BUSINESS TAX INCENTIVES:

ADVANTAGES & PERILS

PRESENTED BY

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WEST VIRGINIA CENTER ON
BUDGET & POLICY

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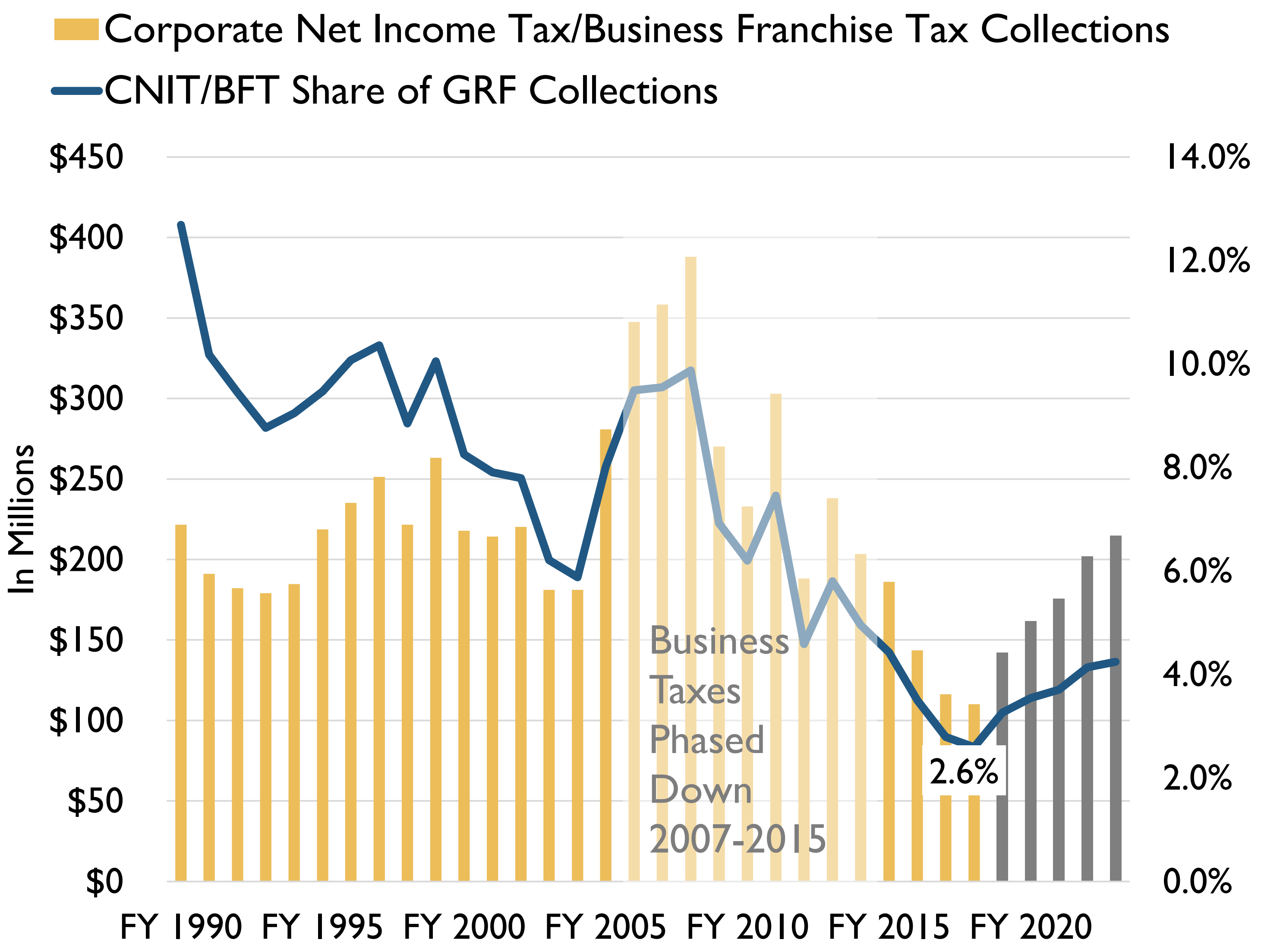
West Virginia Tax Institute – Morgantown, WV

October 30, 2018– 10:15-10:35am

WEST VIRGINIA BUSINESS TAX INCENTIVES FY19

DOES NOT INCLUDE all local property tax abatements, PILOT agreements, leased equipment or land, EDA direct loans or bonds, local tax credits (B&O), customized services, and other state business tax preferences such as direct use exemptions.

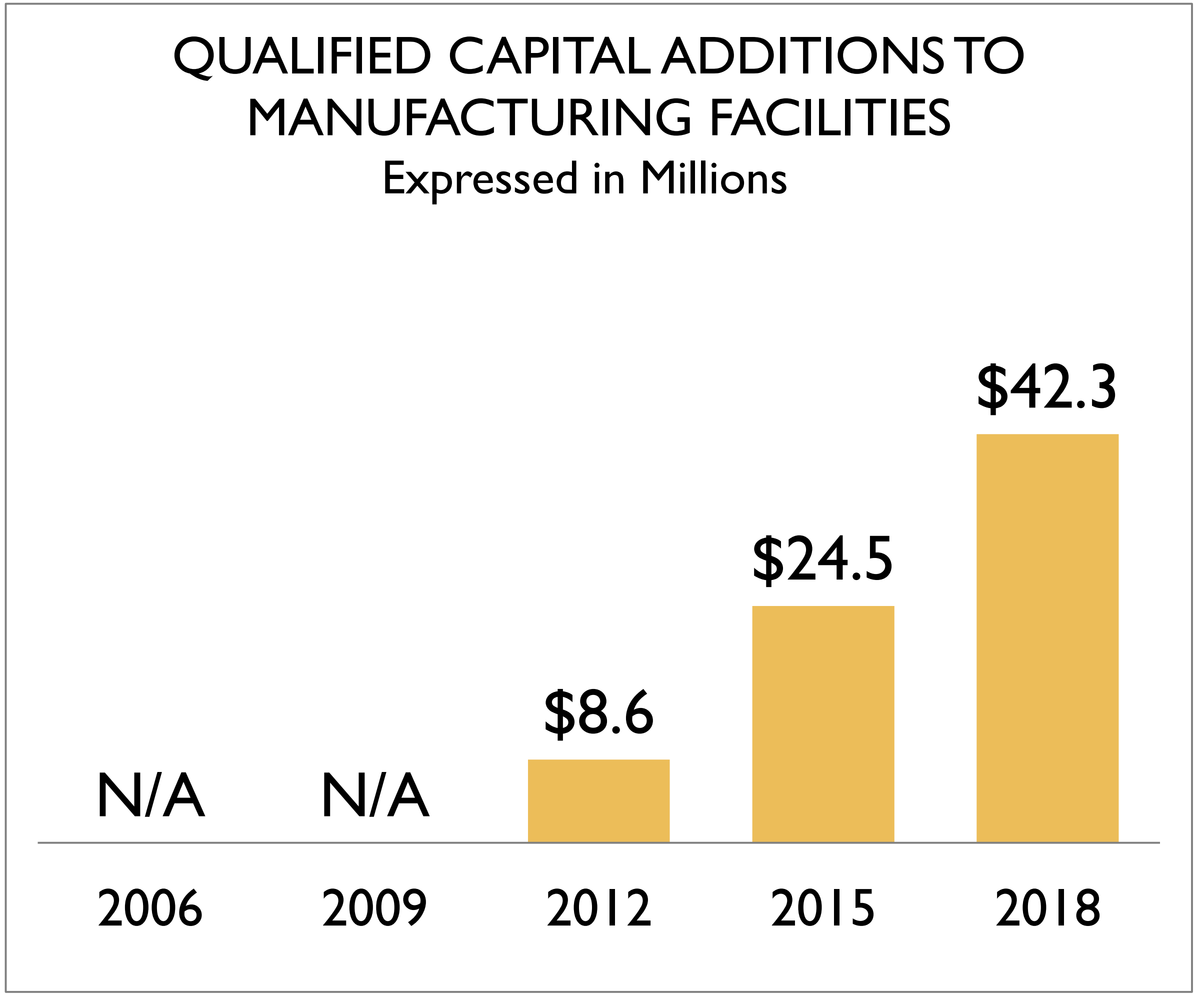
Source: West Virginia State Budget Office, Executive Budget Volume I Budget Report, FY 2019



BUSINESS TAX INCENTIVES MAY BE DECLINING

- Repeal of Business Franchise Tax & Reduction in Corporate Net Income Tax rate
- Repeal & Sunset of Tax Credits (Super Tax Credit)
- Sluggish manufacturing growth (down -43% since 1990, US = -28%)

Source: West Virginia State Budget Office, Executive Budget Volume I Budget Report, FY1988-2019



BUSINESS PROPERTY TAX INCENTIVES MAY BE GROWING…

…NEED MORE INFO…

Source: WV State Tax Department and WV Auditor's Office, WV Tax Expenditure Reports

TRI-STATE COMPETITION FOR A "CRACKER" FACILITY:
PENNSYLVANIA WON WITH $1.6 BILLION IN TAX INCENTIVES

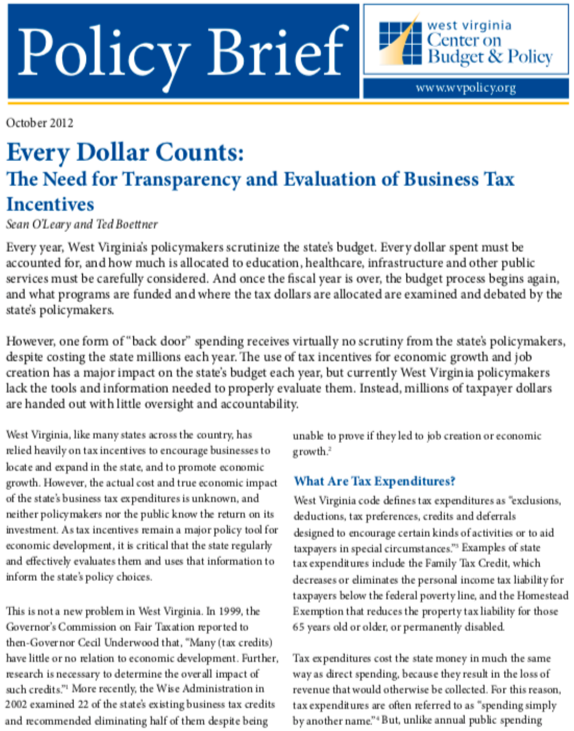
$6 BILLION PROPOSED CRACKER PLANT IN BEAVER COUNTY, PA

West Virginia H.B. 4086 (2012) included an estimated $300 million in property tax abatements, but fiscal note said $0.

PRIOR WVCBP RESEARCH ON BUSINESS TAX INCENTIVES

Conclusions:

- West Virginia does not account for or properly evaluate business tax incentives.
- West Virginia lags behind most states in evaluating business tax incentives.
- ***Recommendations***: Unified Economic Development Budget, Sunset Dates and Transparency (company specific data), and recapture provisions or "claw backs."



Policy Brief

west virginia Center on Budget & Policy

www.wvpolicy.org

October 2012

Every Dollar Counts:
The Need for Transparency and Evaluation of Business Tax Incentives

Sean O'Leary and Ted Boettner

Every year, West Virginia's policymakers scrutinize the state's budget. Every dollar spent must be accounted for, and how much is allocated to education, healthcare, infrastructure and other public services must be carefully considered. And once the fiscal year is over, the budget process begins again, and what programs are funded and where the tax dollars are allocated are examined and debated by the state's policymakers.

However, one form of "back door" spending receives virtually no scrutiny from the state's policymakers, despite costing the state millions each year. The use of tax incentives for economic growth and job creation has a major impact on the state's budget each year, but currently West Virginia policymakers lack the tools and information needed to properly evaluate them. Instead, millions of taxpayer dollars are handed out with little oversight and accountability.

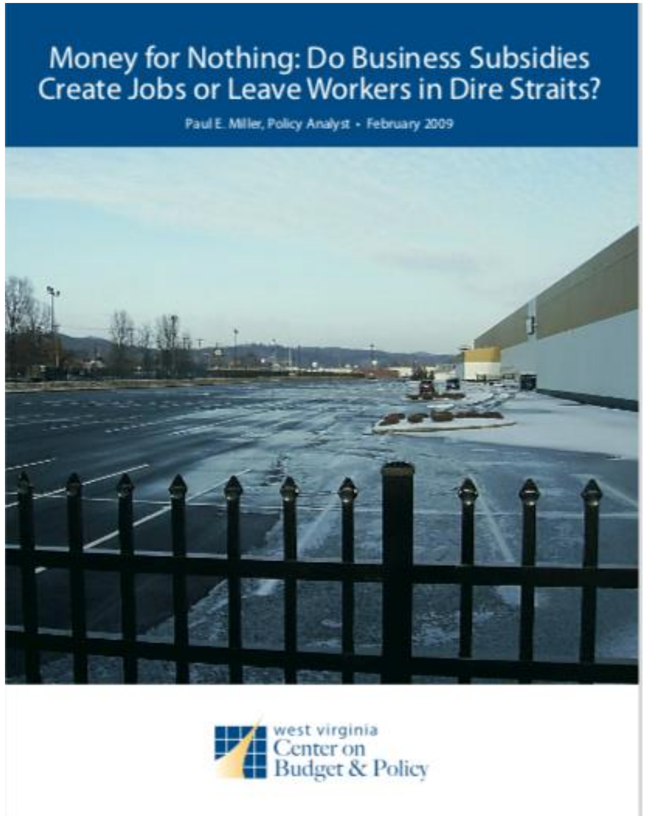
West Virginia, like many states across the country, has relied heavily on tax incentives to encourage businesses to locate and expand in the state, and to promote economic growth. However, the actual cost and true economic impact of the state's business tax expenditures is unknown, and neither policymakers nor the public know the return on its investment. As tax incentives remain a major policy tool for economic development, it is critical that the state regularly and effectively evaluates them and uses that information to inform the state's policy choices.

This is not a new problem in West Virginia. In 1999, the Governor's Commission on Fair Taxation reported to then-Governor Cecil Underwood that, "Many (tax credits) have little or no relation to economic development. Further, research is necessary to determine the overall impact of such credits."[1] More recently, the Wise Administration in 2002 examined 22 of the state's existing business tax credits and recommended eliminating half of them despite being unable to prove if they led to job creation or economic growth.[2]

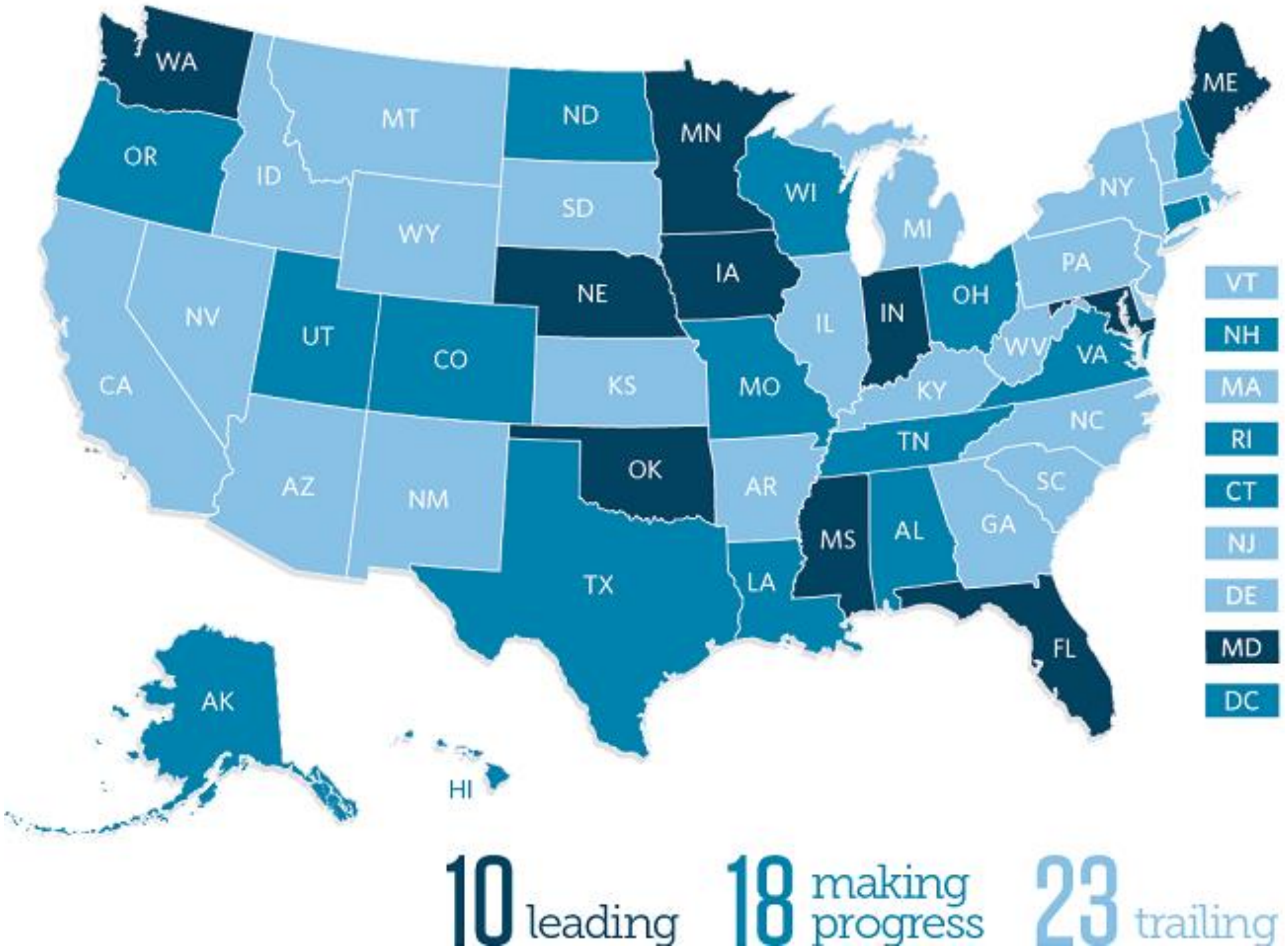
What Are Tax Expenditures?

West Virginia code defines tax expenditures as "exclusions, deductions, tax preferences, credits and deferrals designed to encourage certain kinds of activities or to aid taxpayers in special circumstances."[3] Examples of state tax expenditures include the Family Tax Credit, which decreases or eliminates the personal income tax liability for taxpayers below the federal poverty line, and the Homestead Exemption that reduces the property tax liability for those 65 years old or older, or permanently disabled.

Tax expenditures cost the state money in much the same way as direct spending, because they result in the loss of revenue that would otherwise be collected. For this reason, tax expenditures are often referred to as "spending simply by another name."[4] But, unlike annual public spending



Research made recommendations after examining Tax Credit Review and Accountability Report, Tax Credit Discloser List, Tax Expenditure Studies, Manufacturing Tax Adjustment Credit Report, and EDA Direct Loan Program.



Source: Pew Charitable Trusts, 2017

PEW: WEST VIRGINIA IS "TRAILING" MOST STATES IN EVALUATION OF BUSINESS TAX INCENTIVES

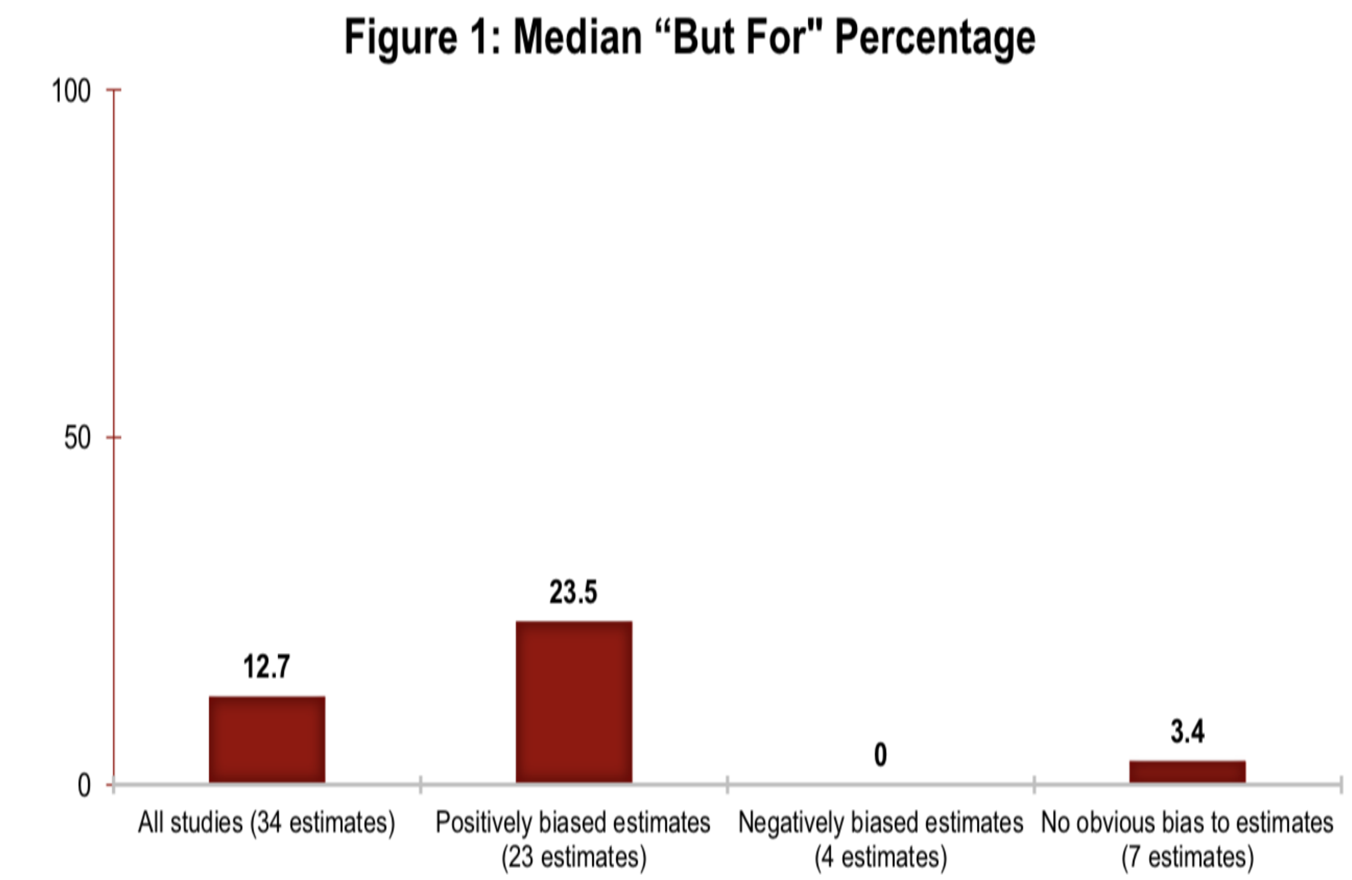
BUSINESS TAX INCENTIVES: DO THEY WORK?

State and local governments spend between $45 and $90 billion in incentives to attract business development. The average incentive package is a 25 percent cut in state/local taxes for export-based businesses (Bartik 2018).

- **Central Problems:**
  - Incentives are not adequately evaluated and are seldom fully transparent.
  - They simply do not work as intended; with costs usually not outweighing benefits.
  - There is no ”free lunch”, incentives have to be paid for and the money comes from somewhere (feedback loop).
  - Aimed at big businesses (aka "mega deals") instead of small businesses and entrepreneurs.
  - **Conservatives**: "picking winners" and distorting business investment (increases corporate taxes, leads to rent-seeking activity (e.g. lobbying).
  - **Liberals**: Redistributes money upwards (from average taxpayer to mostly wealthy capital owners), often subsidizes low-wage jobs and profitable corporations, and creates a "race to the bottom."

HOW OFTEN DO BUSINESS TAX INCENTIVES TIP THE SCALES?

- A 2018 meta analysis of 30 studies by Tim Bartik (Upjohn Institute) finds that typical incentives tip somewhere between **2% to 25%** of firms to favor the location providing the incentive. A failure rate of at least 75 percent. The median "but for" percentage was 12.7%.
- Virginia Joint Legislative Audit and Review Commission (JLARC) survey of 1,300 businesses found that "39% of firms would not have proceed with project(s) except for incentive(s). It was 33% for tax credits. "But for" estimates tend to be positively biased.
- Whether incentives are effective depends heavily on the job multiplier (higher the better, big clusters), use of local unemployed labor, high-wage firms, unemployment rate, education investment (cuts hurt impact), whether they are front-loaded, whether jobs are targeted at industries that create more jobs in other local businesses, and how they grow per capita earnings. 20% to 50% of jobs go to in-migrants over short-run, 85 percent over long-run.

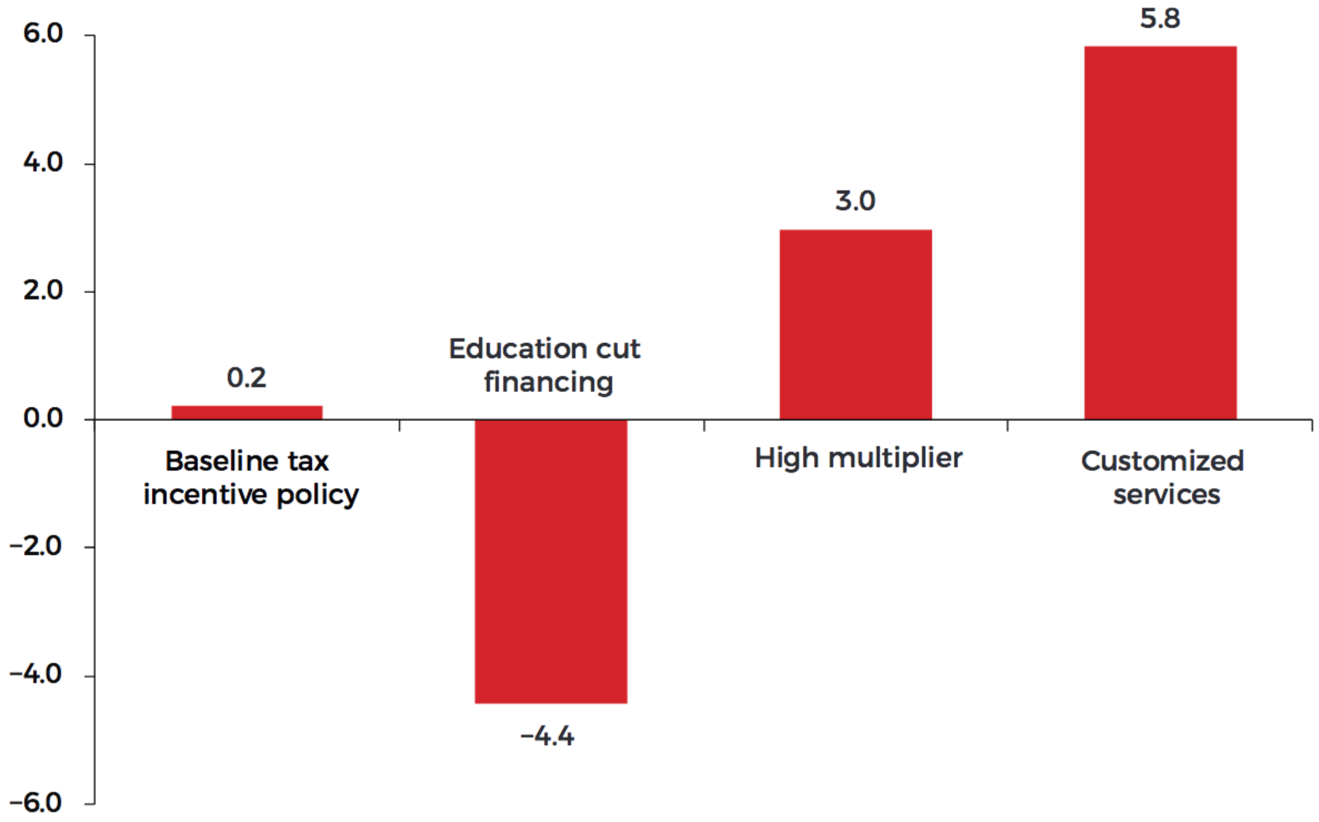


NOTE: State and local business tax literature: range of 4–21% for average incentive. Model assumes average incentive yields 12%. Foxconn (10.7 x average) is 76%.

OTHER FINDING FROM BARTIK ON BUSINESS TAX INCENTIVES

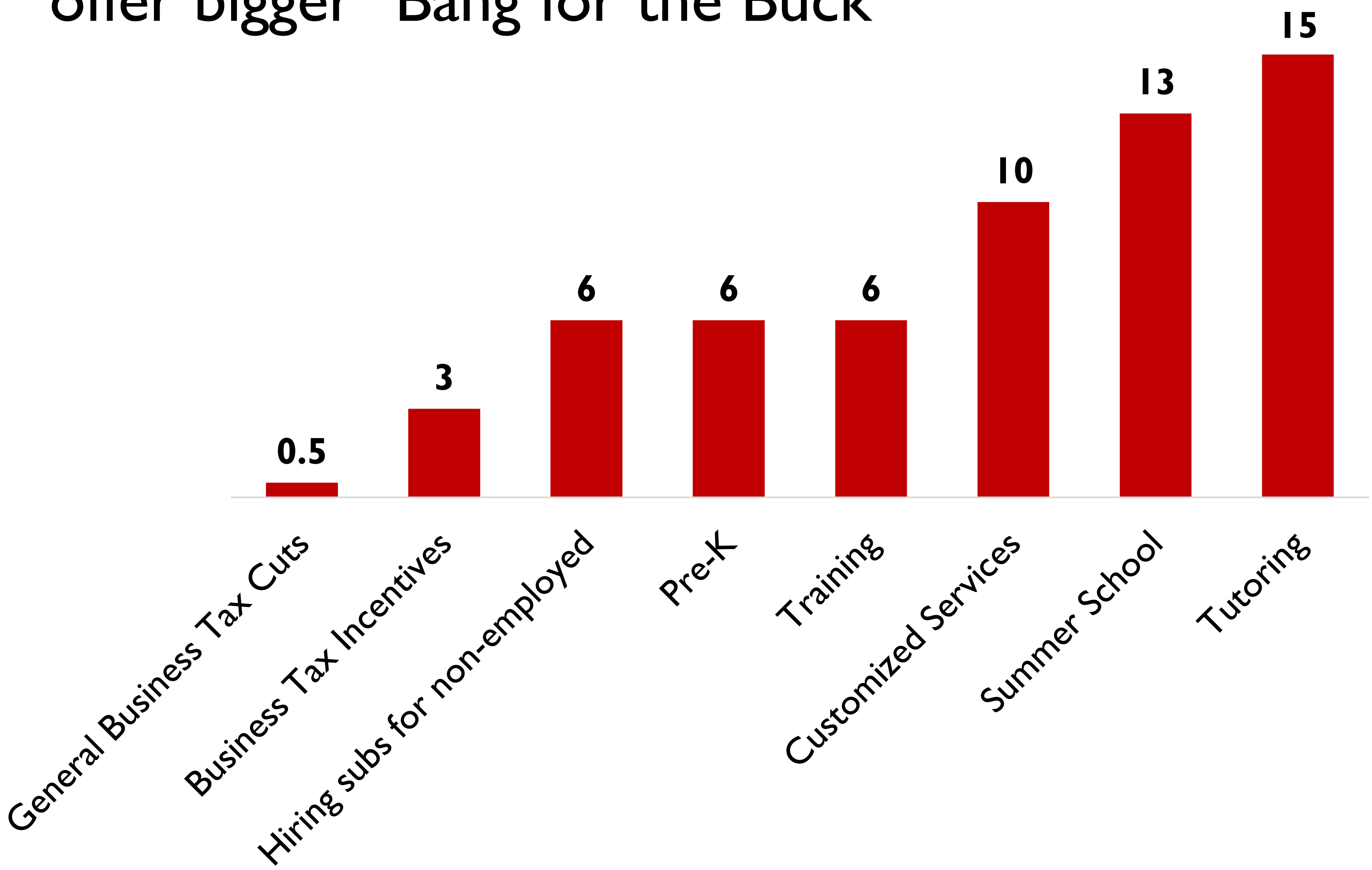
- Bartik: "The net benefits of incentives on local incomes…amount to only 22.3 percent of incentive costs.…In the end, the net income for those in the lowest income quintiles (and the second-highest, surprisingly) actually *drops* as a result of incentive policies. In places where incentives are explicitly paid for by cutting K-12 spending, state per capita income drops by more than $4 for each $1 spent on tax incentives."
- "Preliminary work suggests that a state's incentives are not highly correlated with a state's fortunes. Incentives do not have a large correlation with a state's current or past unemployment or income levels, or with future economic growth."

Figure 1 How Four Different Incentive Policies Affect State Residents: Percentage Effects on Per-Capita Income



NOTE: These four incentive policies all have the same cost: 1 percent of total personal income of state residents.
SOURCE: Executive Summary to Bartik (2018).

Workforce development policies offer bigger “Bang for the Buck”



ARE TAX INCENTIVES BETTER THAN OTHER STRATEGIES?

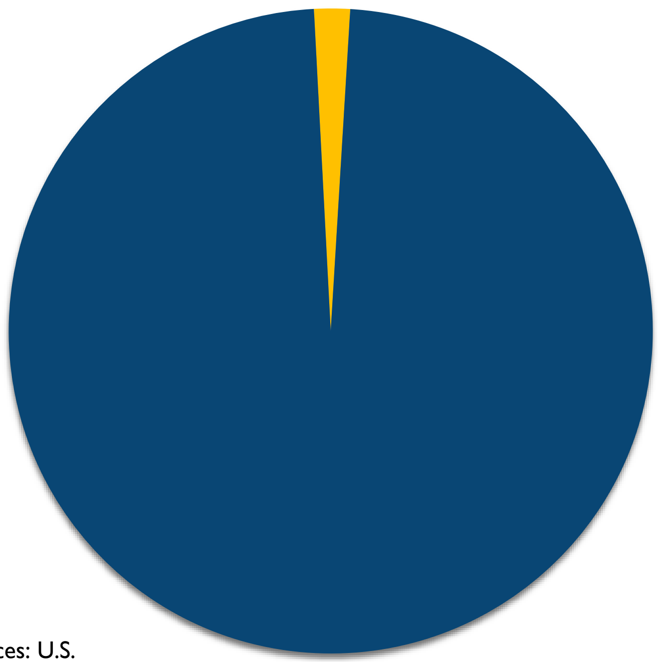
EARNINGS BENEFIT TO COST RATIOS (ROI)

Source: Timothy Bartik, What Works in Economic Development, downloaded from http://www.openskypolicy.org/wp-content/uploads/2016/09/BartikSlides.pdf on Sept. 12, 2016.

STATE AND LOCAL TAXES ON BUSINESSES AS A SHARE OF TOTAL BUSINESS COSTS, ON AVERAGE

1.8%
State & local taxes on businesses combined
(including corporate and individual income taxes, sales taxes, gross receipts, and local property taxes)

98.2%
The real costs
(occupancy costs, labor compensation, energy costs, machinery and equipment, transportation, and business support services)

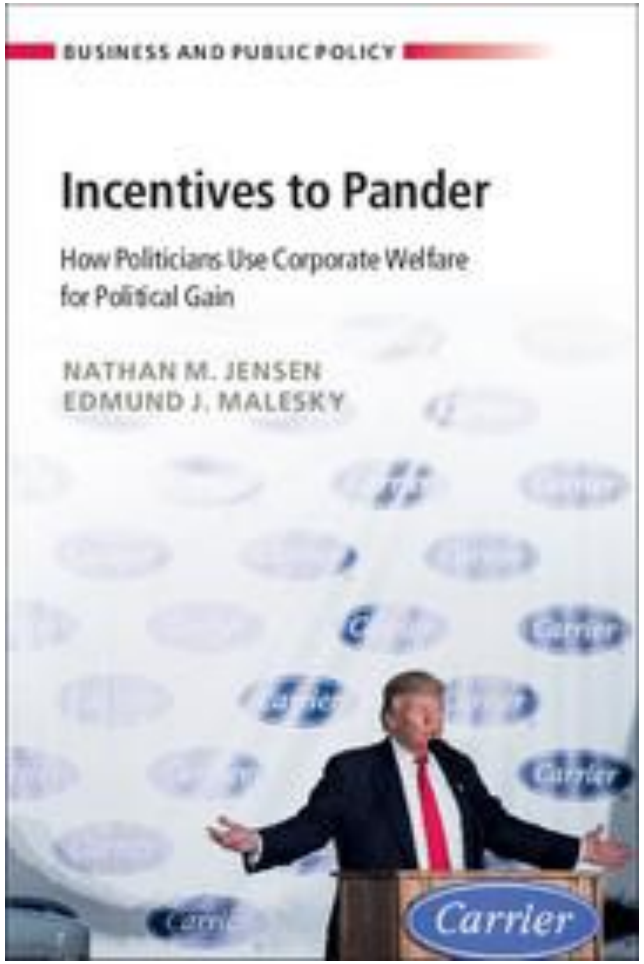


Other factors – also play large role in location factors and growth. – including:

- Quality of life
- Skilled labor
- Proximity to markets
- Land & electricity prices
- Cost of living
- Telecommunications
- Regulatory environment
- Schools
- Infrastructure
- Raw materials

SOURCE: Peter Fisher, www.gradingstates.org This is based on data averaged over three years 2005-2007 from two sources: U.S. Internal Revenue Service, Statistics of Income, Integrated Business Data for all U.S. Corporations, partnerships, and non-farm proprietorships, showing total deductions for business costs on tax returns, at http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data ; and a 2009 report by the Council on State Taxation, which estimates total state and local taxes paid by businesses, available at http://www.cost.org/Page.aspx?id=69654 .

"BUSINESS LOCATION INCENTIVES ARE INEFFECTIVE – SO WHY DO THEY PERSIST IN AMERICAN STATES AND LOCALITIES?"



- It is a winning political strategy to signal to voters that they are aggressively promoting job creation and local economic development.
- Elected mayors – as opposed to appointed city managers – offer larger incentives and engage in weaker oversight of business incentive programs.
- Presenting voters with information on tradeoffs between incentives and other government policies – less funding for schools or lower taxes - can affect the politics of incentives by lower support for these policies.

Scholars Strategy Network, Nathan Jensen, September 27, 2016

CAN THE FEDS STOP THE BIDDING WAR BETWEEN STATES?

- **Jack Markell**, former Democratic governor of Delaware, "Congress should institute a federal tax of 100 percent on every dollar a business receives in state or local incentives that are directed specifically to that company," (Jack Markell, "Let's Stop Government Giveaways to Corporations," *New York Times*, September 21, 2017)

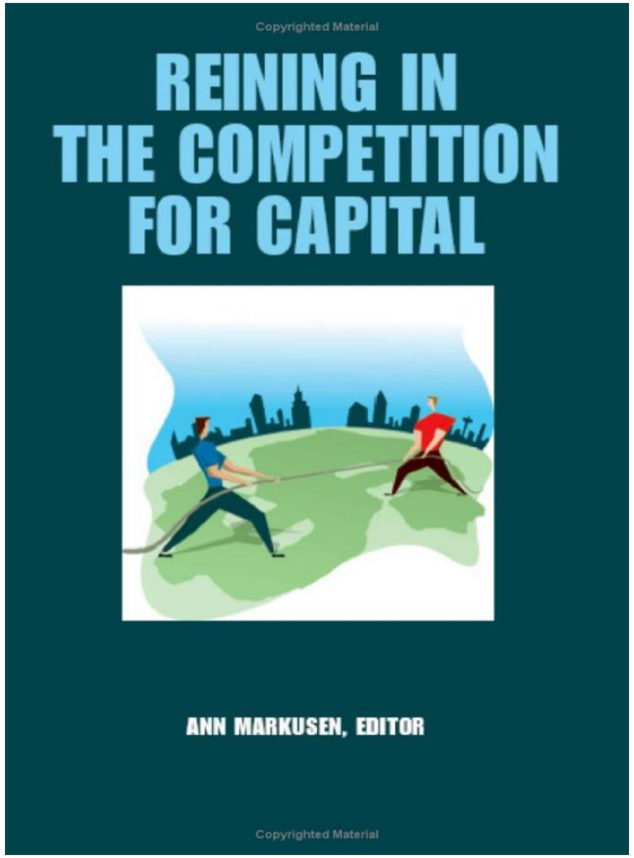
- "Ban all state tax incentives that, on their face, trade lower taxes for economic investment in the state." (**David Gamage and Darian Shanske**, 2016)

- **Arthur J. Rolnick (**Senior Vice President, Director of Research, Federal Reserve Bank of Minneapolis) was lead author of Distorting Subsidies Limitation Act of 1999 (H.R. 1060) ,"Congress could impose sanctions such as taxing imputed income, denying tax-exempt status to public debt used to compete for businesses and impounding federal funds payable to states engaging in such competition.."

CAN THE FEDS STOP THE BIDDING WAR BETWEEN STATES? CON'T

" A federal Main Street Fund would provide funds for any state that diverts money from its traditional economic incentives to invest in management training for new entrepreneurs, modernizing licensure programs, and investing in broadband and other initiatives to support the creation of new businesses."

"Under EU rules, a country's incentives are regarded as export subsidies, which, if they exceed a certain size, are deemed illegal except for special cases. If the EU finds a country's incentive to a firm to be illegal, the firm can be forced to repay the incentive (Sinnaeve 2007)."



RECOMMENDATIONS

- Create an independent Legislative Fiscal Office (34 states) or empower an existing office to conduct annual and rigorous evaluations of business tax incentives.
- Conduct a survey of businesses that have received business tax incentives (e.g. EOTC, Certified Capital Additions) and adopt a plan to regularly evaluate tax incentives using rigorous analysis (e.g. examine tradeoffs, indirect effects, design, how they influence business behavior, etc.).
- Fully implement GASB 77 (Tax Abatement Disclosure) and mandate public reporting fully disclose all business tax incentives at the state and local level (e.g. PILOTs).
- Invite Tim Bartik and others to come help the state implement proper evaluation and cost-benefit analysis of economic development incentives.

Questions?

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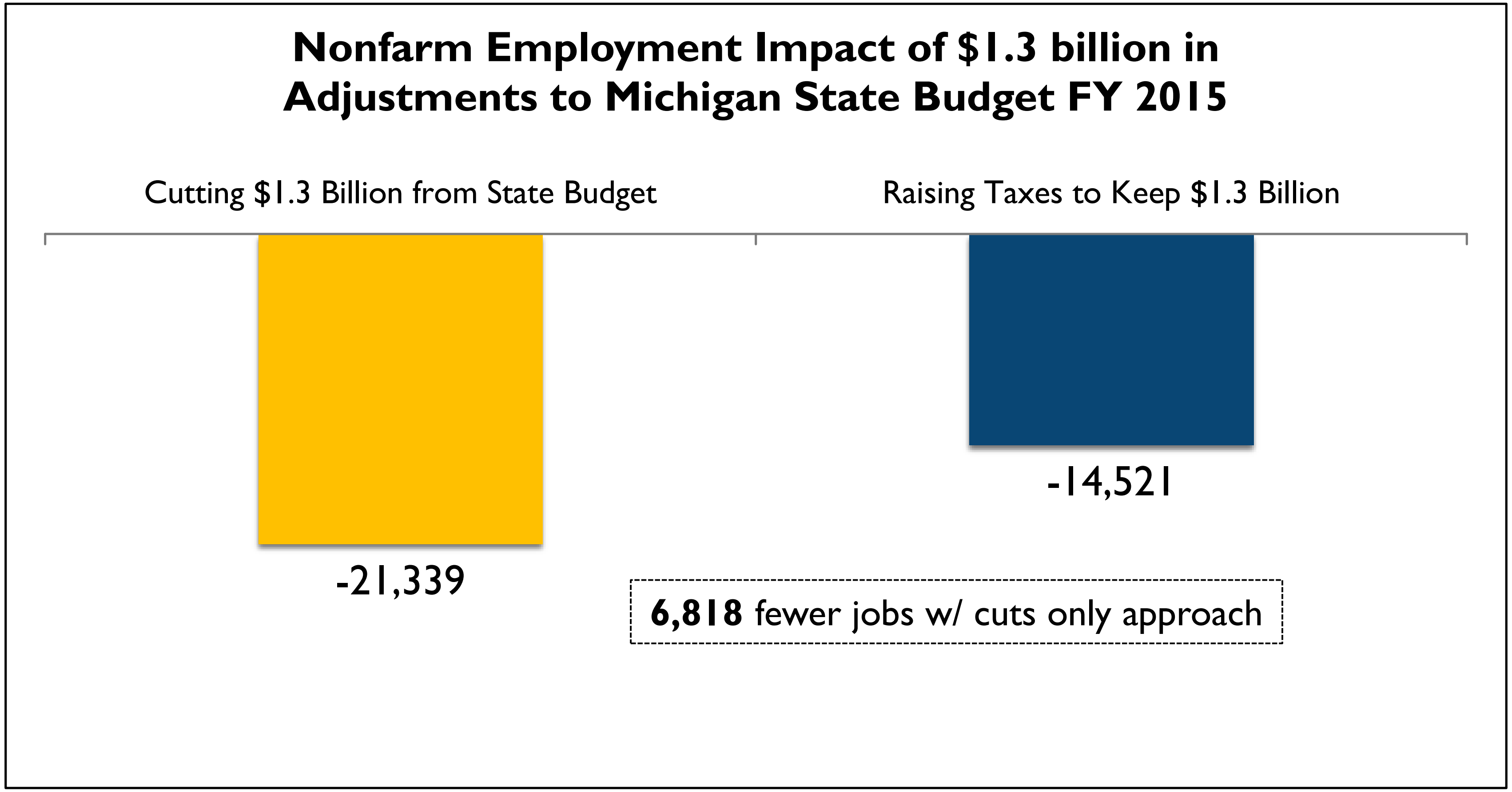
REFERENCES & INFORMATION ON BUSINESS TAX INCENTIVES

- The Upjohn Institute for Employment Research: https://research.upjohn.org/incentives/
- Good Jobs First: https://www.goodjobsfirst.org/ & GJF Subsidy Tracker: https://www.goodjobsfirst.org/subsidy-tracker
- The PEW Charitable Trusts: https://www.pewtrusts.org/en/projects/economic-development-tax-incentives
- Book: Calcagno, Peter and Hefner, Frank L, Economic Development Tax Incentives: A Review of the Perverse, Ineffective, and Unintended Consequences (January 3, 2018). Excerpt from Adam J. Hoffer and Todd Nesbit, eds., For Your Own Good: Taxes, Paternalism, and Fiscal Discrimination in the Twenty-First Century. Arlington, VA: Mercatus Center at George Mason University, 2018. Available at SSRN: https://ssrn.com/abstract=3173791
- Book: Nathan M. Jensen & Edmund J.Malesky, "Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain," Cambridge University Press, February 2018 - https://www.cambridge.org/core/books/incentives-to-pander/E0003C20215EDA5047EA0831FEEB6D92#fndtn-information
- Aaron K. Chatterji," The Maine Street Fund: Investing in an Entrepreneurial Economy,' The Hamilton Project, June 2018. https://www.brookings.edu/wp-content/uploads/2018/06/ES_THP_20180611_Chatterji.pdf
- Terry Rephann (UVA), "Virginia Economic Development Incentive Survey: Making Sense of Policy Impact," presented at NCSL Roundtable on Evaluating Economic Development Tax Incentives, October 17-19, 2018 http://www.ncsl.org/Portals/1/Documents/fiscal/Fiscal_meetings/2018_Meetings/Session_3_Terry_Rephann_Presentation_32821.pdf
- Gamage, David and Shanske, Darien, "Tax Cannibalization and State Government Tax Incentive Programs" (2016). Articles by Maurer Faculty. 2440. http://www.repository.law.indiana.edu/facpub/2440

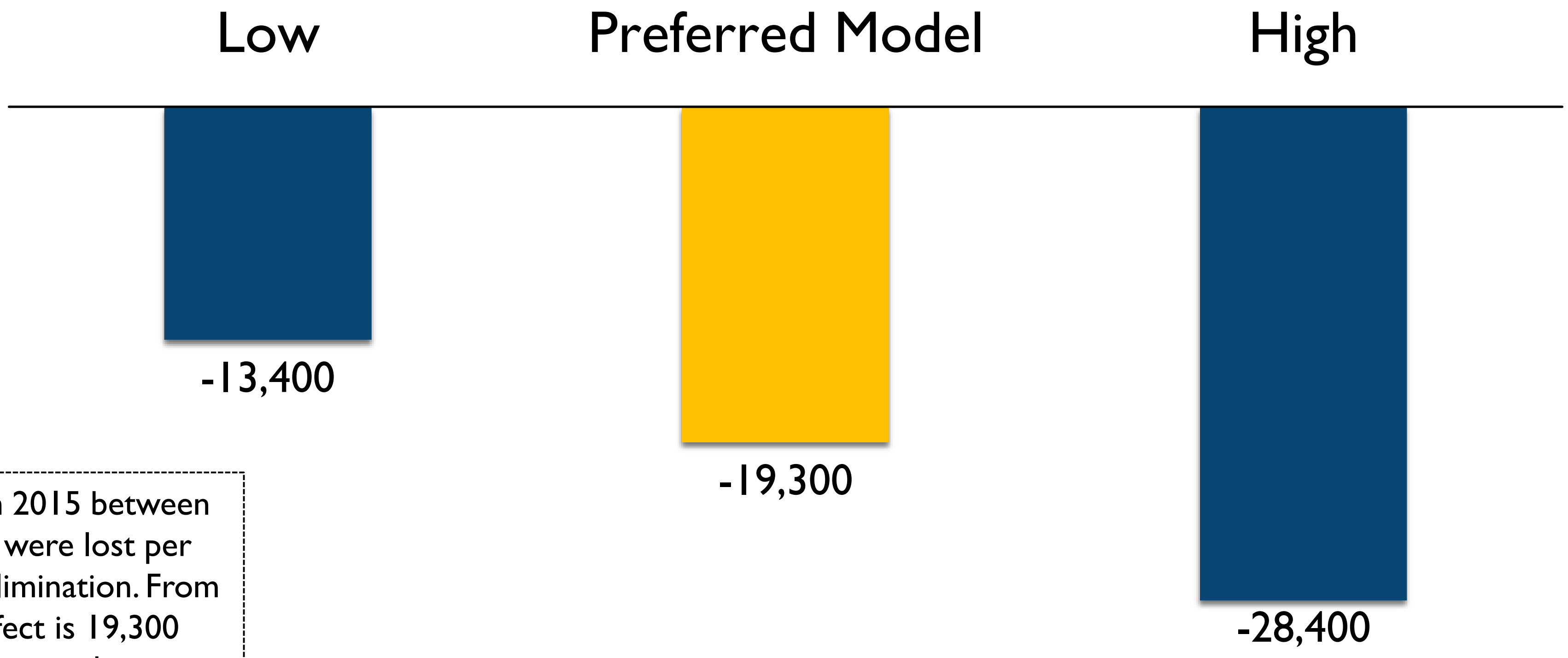
STATE TAXES AND STATE ECONOMIC PERFORMANCE



- The weight of academic research concludes that state and local tax levels have, at most, a small impact on relative rates of state economic performance.
- **Bartik 2004**: Summary of the Literature: Takes 10% cut in total business taxes to generate 2-3% boost in long-run (15-20 years) economic output/jobs assuming quality of services needed by businesses(education, infrastructure) doesn't decline. Requires offsetting taxes on non-job creating households, which almost never occurs (states have to balance budgets!).
- 10% = $360 million (COST FY16: Total WV business taxes = $3.6 billion). Significant amount of revenue loss for a small number of jobs.
- **Bartik 2017**: Economic Impact of Budget Cuts vs Raising Taxes in Michigan

Source: Bartik, Timothy J. 2017. "New Evidence on State Fiscal Multipliers: Implications for State Policies." Upjohn Institute Working Paper 17-275. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research

ESTIMATED JOB IMPACT ON MANUFACTURING JOBS FROM ELIMINATION OF OHIO'S BUSINESS PERSONAL PROPERTY TAX



"We estimate that from 2006 through 2015 between 13,400 and 28,400 manufacturing jobs were lost per year on average because of the tax's elimination. From our preferred model, the estimated effect is 19,300 fewer jobs per year on average" (Mughan and Propheter, September 26, 2017)

Source: Sian Mughan and Geoffrey Propheter, "Estimating the Manufacturing Employment Impact of Eliminating the Tangible Personal Property Tax: Evidence from Ohio," *Economic Development Quarterly*, Volume 31, Issue 4, 2017