Letter of Comment No. 182
File Reference No. 19-20E
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Director of Research and Technical Activities
Project No. 19-20E
Government Accounting Standards Board

January 14, 2015

Dear Director:

I am writing to comment on the proposed standards for reporting the "tax abatements" given by state and local governments as part of their Comprehensive Annual Financial Reports (CAFRs). Let me begin by saying that I welcome this proposal and want to urge the Board to be sure these standards are truly comprehensive.

I write from a unique vantage point because my best-known academic work consists of making estimates of the value of subsidies given to companies by state and local governments. This includes two books: *Competing for Capital: Europe and North America in a Global Era* (Georgetown University Press, 2000) and *Investment Incentives and the Global Competition for Capital* (Palgrave Macmillan, 2011). In my latter book, I estimate that in 2005 state and local governments gave just under $50 billion in business attraction subsidies and perhaps another $20 billion in subsidies not tied to making an investment. In addition, I have written numerous journal articles and book chapters on tax incentives and other forms of subsidies to attract investment. The proposed standards, if done correctly, would put me out of the estimation business, and that would be a great thing. In the United States, there is a terrible lack of transparency in the use of these incentives, which makes informed policy analysis very difficult and, in some cases, impossible. Not only that, the lack of transparency hinders the ability of bond and other financial analysts to determine the true long-term financial position of a government entity that may be seeking to borrow through the bond market.

I am regularly interviewed by, and have my work cited in, well-known publications such as *The Wall Street Journal*, Bloomberg, *The St. Louis Post-Dispatch*, *Los Angeles Times*, etc. I have consulted on these issues for the Organization for Economic Cooperation and Development (OECD), the International Institute for Sustainable Development, the North Carolina Budget and Tax Center, and the Missouri chapter of the Sierra Club. I hold the position of Professor of Political Science at the University of Missouri-St. Louis, where I have taught for 23 years. Let me note for the record that the comments which follow are my own personal recommendations and my views are not necessarily shared by my employer or consulting clients.

Let me begin by highlighting an important terminological problem caused by the Board's use of the term "tax abatement" as its catch-all term for the policies under discussion. In fact, a "tax abatement," properly so called, is only one form of subsidy to attract investment to a state or locality, and most likely not the most important one, depending on the governmental entity in question. A true tax abatement relieves its recipient from having to pay certain taxes that would otherwise be due, most usually the local property tax. It is merely one form of a broader category of support for business investment that I generally call an "investment incentive," "location incentive," or "location subsidy." I define all three of these terms as "a subsidy to affect the location of investment."

What, then, is a “subsidy”? To answer this question, we can turn to the “Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, April 15, 1994,” which was adopted into U.S. law via Public Law no. 103-465. Thus, the definition of a “subsidy” established in the Uruguay Round’s “Agreement on Subsidies and Countervailing Measures” (SCM) is in fact a provision of U.S. law. This is important to keep in mind in the discussion that follows.

Article 1 of the SCM defines a subsidy as follows:

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body [note that his means this section applies to all state and local governments within the United States] within the territory of the Member (referred to in this Agreement as “government”), i.e. where

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); [footnote omitted]

(iii) a government provides good or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; [an anti-evasion rule]

Or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;

And

(b) a benefit is thereby conferred.

To sum all this up, the Agreement on SCM establishes a definition of “subsidy” that includes any potential subsidy mechanism, carried out by any level of government (for example, the Washington B&O tax reduction that was a major element of the European Union’s complaint against subsidies to Boeing, a case the EU won), one not evaded by simply claiming that it was a private body carrying out the subsidy. In effect, if the subsidy exists in law or in fact, the subsidy rules come into play.

This principle that a subsidy existing in law or in fact must be counted is an important one when examining the Board's proposed rules. Some tax measures that are obviously subsidies under the SCM definition (again, something incorporated into U.S. law) might not be considered "tax abatements" using a strict reading of the definition of that term. Consider the case of tax increment financing (TIF). In the states with which I am most familiar, a TIF recipient is *legally* considered to have paid its property tax even though its payment flows immediately back to its own benefit. If the entity has legally paid its property tax, how can one say that government has "foregone" the revenue? The answer, of course, is to look at the facts as well as the law. GASB's rules must ensure that they follow the facts and ignore legal fictions. Otherwise, huge swathes of tax-based subsidies will not be counted, and bond analysts and other researchers will not have the facts they need to establish the true financial situation of a government. This is similarly true of situations where the tax foregone is not due *from the subsidy recipient*. For example, many states allow companies to keep personal income tax withholding from their employees. In Missouri, local taxing districts called transportation development districts collect an extra sales tax from customers, but keep the money until they have received the entire subsidy they negotiated from a municipal government. It does not matter whose taxes are foregone; the rules must capture the subsidy itself in order to be useful. These are not small programs, either. In California, by 2010 TIF was generating $8 billion a year in tax increment for local governments, which was largely plowed back into paying the subsidies they were tied to (or equivalently, paying off bonds which funded the subsidies). In the much smaller Missouri economy, both TIF and transportation development districts see hundreds of millions of dollars of new subsidies committed annually by municipal governments.

In light of the fact that investment incentives may not be entirely tax-based, I believe it to be important to at least cross-list cash grants paid to companies with the "tax abatement" they receive. From anecdotally talking to reporters calling me about various incentive packages they are covering, it appears to me that there is an increasing trend for cash to make up a significant chunk of these packages. If the new rules require such cross-listing, we can then see in one place how much money a state or local government is committing in subsidies to attract businesses. This information gives us important clues about future fiscal trends from a government, as heavy users of incentives tend to remain such well into the future; however, there is no telling from one year to the next what the split will be between cash and tax-based subsidies.

On a related point, the rules absolutely need to include future amounts committed for tax incentives. Once again, without such transparency it is impossible for bond or other analysts to derive a true financial picture for a particular government.

Last, I would urge that the reporting of location subsidies be made on a firm-specific basis. If a single company is receiving tens of millions of dollars in tax breaks per year from a given municipality, with many more tens of millions committed in the future, it could signal that the municipality is highly vulnerable to anything which adversely affected the recipient. A city like Flint, Michigan, was devastated when the numerous subsidized General Motors facilities in the city began to go out of business in the 1980s.

In summary, then, the most important principle to consider is that transparency must be comprehensive. If the rules have loopholes allowing governments to not report certain types of

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subsidies, those subsidies will not be reported, and everyone relying on data reported under the new rules for accurate financial information – from citizens to investors – will be misled by numbers that don't reveal a government's true financial situation. Please require the most comprehensive reporting possible, for your efforts to live up to their potentially game-changing value.

Sincerely,
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