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Platte INSTITUTE for economic research

Taxation and Incentives for Growth

By Dick Clark

Much effort is spent by government and by private organizations to promote Nebraska as a prime location for business development. Chambers of Commerce, the Nebraska Department of Economic Development, and many other entities are all interested in bringing new economic opportunity to the state. Over a number of decades, this drive has resulted in various incentive programs intended to spur economic development and job creation.

These incentives are comprised of various tax exemptions and credits for taxpayers who inject large amounts of capital into the Nebraska market, who create a certain number of new jobs, who build a large data center, or who support the development of small businesses or rural areas.[1] Despite the numerous incentives offered through these programs, what is unclear is whether or not they are the best method for growing a state's economy.

In a recent report from the Mercatus Center at George Mason University, economist Jeremy Horpedahl reviewed Nebraska's tax incentive programs.[2] He cited a 2012 Tax Foundation report indicating that Nebraska's incentive programs are among the most aggressive in the nation.[3] In that tax year, companies operating in Nebraska used just five of the incentive programs to earn more than $332 million in tax credits and used credits totalling more than $123 million against their tax liability.[4]

While Nebraska's development incentive programs are particularly generous, the state is not alone in offering substantial tax incentives as a means for driving economic development. In the forty states that produce incentives reports similar to Nebraska's, Horpedahl identified $389.3 billion in what he characterizes as "tax privilege," or tax expenditures clearly intended to result in

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[1] *See* "Tax Incentives - Nebraska Advantage." Nebraska Department of Economic Development. [URL: http://neded.org/business/tax-incentives]

[2] Horpedahl, Jeremy. "Principles of a Privilege-Free Tax System, with Applications to the State of Nebraska." Mercatus Working Paper. Mercatus Center. September 2014.

[3] *Ibid.*, at 40.

[4] *Ibid.,* citing "Nebraska Tax Incentives: 2012 Annual Report to the Nebraska Legislature." Nebraska Department of Revenue. July 15, 2013.

favorable treatment for some taxpayers over others.[5] Excluding user fees from Nebraska public revenue, privilege in the Nebraska revenue system amounted to 29 percent of the total tax collected by state and local government, or just over $2 billion in 2012.

The rationale for incentive programs — creating a tax environment that favors economic growth — is entirely praiseworthy. But these tax privileges come at the cost of narrowing the tax base tapped for paying the cost of government operations. Any measurable benefits of these incentives must be weighed against that cost. It turns out that economists have been unable to find convincing evidence that tax incentive programs actually result in economic growth.[6] What is clear is that the programs do cause distortions in how capital is allocated in the market, something that reduces economic efficiency in the long run.[7]

Instead of expanding costly incentives programs to provide special privilege for some taxpayers, a better policy to promote economic growth would be to reduce taxes for all taxpayers. Nebraska is still a high-tax state, and targeted incentive programs do not change that fact. It is well-established that states with lower tax burdens experience more economic growth, business development, and job creation.[8] For that reason, rather than engineering new programs to entice entrepreneurs to set up shop in Nebraska, the best reform would be a reduction in Nebraska's tax burden.

The Strong Roots Nebraska plan devised by the Platte Institute would lower the tax burden for all Nebraskans, providing incentives not just to companies with millions of dollars to invest, but to everyday citizens, too. Making Nebraska a friendlier place for all businesses and workers is the best economic development strategy of all.

[5] *Ibid.,* p. 10.

[6] *Ibid.,* p. 30. Citing, Peters, Alan and Peter Fisher. "The Failure of Economic Development Incentives." *Journal of the American Planning Association.* Vol. 70, no. 27. 2004.

[7] *Ibid.* Citing Coyne, Christopher J. and Lotta Moberg. "The Political Economy of State-Provided Targeted Benefits." Working Paper No. 14-13. Mercatus Center. May 2014.

[8] Drenkard, Scott and Joe Henchman. "2015 State Business Tax Climate Index." Tax Foundation. 2014. p. 7. [URL: http://taxfoundation.org/article/2015-state-business-tax-climate-index]