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Exposing Government Favoritism.

A new accounting rule will give taxpayers a better understanding of corporate handouts.

Every paycheck we receive lists the earnings taken away by various payroll taxes. But as aggravating as paying taxes may be, at least we have a partially transparent view of where the money goes. Now, thanks to a new accounting rule, we'll also have better information for how state and local governments provide corporate handouts.

For the first time, city and state governments are releasing financial reports covered by the new Government Accounting Standards Board's Statement 77, which requires governments following "Generally Accepted Accounting Principles" – the widely accepted industry standard – to report the value of tax abatements in their yearly financial statements.

Tax abatements are a common tool used by governments to stimulate economic development, but the taxpayer costs of such agreements are often hidden. This is a problem, because the cost of such corporate handouts from state and local governments is estimated to be as high as $70 billion per year.

The tax abatements that GASB 77, as it's also known, focuses on are part of the larger body of "targeted economic development incentives." Many of these tax breaks are high-profile and subject to vigorous public debate, since they offer large direct subsidies or tax abatements to major corporations, like the recent $3 billion in tax credits offered to Foxconn by Wisconsin.

However, many more are smaller and escape public notice. Regardless of the size of the subsidy, after the initial debate there's often little attention paid to the long-run effects of such subsidies on government budgets, let alone their actual economic impact.

One of the most recent and heavily publicized such examples was the $7 million in tax credits and grants that Indiana provided to Carrier Corporation to prevent it from relocating jobs to Mexico. The size of this deal is relatively small in relation to the $1.4 billion Nevada gave Tesla or the $8.7 billion Washington gave Boeing, and it's likely that few people would have known about the deal had it not been reported so heavily by the media because of President Donald Trump's involvement. The new reporting rule will help illuminate these kind of deals in thousands of local governments across the U.S.

This transparency is important because of the impact these targeted tax breaks can have on local government finances. Pearl, Mississippi offers a dramatic example: In 2005 Pearl provided $28 million in public funding for stadium construction to convince the Richmond Braves minor league baseball team to relocate there. Because the predicted increase in tax revenue from the team's presence has fallen short of expectations, the city has been forced to use taxpayer dollars from the city's general fund to make payments on the municipal bonds they issued to finance the stadium. These payments have consumed more than 5 percent of annual government spending, and led Moody's investment service in 2015 to downgrade Pearl's credit rating to junk bond status.

Furthermore, the new transparency rules will reveal the side-effects of such tax incentives by requiring public entities to report when they lose tax revenue because of abatements given by other governments. For example, school districts will now provide information on the amount of funding lost due to property tax abatements given by their municipal governments.

In addition, the indirect effect of these tax breaks – the influence they have on subsequent government policies and tax increases, and the broader economic impact of such changes – should also become clearer.

This means that that GASB 77-related information might be able to address a number of interesting policy questions. For example: Are tax abatements correlated with subsequent tax increases? And are schooling outcomes or emergency responder response times negatively affected by decreased funding due to tax abatements?

Perhaps more importantly, the fact that such breaks are "targeted" means that government officials are picking winners and losers. They provide a financial advantage to those who lobbied successfully for political favor, while making other firms – often the subsidized business's competitors – bear the burden through higher taxes.

State and local governments are effectively encouraging "rent-seeking" – the wasteful practice of devoting economic resources (time, money, talent, etc.) toward gaining government-granted privilege rather than focusing on increasing productivity or serving customers better. This skewing of business priorities leads to decreased economic growth.

Even worse, when government-granted privileges like these tax breaks are commonplace, ordinary people lose. Either the taxes they pay are correspondingly higher or the quality and quantity of public services are lower than would otherwise be the case.

In short, the new transparency rule will allow us to peek behind the curtain and better quantify the taxpayer money devoted to targeted economic development incentives. It will show taxpayers just how much of their money is being given away in the form of political favors and it will illuminate how government handouts contribute to municipal budget crises, higher taxes and reduced public services. This understanding could offer greater motivation for policy changes to address government favoritism.

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