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Smart Incentives: How to Make the Fiscal Impact of Economic Development Programs More Predictable

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Rapid Cost Increases

GROWING FISCAL IMPACT

States' tax incentive costs can grow quickly and unexpectedly without any explicit choices by policy makers.



SOURCE: The Pew Charitable Trusts, 2012.

Do Incentives Pay for Themselves?



Key considerations:

Some economic activity likely would have taken place even without incentives.

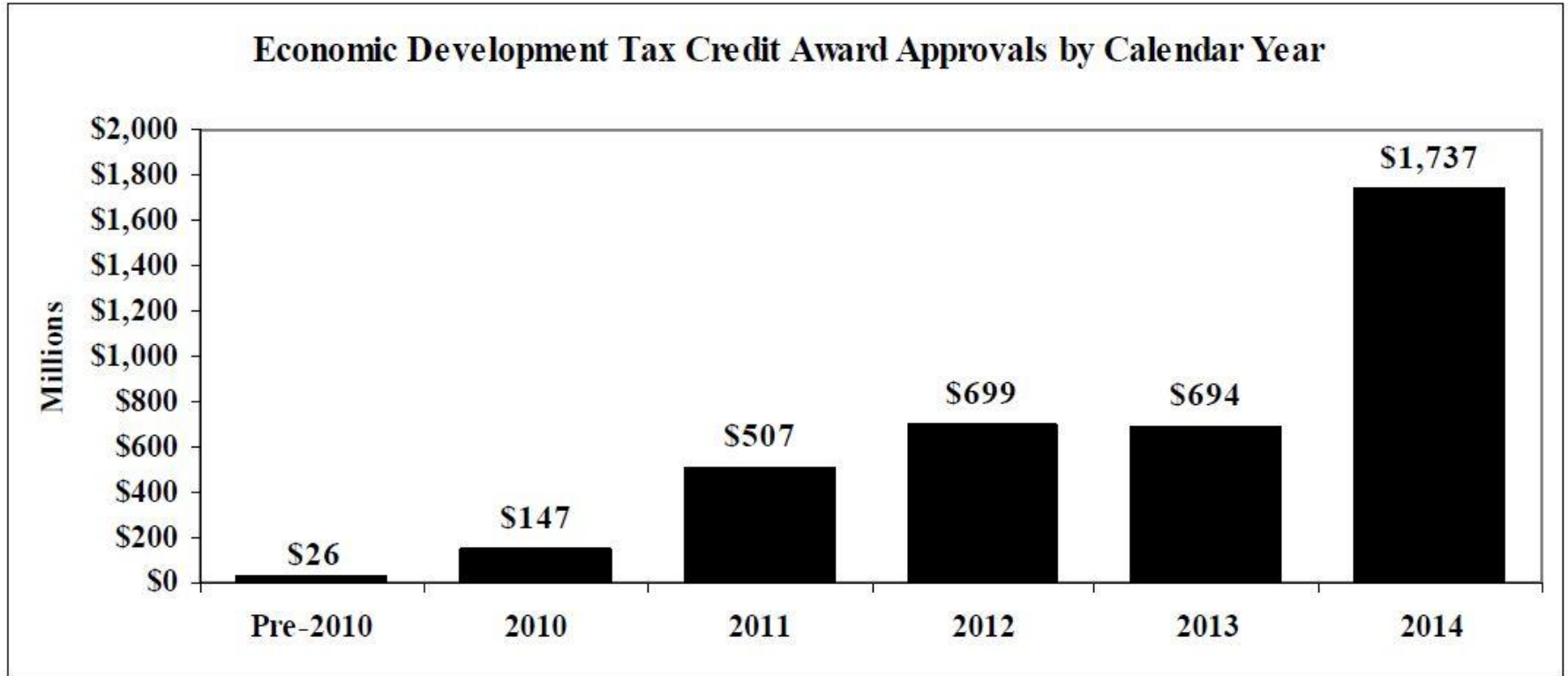
Incentives can have indirect effects that are either positive or negative.

The timing of costs and benefits may not align.

Unpredictable Timing



Growing Tax Credit Commitments in New Jersey



Source: New Jersey Office of Legislative Services

Rising Costs May Reflect Design Flaws



Weaknesses of the New Mexico High Wages Jobs Tax Credit (prior to 2013 reforms):

Companies could claim credits for jobs created many years earlier, even if those jobs no longer existed.

Companies could claim credits for jobs added through mergers or acquisitions without boosting net New Mexico employment.

The program was intended to only benefit export businesses, but a technicality allowed some national retailers to qualify.

Strategies to Address this Problem



- States should gather and share high-quality data on the costs of incentives.
- States should design incentives in ways that reduce fiscal risk.

Strategy #1: Gather & Share High-Quality Data



Regularly forecast the costs of incentives.

Monitor costs and commitments under large and high-risk programs.

Share timely information on incentives across relevant agencies.

Regularly Forecasting the Costs of Incentives



Iowa's quarterly contingent liabilities report

Uncapped Programs	History*			Forecast				
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Adoption Tax Credit ¹²	\$0	\$0	\$0	\$843,000	\$843,000	\$843,000	\$843,000	\$843,000
Biodiesel Blended Fuel Tax Credit ¹³	\$6,123,763	\$7,957,180	\$10,554,568	\$14,617,142	\$15,569,904	\$15,383,239	\$15,545,017	\$12,695,326
Charitable Conservation Contribution Tax Credit ¹⁴	\$647,591	\$835,673	\$494,556	\$646,545	\$631,312	\$635,608	\$647,235	\$664,542
Child & Dependent Care Tax Credit ¹⁵	\$7,494,943	\$4,488,530	\$3,813,708	\$4,094,793	\$6,225,950	\$5,784,899	\$5,447,113	\$5,098,401
E15 Plus Gasoline Promotion Tax Credit ¹³	\$5,158	\$10,017	\$41,127	\$62,693	\$96,106	\$116,431	\$132,098	\$127,272
E85 Gasoline Promotion Tax Credit ¹³	\$1,475,934	\$1,102,484	\$1,387,380	\$1,838,161	\$2,235,385	\$2,348,334	\$2,643,136	\$2,304,147
Early Childhood Development Tax Credit ¹⁵	\$753,173	\$846,434	\$784,165	\$1,006,319	\$1,077,231	\$1,199,689	\$1,278,560	\$1,235,796
Earned Income Tax Credit ¹⁵	\$30,258,024	\$31,031,962	\$65,570,550	\$71,116,030	\$69,527,961	\$68,558,941	\$68,728,505	\$66,977,866
Ethanol Blended Gasoline Tax Credit ¹⁰	\$2,954	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Ethanol Promotion Tax Credit ¹³	\$3,592,993	\$3,078,241	\$1,878,884	\$1,670,684	\$1,531,425	\$1,307,782	\$1,044,942	\$715,477
Farm to Food Donation Tax Credit ¹⁶	\$0	\$0	\$0	\$8,993	\$32,276	\$67,884	\$139,810	\$287,029
Geothermal Heat Pump Tax Credit ¹⁷	\$0	\$1,194,338	\$1,619,386	\$2,158,822	\$2,618,781	\$3,027,167	\$486,849	\$285,482
Iowa Industrial New Job Training Program (260E) ¹⁸	\$51,487,759	\$46,133,961	\$42,757,707	\$46,799,063	\$44,582,650	\$43,668,028	\$44,994,905	\$45,170,475

Source: Iowa Department of Revenue

Strategy #2: Design Incentives in Ways that Reduce Fiscal Risk



- Capping how much programs can cost each year.
- Controlling the timing of incentive redemptions.
- Using cash incentives that are appropriated in the state budget process.
- Limiting the value of incentives to companies' tax liability.
- Linking incentives to company performance.
- Requiring businesses to provide advanced notice of program participation.

Capping How Much Programs Can Cost Each Year



Incentives under the California Competes Tax Credit are awarded based on a competitive application process that happens three times a year.

Updates

For fiscal year 2015-16, GO-Biz will accept applications for the California Competes Tax Credit during the following periods:

- July 20, 2015, through August 17, 2015 (\$75 million available)
- January 4, 2016, through January 25, 2016 (\$75 million available)
- March 7, 2016, through March 28, 2016 (\$50.9 million plus any remaining unallocated amounts from the previous application periods)

Using Incentives that Are Appropriated in the Budget Process



Florida's appropriations approach encourages lawmakers to regularly review economic development programs.

“Fla. jobs programs may get a revamp”

-Tampa Bay Times

“Development money debated”

-Sarasota Herald Tribune

Advantages of Performance-Based Incentive Programs



● No incentives are issued until companies create jobs or make investments.

● Prevents worst-case scenario, when incentives both prove expensive and fail to achieve their economic development goals.

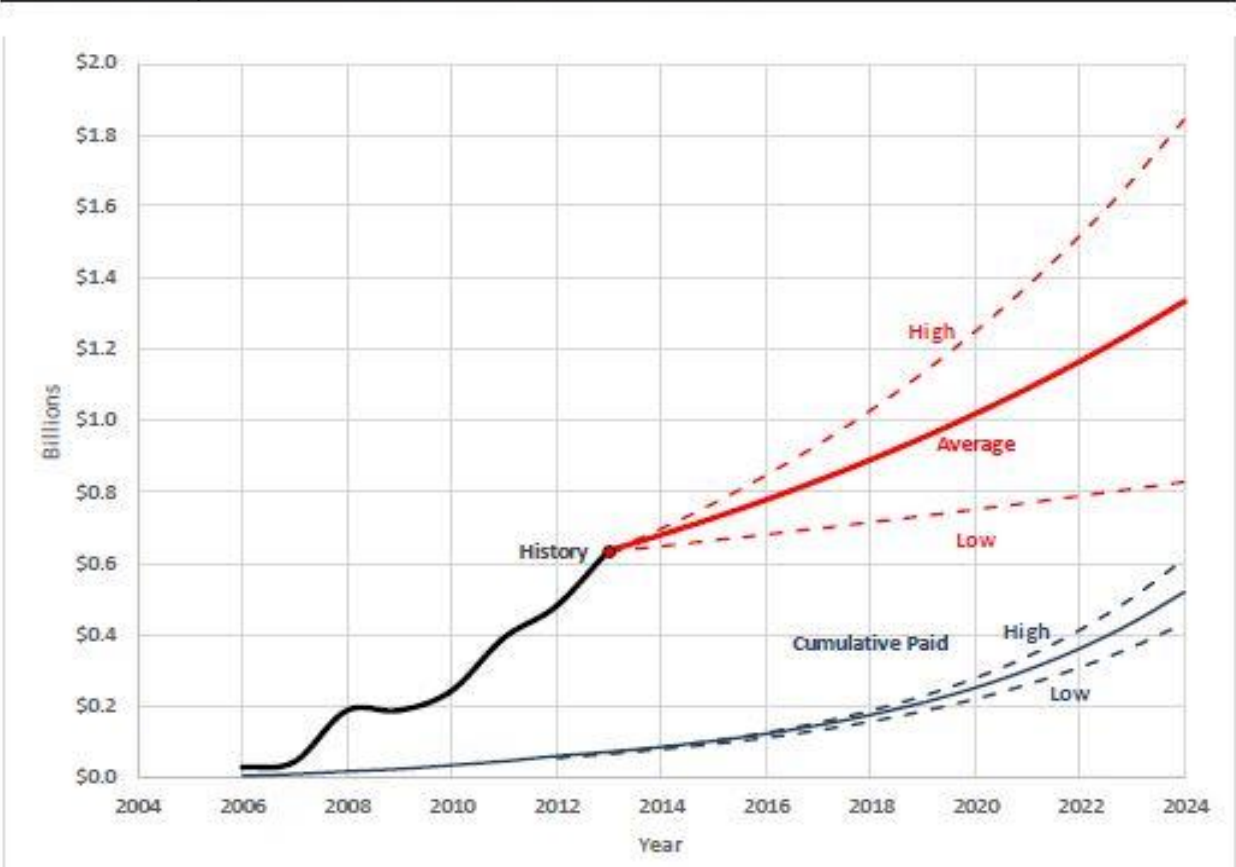
● Avoids having to “clawback” incentive dollars from companies that are already struggling.

Advance Notice of Program Participation Helps Forecasts



Projections for Utah's Economic Development Tax Increment Financing program

Figure 9.1 Summary of 10-Year EDTIF Projection.




Source: Utah Office of the State Auditor


What State Legislators Can Do



Require regular reviews of incentives, including analysis of fiscal risks.



Put in place policies to encourage agencies to share data and monitor costs effectively.

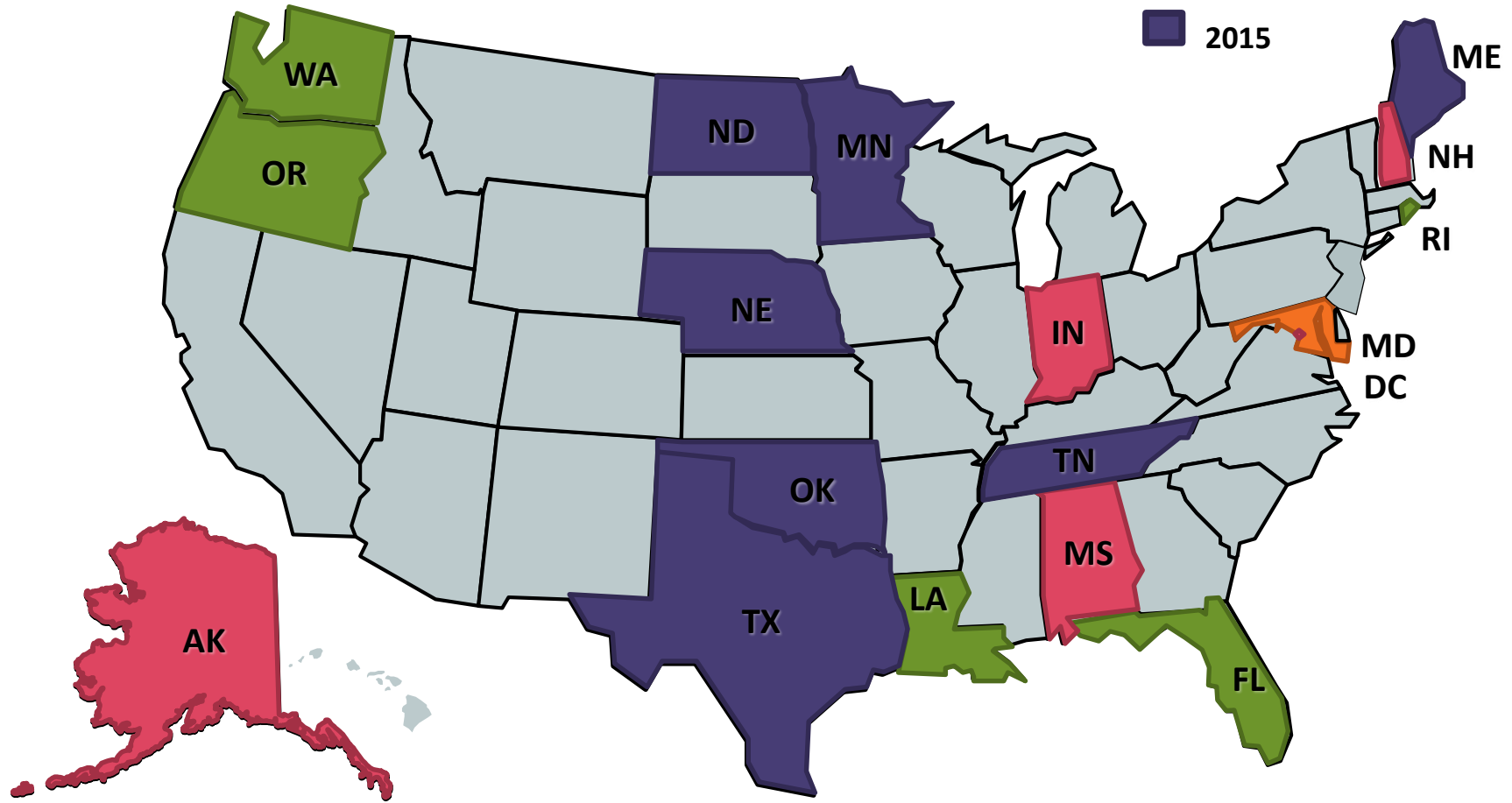


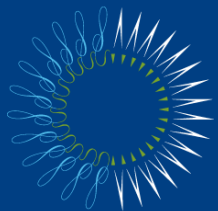
Ensure that any newly created incentives include adequate protections.

Growing Momentum for Tax Incentive Evaluation



- Years
- 2012
 - 2013
 - 2014
 - 2015





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