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It's Time to Reform the Development Subsidy Game

Over the past six years, more than \$2 billion of New York City and New York State funds have gone to some of the world's most profitable companies in the name of job retention. These tax breaks and grants are supposed to strengthen the economy – creating or retaining jobs, increasing tax revenue, and boosting the quality of life. But some companies have reduced their employment levels in New York, despite their subsidies. And the record shows that in numerous cases these companies never seriously considered leaving.

Around the country, taxpayers are demanding more accountability from companies that receive tax breaks and from the public officials that grant them. Thirty-seven states and 25 cities have adopted taxpayer safeguards such as job quality standards. Many have also used “clawbacks,” money-back guarantees that ensure companies either deliver on their job creation promises or pay back taxpayers.

It's time for New York to catch up with this reform movement. The need for reform in New York has been well-documented (see box on page three) but no systematic reforms have been undertaken. Good Jobs New York seeks to build on this research to encourage greater public awareness of the magnitude of the subsidies that have been awarded and their failure to deliver a better economy for all New Yorkers.

This publication is the first in a series of issue briefs that will highlight the need for greater corporate and government accountability when subsidies are given to private corporations.

These issue briefs will cover a range of topics, from the public's right to know how much money is spent on particular deals to the taxpayer safeguards used elsewhere. This first brief outlines the basics of the development subsidy game.

The High Road and the Low Road

Two different strategies have emerged in economic development. The “high road” approach focuses on things that help improve the productivity of all employers: a well-educated workforce, a sound infrastructure, and fair taxes and regulations. It may also involve “cluster” assistance to groups of companies in promising or threatened sectors. The net effect of this strategy is to make employers more loyal to the community and more connected to each other, reducing the likelihood they will leave the area.

The “low road” refers to efforts to compete by cutting costs at the expense of good things like high-quality products, decent wages and a clean environment. In economic development, the “low road” approach relies on attracting or keeping companies by playing favorites with public subsidies: a small number of large corporations get big subsidy packages, often prompted by those companies' threats to relocate. The net effect of this strategy is to create a slippery slope of “me too” demands from other companies, who quickly learn that it is very lucrative to *appear* interested in leaving. Instead of breeding loyalty to the area, the low road teaches companies that government is an easy mark. By its actions, New York has clearly chosen the low road.

Good Jobs New York seeks to ensure that government holds corporations accountable for creating family-wage jobs when they receive tax breaks, grants, and other economic development subsidies.

The Myth: Defenders of Firm-Specific Subsidies Say

- ◆ Subsidy packages retain jobs and economic activity that would otherwise leave New York.
- ◆ It only takes a short amount of time for a company to “pay for” its subsidies by generating income and tax revenue that otherwise would have been lost.
- ◆ By keeping key industry leaders from leaving, these deals ensure New York City’s place as the media and entertainment capital of the world and the center of global finance.

The Reality: Three Fs, not an A

- F** Corporate subsidies raise questions of **fairness**. Special incentive packages create an uneven playing field for other firms in the same industry. Efforts to even the playing field by handing out additional subsidy packages to competitors that complain only add to the cost. Subsidies to big corporations also raise the question of fairness to other taxpayers by increasing the tax burden on small businesses and working families.
- F** Often it seems companies approach NYS and NYC under **false pretenses** for the sake of getting subsidies. In many cases it is very unlikely that the beneficiaries would have left New York “but for” the incentive packages, precisely because New York is seen as the media and finance capital of the world.
- F** There is a real **fiscal cost** to this practice. Giving subsidies to the city’s largest corporations reduces the funds that are available for education, infrastructure, job training, parks, libraries and other public goods.
- A** There is no **accountability** in the current system. New York can get an A rather than three Fs by holding subsidized firms accountable for the new jobs that they promise to create and by opening up the process so that taxpayers can hold public officials accountable for spending public money wisely.

How the Subsidy Game is Played: A Case Study of Media Firms

Most of the city’s big retention deals have been made with leading media and financial firms. The history of media subsidies is telling. NBC received a subsidy package worth \$97 million in 1987, one of the largest in New York City history. Since then, every one of the major media companies in New York City has received its own “retention” package. With remarkable foresight, Rupert Murdoch, whose News America owns Fox Television, released the following statement, “With the mayor’s office prepared to offer NBC a significant cut in taxes, it is only fair and equitable that city hall provide News America and all other media companies with the same tax concessions.”

“Me, Too”

In 1992, Bertelsmann A.G., one of the largest media companies in the world, received a tax break package worth over \$10 million. The following year CBS received a \$49.5 million incentive package. At the time of this deal, Laurence A. Tisch, then the chairman of CBS, said “We never threatened to leave the city, I just wanted us to be treated like everyone else.” (NY Times, 1/29/99) Not surprisingly, Capital Cities/ABC demanded its own subsidies shortly afterwards. It received \$26 million in 1994. Just a few months later, Viacom Inc. – parent company of MTV, VH-1 and Nickelodeon – received \$15 million.

Double Dippers

NBC received a second helping of subsidies worth \$7 million in 1996. Murdoch’s News America received \$20.7 million in 1996 and then another \$24.4 in 1998. In 1999, CBS won a second round of subsidies, worth \$10 million, and promised to fulfill commitments made in their first deal. Time Warner won a double round of subsidies in 1999: \$11 million for its HBO division and \$28 million for Time Inc. A year earlier, Time Warner’s CEO had argued that he was only asking for the same kind of subsidies granted to Time Warner’s competitors: Bertelsmann, Viacom and NBC. (NY Times 6/29/99)

Did they Really Need That Subsidy?

It is unlikely that many, if any, of these media companies would have left the city. In most cases, the deals were illustrations of the ‘me too’ phenomenon, where companies line up for their own handouts once a competitor gets one – how else to explain the Bertelsmann case? In 1999, after receiving a \$28 million tax incentive package to construct a new world headquarters in Times Square, the company walked away from the deal when an environmental review study was added as a condition of the subsidy. Construction is proceeding without the subsidy, and the city was ex-

A Lot to Lose, and a Lot to Gain

Too much is at stake to ignore this issue. New York is off the charts when it comes to spending on retention deals, but has sorely inadequate safeguards to ensure taxpayers get a bang for their buck. Corporate subsidy deals must be reined in before another \$2 billion is spent so loosely.

Much could be gained by intelligently investing these resources in New York's human and physical infrastructure - to reduce class sizes in the public schools, to make sure that all pupils have textbooks for all the courses they are taking and adequate classroom facilities, to allow public libraries to be open for more hours, to improve the public transportation system, to help make more affordable housing available, and to otherwise improve the quality of life for all New Yorkers. And some of these resources could be used for "high road" economic development strategies that stress job training and other types of basic supports for "clusters" of companies in emerging or threatened sectors of the economy.

What Can Be Done

The development subsidy game needs to be addressed on two levels.

- ◆ **De-escalate the Economic War Among the States** Study after study has shown that government subsidies are not a major factor in corporate location decisions. They're merely icing on the cake. But governors and mayors have a hard time refusing to play the development subsidy game. On the chance that a company isn't bluffing, they know they would be skewered by their political adversaries and the press for "losing" Company X. National legislation that creates a disincentive for companies to play states against one another is necessary. Several models for such legislation are currently under consideration and will be discussed in detail in a future issue brief in this series.
- ◆ **Play the Development Subsidy Game as Intelligently as Possible** As long as companies continue to receive public subsidies, tax payers deserve accountability from both the companies and the government officials involved.

Using tax incentives to foster development can sometimes be useful, but these incentives must be used responsibly, with hard, contractual commitments that ensure taxpayers will get a return on their investment. Contracts must also include strong clawback or money-back guarantee provisions to ensure that government recoups public money when companies fail to deliver. Economic development must move beyond press releases and ribbon-cuttings and focus on outcomes. Government officials need to be held accountable, too. Typically these deals are signed and sealed before the

Documenting the Need for Reform

State Comptroller H. Carl McCall

Job Development Authority: Management of Loan Portfolio, December 12, 1995; *New York City Economic Development Corporation: Improvements Needed to Strengthen Industrial Development Agency Program*, June 7, 1995. These and other relevant audits are available at www.osc.state.ny.us/audits/.

Center for an Urban Future

New York New Jobs The Sector Solution, The folly of an economic development policy that relies on corporate tax abatements and the presentation of a new sector-based approach, July 1999. Available at www.citylimits.org/cuf/sector.htm.

City Comptroller Alan G. Hevesi

Audit Report on the Administration of Job Retention Agreements by the Economic Development Corporation, September 19, 1997.

State Senator Franz Leichter

Money for Nothing: The High Cost and Low Success Rate of Business Subsidies in New York, February 1998, by Jonathan Bowles; *New York City Corporate Welfare: City Tax Incentives Granted by the Giuliani Administration, A Failed and Foolish Policy*, August 1997, by Jonathan Bowles. Both of these publications are available at www.goodjobsny.org.

Fiscal Policy Institute

New York State's Industrial Development Agencies: Boon or Boondoggle?, October 1992, by Robert G. Lynch.

Government Finance Officers Association

Government Inc.: Creating Accountability for Economic Development Programs, April 1988 by New York State Comptroller Edward V. Regan.

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public hears about them. The deal-making process needs to be opened up with well-publicized public hearings for all subsidies above a certain size.

Good Jobs New York stands ready to support and work with individuals and organizations that are interested in ensuring that the taxpayer resources devoted to economic development are used much more effectively in the future than they have been in the past.

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Good Jobs New York is a joint project of the Fiscal Policy Institute and Good Jobs First

Good Jobs First is a national clearinghouse tracking best practices in economic development. It provides research, training, consulting and communications to promote corporate accountability for family-wage jobs when companies receive economic development subsidies. GJF is a project of the Institute on Taxation and Economic Policy, based in Washington, DC. For more information, visit the GJF website at www.goodjobsfirst.org.

The Fiscal Policy Institute is a New York-based research and education organization that focuses on state and local tax, budget, economic and related public policy issues. FPI's work is intended to further the development and implementation of public policies that create a strong economy in which prosperity is widely shared by all New Yorkers. For more information, visit the FPI website at www.fiscalspolicy.org.

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