Economic Development Activities

Overview

States offer a variety of business incentives to attract, expand, or retain jobs. Opponents maintain that tax and financial incentives drain dollars from state coffers that could be used for other public services and infrastructure. Advocates of business incentives claim that they have a positive effect on business location decisions and pay for themselves. In an attempt to understand where Utah stands, the Utah Department of Community and Economic Development assembled an incentives workgroup to compare Utah's economic development incentives with other nearby states.

The taskforce found that available surveys of state incentives make it appear that most states have a full menu of incentives to offer. In reality, there are relatively few significant business incentives (at least in western states) and most are restricted, for example, to rural areas and Enterprise Zones. The taskforce also determined that overall, Utah's incentives are "competitive", ranking in the middle of the pack, and that neither a major expansion of existing incentives, nor a range of new incentives appear necessary.

Background

Since the late 1970's, states have offered a variety of business incentives to attract, expand, or retain jobs. Business incentives, using the Council of State Governments definition, are "public subsidies including, but not limited to, tax abatement and financial assistance programs designed to create, retain or lure businesses." Tax incentives refer to credits, abatements, or refunds of corporate or personal income, sales and use, property, or other taxes. Financial incentives are generally any other type of direct loan, grant, loan guarantee, job training assistance, or infrastructure development. In addition to such general tax and financial incentives, some states have gone so far as to pass incentive legislation targeted at specific companies.

Opponents maintain that tax and financial incentives are rarely at the top of the list of factors in a company's location decision. In addition, they contend that these incentives are generally inefficient in creating jobs, often discriminate against existing area businesses, drain dollars from state coffers that could be used for public services and infrastructure, and create a self-defeating zero-sum conflict between the states. Advocates of business incentives claim that they have a positive effect on business location decisions, create jobs, are cost effective, and are necessary in the competitive environment of economic development.

While this debate continues to take place, by 2000, more than 40 states offered incentives in the form of tax credits, exemptions or rebates for such things as equipment and machinery, inventory and goods in transit, manufacturing raw materials, job creation, and research and development. Recently, states have begun linking these exemptions to corporate and personal income taxes. Some states provide low- or zero-interest loans or grants for land, building construction, machinery or plant expansion.

In an attempt to illuminate this ever-changing landscape, the Council of State Governments and the National Association of State Development Agencies, among others, periodically publish reports on the various tax and other incentives that states offer businesses to expand or relocate. However, it is difficult and frequently misleading to try to determine how the various incentive packages compare, or the value of these incentives to businesses, based on these surveys.

Department of Community and Economic Development Taskforce on Incentives

As a result, in September 2002, the Utah Department of Community and Economic Development assembled an incentives workgroup to compare Utah's economic development incentives with other nearby states.

The workgroup decided that three steps were required in order to accomplish this. First, it needed to identify the major incentives available in each state. Second, for the analysis to be meaningful, it was necessary to understand the general tax structure of the states being compared. This would include an understanding of their major taxes, their rates, and tax exemptions related to economic development. The third step was to decide which incentives certain targeted companies would be eligible for in each state, and how much the incentives would be worth.

To assess the value and impact of the various types of incentives, eight test cases were constructed based on examples from Utah's "ecosystems". These examples were chosen from companies that had applied for Industrial Assistance Fund grants and for which complete project data was available. Because of time and resource constraints, the workgroup limited its study to Utah, eight western states, plus an eastern state with which Utah was "competing" for a specific project.

A simplified economic impact model was developed for each state, using the Bureau of Economic Analysis' RIMS II earnings and employment multipliers, and containing each state's tax rates, average per capita government expenditures, as well as other related economic and demographic data. Holding project data constant, an impact model was developed for the eight test cases in each of the ten states.

Members of the workgroup were then assigned a state and asked to determine which of "their" state's incentives would apply to the eight test cases. Only each state's major incentives (usually established by statute) and available to companies seeking to locate in a large metropolitan area, were included in the evaluation. Examples of the types of incentives included are sales and property tax exemptions for machinery and equipment; sales and income tax credits for job creation and/or investment in machinery and equipment; customized job training programs, credits for on-site child care, and direct grants.

Taskforce Findings

Based on a simple cataloging of state incentives, it appears that most states have a full menu of incentives to offer. In reality, there are relatively few significant business incentives (at least in the western states which constituted the majority of the comparison states), and most are restricted, for instance, to rural areas and to Enterprise Zones. As an example, Utah's state-level incentives include:

- A sales and use tax exemption for machinery and equipment purchased or leased by a manufacturer for use in new or expanding operations in Utah.
- A research and development income tax credit for machinery and equipment, applicable to corporate or personal income.
- The Industrial Assistance Fund (IAF), which a company may apply to for assistance in relocation or expansion costs.
- The "Custom Fit Training Program," which provides employee training for new or expanding companies.

- Rural Enterprise Zones that provide tax credits for companies locating in rural areas that qualify for assistance.
- The Private Activity Bond Authority (PAB) which is a tax-exempt bonding authority to create a lower cost, long-term source of capital.

Based on a ranking of the incentives that were potentially available to the eight test cases, Utah's incentive package appears "competitive". Utah ranked fifth overall out of the ten states. The most common incentive is a sales tax exemption for manufacturing equipment and machinery. Nine out of the ten states have this. Eight states offer some type of customized employee training. Four of the comparison states have an investment tax credit.

Some recent studies conclude that incentives have a positive effect in stimulating overall economic growth within a state. On the other hand, fewer and lower tax rates are more economically efficient than a broad range of tax/fiscal incentives (the tax system is easier to administer, less liable to abuse, less distorting to the economy, etc). The more the incentives were made available to companies, and the broader the eligibility for these incentives, the less their effectiveness. They merely shift the tax burden to others and are subject to the problems just noted.

Furthermore, adopting a particular incentive because other states have it is not necessarily good policy. According to the 2000 Council of State Governments incentives survey, just over half of the states use any kind of cost/benefit assessment in designing or allocating their incentives, and even fewer use a full fiscal impact model in their business recruiting efforts.

Taskforce Recommendations

In general, without other offsetting factors, recruiting companies that pay an average annual wage below the state average will result in a net fiscal loss to Utah state government. Recruiting companies with capital investment less than their industry average will usually result in a net loss for local government. Consequently, with few exceptions, Utah's incentives should be targeted to industries and companies that pay higher than the state average wage and fit within Utah's recognized clusters/ecosystems.

The Industrial Assistance Fund is effective and a unique incentive among the states. It accounted for one-fourth of Utah's total incentive package in the eight test cases. In addition, Utah also has several potentially effective incentives that are not currently being fully utilized. For example, Private Activity Bond financing represents a potentially significant incentive for some firms. Utah should increase the allotment of PAB funds available for manufacturing projects and expand the use of this resource as a major incentive.

Based on the findings of the taskforce, neither a major expansion of existing incentives nor a range of new incentives appear necessary in Utah, nor are they desirable from an economic efficiency standpoint.

Finally, Utah should establish and publish a set of clear guidelines regarding the availability, criteria, and use of state incentives. These should then be promoted by training economic development practitioners on their potential use and advantages for the state.