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The Forever War

by Billy Hamilton

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In this installment of State Tax Merry-Go-Round, Hamilton examines states' use of tax incentives to lure business, finding that the supposed economic war between the states has dragged on with not much changing.

I became the chief revenue estimator of Texas — my actual job title — when I was 31. Naively, I took the job at the beginning of a dark time economically in Texas. The aftershocks of the OPEC oil crisis were unfolding even as I made myself at home in my new office. The drop in oil and natural gas investment and drilling activity spread to other parts of the economy, pitching the state into an economic nosedive and plunging state finances into a fiscal hole that took almost a decade to escape. It also created a fairly tense work environment for people whose job included forecasting oil and gas prices several years into the future with the state budget on the line.

It was during this time, in the early 1980s, that I first stumbled onto the topic of economic development and how — or even if — a state government can do anything to encourage it. My boss, who was the comptroller of public accounts, the state's tax collector, asked the revenue-estimating group to produce a list of ways that the state government could improve the economy. We weren't economic development experts, but we were as close to experts as anyone else in an agency full of lawyers, accountants, and auditors.

We eventually came up with a list of about 50 possible actions, many borrowed from other states. I remember two things about the list. One was that many of the ideas involved using business incentives, including tax breaks, to encourage businesses to locate or stay in the state. The other was the then-new notion of an "economic war between the states" over those incentives. That was news to me.

The Second War

During our group's deliberations, we ran across a *BusinessWeek* article from 1976 titled "The Second War Between the States."[1] I have since learned that the article likely was the first public reference to interstate economic competition as a "war." The first war, of course, was the Civil War, a very real and tragic intersectional conflict. This certainly wasn't that, but the phrase neatly encapsulated the idea that the states were engaged in a bitter competition over jobs and investment, and each state had to fight its own battles, often using its tax systems as ammunition.

The fulcrum of the competition at that time was the emergence of the Sun Belt, a term that was coined only seven years earlier to refer to the Southern tier of states from Florida to southern California. The term was first used by political strategist Kevin Phillips in his book *The Emerging Republican Majority* and referred to not only economic shifts from North to South but also the

[1] *BusinessWeek*, "The Second War Between the States" (May 17, 1976).

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changing political dynamics of the country.[2] (Phillips was the guy who once quipped that "the whole secret of politics is knowing who hates who.")

The division signaled a sea change in the traditional alignment of economic power in the country, with the Southern states becoming more prominent, a vast change from past decades.

During the Depression, the 11 Southern states of the old Confederacy seemed trapped in a grinding cycle of poverty and decline that had characterized the region since the Civil War. Something needed to be done, and that something turned out to be the Balance Agriculture With Industry program created in Mississippi in 1936. The program's goal wasn't competition but, as one historian put it, "to minimize the effects of the Great Depression by coupling low taxes, cheap land, and low wages with tax abatements and other subsidies and incentives to entice northern industries to expand or relocate in the South."[3]

Other Southern states soon followed with their own development efforts — and collectively, they began a slow but steady climb up from rock bottom, gaining population and per capita income for the next four decades, culminating with the emergence of the Sun Belt.

The Southern growth spurt really took off after World War II, and the region grew into one of the country's great success stories. And in the same period, the first rough outlines of the economic war to come took shape. Economic development, often in the form of locally publicized ribbon cuttings, had long been a popular political activity, and the states, flush with postwar prosperity, began doling out incentives. By 1959 five states had state industrial finance authorities, public agencies that guaranteed loans to industrial borrowers for expansions or location in the state. By 1963 the number had swelled to 19 states.

The Southern states continued to have success, as businesses flocked south, drawn by cheap labor and warm temperatures. All too soon, the South's gains began to impinge on the suddenly hard-pressed states of the North and Midwest, where traditional industries were simultaneously leaving for other countries under the pressure of international competition.

By the end of the turbulent 1960s, this trend made it apparent to astute analysts like Phillips that something important was afoot that had long-term political implications. By the mid-1970s, the competition was apparent to even casual observers and took an increasingly bitter turn because of rising unemployment caused by the energy crisis and subsequent recession. Soon, a full-blown "war" was underway as states loaded up on programs to revitalize and grow their economies and create jobs.

Life During Wartime

Even in periods of relative economic prosperity, the war didn't abate as global competition grew more intense. As a 1996 study of the issue by the Minnesota Federal Reserve described the state of play: "Now, the lethal combination of highly mobile firms, slow growth and relentless corporate downsizings is intensifying the war between the states for big business and the jobs they bring. The average number of state incentive programs has more than doubled to 24 over the past two decades."[4]

The states and their local governments found themselves in a dilemma partly of their own making. As Michael Wasylenko of Syracuse University said at the time in the *New England Economic Review*:

> Those who shape state and local fiscal policy have had a sustained interest in the role that taxation plays in the economic development of states, regions, cities, and special districts or zones. At least 75 studies of employment growth, investment growth, or firm location include an analysis of taxes. Interest in the topic is fueled further when firms complain about the business climate in general or about taxation in particular. State or local policymakers then have the unenviable task of deciphering firms'

[2] Kevin Phillips, *The Emerging Republican Majority* (1969).

[3] Landy Carien Johnson, "Balance Agriculture With Industry Program (BAWI)," *The Mississippi Encyclopedia* (undated).

[4] Chris Farrell, "The Economic War Among the States: An Overview," Federal Reserve Bank of Minneapolis, June 1, 1996.

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> complaints and deciding whether additional tax incentives and lower taxes represent economic rents or constitute a timely and necessary response to keep firms in place.[5]

Although Wasylenko was mainly interested in taxes, the tools of economic competition took many forms, some older than the country and some newer.

At the most basic level, companies make location decisions based on the public services available, like transportation systems, schools, and workforce. These services benefit all the state's citizens, but other incentives became important tools in economic development as well, and many of those benefited only select industries or even individual taxpayers.

This wasn't a new development. According to a history of state business subsidies: "The first recorded subsidy in this country was a bounty given out in the year 1640 by the colony of Massachusetts to producers of linen, woolen, and cotton cloth. By 1789, all but the colony of Delaware made payments to citizens for producing certain types of goods."[6]

Over time, subsidies evolved and became more diverse. One article argues that Delaware was the first state with targeted economic incentives, namely its attractive — some would say "lax" — incorporation laws, enacted in the early 1900s after being pioneered and then abandoned by New Jersey.[7] What was different was that in the days before mass communications and easy travel, the states were less interconnected economically. They did what they did, and other states did, too, and while efforts to gain bragging rights over neighboring states were present, they mainly were a source of opportunity, not an obsession. It wasn't a war.

Insofar as other economic incentives were concerned, Mississippi was again a pioneer — more out of necessity than anything else — but given enough time, the basic idea of economic incentives grew, and creative people came up with new ways to lure business.

While incentive programs originally targeted manufacturing — or really, any business that needed a new location and had jobs to offer — they slowly came to include a range of more narrowly targeted incentives. Minnesota pioneered the first research and development credit in 1981.[8] Today, 35 states offer R&D credits, albeit with varying restrictions and conditions. Similarly, the first state-sponsored biotech initiative, the North Carolina Biotechnology Center, was founded in 1984 at the Research Triangle Park. Many states followed.

Deals and Megadeals

Since then, some states have followed the latest fads, chasing the "next big thing." In 2012 Minnesota was the first state to enact a tax break for data centers, and now 36 states have some kind of legislation authorizing tax incentives for new data center development.[9] Data centers offer the possibility of economic development, particularly in rural areas, but they don't create many jobs relative to their size, which has grown significantly in recent years.

Though increasingly controversial for their energy demands and water use, data centers have gathered momentum lately with the increased state attention to the supposedly vast potential of another next big thing, artificial intelligence, which requires obscene amounts of computing power (and electricity). Global data center capacity is expected to double in the next five years as tech companies seek computing power for AI and cloud storage, according to a report released last year by Moody's, and utilities in some states — including California, Illinois, Iowa, and Virginia — are already struggling to meet the demand.[10]

[5] Michael Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New Eng. Econ. Rev.* 37-52 (Mar./Apr. 1997).

[6] Sandra Kanter, "A History of State Business Subsidies," *Proceedings of the Annual Conference on Taxation Held Under the Auspices of the National Tax Association-Tax Institute of America* (1977).

[7] Beverly Moran, "The Second War Between the States: How the United States Became the World's Best Tax Haven," 16(2) *Law & Dev. Rev.* 295-324 (2023).

[8] Arrizka Faida, "Innovation Lightbulb: The U.S. State-Level R&D Landscape," Center for Strategic and International Studies (Washington, D.C.), Nov. 8, 2024.

[9] Jake Remington and Rod Carter, "An Overview of State Data Center-Related Tax Incentives," *Development*, National Association of Industrial and Office Properties (Winter 2024/2025).

[10] Moody's CreditView blog, "Navigating the Future of Data Centers Amidst Rapid Expansion" (July 31, 2024).

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Other "hot" industries that have caught the fancy of state governments at least briefly in recent years include tech-based industries generally, blockchain, electric vehicles, batteries (for those vehicles), semiconductors, hydrogen power generation, and, lately, quantum computing. States also have developed a weird fondness for providing incentives for warehouses for companies like Amazon that have spread their distribution networks across the country to make next-day delivery or even same-day delivery possible.

More and more states and some local governments have also elected to swing for the fences on economic development projects that involve not dozens — or even hundreds — of jobs, but thousands. This has led to the creation of what Good Jobs First, a Washington-based think tank that monitors (and mostly doesn't like) business tax incentives, dubbed "megadeals," those involving public subsidies of $75 million or more.

According to Good Jobs, the megadeal trend is older than I imagined:

> The era of the megadeal began in the late 1970s, when state and local officials in Pennsylvania put together a package worth about $100 million to persuade Volkswagen to build an assembly plant — the first foreign car manufacturing facility in the United States — in Westmoreland County. Starting in the early 1980s, the major Japanese automakers and many of their European counterparts got their own deals to help them penetrate the world's largest automobile market. The Big 3 domestic carmakers got deals of their own.[11]

Movies and Sports

Two other economic development tax breaks can be added to the list because of their popularity — those that encourage film and television production and those for professional sports stadiums, the vanity projects of state economic development.

Movie and television incentives have long been a controversial topic in the states, offering a sort of fatal attraction for the states all out of proportion with their benefits, which are small.

In the 1990s, with old Hollywood an increasingly distant memory, states began seeing the opportunity to debut their own production incentives as an effort to capture some of the perceived economic benefits of film and TV production. Louisiana was the first state to do so in 2001, and in 2002 the state passed legislation to further increase the scope of its incentives.

Other states soon followed, and now 37 states offer film or TV incentives, according to the National Conference of State Legislatures.[12] Over time, some states have reduced or even eliminated their programs, but in most cases, the programs eventually return. As the NCSL noted last year, "Since 2021, with the economy well on the rebound after the pandemic, at least 18 states have enacted measures to implement or expand film tax incentives." Legislatures in several states, including California, Nevada, New York, and Texas, are considering expanding their programs in this year's legislative sessions.

Professional sports stadiums are another fatal attraction for state and local governments and involve billions of dollars in public investment. A 2022 study by three sports economists reported that "between 1970 and 2020, state and local governments devoted $33 billion in public funds to construct major-league sports venues in the United States and Canada, with the median public contribution covering 73 percent of venue construction costs."[13] Last October the Tax Foundation reported that an estimated $13 billion in public subsidies had been proposed for teams in 2024. The foundation questions the value of these subsidies: "Often, the only economic benefits occur near the stadium — and fall far short of expectations. State and city governments

[11] Philip Mattera and Kasia Tarczynska, "Megadeals: The Largest Economic Development Subsidy Packages Ever Awarded by State and Local Governments in the United States," Good Jobs First (June 2013).

[12] National Conference of State Legislatures, "State Film and Television Incentive Programs" (Apr. 8, 2024).

[13] John Charles Bradbury, Dennis Coates, and Brad Humphries, "The Impact of Sports Franchises and Venues on Local Economies: A Comprehensive Survey," 37(4) *J. Econ. Surv.* 1389-1431 (Sept. 2023).

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are subsidizing development within a single neighborhood, with no tangible benefits for the rest of the city or state."[14]

Still, state and local governments continue to embrace the game since professional sports franchises are highly valued for reasons that can't be reduced to a simple dollar-and-cents equation. For example, in Missouri, lawmakers this session have continued to search for a workable incentive package to keep the Kansas City Chiefs and Royals on the Missouri side of the border with Kansas.[15]

Missouri lawmakers are looking for a way to counter a package put together for the Chiefs by the Kansas Legislature, which would provide so-called STAR (sales tax and revenue) bond assistance to the team totaling $3 billion to build a new stadium on the Kansas side of the border, a significantly larger amount than the $1 billion in total STAR bonds active in the state. The Kansas Policy Institute recently called the controversial package an example of the "game of lobbying for billion-dollar enterprises to receive handouts [from the Legislature] *while ordinary Kansans still haven't received significant income tax relief*."[16]

Kansas made its move after voters in Kansas City, Missouri, rejected proposed subsidies to the teams in April 2024, returning to the long-standing battle for economic development between the two states that has raged for years in the Kansas City metro areas as companies have periodically moved back and forth across the border, chasing new incentive packages.

But Missouri voters' rejection also represents a new trend in which voters are rejecting various large incentives, often concerned about their impact on local areas or the perceived cost in tax dollars. The same happened in New York City in 2019 amid stiff public backlash to the proposal for Amazon's second headquarters, although the project had support from both the city mayor and the governor.

[14] Adam Hoffer, Joseph Johns, and Craig Depken, "Taxpayers Shoulder a Heavy Burden for Sports Stadium Subsidies," Tax Foundation Tax Policy Blog, Oct. 3, 2024.

[15] "In Focus Missouri: Tax Incentives to Keep KC Sports Teams," *Spectrum News*, Apr. 27, 2025.

[16] Ganon Evans, "What the Proponents of Subsidies for the Chiefs Aren't Telling You," Kansas Policy Institute, June 13, 2024 (emphasis in original).

Where You Stand Depends on Where You Sit

A final point about tax and other incentives for economic development is that, like the Kansas STAR bonds, they've always been controversial. The variation in views on their benefit or necessity has only grown stronger as the economic battle between the states has dragged on, year after year, decade after decade.

The consensus among economists is that while incentives may play a role in business location decisions, they are not a top consideration, except, possibly, in a few isolated cases. As far back as 1961, the well-known tax economist John Due of Purdue University reviewed the impact of state and local tax incentives for economic development and concluded that those considerations are rarely key factors in industrial location.[17]

In 1981, following the recession of the 1970s and the Sun Belt/Frost Belt controversy, the U.S. Advisory Commission on Intergovernmental Relations, an independent federal advisory agency that studied the intergovernmental relations of states and localities with the federal government, examined the disparities in regional economic growth patterns, their underlying causes, and whether Congress should do anything about it. One issue examined was the:

> persistent concern that tax-based competition for people, capital, and jobs will reach the point where many state policymakers will feel obliged to pursue a "beggar thy neighbor" strategy. Such a strategy could be harmful in two ways: (1) certain states may be vulnerable to a competing state that adopted a probusiness tax policy; and (2) the state espousing this strategy might shortchange its own citizens' public services.[18]

In those days, there was at least the belief that Congress could or would take action to harmonize the intergovernmental system if needed. But in this case, while acknowledging

[17] John Due, "Studies of State and Local Tax Influences on Location of Industry," 14(2) *Nat'l Tax J.* 163-173 (June 1961).

[18] U.S. Advisory Commission on Intergovernmental Relations Report A-76, "Regional Growth: Interstate Tax Competition" (Mar. 1981).

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the problems created by interstate tax competition, the commission concluded that it was best to leave well enough alone while monitoring the issue: "Short of highly coercive or expensive action, there seems to be no easy way for the federal government to stop or inhibit states from using tax, spending, and regulatory policies to try to manipulate their industrial development."

This criticism of tax incentives and interstate competition has continued, usually coming from the liberal side. Recently though, the argument has bent back on itself, and some conservative critics have joined in condemning the practice of "corporate welfare," presumably for taking away resources better used to eliminate income taxes.

In any case, the issues linger unresolved, and in the meantime, the pure economics of interstate tax competition continue to be written about — and generally ignored by state legislatures. Richard Pomp of the University of Connecticut School of Law summed the divergence up neatly in a 1980 panel discussion:

> The pressure to adopt tax incentives and similar measures is irresistible. State and local officials often feel that they have little power to affect their local economies and thus feel compelled to do something — to do anything. . . . It is not surprising, therefore, that tax incentives are easy to legislate. They give lawmakers a feeling that they have done something constructive.[19]

Even at that, Pomp said many issues remained unresolved about incentives beyond simple political utility. In the same panel discussion, he asked:

> Tax incentives clearly are in vogue, but their use raises a series of nagging questions. For example, do these incentives work? Do firms really choose a location on the basis of state and local taxation, or do they base their decisions on other grounds and then simply bargain with various jurisdictions for the best deal they can get? What percentage of business costs are actually represented by state and local taxes?

Many, if not all, of those questions remain unanswered — or answered unsatisfactorily — 45 years later. Meanwhile, the band plays on.

The New Art of War

I tend to agree with Pomp, which I have found is always the best thing to do in tax debates. Accumulate all the evidence to the contrary you want, but lawmakers are still going to enact incentives whenever they decide it is to their advantage to do so. As Pomp said, doing so gives lawmakers a feeling they have done something constructive, and everyone likes a good groundbreaking or ribbon cutting. That may not be what the data show, but it is what politics dictate — at least until voters begin to buy into the corporate welfare argument in larger and more convincing numbers.

The question, then, is how to create and manage incentive programs in a responsible way. In a 1996 paper, Timothy Bartik of the W.E. Upjohn Institute on Employment Research took the inevitability of subsidies for granted and listed eight separate policy issues for states to consider in the creation and use of incentives. The list is still worth looking at today. It covers everything from benefits and costs, to targeting, to federal involvement. On the all-important issue of actual economic value, he concluded: "Economic development incentive programs are more likely to pass a benefit cost test if (1) local unemployment is high, so the new jobs are needed by local residents; (2) the jobs pay higher wages; (3) more of the jobs go to local residents."[20]

Bartik always makes sense, but I ran across a more obscure guide on the subject that was put forward by Graham Toft and James Laughlin of the Indiana Economic Development Council in 1996 that also contains a lot of common sense about incentives — they called their principles "The New Art of War" because "the hyper-

[19] Richard Pomp et al., "Can Tax Policy Be Used to Stimulate Economic Development?" Remarks prepared for Multistate Tax Commission's State and Local Business Tax Symposium (1980).

[20] Timothy J. Bartik, "Eight Issues for Policy Toward Economic Development Incentives," Federal Reserve Bank of Minneapolis, June 1, 1996.

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competitive economic environment now facing the United States equally affects business and state and local decision-makers."[21]

Toft says they proceeded from two assumptions: "(1) that incentives be treated like any other public expenditure, that is, as an investment choice evaluated on a reasoned risk-reward basis and (2) that, given the public's sour mood toward government, incentives be designed and administered according to strict standards of accountability." These principles, Toft writes, "call for determining and deciding upon an acceptable rate of return, specifying outcomes and compensating the firm on performance, and requiring tight development agreements, which include clawback provisions." In short, the ideas aren't so different from the prescription the Pew Center on the States later laid out in its 2012 report on how to evaluate state tax incentives, possibly the best blueprint for responsible state use of business tax subsidies.[22] In essence, both guides suggest not being too enthusiastic or giving away more than is received in return; keeping track of how companies are performing; and being prepared to claw back incentives on projects that go wrong.

That many of the studies I've cited date back decades signifies how long the supposed economic war between the states has dragged on with not much changing — except that the dollar figures have grown larger and states have begun making some efforts at accountability, although that still varies from state to state.

That doesn't mean the debate over incentives is completely absent from state legislatures, or that the debate has become demonstrably more thoughtful. In this year's legislative session in Nebraska, a bill has been introduced (L.B. 650) that looks to help plug the state's budget gap by about $51 million, largely by clawing back several business incentives. The Legislature's Revenue Committee chair, Sen. R. Brad von Gillern (R), introduced the bill and told lawmakers that the committee used a last-in, first-out approach in targeting initiatives previously approved by the Legislature and former Gov. Jim Pillen. He said the package scales back or repeals incentives and programs the committee believed would have the least negative impact on a typical taxpayer. Nevertheless, it's stirred up significant controversy, so we'll see how far it gets.

The story of the economic war between the states reminds me of a sci-fi novel from the 1970s called *The Forever War* by Joe Haldeman, which doubles as a space opera and Vietnam allegory. It tells the story of human soldiers fighting an interstellar war against an alien civilization known as the Taurans that has become a forever war, a seemingly unending state of war with no clear conditions that could lead to its conclusion. In the same way, the interminable, often self-defeating economic war between the states has become its own sort of forever war.

The economic war has gone on so long that few people remember when it started or what anyone, decades ago, thought about it. Thus, states continue to build on policies whose original purposes may be long since forgotten or obsolete. In that regard, a quote in the book sums up the sheer pointlessness of the whole endeavor: "The 1143-year-long war had begun on false pretenses and only because the two races were unable to communicate. Once they could talk, the first question was 'Why did you start this thing?' and the answer was 'Me?'" ■

[21] Graham Toft, "Doing Battle Over the Incentives War: Improve Accountability but Avoid Federal Noncompete Mandates," Federal Reserve Bank of Minneapolis, June 1, 1996.

[22] Pew Center on the States, "Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth" (Apr. 2012).

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