities, agencies and corporations; city councils, Downtown Development Authorities, Tax Increment Finance Districts, school districts and any other entity with the power to award any form of tax abatement that would reduce the tax revenues to any government entity in upcoming fiscal years.

**Since state “economic development” tax abatements are designed to lure jobs or investment across state lines, such a prohibition is squarely within Congress’s Commerce Clause power to regulate commerce among the states.**

A final rule that clarified ARPA’s statutory language by defining any vote of a public body established under ultimate authority of state statute to award a tax abatement as a “final legislative or regulatory action” under Section 602(c)(2)(A) would stand apart from concerns many have over a potential usurpation of state taxing authority by the federal government. Tax abatements by states or their subsidiary entities for the purposes of “economic development” are uniquely and inherently a matter of interstate commerce, as their stated intent is to attract jobs or investment across state lines. In virtually every case, this is a matter of black-letter law as the enabling state statute specifically requires a finding of the approving authority that there was “competition” with other states for the project in question.

As such, a prohibition on using federal funding to offset such tax abatements is squarely within Congress’s Article I authority “to regulate commerce…among the several states” and is consistent with long-standing principles of federalism.

As for the burden of complying with this clarified Final Rule, state and local governments should already be tracking and reporting these forms of tax abatements in their Certified Annual Financial Reports under Government Accounting Standards Board Rule 77; treating them separately from other tax credits or abatements for the purposes of Section 602(d) certification and reporting requirements is not an onerous requirement on state and local government officials.

## Conclusion:

Secretary Yellen, thank you for the opportunity to comment on this important matter. I can be reached by email at john@economicaccountability.org, by phone at (313) 460-7441 or by mail at the Center for Economic Accountability, 1415 Aline Drive, Grosse Pointe Woods MI 48236.

Sincerely,

John C. Mozena
President
Center for Economic Accountability