CAPITOL IDEAS

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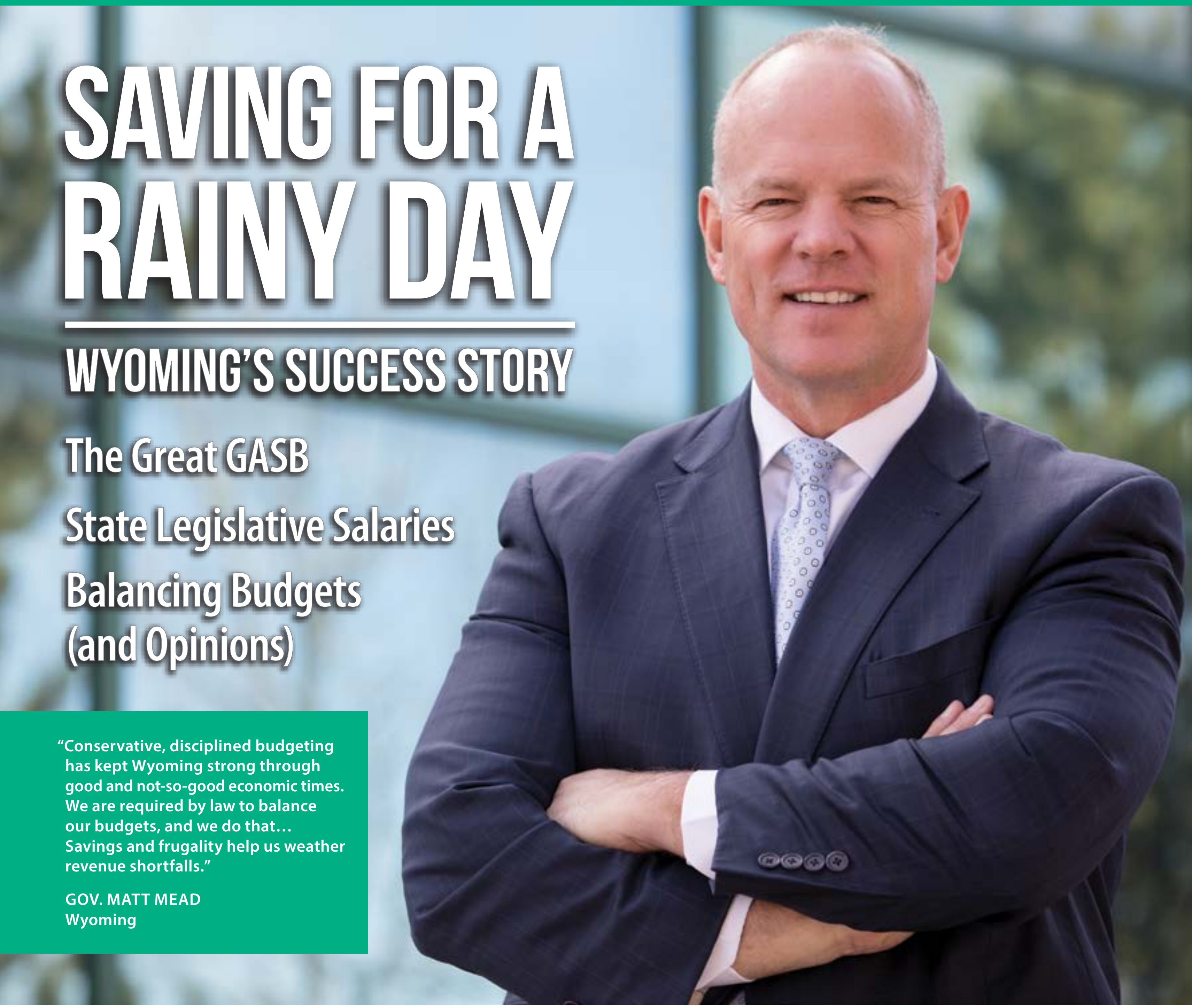
SPOTLIGHT: The Fiscal State



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"Conservative, disciplined budgeting has kept Wyoming strong through good and not-so-good economic times. We are required by law to balance our budgets, and we do that… Savings and frugality help us weather revenue shortfalls."

GOV. MATT MEAD
Wyoming

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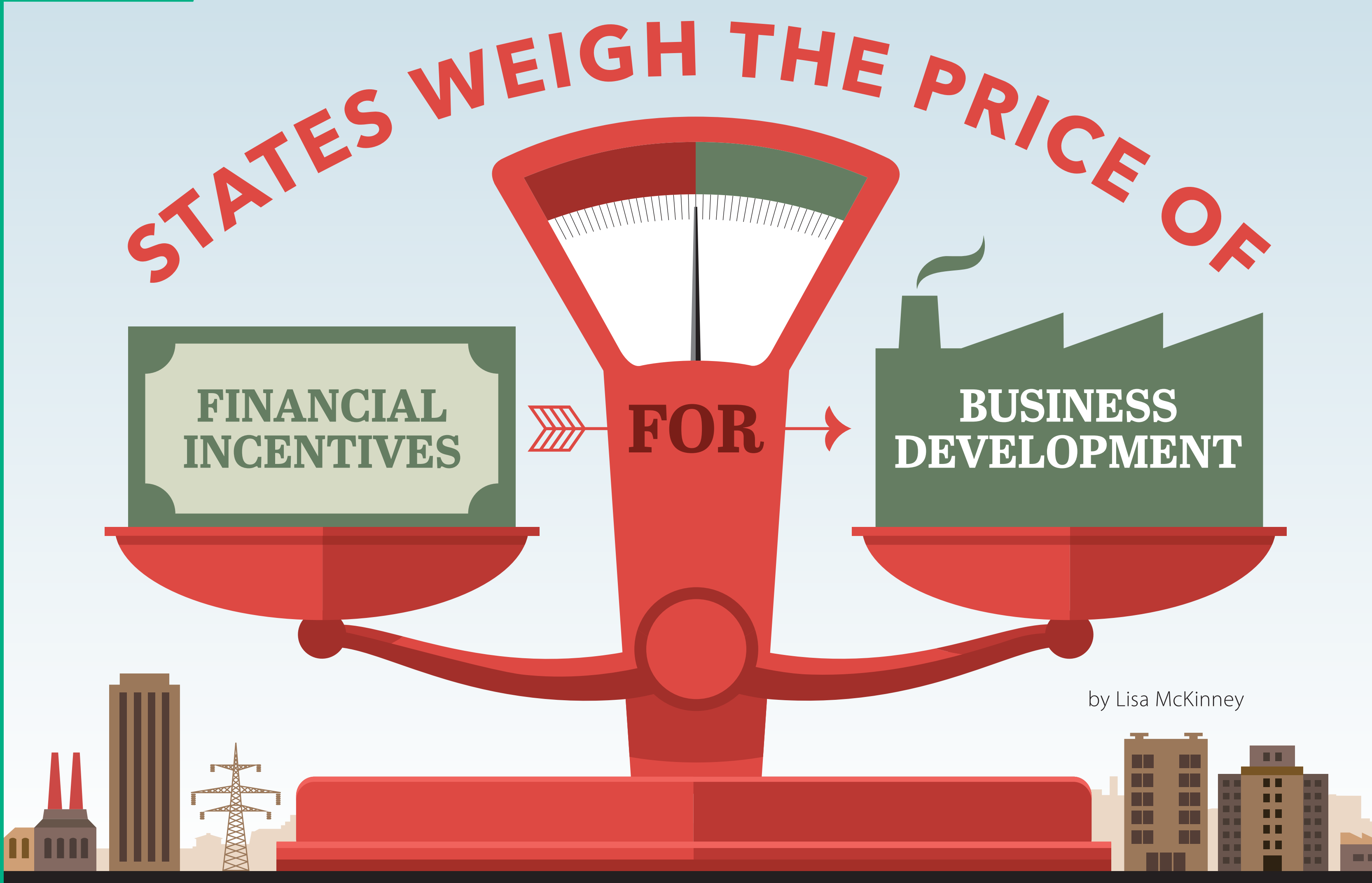

by Lisa McKinney

This year, states will have the opportunity to better evaluate the efficacy and value of tax incentives designed to attract, expand and retain business activity in their states with the implementation of the Governmental Accounting Standards Board's Statement 77, or GASB 77, which for the first time requires state and local governments to disclose in their financial statements how much revenue was lost to tax abatements for economic development.

The statement, which was issued in 2015, applies to all state and local budgets starting after Dec. 15, 2015, that conform to GASB's Generally Accepted Accounting Principles, or GAAP. Data will start coming in as early as April, with a heavy stream coming in by November and December, as governments close their 2016 fiscal years and begin the reporting process.

"This is really going to help bring the debate back around to the big picture about opportunity costs," said Greg LeRoy, executive director of Good Jobs First, a policy resource center that tracks subsidies and tax abatements. "At what point do you overspend on incentives to the point that it harms public goods that benefit all employers? … Tens of billions of dollars that have never been publicly reported are going to be dragged out of the shadows."

Financial incentives for economic development are intended to motivate a business to do something it would not have otherwise done, such as locate or relocate in a specific state, expand their facilities, or create more jobs. They include tax credits, exemptions and deductions; low-cost capital financing and loan guarantees; and even cash grants.

GASB 77 is reflective of a shift in state legislatures to more closely track the efficacy and return on investment of tax abatements and other financial incentives for economic development. Because data about government spending in this area hasn't been closely tracked and is often dispersed among various state, county and local agencies, it is difficult to determine if the estimated $70 billion being forfeited every year by state and local governments is worth it.

"In some states, tax expenditures can actually exceed revenues," said Jennifer Burnett, CSG director of fiscal and economic policy. "With every dollar being scrutinized, it doesn't make sense to give incentives a pass on that level of scrutiny. To be able to evaluate them you have to have good data." The costs can also be unpredictable; the costs of some state tax incentive programs have increased quickly and unexpectedly by tens or hundreds of millions of dollars, according to Pew's Business Incentives Initiative.

North Dakota is among 23 states that have passed laws requiring independent evaluation of their tax incentive programs since 2012, according to Pew. The state passed SB 2057 in 2015, requiring the legislature to evaluate the state's tax incentive programs over a period of

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six years to determine whether the programs are benefiting the state through job creation and other goals, whether the incentive has a positive influence on business behavior, and the overall effect of the incentive on the state economy, among other measures of success.

North Dakota’s Interim Political Subdivision Taxation Committee reviewed its first round of incentive programs in 2016. As a result of their analysis, the committee drafted bills to repeal four incentive programs due to lack of use.

“It was the first time in our state’s history that we actually looked at economic incentives to see if they are working,” said North Dakota state Rep. Jason Dockter, chair of the Interim Political Subdivision Taxation Committee. “There has been a wave of states, because of economic pressures, now looking at these incentives.”

The committee also drafted a bill to reform the state’s Angel Fund Investment Credit because of misuse. The committee discovered that nearly half of the money meant to fund start-up businesses in the state was going to out-of-state companies. They also determined that a 45 percent tax credit was being given immediately upon putting money in a venture capital fund, regardless of whether that money was eventually invested in a business before it was withdrawn.

Dockter said analyzing the worthiness of tax incentives was often a frustrating process because the data necessary for calculating their return on investment was not available.

Tax and other financial incentive programs have long been a key policy lever for business development, but critics express concerns about eroding the tax base, the influence of site-location consulting firms in pushing financial incentives, the potential for corruption or arbitrarily favoring certain industries or companies, and the lack of accountability for companies that don’t create as many jobs or pay as high a wage as promised. Additionally, critics say that these programs simply pit states against one another for existing business in a “race to the bottom” rather than actually creating new economic activity.

Recently, some states have tried to combat these pitfalls by including sunset clauses that ensure the laws don’t stay on the books indefinitely and claw-back provisions that require companies to pay back the money gained through subsidies or tax abatements if they don’t live up to what they promise. Some states are requiring companies to meet certain criteria upfront, such as wages paid, jobs created, health insurance and other benefits provided, capital investment made, and taxes created. In Wyoming, for example, the state’s economic development staff does due diligence on each project and closely follows its development. The state’s constitution requires the investments to be made with governmental entities rather than companies, allowing the governmental entity to retain the assets created if the project fails, according to a 2011 CSG report, *State Business Incentives: Trends and Options for the Future*.

Additionally, it is unclear how much financial incentives ultimately influence business choices. The initial decision about where to locate or expand business activities is based on business needs such as the supply chain, the availability of an appropriate workforce, utility and energy costs, access to higher education facilities for training, and marketplace demand, said Doug Stang, director of State and Local Government Affairs at 3M. Typically incentives are a very small portion of the total investment, he said.

“Government incentives are secondary to the business needs,” said Stang. “Once one of our businesses determines that this is a region that fits with what we need business-wise then we would engage to see what incentives would be available. It could be that one final piece of the puzzle that makes it make sense to invest in a certain region.”

Conversely, in some cases, excessive requirements attached to a tax incentive may be seen as too burdensome to be worthwhile, said Stang.

The portion of the total cost of business taken up by all state and local taxes combined is about 2 percent for the average company in the U.S., according to LeRoy of Good Jobs First.

“It’s business basics—labor, occupancy, logistics, energy—tiny changes in any of those big variables dwarfs anything you can do with the tax code,” he said. “So the punchline for public officials is to say, instead of obsessing over pocket lint—the 2 percent—think of what it is you can do to help the company with the 98 percent. That means making sure you have a great, productive workforce, making sure you have an efficient, modern infrastructure, making sure you have quality of life and amenities that enable you to attract the talent that an employer would want to recruit to a community. … That’s not about tax giveaways, that is about adequate revenue and quality of services, and, frankly, it’s what matters.” CI