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Economic Development Incentives, Accountability Legislation and a Double Negative Commerce Clause

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ECONOMIC DEVELOPMENT INCENTIVES, ACCOUNTABILITY LEGISLATION AND A DOUBLE NEGATIVE COMMERCE CLAUSE

> To the States, or any one of them, or any city of the States, *Resist much, obey Little,*
>
> Once unquestioning obedience, once fully enslaved,
>
> Once fully enslaved, no nation, state, city, of this earth, ever afterward resumes its liberty.[1]

> [W]hen the private corporation to be aided by eminent domain is as large and influential as General Motors, the power of eminent domain, for all practical purposes, is in the hands of the private corporation. The municipality is merely the conduit . . . .
>
> Eminent domain is an attribute of sovereignty. When individual citizens are forced to suffer great dislocation to permit private corporations to construct plants where they deem it most profitable, one is left to wonder who the sovereign is.[2]

I. INTRODUCTION

In the last two decades, states and municipalities have increasingly used public assets to keep local businesses from relocating or to lure businesses away from other states.[3] Incentives take the form of direct subsidies, low-interest loans or development bonds, investment tax credits, property, income and franchise tax abatements, infrastructure improvements, worker training and the gift or sale of property seized by eminent domain.[4] The amount of

1. WALT WHITMAN, *To the States*, *in* LEAVES OF GRASS 9 (Avatine Press 1931).

2. Poletown Neighborhood Council v. City of Detroit, 304 N.W.2d 455, 481 (Mich. 1981) (Ryan, J., dissenting).

3. *See*, *e.g.*, Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 383 (1996); Declaration of Policy, 1994 Iowa Acts (75 G.A.) ch. 1008, § 1 (1994). More than forty states offer incentives that were rarely used as of 1980. *See* Kary L. Moss, *The Privatizing of Public Wealth*, 23 FORDHAM URB. L.J. 101, 106 (1995).

4. *See* Steven R. Little, *Corporate Welfare Wars: The Insufficiency of Current Constraints on State Action and the Desirability of a Federal Legislative Response*, 22 HAMLINE L. REV. 849, 854-56 (1999).

assistance given by these methods has also increased dramatically.[5] At the same time, states and municipalities have traditionally had no recourse in the event an incentive recipient relocates again, cuts back commercial activity or otherwise fails to deliver on promised jobs and economic benefits.[6]

Little evidence suggests that these economic development incentives are having a net economic benefit in the communities that provide them.[7] Rather, since all states are doling out incentives, the competition among states for location of businesses and industry results merely in the expectation of a public contribution to business location decisions, and an overall shift in resources from public to private.[8] This shift in resources occurs at an inopportune time, as in this decade many cities have gone bankrupt, or had to close or sell facilities such as schools and hospitals, lay off essential employees and reduce allocations to infrastructural improvements to avert fiscal collapse.[9] Some commentators have likened the interstate competition for business to a "race to the bottom,"[10] analogous to the frantic modification in corporate law at the turn of the century to attract businesses into incorporating within a particular state,[11] but with potentially greater economic consequences to the participants. Others have likened this competition to a "second Civil War,"[12] and there has been an academic outcry for a federal legislative response.[13]

5. It is impossible to decipher accurately how much assistance is given out annually, as records are often not made public. *See, e.g.*, Donald L. Barlett & James B. Steele, *Special Report: Corporate Welfare, a System Exposed*, TIME, Nov. 9, 1998. Furthermore, the amount of *indirect* subsidies to businesses in the form of tax abatements and credits is even more difficult to calculate. Estimates of aid from state and local authorities, not including federal aid, run as high as $50 billion annually. *See* KENNETH P. THOMAS, COMPETING FOR CAPITAL: EUROPE AND NORTH AMERICA IN A GLOBAL ERA 159 (2000). In 1992, Massachusetts claimed a $2.5 billion yearly loss due to commercial tax abatements, a figure amounting to more than one-third of the state's total estimated revenues absent the abatements. Meanwhile, Michigan identifies nearly $4.9 billion in such tax incentives. *See* Enrich, *supra* note 3, at 388.

6. *See* Moss, *supra* note 3, at 103.

7. *See generally* GOOD JOBS FIRST, INSTITUTE ON TAXATION AND ECONOMIC POLICY, MINDING THE CANDY STORE: STATE AUDITS OF ECONOMIC DEVELOPMENT 35-41 (2000) [hereinafter GJF Audit Survey] (discussing the results of fifteen state audits that show little evidence that development programs are improving the economic conditions they were created to address). The debate on the economic value of development incentives is explored further *infra* notes 65-88 and accompanying text.

8. *See* Clayton P. Gillette, *The Law and Economics of Federalism: Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 479 (1997).

9. *See* Peter Dreier, *America's Urban Crisis: Symptoms, Causes, Solutions*, 71 N.C. L. REV. 1351, 1371-74 (1993) (discussing corporate flight as a root cause of the fiscal calamity facing many American cities).

10. Gillette, *supra* note 8, at 451.

11. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548-64 (1933) (Brandeis, J., dissenting).

12. Enrich, *supra* note 3, at 377.

13. *See generally* Little, *supra* note 4; Matthew Schaefer, *State Investment Attraction Subsidy Wars Resulting From a Prisoner's Dilemma: The Inadequacy of State Constitutional*

A congressional act is usually seen as the most rational solution to the interstate subsidy wars, because a state's unilateral attempt to restrict location subsidies would theoretically place that state at an immediate disadvantage in competing for business.[14] Several attempts by state governors to negotiate non-compete agreements have failed.[15] However, in recent years, states and municipalities have begun adopting measures for self-empowerment in the granting of development incentives. Since 1994, at least sixty jurisdictions have enacted legislation that conditions receipt of assistance on meeting job creation goals or other economic criteria, or otherwise holds businesses accountable for public benefits expected to result from the incentives.[16] Many of these statutes include "clawbacks,"—provisions that allow state and local governments to recoup their costs when recipients of development incentives fail to live up to their end of the bargain.[17] Other provisions permit the development agency to rescind or recalibrate the assistance being given, or to assess damages, upon the non-occurrence of certain specified goals.[18] Thus far, there has been little negative impact on the perceived business climate of communities operating under these accountability statutes, and the trend is being described as a "quiet revolution in economic development that the media has overlooked."[19]

Given the recent proliferation of accountability legislation, the financial magnitude of the subsidies they govern, and the lack of success recipients have had in meeting targets contemplated by the granting of incentives, it is nearly

Solutions and the Appropriateness of a Federal Legislative Response, 28 N.M. L. REV. 303 (1998); Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, THE REGION (March 1995), *reprinted in* 10 STATE TAX NOTES 1895 (1996); Mark Taylor, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 TEX. L. REV. 471 (1994). For a discussion of the form that such a federal act might take, see *infra* notes 104-10 and accompanying text.

14. While governor of Illinois, Jim Edgar admitted that a unilateral cutback in business subsidies would be "just as unrealistic as it would be for the United States to have withdrawn unilaterally from the nuclear arms race." Jim Edgar, *Are Economic Development Incentives Smart?*, STATE GOV'T NEWS (Council of State Governments) (March 1993), *reprinted in* GREG LEROY, NO MORE CANDY STORE 14 (1994). *See also* Chris Farrell, *The Economic War Among the States: An Overview*, THE REGION (June 1996), *available at* http://woodrow.mpls.frb.fed.us/sylloge/econwar/farrel.html (last visited Nov. 14, 2001) (stating that a state's unilateral act to limit development incentives would be "economically suicidal").

15. *See* Jennifer L. Gilbert, *Selling the City Without Selling Out: New Legislation on Development Incentives Emphasizes Accountability*, 27 URB. LAW. 427, 446-47 (1995).

16. *See* GOOD JOBS FIRST, INSTITUTE ON TAXATION AND ECONOMIC POLICY, THE POLICY SHIFT TO GOOD JOBS: CITIES, STATES AND COUNTIES ATTACHING JOB QUALITY STANDARDS TO DEVELOPMENT SUBSIDIES 1 (2000).

17. *See, e.g.*, MD. CODE ANN. STATE FIN. & PRO. § 7-314 (1999).

18. *See infra* notes 160-83 and accompanying text.

19. Interview, Greg LeRoy: *On Incentives and Accountability*, 17 STATE TAX NOTES 837, 838 (Sept. 30, 1999).

inevitable that a case will soon arise to challenge the legality and enforceability of these statutes. This Comment will make a comparative survey of such legislation, discuss their relative economic and prudential merits and analyze the language of the provisions therein as to their practicability and constitutionality. Part II of this Comment will provide background information to the study of development subsidies, concentrating on case studies that demonstrate a need for accountability legislation. Part III will map out the landscape of such legislation, using examples from Arizona, Iowa, Indiana and Louisiana. Part IV will discuss legal and empirical challenges to the enforceability of the statutes, including contractual challenges, the theory of regulatory capture, weaknesses in statutory construction, and, especially, the Dormant Commerce Clause, which this Comment will argue mandates, rather than undermines, accountability in development incentives. Part V will conclude with a call to states and municipalities for continued self-empowerment by seizing the opportunity to confront the traditional "prisoners' dilemma" in interstate competition for location of businesses.

II. BACKGROUND

A. *History of Development Incentives*

The practice of granting public funds to private businesses to encourage development is nothing new in America's history. Between 1722 and 1776, in what has been called "a series of 'shady land deal[s],'"[20] the city of New York granted much of its waterfront property to the city's richest and most powerful residents in exchange for restrictive covenants to build streets and develop the city's port facilities, while ensuring public access to certain roads and docks.[21] Immediately after the formation of the union of American states, Massachusetts, Georgia and others courted businesses with public assistance to encourage growth in their underdeveloped economies.[22] In the nineteenth century, Midwestern cities fought fiercely to subsidize railways and to become transportation and shipping hubs, and the federal government granted significant tracts of land to encourage the expansion westward.[23]

20. HENDRIK HARTOG, PUBLIC PROPERTY AND PRIVATE POWER 45 (G. Edward White ed., 1983) (quoting Milton Klein, *Introduction to* THE INDEPENDENT REFLECTOR 30 (Milton Klein ed., 1959)).

21. *Id*. at 48-51.

22. *See, e.g.*, OSCAR HANDLIN & MARY FLUG HANDLIN, COMMONWEALTH (rev. ed. 1969). In fact, early corporate charters, which conferred upon banks, factories and other groups of private individuals a quasi-governmental power to levy taxes on their members, provided a key form of indirect assistance to the economy when public coffers were already drained from pre-revolutionary war debt. *See id.* at 91-105.

23. *See* WILLIAM CRONON, NATURE'S METROPOLIS 63-74 (1991) (discussing the role of railroads in Chicago's economic expansion).

Much of the modern policy toward state incentives to economic development began during the Great Depression, when tightened government control of economic matters gained favor over the laissez-faire approach of years past.[24] Southern states instituted a series of programs which sought to lure businesses from the North with promises of subsidies, tax relief, facilities, training, and low-wage and non-unionized workers.[25] Consistent with the tendency of development programs to sprout during emerging economies or times of economic crises, welfare programs reappeared in the 1970s and 1980s when the country's energy crisis and consequent shift from industrial activity caused Northeastern and Midwestern cities to search for new incentives to dissuade businesses from leaving for "sun belt" states.[26] During these decades, the state of Michigan particularly felt pressure to keep local jobs in the wake of threats by General Motors Corporation ("GM") to relocate to more advantageous environs.

B. The Michigan Example Part 1: The Poletown Case

Perhaps the most demonstrative example of the competing tensions between the economic desperation of old, industrial cities and the desire for moderation and accountability in economic development incentives is the case of *Poletown Neighborhood Council v. City of Detroit*.[27] In 1980, GM announced its plan to close its Cadillac and Fisher body plants in Detroit in favor of a newer, more automated facility that could produce cars to compete with a wave of lightweight and fuel-economic imports.[28] GM notified the city and offered to build the new facility in Detroit, employing 6,000 locals, if a suitable site could be found.[29] The City of Detroit, faced with an 18% unemployment rate and a continuous exodus of manufacturers to "sun belt" states, acted quickly, giving GM a list of nine proposed sites.[30] Only a 465-

24. *See* Taylor, *supra* note 13, at 674.

25. *See, e.g.*, Farrell, *supra* note 14; Little, *supra* note 4, at 853. In 1936, often credited as the first "shot fired" in the economic war between the states, the city of Durant, Mississippi issued $25,000 in industrial revenue bonds and erected a building for Real Silk Hosiery Mills. Nine years later, the city approved a bond of $60,000 to expand the facility. Real Silk never employed more than 150 people locally and left Durant before its lease was up. Mississippi remains the poorest state in the nation. *See* "Durant, Mississippi: Where It All Began," *in* Barlett & Steele, *supra* note 5.

26. Farrell, *supra* note 14.

27. 304 N.W.2d 455 (Mich. 1981). The razing of Poletown for construction of a new GM plant was documented in a documentary film, POLETOWN LIVES! (Information Factory 1983) (on file with the Saint Louis University Law Library, or available by contacting Information Factory, 3512 Courville, Detroit, MI 48224), and in JEANIE WYLIE, POLETOWN: COMMUNITY BETRAYED (Illini Books ed. 1990).

28. *Poletown*, 304 N.W.2d at 460 (Fitzgerald, J., dissenting).

29. *Id*.

30. *Id.* at 465-67 (Ryan, J., dissenting).

acre site, which would require the condemnation of an entire community of first- and second-generation Polish Americans, was found adequate by GM.[31]

Subsequent correspondence between GM and the economic development corporations of the cities of Detroit and neighboring Hamtramck demonstrates the extent of control which GM maintained over the terms and conditions of the project.[32] These corporations were simply the "alter egos" of the municipalities they represented, chaired by the mayors of each city.[33] By a series of memoranda, drafted by GM and left unaltered except for signatures by the municipalities, the City of Detroit was required to take title to the property within six months and make improvements to roads and utilities, at an eventual cost of over $200 million, then sell the property to GM for $8 million.[34] The two cities further agreed to grant GM the "maximum allowable tax abatement under [Michigan] law for a period of 12 years."[35]

Under Michigan's "quick take" statute,[36] the City of Detroit began the process of condemnation and compensating the owners of the Poletown properties. Even though alternative architectural plans had been proposed that would have saved much of the homes therein, the city proceeded with notices of eviction to the owners of the neighborhood's 1,400 homes, 144 businesses and 16 churches, many of which were to become landscaped lawns, ponds and parking surrounding the plant.[37] A minority of residents resisted, filing suit to enjoin the condemnation proceedings and making as their headquarters the Immaculate Conception Church in Poletown. However, despite the pleas of the church's priest, Father Joseph Karasiewicz, the archdiocese of the Catholic Church sold the church for $1.3 million.[38] Many local businesses soon followed.[39] By the time the *Poletown* case reached the Michigan Supreme Court, which granted a motion for immediate consideration and an application for leave to appeal prior to a decision by the lower appellate court,[40] the case's conclusion was attended with an "overwhelming sense of inevitability."[41] By a 3-2 decision, rendered within ten days of oral argument, the court held that the exercise of eminent domain for use by a private corporation carried the public

31. *Id*. at 467-68.
32. *Id*. at 468-71.
33. *Poletown*, 304 N.W.2d at 468-69 (Ryan, J., dissenting).
34. *Id*. at 469.
35. *Id.* at 470.
36. MICH. STAT. ANN. §§ 8.265(1)-(27) (Michie 1997 & Supp. 2000).
37. WYLIE, *supra* note 27, at 51-52.
38. *Id.* at 117.
39. *Id*. at 130.
40. *Poletown*, 304 N.W.2d at 457.
41. *Id*. at 481 (Ryan, J., dissenting).

purpose of revitalizing the local economy and hence was a valid exercise of police power under the Michigan constitution.[42]

C. Rising Incentives and the Problem of Accountability

The *Poletown* decision is consistent with judicial decisions in other states. Each of these courts generally ask whether the object sought to be accomplished by eminent domain is primarily for the benefit of the public as compared with the benefit to private interests.[43] This "ends justify the means" analysis, combined with judicial deference to legislative determinations of "public purpose," has meant that the acts of economic development agencies have gone virtually without judicial check for thirty years.[44]

Given this free rein, development authorities have given out increasingly large incentive packages. In 1994, Alabama offered a package to Mercedes-Benz whereby it would clear and improve a factory site, upgrade utilities, buy 2,500 of the vehicles produced, and train and pay the salaries of the workers for one year.[45] Northwest Airlines received an incentive package from Minnesota in 1991 worth nearly $838 million.[46] Michigan gave inducements totaling $80 million to Blue Water Fibre for a paper-recycling mill, at a cost of $2.4 million dollars *per job*.[47] Furthermore, in 1995, Ohio and the City of Toledo put together an incentive package worth $262 million for a facility to keep Chrysler manufacturing Jeeps in Toledo, even though the new plant would employ over 700 *fewer* workers than before.[48]

Meanwhile, recipients of incentive packages were not always living up to their end of the bargain. As of 1996, Northwest had not yet completed two maintenance facilities, the target of fifty percent of Minnesota's subsidy, even

42. *See id*. at 459. Subsequent to the court's decision, residents of Poletown occupied the Immaculate Conception Church in an illegal vigil. The City turned off the church's water and electricity, then raided the church with sixty members of a Special Weapons Assault Team (SWAT). Twelve people were arrested, many of whom were in their seventies or older. For his criticisms, Father Karasiewicz was effectively appointed to a position in the Catholic Church where he would no longer be able to speak to the masses. *See* WYLIE, *supra* note 27, at 153-91.

43. *See*, *e.g.*, State ex rel. Brown v. Warr Acres, 946 P.2d 1140, 1147-49 (Okla. 1997) (Kauger, C.J., concurring).

44. *See* Moss, *supra* note 3, at 118-26; Maready v. Winston-Salem, 467 S.E.2d 615, 626-27 (N.C. 1996).

45. *See* David E. Buchholz, *Mercedes-Benz: The Deal of the Century*, *available at* http://www.cfed.org/main/econDev/bi/main/vignettes/mercedes.htm (last visited Nov. 7, 2001). The Mercedes-Benz package would cost Alabama roughly $153 million, an expenditure of between $153,000 and $220,000 per job promised. *See id*.

46. *See* Michael H. LaFave, *Taking Back the Giveaways: Minnesota's Corporate Welfare Legislation and the Search for Accountability*, 80 MINN. L. REV. 1579, 1579 (1996).

47. *See* Farrell, *supra* note 14.

48. *See* David E. Buchholz, *Toledo: Failing to Deliver*, *available at* http://www.cfed.org/main/econDev/bi/main/vignettes/toledocf.htm (last visited Nov. 7, 2001).

though the facilities had been scheduled for completion three years earlier.[49] At the same time, the Mercedes plant in Alabama had cost the state nearly twice the anticipated amount, produced one-half the expected jobs, and only fourteen percent of the plant's suppliers were located within Alabama borders.[50] The Toledo plant, ultimately with the aid of tax incentives, was almost entirely automated, and the assembly of Jeeps by laser-guided robots resulted in the disappearance of an additional 2,800 jobs.[51] Absent specific provisions in a contract or authorizing statute holding recipient businesses accountable for promises of jobs and economic growth made during negotiations, states and municipalities are quite often helpless against subsidy abuse.[52]

D. The Michigan Example Part 2: The Willow Run Case

A good example of the helplessness of some municipalities in negotiating incentive deals is the case of *Charter Township of Ypsilanti v. General Motors Corp*. ("*Willow Run Case*").[53] In 1984 and 1988, the township of Ypsilanti, Michigan, located just thirty miles from the *Poletown* plant, offered GM twelve-year property tax abatements for investments related to the production of a new car at its Willow Run plant.[54] In its 1984 tax abatement application, GM stated that its investment would create 200 jobs and help retain 4,300 more.[55] Its 1988 application claimed 4,900 jobs would be retained by its

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49. *See* LaFave, *supra* note 46, at 1580.

50. *See* Allen R. Myerson, *O Governor, Won't You Buy Me a Mercedes Plant?*, N.Y. TIMES, Sept. 1, 1996, at F1.

51. Gideon Kanner, *The New Robber Barons*, NAT'L L.J., May 21, 2001, at A19. The Toledo package is currently being challenged in federal district court for its constitutionality, as discussed *infra* notes 102-103 and accompanying text.

52. *See*, *e.g*., Yonkers v. Otis Elevator Co., 649 F. Supp. 716, 728 (S.D.N.Y. 1986) (denying the city relief where a recipient of financial incentives had made no clear commitment to operate its plant for any period of time); *In re* Indenture of Trust, 437 N.W.2d 430, 436 (Minn. Ct. App. 1989) (finding that an incentive agreement created no obligation upon the recipient to forbear from transferring jobs and equipment out of state).

53. 506 N.W.2d 556 (Mich. Ct. App. 1993).

54. *See id*. at 558. The tax abatements were made pursuant to Michigan's Plant Rehabilitation and Industrial Development Districts Act. MICH. COMP. LAWS §§ 207.551-.571 (LEXIS through 1994 legislation). Under the Act, municipalities create industrial development districts, which allows companies within such districts to apply for exemptions with the city and state tax authorities. From 1975 to 1990, General Motors received tax abatements on investments totaling more than $1.3 billion on its operations in Ypsilanti alone. *See* Taylor, *supra* note 13, at 676-77. Michigan's authorizing statute is weak on protections to the state, authorizing tax abatements that will "have the *reasonable likelihood* to create employment, retain employment, prevent a loss of employment, or produce energy in the community in which the facility is situated." MICH. COMP. LAWS § 207.559(2)(e) (emphasis added).

55. *See* Scott J. Ziance, *Making Economic Development Incentives More Efficient*, 30 URB. LAW. 33, 36 (1998).

investment.[56] In negotiations, GM pledged to continue production and maintain employment at the plant, subject to "favorable market demand."[57] In 1991, when GM decided to move its Willow Run operations to Arlington, Texas, the township sued for injunctive relief.[58]

The trial court granted such relief, finding no contract in the authorizing statute or tax abatement applications, but finding GM was bound by promissory estoppel to remain at the Willow Run plant.[59] It concluded that it would be grossly unfair if GM, having "lulled the people of the Ypsilanti area into giving up millions of tax dollars which they so desperately need to educate their children," was allowed to move its operations built with tax assistance "simply . . . because it thinks it can make these same cars cheaper somewhere else."[60] On appeal, however, the decision was reversed. Holding that representations of job retention made during hearings and negotiations were nothing more than "hyperbole and puffery," the Michigan Court of Appeals overturned the injunction on a clearly erroneous standard.[61] As the court noted, "[i]t has never been held that an abatement carries [inherently] a promise of continued employment."[62]

The *Willow Run Case* was frequently discussed by commentators.[63] It demonstrates that development incentives, by themselves, do nothing to alleviate the problem of businesses leaving dependent communities in favor of more profitable business climates.[64] Absent a statutory or contractual provision holding the recipient legally accountable, the recipient business can still relocate at any point.

E. The Economic Debate

Numerous studies indicate that businesses do not decide where to invest on the basis of development incentives.[65] Moreover, there are indications that such incentives have no net benefit to the individual communities that provide

56. *See id*.

57. *Willow Run Case*, 506 N.W.2d at 558.

58. *See* Ziance, *supra* note 55, at 36.

59. *See Willow Run Case*, 506 N.W.2d at 558.

60. *Id*.

61. *Id*. at 559.

62. *Id*. at 561.

63. *See, e.g.*, David L. Gregory, *Company Closings and Community Consequences*, 72 U. DET. MERCY L. REV. 1 (1994); Ziance, *supra* note 55, at 36-38; Gilbert, *supra* note 15, at 449-50; Annett Pinckney, *Tax Abatements and Industrial Location:* Township of Ypsilanti, Mich. v. Gen. Motors Corp., 59 TAX NOTES 1537 (1993); Moss, *supra* note 3, at 126-28.

64. *See* Ziance, *supra* note 55, at 37.

65. *See* Peter O'Brien, *The Automotive Industry: The Permanent Revolution*, *in* INDUSTRY ON THE MOVE: CAUSES AND CONSEQUENCES OF INTERNATIONAL RELOCATION IN THE MANUFACTURING INDUSTRY 53, 81 (G. van Liemt ed., 1992); Moss, *supra* note 3, at 109.

them.[66] For example, Louisiana granted tax exemptions that cost its school system $941 million during the 1980s.[67] During the same period, it remained among the lowest ranking states in adult literacy and average teacher pay,[68] and was one of the slowest growing states in terms of personal income.[69] South Carolina, meanwhile, has added 200,000 jobs since 1990 via a series of "sweetheart" tax breaks to companies, but remains dead last in high school SAT scores, retains four homes in ten that are unconnected to sewers, and maintains a strained tax base that allows little leeway in improvement to the public infrastructure.[70] Finally, Alabama, whose multimillion-dollar courting of a Mercedes plant as discussed *supra*, is last in elementary and secondary school spending.[71]

The failure of these southern states to bolster their local economies by the use of development incentives may not be because the incentives, in a vacuum, fail to stimulate investment decisions. Rather, low-performing states are often unable to outbid wealthier states for development projects in a competitive environment where all states are willing to spend public dollars to encourage private investment.[72] Given the relative inability of development incentives to redistribute capital into under-performing economies and the widespread public sentiment against welfare generally, one is left to wonder why states and municipalities engage in bidding wars for industry location at all.

The traditional explanation is that they do so out of necessity; that if they did not offer companies incentive packages, another locality would, luring away vital businesses. The problem is often described by the "prisoners' dilemma" analogy.[73] In the prisoner's dilemma, two co-conspirators to a crime are interrogated independently by the authorities, who try to get confessions from each implicating the other. Because each prisoner faces the stiffest sentence if he remains silent and the other confesses, each one confesses out of fear that the other will first. Thus, two prisoners who share the common goal of testimonial silence and subsequent acquittal, each compromise their best interest when thrown into competition with one another.[74]

66. *See generally* GJF Audit Survey, *supra* note 7, at 35-41.

67. *See* Moss, *supra* note 3, at 110.

68. *See id.*

69. *See* DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, REVISED STATE ESTIMATES FOR PERSONAL INCOME 1969-1998 (1999).

70. Jay Hancock, *S.C. Pays Dearly for Added Jobs*, BALT. SUN, Oct. 12, 1999, at A1 (citing a study by the Strom Thurmond Institute of Clemson University).

71. *See* Myerson, *supra* note 50.

72. *See* THOMAS, *supra* note 5, at 6 (citing PETER S. FISHER & ALAN H. PETERS, INDUSTRIAL INCENTIVES: COMPETITION AMONG AMERICAN STATES AND CITIES 26 (1998)).

73. *See, e.g.*, Schaefer, *supra* note 13, at 311-12; Taylor, *supra* note 13, at 693; Little, *supra* note 4, at 858-59.

74. For a thorough discussion of the prisoner's dilemma, see R. DUNCAN LUCE & HOWARD RAIFFA, GAMES AND DECISIONS: INTRODUCTION AND CRITICAL SURVEY 94-97 (1957).

The analogy to the "economic war among the states" is clear.[75] Although states and municipalities will always be in competition for business, they would enjoy the maximum economic benefit if such competition were based on quality of education and public works, fiscal stability and regulatory predictability rather than direct financial assistance.[76] Most negotiations between localities and businesses for location incentive packages happen behind closed doors and without the knowledge of other competing localities.[77] Thus, the local and state governments are forced to offer special treatment out of fear that failure to do so will render them at a competitive disadvantage in the economic development game.[78]

The aggregate economic impact of this competition is a shift in wealth from labor to capital, from individuals to corporations or from the public realm to private concerns.[79] First, at least a portion of the state revenues allocated to capital investment would presumably otherwise have been spent for some purpose that benefited labor—perhaps health care, education or social security.[80] Second, that portion of state or local revenue which would have derived from the cash, taxes or other resources being forfeited via the development incentive must either be borne elsewhere, in the form of higher property or sales taxes, or result in a reduction of public goods and services.[81]

75. Burstein & Rolnick, *supra* note 13.

76. *See* Taylor, *supra* note 13, at 693.

77. *See*, *e.g.*, ARIZ. REV. STAT. ANN. § 41-1505.07(K) (West 1999) (requiring that all information provided in applications for public assistance be kept confidential); CAL. GOV. CODE § 6254.15 (West Supp. 2001) (exempting from the Freedom of Information Act disclosure information provided in connection with a subsidy proposal). The confidentiality of these negotiations creates the potential for "whipsawing," or using the possibility of more attractive offers from competing states to drive up the negotiated value of incentive packages. *See* Moss, *supra* note 3, at 132. For example, in 1992 and 1993, staff of Intel Corporation visited six southwestern states with prepared reports asking for tax credits, relocation assistance, employee training and other perks as inducements to locate a new semiconductor fabrication plant in that state. *See* John Howe & Mark Vallianatos, *Making Corporations Accountable Through Legislative Initiatives*, *in* PUBLIC SUBSIDIES, PUBLIC ACCOUNTABILITY 43, 45 (Grassroots Policy Project 1998). By playing one state against another, Intel eventually landed a deal in Rio Rancho, New Mexico that garnered them a thirty-year tax exemption and other perks worth nearly $300 million. *See Intel: A Cautionary Tale?*, *available at* http://www.cfed.org/main/econDev/bi/main/case_studies/Intel.htm (last visited Nov. 7, 2001). In response to this practice, some districts have enacted "right to know" laws, which require that agency review of information given in connection with applications for financial assistance be reported to the public. *See* Howe & Vallianatos, *supra*, at 44 (discussing the "right to know" element of the Boston living wage ordinance).

78. *See* Merrill Goozner, *Governments Rethink Corporate Tax Breaks*, CHI. TRIB., Mar. 14, 2000, at N1.

79. *See* THOMAS, *supra* note 5, at 4.

80. *See id.* at 17 n.11.

81. *See* Peter Enrich, Business Tax Incentives: A Status Report (AALS Paper Draft July 24, 2001) (on file with the author).

Indeed, corporate income taxes as a percentage of nationwide tax revenue decreased in the United States from 20.3% in 1955 to 9.6% in 1996.[82] Moreover, while a jurisdiction to which a recipient business relocates may be able to claim a net increase to its tax base from that single transaction, any such increase is *a fortiori* less than the decrease to the tax base in the jurisdiction from which the recipient business departs, so long as the new jurisdiction was offering more than the former was already giving.[83] As the economic development game is played nationwide, or even globally, the movement of capital from one jurisdiction to another ultimately does not collectively increase the number of taxable sources of income, but instead depletes the competing jurisdictions' collective ability to provide public goods and services.

Economists willing to defend development incentives generally do so on two grounds. First, some argue that multi-state bidding for investment is not a "race to the bottom," but is itself an efficient system whereby the participant jurisdictions will only bid up to the point at which marginal benefits, such as the increased tax revenue from additional jobs, no longer exceed the marginal cost, including the incentive itself as well as the cost of additional public services.[84] Meanwhile, recipient businesses would only relocate when the incentive package and resultant synergies exceed the relocation costs, and the intersection of these two curves would supply a static price toward which negotiating parties would tend to gravitate, a static price that ultimately results in the taxing of capital investment at an economically optimal level. This argument, however, ignores the possibility of governors, mayors, councilmen and development officials factoring into the equation the political benefit from luring a high-profile industry during their tenures, as well as the vast informational asymmetry that develops when a private firm with confidential information regarding actual costs and future strategies negotiates with a public agency whose activities must be disclosed.[85]

The actual practice of development agencies, in fact, rarely involves an effective evaluation of the economic costs and benefits from a particular development incentive; nor is there commonly a consideration of the likelihood of the recipient business relocating into the community absent the incentive.[86] Thus, the actual practice of these agencies seriously undermines the second defense of development incentives proffered by some economists—that efficiencies are created when the superior local knowledge of development

82. *See* THOMAS, *supra* note 5, at 8.

83. *See* Burstein & Rolnick, *supra* note 13.

84. *See, e.g.*, Gillette, *supra* note 8, at 488-93; *see generally* Dan Black & William Hoyt, *Bidding for Firms*, 79 AM. ECON. REV. 1249 (1989).

85. *See* THOMAS, *supra* note 5, at 5; *see also supra* note 77 (discussing "whipsawing").

86. *See* GJF Audit Survey, *supra* note 7, at 36-41.

agencies serves to match industries with their most productive and synergistic jurisdiction.[87] Case studies indicate that these synergies are rarely sought, much less achieved. For example, in 1994, the city of Amarillo, Texas indiscriminately sent a check in the amount of $8 million to about 1,300 businesses nationwide, payable in the event that the recipient created 700 jobs in the city.[88] Therefore, even if competition for business in the form of development incentives is theoretically defensible, the unrestrained practice of development agencies has been such that predictions of inefficiency and public fiscal problems will be more on target.

F. Proposed Alternative Solutions to the Economic War Among the States

Many commentators have proposed judicial and legislative solutions to the problem of competition in bidding on business location decisions.

1. Invalidation by the Commerce Clause

Some have claimed that the Commerce Clause[89] may operate as a restraint on state activity in bidding wars.[90] By construction, the Commerce Clause operates negatively as a limitation on state power to regulate or otherwise interfere with interstate commerce, even in the absence of congressional action.[91] When state legislation conflicts with the clause's purpose of protecting a national common market, it becomes subject to judicial review as to whether its burden on interstate commerce outweighs the local interest in the particular legislation.[92] If that burden is clearly excessive, the law will be struck down.[93]

Arguably, Commerce Clause jurisprudence would play its intended role by "preventing the harmful consequences of competitive state efforts to distort the national economy for parochial ends."[94] The doctrine as it stands now invalidates laws that propagate "economic protectionism" by discriminating against out-of-state interests in favor of local ones.[95] In fact, there exists a long line of Supreme Court decisions invalidating state tax laws that discriminate against interstate commerce by giving preferential treatment to in-state

87. *See* Gillette, *supra* note 8, at 485.

88. *See* Jane Seaberry, *Amarillo Lures Businesses with $8 Million Checks*, DALLAS MORNING NEWS, Sept. 13, 1994, at D1.

89. U.S. CONST. art. I, § 8, cl. 3 ("the Congress shall have Power . . . to regulate Commerce . . . among the several States . . . .").

90. *See generally* Enrich, *supra* note 3; Walter Hellerstein & Dan Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789 (1996).

91. *See* Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 350 (1977).

92. *See* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

93. *See id*.

94. Enrich, *supra* note 3, at 468.

95. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 470 (1981).

economic activity.[96] Though development incentives are specifically targeted, their statutory authority often makes incentives available to any corporation meeting certain minimum requirements and willing to relocate within the state.[97] Investment tax credits, which give a direct tax savings for every dollar of in-state investment, are often cited as the paradigmatic example of a constitutionally impermissible development incentive.[98]

Other development incentives, such as direct subsidies, may distort the market in favor of a particular in-state enterprise, but they do so at the equal exclusion of other in-state and out-of-state businesses. Even if that constitutes preferential treatment to in-state interests, the state is attempting to foster local welfare only by spending the financial resources of its residents.[99] Property tax exemptions also seem particularly insulated because nonresidents would not be subject to the tax in the first place. At present, the Supreme Court has yet to decide the issue,[100] primarily because the class of plaintiffs with standing to challenge development incentives, namely interstate businesses, are the primary beneficiaries of such incentives.[101]

The theory was, however, recently debated in a federal district court, where a consortium of concerned individuals and small businesses challenged the grant by Ohio and the city of Toledo of a $280 million incentive package to retain a Jeep manufacturing plant, now operated by DaimlerChrysler, Inc., at its current location.[102] The tax provisions challenged, in particular, include a credit against Ohio's corporate excise tax and a property tax abatement on the

96. *See, e.g.,* South Central Bell Tel. Co. v. Alabama, 526 U.S. 160 (1999) (holding that a state franchise tax scheme that allowed domestic corporations to reduce the par value of their stock while denying foreign corporations the same opportunity impermissibly discriminated against interstate commerce); Camps Newfound/Owatonna v. Town of Harrison, 520 U.S. 564 (1997) (striking down a Maine property tax exemption restricted to organizations that served primarily in-state interests); Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) (invalidating state tax scheme requiring shareholders in foreign corporations to pay a tax on a higher percentage of their stock's value than shareholders in exclusively domestic corporations); Assoc. Indus. of Mo. v. Lohman, 511 U.S. 641 (1994) (invalidating one-time Missouri use tax imposed on personal property purchased outside the state in all political subdivisions where the use tax exceeded the intrastate sales tax).

97. *See, e.g.,* MD. CODE ANN. art. 83A, § 5-1102 (2000) (providing an automatic income tax credit to any certified business that creates or expands an in-state business facility that results in the creation of sixty or more jobs in specified industries).

98. *See* Enrich, *supra* note 3, at 434-37; Hellerstein & Coenen, *supra* note 90, at 817-18.

99. *See* Gillette, *supra* note 8, at 482.

100. *See* West Lynn Creamery v. Healy, 512 U.S. 186, 199 n.15 (1994) ("We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that 'direct subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause.") (citations omitted).

101. *See* Schaefer, *supra* note 13, at 323.

102. *See* Cuno v. DaimlerChrysler Corp., 154 F. Supp. 2d 1196, 1198 (N.D. Ohio 2001).

plant's machinery and equipment.[103] In any event, and without immediately passing on the merits of the Toledo claim, this Comment will presume that at least one relocation incentive would pass constitutional muster for the purpose of demonstrating the problems with applying current Commerce Clause jurisprudence to recent accountability legislation, as will be done in Part IV, *infra*.

2. A Federal Legislative Response

Given the Commerce Clause's purpose in protecting the economic unity of our nation,[104] there seems to be a federal interest in constraining the use of industrial location subsidies. Such a constraint could be effectuated in many ways: by conditioning federal grants upon limiting the use of location subsidies,[105] by imposing an excise tax upon the subsidies[106] or by creating a private right of action similar to that which exists under antitrust law.[107] Representative David Minge of Minnesota recently proposed the Distorting Subsidies Limitation Act,[108] which would require that grants or tax deferrals be taxed at the same rates that currently apply to other corporate income.[109] While the House Budget Committee held a hearing on this bill and other concerns relating to unnecessary business subsidies,[110] the bill remains in committee.

3. International Trade Agreements

Multilateral trade agreements, such as the proposed Multilateral Agreement on Investment (hereinafter, "MAI") and the North American Free Trade Agreement (hereinafter, "NAFTA") may limit economic development incentives as they are currently used in practice.[111] These agreements forbid certain laws that put foreign investors at a commercial disadvantage in relation to domestic investors.[112]As such, the test of discriminatory effect under NAFTA and MAI is stricter than the scrutiny given development incentives

103. *See id.* Though the original complaint was dismissed by the District Court, that dismissal is currently on appeal to the United States Court of Appeals for the Sixth Circuit.

104. *See* H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 537 (1940).

105. *See* Taylor, *supra* note 13, at 710-12 (providing an example of such a model statute).

106. *See* Little, *supra* note 4, at 891.

107. *See id.* at 890-91.

108. H.R. 1060, 106th Cong. (1999).

109. *See id*.

110. *See Unnecessary Business Subsidies*, *Hearing Before the Committee on the Budget of the House of Representatives*, 106th Cong. (1999).

111. *See* GEORGETOWN LAW CENTER AND CORPORATION FOR ENTERPRISE DEVELOPMENT, FEDERALISM AND FOREIGN INVESTMENT: THE EMERGING CONFLICT BETWEEN INTERNATIONAL INVESTMENT AGREEMENTS AND TRADITIONAL STATE/LOCAL AUTHORITY 3 (Apr. 1999 draft).

112. *See id*. at 7.

under the Dormant Commerce Clause.[113] Furthermore, the Uruguay Round Subsidies Agreement,[114] negotiated under the General Agreement on Tariffs and Trade, would constrain domestic subsidies that are targeted at one or a limited group of specific enterprises.[115] A thorough discussion of the impact of these agreements is beyond the scope of this Comment.[116] Considering the fact, however, that these agreements must be enforced by member nations, and that the discriminatory impact of the location incentives thereunder must be international in scope, there is little reason to believe these international agreements will have a dramatic impact on local economic development activity.[117]

4. State Regulation and Multilateral Agreements

As discussed before, states and municipalities perceive themselves in a prisoner's dilemma whereby limitation and regulation of subsidy arrangements would render them at a competitive disadvantage in the market for location of businesses.[118] An often-suggested strategy for curbing development bidding has been to negotiate a noncompetition agreement among the states.[119] During the 1970s, Michigan Governor William Milliken called for such a compact. Several midwestern states attempted a similar regional agreement in 1988.[120] In October of 1991, Connecticut, New Jersey and New York signed a pact agreeing to end attempts at luring businesses from each other.[121] To date, however, there has been no legal action taken under this agreement, despite frequent relocation of businesses among the states involving significant incentive packages.[122] It does not appear likely that a binding agreement among the fifty states will be negotiated anytime soon.[123]

113. *See id*.

114. AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES, H.R. Doc. No. 103-316, at 1533 (1994).

115. *See* Schaefer, *supra* note 13, at 327-31 (stating that most location incentives would fail to meet the criteria of the Uruguay Round Subsidies Agreement).

116. For a more thorough discussion of the relationship between international agreements and economic development incentives, *see* MORRIS L. SWEET, REGIONAL ECONOMIC DEVELOPMENT IN THE EUROPEAN UNION AND NORTH AMERICA (1999).

117. *See* Schaefer, *supra* note 13, at 331.

118. *See supra* notes 73-78 and accompanying text.

119. *See* Gilbert, *supra* note 15, at 446.

120. *See id*. *See also* Little, *supra* note 4, at 875-76.

121. *See* Gilbert, *supra* note 15, at 447; Schaefer, *supra* note 13, at 322.

122. *See* Schaefer, *supra* note 13, at 321.

123. *See id*. at 322-23. Furthermore, such an agreement may violate the Compact Clause of the Constitution. U.S. CONST. art. I, §10, cl. 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State"). The Compact Clause prohibits agreements that encroach upon federal power or increase the political power of the states. *See* United States Steel Corp. v. Multistate Tax Comm., 434 U.S. 452, 466-70 (1978).

III. LEGISLATION

Considering the difficulties in negotiating a nationwide non-competition agreement, the unlikelihood of federal intervention and the lack of precedent for a suit enjoining subsidies under the Commerce Clause, it is not surprising that states and municipalities have begun to look for local legislative solutions to the problem of unchecked competition for investment. One effective rallying point for critics of the current practice of development agencies has been the adoption of what has generally been termed "accountability legislation," that is, legislation that attaches minimum employment, wage, tenancy or other standards to incentive packages.[124] Indeed, in the last twenty years, at least fifty-six cities, counties and states have passed provisions[125] that often allow for the reclamation of the value of the tax abatement or other assistance if the recipient fails to meet certain performance requirements.[126] The advantage of these measures is that they may be implemented unilaterally[127] with little apparent harm to the perceived business climate of the community enacting them.[128] The trend toward using accountability measures in incentive packages has been described as a turning point in the cutthroat interstate battle for business.[129]

Accountability legislation seeks to ensure that public investment in private companies yield public benefits.[130] As such, it has the potential to address some of the political problems that undermine economic defenses to location incentives.[131] There are three categories of accountability legislation: (1) "right to know" laws that grant public access to information regarding incentive application and grants; (2) laws that set minimum standards for corporations qualifying for public assistance; and (3) laws with provisions that enforce these standards by allowing the state or municipality to recoup its

124. *See* Enrich, *supra* note 81.

125. *See* Goozner, *supra* note 78.

126. *See id*.

127. *See* Gilbert, *supra* note 15, at 429.

128. Telephone Interview with Greg LeRoy, Director, Good Jobs First, a project of the Institute on Taxation and Economic Policy (Oct. 24, 2000). For example, Arlington, Texas, the beneficiary of the GM move discussed in *The Willow Run Case*, was able to attract the plant despite a somewhat stringent contract governing the incentive. *See* Ziance, *supra* note 55, at 41. *See also* Kary L. Moss et al., *Legal Strategies to Achieve Tax Subsidy Accountability*, *in* PUBLIC SUBSIDIES, PUBLIC ACCOUNTABILITY 58-76, 74 n.10 (Grassroots Policy Project 1998).

129. *See* Michael Phillips, *Localities Force Firms to Keep Promises*, WALL ST. J., June 26, 1996, at A2.

130. *See* LaFave, *supra* note 46, at 1590. *See also* Declaration of Policy, IOWA ACTS 1994 (75 G.A.) ch. 1008 §1 (declaring that "[p]ublic subsidies should be in the form of investments in people, resulting in a better educated and skilled workforce," and that "[t]he state owes it to its citizens to ensure that all development agreements include provisions for recouping subsidies when businesses fail to meet [their] obligation [of delivering on promised benefits]").

131. *See supra* note 84 and accompanying text.

investment.[132] This section will discuss a few samples of these laws, specifically those that set standards to be incorporated into incentive agreements and include a means of enforcing such standards.[133] Relevant inquiries, to be made in Part IV of this Comment, include the specificity with which the statute addresses future contingencies, the extent of the discretion given local development authorities in defining contractual terms and conditions and the extent to which these conditions burden interstate commerce.

A. Iowa's New Jobs and Income Act

Under Iowa's New Jobs and Income Act,[134] development incentives may be in the form of an investment tax credit, a tax exemption for machinery and equipment, a community property tax exemption or other benefits. The recipient business must demonstrate, prior to receiving benefits and subject to approval by the community where the business is located, that it (1) has not closed or substantially reduced operations in another area of the state to relocate, (2) will provide 80% of the cost of medical and dental care for its full-time employees, (3) will pay a median wage of at least eleven dollars per hour (indexed to 1993 dollars) or 130 percent of a county-wide median wage, (4) will make a minimum investment of $10 million (indexed to 1993 dollars) and (5) will create at least fifty (and sometimes seventy-five) jobs.[135] Failure to comply with performance requirements may subject the recipient to penalties or require that recipient repay the assistance according to a calibrated scale based on the percentage of requirements met.[136]

B. Arizona's Standards for Eligibility for Economic Development Assistance

Arizona's economic development accountability law[137] is an example of a weaker and more discretionary statutory construction. Under Arizona law, the state's Economic Development Commission selects candidates for financial

132. *See* Howe & Vallianatos, *supra* note 77, at 43-44.

133. For examples of such accountability laws not discussed herein, *see*, *e.g.*, CONN. GEN. STAT. ANN. § 12-217(m) (West 1997); CONN. GEN. STAT. ANN. § 32-5(a) (West 1997); 20 ILL. COMP. STAT. ANN. 655/5.5 (West 1993); KY. REV. STAT. ANN. §§ 154.24-010 to -150, and §§ 154.26-010 to 154.26-100 (Michie 1996); ME. REV. STAT. ANN. tit. 5, §§ 13070-J to 13070-M (West 1996, supp. 2000); ME. REV. STAT. ANN. tit. 36, § 5215 (West 1996); MD. CODE ANN., STATE FIN. & PROC. § 7-314 (2000); MD. ANN. CODE art. 83A, § 5-1102 (1999); MINN. STAT. § 116J.994 (1998); NEB. REV. STAT. § 77-4107 (1996); S.B. A03325, 1999-2000 Reg. Session (N.Y. 1999); OHIO REV. CODE ANN. § 122.17 (West 1996); VA. CODE ANN. § 58.1-439 (Michie 1998).

134. IOWA CODE ANN. §§ 15.326-.337 (West 1995).

135. *See id.* § 15.329(1).

136. *See id.* § 15.330. *See also* Gilbert, *supra* note 15, at 484-85.

137. ARIZ. REV. STAT. ANN. § 41-1505.07 (West 1999).

assistance projects based on a number of factors, including (1) the anticipated resulting increase in the state's tax base, (2) the extent of public benefit, (3) the wages to be paid, (4) the number of jobs created, (5) the comparative cost of the project, (6) the percent of products being sold out of state and (7) any related benefits.[138] No single factor is dispositive and no minimum amounts are mandated, except that assistance may not exceed fifty percent of the estimated increase in tax revenue directly or indirectly deriving from the transaction.[139] The recipient business must enter into a memorandum of understanding with certain discretionary minimum standards that allow the commission, at its instance, to stop, readjust or recapture all or part of the state's investment.[140]

C. Indiana's Economic Development for a Growing Economy Tax Credit

Indiana's Economic Development for a Growing Economy Tax Credit[141] authorizes a credit for investments that are economically sound, create new jobs, will have an overall positive fiscal impact for the state, that are actively being courted by other states and for which there exists a disparity between the cost of locating in Indiana and the cost of locating in the competing state.[142] Recipients must enter into a tax credit agreement, which requires that average wages of the employees of the qualifying business exceed the average wages in the county in which the project is located, and that operations must be maintained at that location for at least two times the number of years in the term of the tax credit.[143] While the terms of required agreements in Indiana are stricter than under Arizona law, the tax commissioner retains discretion as to whether to enforce the agreement, and the amount received in return may not exceed the total amount of the credit.[144]

D. Louisiana's Quality Jobs Program Act

Louisiana's Quality Jobs Program Act[145] states its purpose as "an inducement to locate in Louisiana for any business operation that does not have to be located in Louisiana in order to profitably and rationally conduct its business."[146] The Act creates an incentive tax credit to be given for up to ten

138. *See id.* § 41-1505.07(B).
139. *See id.* § 41-1505.07(D).
140. *See id.* § 41-1505.07(H).
141. IND. CODE ANN. § 6-3.1-13 (West 1996).
142. *See* Gilbert, *supra* note 15, at 483.
143. *See id.* at 483-84.
144. *See id.* at 483-84.
145. LA. REV. STAT. ANN. §§ 51:2451 *et seq.* (West 2001).
146. *Id.* § 51: 2452.

years[147] to qualifying businesses engaged in a "basic industry" and calculated according to a complex formula.[148] Qualifying businesses must contract with the state, subject to approval by the governor,[149] to pay its employees (eighty percent of which should be employed full-time) an average of one and one-half times the minimum wage, with a total gross payroll of new jobs to exceed one million dollars within three years of contracting with the state.[150] Failure to meet the gross payroll requirement within three years will result in an increase in the recipient's tax liability in the amount of any credits previously taken.[151] After qualification and the filing of an initial report,[152] the incentive tax credit is self-executing. It is notable that the Louisiana tax credit calculation considers cost to the state in the formula, as the credit is a percentage of the estimated tax revenue resulting from the new jobs created, minus the state costs in the form of education and social services incident to those jobs.[153]

IV. ANALYSIS

Thus far, there are only a few isolated incidents of states and localities using accountability statutes and clawback provisions to recoup their investment when recipients fail to live up to their end of the bargain.[154] In 1996, New York City recovered $60,000 from Bank of America when it transported equipment out-of-state that had been purchased with a city sales tax exemption.[155] At the same time, Indianapolis had publicly expressed an intent to recover tax abatements from companies that had failed to maintain their qualification for the tax break.[156] Since the majority of these statutes have been recently enacted,[157] it is far too early to declare them a success or failure. A predictive analysis of future incentive deals, however, based on the provisions of the enabling legislation, may be derived from principles of contract law, constitutional law and political and economic theory.

147. *See id.* § 51:2454(A)-(B) (providing for a five-year initial contract and the possibility for a five-year renewal).

148. *See id.* § 51:2455. The term "basic industry" is defined at § 51:2453(1)(a) of the Act and includes transportation, construction, communications, equipment rental, computer-related services, medical services and engineering and architectural services.

149. *See id.* § 51:2454(A).

150. *See* LA. REV. STAT. ANN. § 51:2455(E).

151. *See id.* § 51:2457(B).

152. *See id.* § 51:2457(A).

153. *See id.* §§ 51:2453(2)-(5), 51:2455.

154. *See* Howe & Vallianatos, *supra* note 77, at 55.

155. *See id.*

156. *See* Phillips, *supra* note 129, at A2.

157. *See Accountability Legislation*, *in* PUBLIC SUBSIDIES, PUBLIC ACCOUNTABILITY 88-96 app. (Grassroots Policy Project 1998).

A. Contractual Provisions

As noted above, and demonstrated by *The Willow Run Case*,[158] the success of these accountability statutes will depend in part on the specificity and enforceability of the legislative or contractual provisions that legally enable the use of incentives. Contractual provisions are always available to the municipal lawyer who wishes to condition an incentive package on compliance by the recipient with certain terms. They offer the added flexibility of tailoring each incentive deal to the particular needs of the parties. But absent a statutory provision requiring a minimum of accountability, economic development authorities have not shown much enthusiasm in using contracts to ensure performance.[159]

1. Recalibrations

Incentive deals can be given teeth in several ways. First, the amount given may be recalibrated upon the occurrence of a specified event; that is, the amount of the assistance would be adjusted to reflect actual performance or changing business conditions.[160] Recalibrations may be de novo, in that future expected benefits, but not past performance, will be used as the basis for recalculating the amount of assistance given.[161] Alternatively, contracts or statutes may provide for a recalibration with clawbacks, which would adjust future subsidies to recover overpayment based on past performance.[162] For example, under Louisiana's Quality Jobs Program Act,[163] the recipient business's tax credit will be reduced in proportion to the extent the recipient fails to meet certain gross payroll requirements.[164] Another, more gentle variation on the recalibrated incentive is the "ratcheted recalibration," which adjusts the subsidy gradually, in order to give the recipient business time to adjust to the financial impact of the decrease in assistance.[165]

So long as all of the possible triggering events are accounted for in the contract or enabling legislation, recalibrations may be the least problematic accountability provision doctrinally, as well as the least abhorrent to recipient businesses.[166] However, provisions considering future contingencies may be

158. *See supra* notes 57-62 and accompanying text.

159. *See* Kary L. Moss et al., *Legal Strategies to Achieve Tax Subsidy Accountability*, *in* PUBLIC SUBSIDIES, PUBLIC ACCOUNTABILITY 58, 59 (Grassroots Policy Project 1998) (discussing a survey by the Sugar Law Center for Economic & Social Justice that found most development programs using contracts were required to do so by statute).

160. *See* Ziance, *supra* note 55, at 42.

161. *See id.* at 43.

162. *See id.*

163. LA. REV. STAT. ANN. §§ 51:2451-:2461 (West 2001).

164. *See supra* text accompanying notes 151 and 153.

165. *See* Ziance, *supra* note 55, at 43.

166. *See id.*

difficult to draft.[167] More importantly, the dependence of these provisions on future in-state activity may render them useless in the event a recipient wants to leave the state entirely. For example, Louisiana's calibrated reduction in tax credits would do little to curb a business from leaving in the event the company was not realizing overall profits.

2. Rescissions

A legislature may also direct, or delegate to a development authority the power to direct, that a public assistance contract be rescinded or cancelled upon the occurrence of a certain specified event.[168] As with any contractual provision, this cancellation must be assented to by both parties and should be clearly drafted. For example, Illinois' High Impact Business tax credit[169] provides for automatic cancellation if it is determined that the recipient would have relocated to Illinois absent the tax credit or if the recipient otherwise fails to comply with the terms and conditions of the statute.[170] Once again, these provisions do little to curb a relocating business that has no intention of reaping the future benefits of in-state activities in any event, but they may prevent a state from sinking substantial amounts of money into a failing venture.

3. Clawbacks

The most widely utilized enforcement mechanism in new accountability legislation has been clawbacks.[171] While the term "clawback" is sometimes used to describe any type of subsidy accountability measure,[172] as used in this section it refers specifically to those provisions which enable a state or locality to recapture all or part of the cost of its investment without regard to future activity. For reasons discussed in the following two paragraphs, clawback provisions must be carefully drafted to avoid a judicial designation as liquidated damages.[173] Typically this is done by referring to the recaptured amount as a "payment" rather than "damages,"[174] or by reinforcing the

167. *See* Gilbert, *supra* note 15, at 466-73 (describing the problems related to the enforcement of a Louisiana provision that tied a property tax exemption to certain environmental factors).

168. *See* Ziance, *supra* note 55, at 41.

169. 20 ILL. COMP. STAT. ANN. 655/5.5 (West 1993).

170. *See* 20 ILL. COMP. STAT. ANN. 655/5.5(f).

171. *See, e.g.*, Appendix, *Accountability Legislation*, *in* PUBLIC SUBSIDIES, PUBLIC ACCOUNTABILITY 88-96 (Grassroots Policy Project 1998) (charting at least 25 state and local laws that include a clawback provision as a necessary condition to the granting of business assistance).

172. *See, e.g.*, Moss, *supra* note 3, at 138.

173. *See* Ziance, *supra* note 55, at 42.

174. *Id.*

ongoing nature of the contract by requiring repayment on a sliding scale; that is, requiring less to be repaid the longer the business remains in the state.[175]

For example, Iowa's New Jobs and Income Act[176] provides for a calibrated system of recapture in the event that a recipient business fails to create a certain number of new jobs to be negotiated by the development authority but not less than fifty.[177] In no event does the amount to be repaid exceed the amount given in assistance. Similarly, Indiana's clawback statute, the Economic Development for a Growing Economy Tax Credit,[178] limits assessments against the recipient to the amount received in assistance.[179] The assessments, however, are discretionary and made only upon the request of the director of the Commerce Department.[180] This provides the authorized agency with a significant amount of leeway to decide which non-compliant businesses should be sanctioned, but also gives no assurances as to enforcement.

4. Liquidated Damages and Penalties

Certain accountability measures provide for a monetary fee to be paid in the event of default. Under contract law, these penalties will not be enforced if classified as such by a court.[181] Rather, to be an enforceable liquidation of contractual damages, the amount to be paid "must be a reasonable estimate, at the time of contracting," of the damages likely to result from a breach, and the estimate must be shown as necessary due to the difficulty in measuring damages "after the breach occurs."[182] In the case of location incentives, the difficulty in quantifying damages should be found where secondary losses exist, such as those from incident businesses that fail when a vital economic industry moves away.[183] However, development authorities and legislatures must consider the reasonableness of the estimate when drafting penalty and clawback clauses. For example, where a clawback is scaled according to the percentage of performance completed under the contract and the recipient business is an industry of the type that is an integral part of the local economy, it is less likely that a court will refuse to enforce the provision as a penalty.

175. *See* Gilbert, *supra* note 15, at 460.

176. IOWA CODE ANN. §§ 15.326-.337 (West 2000).

177. *Id.* § 15.330. Specifically, the statute provides that a business shall repay one-quarter of the assistance given if it meets between 75 and 90 percent of the expected job quota, and one-half of the assistance given if it meets between 50 and 75 per cent of the expected job quota. If the recipient fails to meet one-half of the job quota, then it must repay its assistance in inverse proportion to the percentage of expected jobs it did create.

178. IND. CODE ANN. § 6-3.1-13 (Michie 1998).

179. Gilbert, *supra* note 15, at 484.

180. *See id.*

181. *See* Priebe & Sons, Inc. v. United States, 332 U.S. 407, 417 (1947) (Frankfurter, J., dissenting).

182. Lake River Corp. v. Carborundum Co., 769 F.2d 1284, 1289-90 (7th Cir. 1985).

183. *See* Ziance, *supra* note 55, at 43.

B. *Political and Economic Theories*

Another obstacle to the future proliferation and success of accountability legislation is the threat of regulatory capture. "Regulatory capture" is the phrase used to describe the theory that a legislative body or regulatory agency will eventually represent the interests of a narrow group of people, rather than those of the public at large.[184] The theory derives from the observation by economist Mancur Olson that members of a large group have less incentive to participate in that group's activities than those of a small group because active participation is more difficult and less likely to contribute to the group's overall success.[185] As a result, there is a tendency for smaller, more intensely focused special interests, rather than nebulous "public" interests, to dominate legislatures and regulatory agencies.[186]

As a practical matter, the theory of regulatory capture helps explain the widespread existence of industrial location incentives. Such incentives are substantially similar to the prototypical "capture" scenario, where "[a] relatively small number of incumbent competitors support such measures with intensity, while consumer opposition is diluted and widely distributed."[187] As the problem of capture acts upon state legislatures, it also provides a potential obstacle to the enactment of meaningful accountability statutes.[188] However, the continued efforts of certain public interest groups, such as Citizens for Tax Justice, does serve to level the playing field.

The threat of regulatory capture is greatest where a state agency regulates a particular industry or necessarily deals with a limited class of interests.[189] In the enactment of accountability legislation, a tension exists between the need to mitigate the effects of regulatory capture by denying the responsible agency absolute discretion in enforcement and the need to preserve flexibility so that incentive deals may be adaptable to unforeseen circumstances. Generally, the potential for regulated groups to influence regulatory policy increases in proportion to the discretion vested in the regulating agency.[190] Thus, Iowa's New Jobs and Income Act[191] and Louisiana's Quality Jobs Program Act,[192]

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184. *See* Herbert Hovenkamp, *Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem*, 97 YALE L.J. 1017, 1021 (1988).

185. *See generally* MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION (1965).

186. John Shepard Wiley, *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713, 724-25 (1986).

187. *Id*. at 725.

188. *See id*. at 732.

189. *See* Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167, 169-70 (1990).

190. *See* Mark Seidenfeld, *Bending the Rules: Flexible Regulation and Constraints on Agency Discretion*, 51 ADMIN. L. REV. 429, 459 (1999).

191. IOWA CODE ANN. §§ 15.326-.337 (West 1995). *See supra* notes 134-136 and accompanying text.

two statutes that provide for mandatory recapture of incentives in the event of default, will do more to mitigate the threat of regulatory capture than the Indiana[193] and Arizona statutes,[194] which leave enforcement decisions to the discretion of the authorizing office.

If authorized agencies do decide to go after some of the biggest offenders, then it is a reasonable expectation that the recapture of incentives will be challenged in court, given the size of the financial packages at stake.[195] One of the likely defenses will be that the recapture provisions violate the Commerce Clause, with the allegation that these state laws improperly burden or discriminate against interstate commerce.

C. Constitutional Issues: The Dormant Commerce Clause

The Commerce Clause[196] provides an affirmative grant to Congress to regulate interstate commercial activity, to avert "jealousies and aggressions"[197] between the several states and to encourage a new nation's prosperity through "union and not division."[198] As a corollary to this grant of power, the United States Supreme Court has construed the clause to prohibit the states from interfering with Congressional authority by enacting laws that isolate each state from the national economy by discriminating against competition from outside the state.[199] Though the contours of this judicial construction, colloquially referred to as the "dormant" or "negative" Commerce Clause, are somewhat murky,[200] its application to two areas of state legislation have been clear. First, a state regulation that merely promotes the in-state economy by making its regulatory and commercial frameworks more attractive to businesses will not be deemed unconstitutional.[201] Second, a state regulation that discriminates against out-of-state interests by providing local businesses with an economic advantage, even where the business could be operated more

192. LA. REV. STAT. ANN. §§ 51:2451 *et seq*. (West 2001). *See supra* notes 145-153 and accompanying text.

193. IND. CODE ANN. § 6-3.1-13 (West 1996). *See supra* notes 141-144 and accompanying text.

194. ARIZ. REV. STAT. § 41-1505.07 (1999). *See supra* notes 137-140 and accompanying text.

195. For examples of large incentive deals, see *supra* notes 45-48 and accompanying text.

196. U.S. CONST. art. I, § 8, cl. 3.

197. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (1935).

198. *Id*. at 523.

199. *See*, *e.g.*, Philadelphia v. New Jersey, 437 U.S. 617, 627 (1978) ("The Court has consistently found parochial legislation of this kind to be constitutionally invalid . . . .").

200. *See*, *e.g.*, Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959) (describing Dormant Commerce Clause jurisprudence as a "quagmire").

201. *See*, *e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336-37 (1977) (refusing to hold that "a [s]tate may not compete with other states for a share of interstate commerce" because "such competition lies at the heart of a free trade policy").

efficiently outside the state, absent such regulation, is "virtually *per se* illegal."[202] The Dormant Commerce Clause as it pertains to economic development incentives represents a curious intersection of these two principles, particularly where the incentive is expressly conditioned upon the recipient's continuing to remain within the regulating state's borders or engaging in hiring practices or other activities to the state's benefit.

1. Framers' Intent

It has been contended that all location incentives, whether they are tied to a system of recapture in the event of default or not, are inconsistent with the Framers' intent in creating a barrier-free trade union.[203] From an economic perspective, location incentives are essentially a disguised barrier to the free movement of capital to the extent they redirect investments across borders to areas in which they would not have occurred absent the incentive.[204] Indeed, some economic unions that fall short of a confederacy still impose quasi-constitutional limitations on economic aid granted by their member states.[205]

There is some basis for the notion that competition among the states in the form of development incentives was a concern for the drafters of the Constitution in vesting the federal government with the commerce power. Alexander Hamilton, writing on commercial competition as a source of contention among the states, expressed particular worry about states adopting commercial policies peculiar to themselves, creating "distinctions, preferences, and exclusions, which would beget discontent."[206] A "race to the bottom" in location incentives creates rivalries among the states that are very similar to those during the time of the nation's confederacy.[207] However, Alexander Hamilton, himself, was granted a tax abatement by the state of New Jersey in 1791 to start a business.[208] Furthermore, there exists equal evidence that the divisive commercial policies about which the Framers were concerned may

202. Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970). *See also Philadelphia*, 437 U.S. at 624 ("[W]here simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected.").

203. This is the vision of the Commerce Clause attributed to James Madison, who intended the clause to be self-executing in its prevention of state interference with interstate commerce, thereby fostering economic union. *See* Burstein & Rolnick, *supra* note 13

204. *See* THOMAS, *supra* note 5, at 4.

205. *See, e.g.*, European Economic Community (EEC) Treaty, art. 87-89 (ex. art. 92-94) (limiting state aid to enumerated circumstances that carry a presumption of compatibility with the European common market).

206. THE FEDERALIST NO. 7, at 29 (Alexander Hamilton) (Bantam Classic ed., 1982).

207. *See* Enrich, *supra* note 3, at 423.

208. *See* Edward Regan, *Government, Inc., Creating Accountability for Economic Development Programs*, RESEARCH CENTER OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION 25 (Apr. 1988).

have been protective tariffs rather than direct subsidies or indirect economic incentives.[209]

2. Discrimination Against Interstate Commerce

Consistent with the notion of Framers' intent, early Dormant Commerce Clause jurisprudence analogized a state's impermissible use of its tax and police powers for the purpose of economic protectionism to customs duties that undermined the free trade union created by the Constitution.[210] Such is the origin of the Court's anti-discrimination case law, which renders invalid any state law which manifestly discriminates against interstate commerce, unless the law advances a legitimate local purpose and there exists no less restrictive alternative.[211] Discrimination, in this sense, has come to mean the "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[212] For example, a Maine charitable property tax exemption that excluded a portion of the tax benefit to charities "conducted principally for the benefit of persons who are not residents of Maine"[213] facially discriminated against interstate commerce and was *per se* invalid under the Commerce Clause.[214]

Statutes that are facially discriminatory against interstate commerce are not the only statutes that may fail to pass constitutional muster. Rather, states which enact statutes that have as their apparent intent the furtherance of a legitimate local purpose, but also have the practical effect of discriminating against out-of-state competition, must also justify the discriminatory impact in terms of the local benefits deriving from the statute and the unavailability of a less restrictive alternative.[215] For example, in *Minnesota v. Barber*,[216] the

209. *See* THE FEDERALIST NO. 7, at 30; Hellerstein & Coenen, *supra* note 90, at 847; *see also* 3 M. FARRAND, RECORDS OF THE FEDERAL CONVENTION OF 1787, at 478 (rev. ed. 1966) (reprinting a letter from James Madison attributing the inclusion in the Constitution of the Commerce Clause to concern over tax abuse by importing states).

210. *See* H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 532-33 (1949).

211. *See, e.g.*, Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93 (1994) (holding that a surcharge imposed on out-of-state waste facially discriminated against interstate commerce and was unconstitutional).

212. *Id.* at 99.

213. Camps Newfound/Owatonna, Inc. v. Harrison, 520 U.S. 564, 568 (1997).

214. *See id.* at 575-76.

215. *See* Dean Milk Co. v. Madison, 340 U.S. 349, 354 (1951) (stating that a contrary view "would mean that the Commerce Clause of itself imposes no limitations on state action . . . save for the rare instance where a state artlessly disclosed an avowed purpose to discriminate against interstate goods."). The test which the Court has used to determine the existence of a valid statutory purpose unrelated to economic protectionism and the non-existence of a less restrictive alternative will be referred to herein as the "strictest scrutiny" test. Thus far only one law has survived the "strictest scrutiny" analysis. *See* Maine v. Taylor, 477 U.S. 131 (1986) (upholding a Maine prohibition against importing bait fish because there was no other means by which the state could prevent the spread of parasites damaging to its native fish population). A lesser

Court invalidated a law forbidding the sale of meat in Minnesota unless the animal had been inspected by a state official within the twenty-four hours before slaughter. Though the ostensible purpose of the statute was to protect the health of Minnesota citizens, its necessary effect was to exclude from that market any animal slaughtered outside the state.[217] The Court viewed such an effect as contrary to the notion of the republic as a free trade union, and struck down the statute where its object, ensuring the meat's safety, could have been accomplished by less restrictive means.[218]

3. Burden on Interstate Commerce

The threshold question, then, in determining whether a state statute is so contrary to the free flow of interstate commercial trade that it must be invalidated by the Commerce Clause is whether it discriminates against interstate commerce or regulates commerce even-handedly.[219] If the statute discriminates against interstate commerce, either facially or in effect, then the Court will analyze the statute under the "strictest scrutiny" test outlined above.[220] Determination that a law is nondiscriminatory does not yet end the analysis. A statute may regulate even-handedly yet fail Dormant Commerce Clause analysis if it incidentally burdens interstate commerce and that burden is "clearly excessive in relation to the putative local benefits."[221] If the statute's purpose is to protect the health and welfare of its citizens, then the nondiscriminatory statute is likely to be upheld, as this is a subject of local regulation which has long been recognized.[222] On the other hand, less vital local interests may not be sufficient. In *Pike v. Bruce Church*,[223] for example, the Court refused to enforce an Arizona law that, as applied to an Arizona grower of cantaloupes who packed the fruit in California, would forbid the grower from transporting the fruit out-of-state unless they were packaged according to Arizona law.[224] The grower thus faced the loss of its entire year's

scrutiny may be available for laws that are discriminatory in effect, but where a legitimate local purpose is advanced and the law is not "patently" discriminatory. *See* Chem. Waste Mgmt., Inc. v. Hunt, 504 U.S. 334, 343 n.5 (1992).

216. Minnesota v. Barber, 136 U.S. 313 (1890).

217. *See id*. at 322.

218. *See id*. at 328-29.

219. *See* Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 99 (1994).

220. *See supra* note 215 and accompanying text; *see also* Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 353 (1977); Fort Gratiot Sanitary Landfill v. Mich. Dep't of Natural Res., 504 U.S. 353, 359 (1992); Hughes v. Oklahoma, 411 U.S. 322, 337 (1979).

221. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

222. *See* S. Pac. Co. v. Ariz. *ex rel*. Sullivan, 325 U.S. 761, 796 (1945) (Douglas, J., dissenting).

223. *Pike*, 397 U.S. at 137.

224. *See id*. at 146.

crop, as it owned no nearby Arizona packing facility.[225] This burden clearly outweighed the purpose of the law, which was to protect the reputation of Arizona growers by prohibiting Arizona cantaloupes from being deceptively packaged.[226]

4. Commerce Clause Jurisprudence Applied

The Supreme Court's Dormant Commerce Clause tests seem straightforward enough in theory. In each case, the object sought to be achieved is "a national market for commercial activity,"[227] an object often overstated in the case law with broad brushstrokes of rhetorical eloquence.[228] In application, however, these tests have caused "negative-commerce-clause jurisprudence [to drift] far from its moorings."[229] This is especially so in application to development incentives, where the Court's anti-discrimination case law strictly applied would require arbitrary restructuring in favor of one taxing scheme over another, each with the same purposes and effects, and in application to accountability legislation, where the case law would effectively undermine language that seeks to further national economic growth and responsibility.

A Bright Line Blindly Drawn. In application, the Court's focus on the disparate treatment of in-state and out-of-state enterprises in its anti-discrimination case law, rather than the distortion of the national economy with which the Framers were concerned,[230] would result in the different jurisprudential treatment of location incentives that have substantially similar purposes and effects. For example, investment tax credits arguably facially discriminate against interstate commerce by offering businesses a lower tax

225. *See id*. at 140.

226. *See id.* at 142.

227. Camps Newfound/Owatonna, Inc. v. Harrison, 520 U.S. 564, 595 (1997) (Scalia, J., dissenting).

228. Such language, used in dicta, often makes a persuasive case for either side of the debate over the constitutionality of development incentives. *Compare, e.g.*, Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970) ("The Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere."), *and* West Lynn Creamery v. Healy, 512 U.S. 186, 193 (1994) (analogizing a subsidy to in-state producers of milk to protective tariffs and "their distorting effects on the geography of production"), *with* Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977) ("Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of interstate commerce and industry."), *and* Bacchus Imports v. Dias, 468 U.S. 263, 271 (1984) ("No one disputes that a State may enact laws . . . that have the purpose and effect of encouraging domestic industry."). *See also* Hellerstein & Coenen, *supra* note 90 at 791-92 (introducing the "palpable tension" in the Court's anti-discrimination case law).

229. *Camps Newfound/Owatonna*, 520 U.S. at 595 (Scalia, J., dissenting).

230. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992).

burden for each new facility or piece of equipment transferred in-state than that which would be faced by an equivalent business out-of-state.[231] Meanwhile, a property tax abatement generally places no discriminatory burden on out-of-state entities because they are not subject to the tax in the first place.[232] Investment tax credits and property tax abatements, however, share the same economic intent and effect—they both seek to encourage in-state investment, not by efficiencies and infrastructural advantages, but by directly reducing the relative tax of the enterprise relocating in-state.[233] A rule requiring states to contain their tax incentives within activities taxable only to in-state enterprises would do little to further the goals of illegalizing discriminatory taxes or mitigating interstate competition for business and its resultant economic distortion.[234]

231. *See, e.g.*, Enrich, *supra* note 3, at 434-36 ("The statutory provisions establishing ITC's typically include an express requirement that qualifying investments must be located within the state, leaving little room for question that the provisions discriminate on their faces."). This conclusion also finds support in the language of six Dormant Commerce Clause cases involving tax incentives that the Court has heard since 1977. In each of the six cases the Court ruled against the operation of the state statute. *See* Roundtable, 56 STATE TAX REV. 49, at 9 (1995). For example, in *Boston Stock Exchange* the Court struck down a New York law that imposed a higher tax burden on interstate sales of securities than those that were conducted wholly in New York. *See Boston Stock Exch.*, 429 U.S. at 331. The Court found the law prevented tax-neutral decisions about when and where to purchase securities and created both a local advantage to New York and a discriminatory burden on neighboring states. *See id*. The result was a tax structure that diverted sales from their "most economically efficient channels" in a manner which was "wholly inconsistent with the free trade purpose of the Commerce Clause." *Id.* at 336.

Moreover, of the state statutes involved in these six cases, the one at issue in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), bears the most resemblance to the economic development incentives discussed herein. In *Westinghouse*, the Court invalidated a New York state tax credit that accrued as a percentage of the gross receipts from export products shipped from a taxpayer's regular place of business within New York. *See id.* at 407. The Court found that the "discriminatory economic effect" of a tax credit that favored local transactions was indistinguishable from a tax that simply imposed a higher rate on out-of-state transactions, as in *Boston Stock Exchange*. *Id*. at 404-05. Thus, the tax credit improperly fostered local development by creating a preferential trade area within a state's borders in contravention of the Commerce Clause. *See id*. at 405.

232. *See* Enrich, *supra* note 3, at 446-47.

233. *See id.* at 447.

234. This is because one of two results would ensue. On the one hand, if the relative share of a single state's tax revenue shifted from activities taxable only to in-state enterprises to activities taxable to all, the constitutional property tax abatement and the unconstitutional investment tax credit ultimately would become equally discriminatory. In effect, out-of-state businesses would share a greater percentage of the cumulative state tax burden. This first result, however, is unlikely, because an increase in tax on other economic activities would have the effect of discouraging such activities. The second result would either be an increase in the tax burden borne by individuals, or, more likely, a decrease in the availability of public goods and services, which is the very problem which gave rise to the search for this attempted solution.

Bright lines become even more muddled when one considers the differing treatment of incentives in the form of cash outlays versus those in the form of tax relief. The Court has never ruled on the constitutionality of direct expenditures to encourage investment, but early indications were that the Court seemed to assume their constitutionality.[235] In the words of the Court, "[d]irect subsidization of domestic industry does not ordinarily run afoul of [the Commerce Clause]; discriminatory taxation . . . does."[236] This assumption runs against the common logic that a location incentive is economically equivalent whether it is given before taxes become due or afterwards. Legitimate efforts have been made to distinguish direct subsidies from taxes on the basis of their political visibility,[237] but nonetheless several commentators have properly questioned the assumption that a determination that a state program is a "subsidy" or a "tax credit" should be the touchstone of the constitutional analysis.[238]

The Double-Negative Commerce Clause. Even more troubling than the incoherence in the application of the Court's anti-discrimination case law to location incentives, generally, is the clarity with which the law seems to illegalize the very accountability measures designed to curb, in the absence of congressional action, the deleterious effects of economically distorting subsidies in the first place. For example, Indiana's Economic Development for a Growing Economy Tax Credit[239] expressly requires, as a precondition to obtaining the credit, a showing that the recipient business is actively being courted by other states and that there is a disparity between the cost of locating in such states and the cost of locating in Indiana.[240] Illinois' "High Impact Business" tax credit[241] provides for automatic rescission of the credit if it is determined that the recipient would have otherwise relocated to Illinois absent

235. *See supra* note 100 and accompanying text.

236. New Energy Co. v. Limbach, 486 U.S. 269, 278 (1988).

237. *See* Hellerstein & Coenen, *supra* note 90, at 847-48; Enrich, *supra* note 3, at 442-43. *See also* Camps Newfound/Owatonna, Inc. v. Harrison, 520 U.S. 564, 591 (1997).

238. For critical commentary, *see generally* BORIS I. BITTKER, BITTKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE §6.06[G], at 6-77 *et seq*. (1999); Note, *Functional Analysis, Subsidies, and the Dormant Commerce Clause*, 110 HARV. L. REV. 1537 (1997); Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379 (1998). For a Supreme Court criticism, see *Rosenberger v. Rector of the University of Virginia*, 515 U.S. 819, 859 (1995) (Thomas, J., concurring) ("A tax exemption is in many cases economically and functionally indistinguishable from a direct monetary subsidy."). *See also* West Lynn Creamery v. Healy, 512 U.S. 186, 208-09 (1994) (Scalia, J., concurring) (noting that subsidies funded out of general revenues always have the effect of burdening interstate commerce because at least a portion of those revenues derive from taxes on out-of-state products).

239. IND. CODE ANN. § 6-3.1-13 (West 1996).

240. *See* Gilbert, *supra* note 15, at 483.

241. 20 ILL. COMP. STAT. ANN. 655/5.5 (West 1993).

the credit.[242] Given that the diversion of business from its "most economically efficient channels" is "wholly inconsistent with the free trade purpose of the Commerce Clause,"[243] those portions of the Indiana and Illinois statutes which seek to enforce the otherwise unstated purpose of the incentive could hardly be said to withstand constitutional scrutiny. In other words, even though the diversion of business from its "most economically efficient channels" would actually *increase* absent that language, it is precisely that language which renders such incentive packages facially discriminatory and hence unconstitutional. Indeed, the Toledo litigation[244] seeks to invalidate an Ohio property tax exemption solely on the grounds that it is "conditioned upon the taxpayer's agreement to provide a specified number of jobs, and a specified volume of investment, within the state of Ohio."[245]

The end result of that logic is the use of the Commerce Clause, through years of judicial interpretation, to undermine the very purposes it was designed to serve. The inherent tension in the negative aspect of the Commerce Clause is between, on the one hand, the desire to avert "jealousies and aggressions"[246] among the several states by "creat[ing] an area of free trade" free from parochial interference[247] and, on the other hand, "considerations of state sovereignty [and] the role of each State 'as guardian and trustee for its people.'"[248] Severing an allegedly constitutional location incentive from its allegedly unconstitutional enforcement mechanism serves neither side of that debate. Instead, it interferes with state autonomy by declaring as unconstitutional the only realistic means by which a state can ensure its treasury is put to productive use in the "economic war among the states" while sanctioning competitive state efforts that prolong the distorting effects of that war on the national economy. What remains is a constitutional black hole, where "the essential and patently unobjectionable [function] of state government—to serve the citizens of the State"[249] is paralyzed, and the Commerce Clause collapses inward to serve a purpose directly opposite of that which its authors intended.

States as Market Participants. There is some merit to the argument that in contracting for benefits to its citizens in exchange for financial relief, the state is acting as a participant in the market for investment, thus placing location

242. *See* 20 ILL. COMP. STAT. ANN. 655/5.5(f).

243. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977).

244. *See supra* notes 102-103 and accompanying text.

245. Plaintiffs' Memorandum in Opposition to All Defendants' Motions to Dismiss Re: Inapplicability of Commerce Clause at 28, Cuno v. DaimlerChrysler Inc., 154 F. Supp. 2d 1196 (N.D. Ohio 2001) (No. 3:00cv7247).

246. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (1935).

247. McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944).

248. Reeves, Inc. v. Stake, 447 U.S. 429, 438 (1980).

249. *Id*. at 442.

incentives in a category of cases with which the Commerce Clause is unconcerned.[250] States that are acting as market participants, not as market regulators, are free to act in a manner that discriminates against out-of-state interests where Congress is otherwise silent on the issue.[251] The justification is that when the state is acting as market participant, the citizens of that state, and not the outside interests, are bearing the burden of providing the in-state benefit.[252] Similarly, when a development authority is contracting with businesses to induce the development of new facilities and new jobs, the state is acting simultaneously as an investor and a promoter, and its taxpayers are the ones that bear the burden if the venture fails. Thus, in specifying conditions under which the assistance is to be given, the state is doing nothing more than a private actor might do in the same situation.

It has been argued that the market participant exception may not apply, however, where accountability measures in subsidies and incentive tax credits are used to foster goals that are unrelated to the state's proprietary interest in market transactions.[253] For example, one commentator notes that a property tax exemption used as an inducement to relocate within the state and tied to the requirement that the recipient pay its employees a minimum salary may not provide the essential nexus to qualify for the exception.[254] In other words, the incentive improperly ties the exemption to an activity, the payment of employees, entirely distinct from the state's investment in the property.[255] Here the state is arguably using contractual arrangements to act as regulators. It might be argued, then, that almost all recapture provisions invalidate a location incentive that otherwise would fall under the market participant exception.[256]

As with the case law from which the exception was carved, the severance of the allegedly unconstitutional accountability measure from the allegedly constitutional incentive undermines both the "creation of a barrier-free market" motive of and the "state autonomy" limitation on the Commerce Clause. Certainly, a more sensible policy would be one that fosters a "[s]tate's power

250. *See* White v. Mass. Council of Constr. Employers, 460 U.S. 204 (1983) (upholding, under the market participant exception, a city requirement that half of all workers on publicly funded construction projects be local residents).

251. *See* 2 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 11.9, at 183 (3d ed. 1999); *see also Reeves*, 447 U.S. at 429 (holding that a state may, as market participant, limit the sale of cement produced at a state-operated cement plant to its own residents).

252. *See* 2 ROTUNDA & NOWAK, *supra* note 251, at 184.

253. *See* Moss et al., *supra* note 159, at 68.

254. *See* Hellerstein & Coenen, *supra* note 90, at 826.

255. *See id.*

256. *See generally* Edward P. Lazarus, *The Commerce Clause Limitation on the Power to Condemn a Relocation*, 96 YALE L.J. 1343 (1987).

to experiment with different methods of encouraging local industry,"[257] while containing any "distorting effects on the geography of production."[258] That policy is furthered by a structure of state economic development that courts enterprises on the basis of their synergies with surrounding communities and the likelihood that development assistance, if pursued nationwide, will collectively nurture, rather than sap, the internal public resources of those communities. Those portions of state statutes that require, as a precondition to the giving of assistance, specific findings as to the net public benefit of such a transaction, and ensure those benefits by instituting financial consequences in the event of non-compliance, are thus the saving grace of such statutes, rather than their downfall, in terms of their conformity with the underlying purposes of the Commerce Clause.[259]

Consider, again, the distinction made in the case law between subsidies and discriminatory tax provisions. As this Note has demonstrated, if classification as a "subsidy" were all that is necessary to constitutionally sanctify a location incentive, then "little imagination is required to foresee future state actions 'set[ting] barrier[s] to traffic between one state and another as effective as if customs duties . . . had been laid . . . .'"[260] The underlying justifications for the distinction, however, are sound, even if actual practice does not support the classification terms. One justification is that a subsidy, as part of a state's annual appropriations, is made public and exposed to recurring review, whereas tax credits, as a permanent statutory feature, are more insulated from political checks.[261] A second is that tax credits are indiscriminate and available to all who meet the statutory requisites, while subsidies are traditionally targeted for their unique community benefit.[262] A third justification is that subsidies are given in a fixed amount, but tax deductions and credits, being dependent on the amount of taxable income or property for which the beneficiary receives a percentage exemption, are dynamic and often uncapped.[263] When accountability legislation requires the targeting of specific businesses on the basis of expected public benefits, subjects the financial assistance to meaningful and ongoing review, and

257. Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 816 (1974) (Stevens, J., concurring).

258. West Lynn Creamery v. Healy, 512 U.S. 186, 193 (1994).

259. The corollary of that conclusion is that indiscriminate and unchecked development incentives are more likely to be found contrary to the protection of a national common market. For that reason, this Note does not take issue with at least one of the claims in the pending Toledo litigation and will not enter the debate as to whether location incentives, as a whole, should be upheld or struck down.

260. *Hughes*, 426 U.S. at 828-29 (Brennan, J., dissenting) (citations omitted) (alterations in original).

261. *See* Zelinsky, *supra* note 238, at 401-03.

262. *See id.*, at 404-06.

263. *See id.*, at 401-03.

bestows the power to rescind, modify or recoup the assistance given, it renders location incentives more like the presumably constitutional "subsidy" rather than the discriminatory tax.

Finally, not all state policies that have the obvious purpose or effect of discriminating against out-of-state interests are prohibited by the Constitution. For example, policies such as the reduction of college tuition for residents, the award of social welfare benefits and payments to physicians in rural and low-income areas, are commonly accepted as legally permissible without litigation.[264] The common thread of these policies is that they are state expenditures in support of public goods and services, in furtherance of "the essential and patently unobjectionable purpose of state government."[265] In the current interstate competition for location of businesses, states are attempting, albeit misguidedly, to employ a private intermediary to accomplish these public goals. Ultimately, however, the extent to which authorizing statutes guarantee the investment is put to public purposes is directly proportional to the extent to which the state is acting as a "purchaser" of public goods within the meaning of the market participant exception to the Dormant Commerce Clause.

V. CONCLUSION

With the recent enactment of accountability legislation, over sixty jurisdictions have taken the first step in striking a balance between the pressure to remain competitive as an attractive location for industry and the need to ensure that their financial stake is not abused. As this Comment illustrates, careful drafting of the provisions therein, after giving consideration to contract law, political and economic concerns, and constitutional issues, will be the ultimate factor in determining whether these statutes sink or swim. Ultimately, however, their mere enactment is a signal to other legislators that states and municipalities may empower themselves to make economic development more efficient and curb the shift in resources from valuable public goods and services to the private concerns of those wielding more substantial economic clout.

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264. *See* BITTKER, *supra* note 238, at 6-76.

265. Reeves, Inc. v. Stake, 447 U.S. 429, 442 (1980).

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