BUSINESS TAX INCENTIVES:
ADVANTAGES & PERILS

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West Virginia Tax Institute – Morgantown, WV
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<table>
<thead>
<tr>
<th>In Millions</th>
<th>TOTAL</th>
<th>$195.8</th>
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<tbody>
<tr>
<td>Certified Capital Additions</td>
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<tr>
<td>Industrial Expansion/Revitalization</td>
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<td>Thin-Seam Coal Rates</td>
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<tr>
<td>TIFs</td>
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<td>Low-Income Electric, Gas &amp; Water</td>
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<td>Economic Opportunity</td>
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<td>Manufacturing Property Adjustment</td>
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<td>WV Film (eliminated)</td>
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<tr>
<td>Manufacturing Investment</td>
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<td>Tourism Development</td>
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<td>Special Aircraft Property</td>
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<tr>
<td>Manufacturing Production Property</td>
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<td>Natural Gas/Oil Exclusions</td>
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<td>Coal-Loading Facilities</td>
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<td>Rehabilitated Buildings (doubled in...</td>
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<td>Apprenticeship Training</td>
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<td>High-Technology Business Property</td>
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**Source:** West Virginia State Budget Office, Executive Budget Volume 1 | 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%)

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

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

$6 BILLION PROPOSED CRACKER PLANT IN BEAVER COUNTY, PA
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.”

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.
PEW: WEST VIRGINIA IS “TRAILING” MOST STATES IN EVALUATION OF BUSINESS TAX INCENTIVES

Source: Pew Charitable Trusts, 2017
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.

Figure 1: Median “But For” Percentage

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%.
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.”
Workforce development policies offer bigger “Bang for the Buck”

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

“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..”
“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.
It's easy to join our mailing list!

Just send your email address by text message:

Text
JOINWVCBP
to 22828 to get started.

Message and data rates may apply.
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
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
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

### Nonfarm Employment Impact of $1.3 billion in Adjustments to Michigan State Budget FY 2015

- Cutting $1.3 Billion from State Budget: -21,339
- Raising Taxes to Keep $1.3 Billion: -14,521

6,818 fewer jobs w/ cuts only approach

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).