Since the Great Recession, states have been faced with high levels of unemployment, an increased demand for safety net services and a shrinking revenue base. Although the past year has brought some improvements, the number one question on state policymakers’ minds continues to be: “What can we do to encourage job growth?” Traditionally, a key policy lever for development and job creation strategies was—and remains—tax and financial incentive programs designed to encourage new firms to start up or existing firms to grow or relocate.

Over the past three decades, states have developed various incentive programs designed to encourage economic activity in order to create, retain or expand business opportunities. In addition to tax and financial incentives, some states have used customized, company-specific incentives to engage in bidding wars with other states, making interstate competition for industries and businesses increasingly intense.

Trends in the Use of Tax and Financial Incentives
From the 1970s into the late 1980s and early 1990s, the number of states providing tax and financial incentives to businesses and the types of incentives being offered increased significantly. Over the past 10 years, the number of states offering incentives of varying degrees and types has become
relatively stable.

In 1977, at least 28 states offered tax concessions or credits to businesses for equipment and machinery, goods in transit, manufacturers’ inventories, raw materials in manufacturing and job creation. In 1998, the number of states offering those incentives had grown to 42; by 2008 that count stood at 44 states.

The number of states offering an excise tax exemption in 2008 stood at 28—nearly triple the 10 states offering it in 1977. That year, 21 states offered a corporate income tax exemption and 19 states offered a personal income tax exemption; by 2010, the number of states offering these exemptions grew to 41 and 37, respectively.

Similarly, the number of states with financial incentive programs also increased over the past three decades. In 1977, fewer than 20 states offered special low-interest loans for building construction, equipment, machinery, plant expansion and establishment of industrial plants in areas of high unemployment. By 1998, more than 40 states offered those incentives—a number that remained essentially the same over the next decade.

During the past 10 years in particular, export promotion for small and medium-sized enterprises has become an increasingly important component of state economic development strategies. Nearly half the states responding to a CSG survey reported providing grants to small businesses as part of their export assistance portfolios.

The “New Energy Economy” has emerged alongside export promotion as a key focus of state economic development programs, with as many as 39 states developing policies and making explicit investments to advance green economic development as part of their Great Recession recovery strategies.

All 50 states, the District of Columbia and Puerto Rico offer two or more types of incentives for renewable energy. Similarly, 48 states, the District of Columbia and Puerto Rico offer at least one type of incentive for energy efficiency.

**Criticisms of Effectiveness**

While incentives are in use in every state and Puerto Rico, researchers and state policymakers have questioned the effectiveness, impact and true costs of those programs, especially in the current fiscal environment of austerity measures and years of big budget gaps. Although incentives continue to be a popular economic tool in many states, some state leaders are increasingly critical of programs that pull revenue away from a shrinking tax base without clear evidence of a payback.

One of the criticisms applied to an incentive-focused development strategy is that incentives are a zero-sum game because they create bidding wars among states. One state luring business away from another with the promise of tax benefits does not create new economic activity; it simply transfers existing activity into another geographic location.

Some studies have shown that a company’s decision to locate in a particular state has less to do with the incentives offered and more to do with the pre-existing assets of a state, such as workforce education levels, transportation capacity and access, housing affordability, and a geography appropriate for the firm’s needs.

In addition, some argue that incentives are used inappropriately to correct weak spots in the economic climate, tax or regulatory infrastructure of a state. Instead, they argue, state policymakers should engage in strategic planning to improve their overall business climates, including initiating a
review and analysis of regulatory barriers, tax codes, business permitting systems, workers’ compensation systems and labor relations.

[3] Download Table A: "State-by-State Tax Incentives Offered in 2010"


Making Incentives Pay
Given the significant amount of funding at stake—in some cases, upward of half a billion dollars per state economic development program per year—many states are now using a number of strategies to ensure their investments are paying off, including:

- Specify qualifications for a tax break—States often require companies to meet certain criteria—such as wages paid, jobs created, health insurance and other benefits provided, capital investment made, and taxes created—to qualify for a tax break or incentive. Forty-three states have a rule for at least one of their incentive programs that addresses this type of qualification. Some states provide additional or stand-alone incentives for firms that create jobs in a particularly high-growth area or jobs that pay a high wage. In New Mexico, for example, an eligible employer may receive a tax credit for each new high-wage job it creates under the High Wage Jobs Tax Credit. The credit amount equals 10 percent of the wages and benefits paid for each new job created.

- Strengthen the approval process—In Texas, for example, the governor, lieutenant governor and speaker of the house must OK all projects that receive money from the state’s Enterprise Fund. In Wyoming, the state’s economic development staff does extensive diligence on each project and follows development of those projects throughout its life. As required by the state’s constitution, the investments are with the governmental entities rather than companies directly and should the endeavor fail, the governmental entity retains the assets created.

- Public disclosure and online accountability—One strategy states increasingly are employing is the use of online transparency and accountability systems. These systems provide the public with company-specific information on the amount of the tax subsidy, comparisons on the number of jobs promised and the number of jobs actually created, wage levels for employees, and the company’s compliance record with various state rules and regulations. Show Us the Subsidies, a December 2010 report by the group Good Jobs First, singled out Illinois, Ohio and Wisconsin as having some of the most robust online disclosure systems in the nation. The report also found that 37 states provided online recipient disclosure for at least one key subsidy program, which is a significant improvement over 2007 when only about 23 states were doing so.

- Clawbacks—Some states penalize businesses that don’t comply with the requirements of the tax incentive. Minnesota, for example, has an especially strong clawback law. First, all state and local subsidy agreements must contain clawback provisions. Second, the granting jurisdiction in Minnesota can recapture all or part of a subsidy, with interest, and any company that does not meet its contractual commitment also can be barred from future tax incentives. Currently, at least 37 states use some form of clawback provision, either written into their statutes or defined by program guidelines.

- Post-Performance Awards—Providing incentive-based awards after a firm has met the criteria for an award ensures the state will see the return it specifies and creates more of a backend accountability system. It also provides a true incentive for businesses to perform in the manner they have promised. If businesses cannot perform in that manner, states do not have to chase a business for reimbursement for a promise unfulfilled. In Utah, all state incentives are awarded on a post-performance basis so that companies must meet specific milestones, including generation of new state tax revenue, before incentives are disbursed.

Other common mechanisms states use include placing sunset provisions in statute so tax incentive
programs cannot continue without additional legislative action and closely monitoring programs using performance audits. For example, in Nevada, audits are conducted for all incentives to affirm that the agreed upon number of workers have been hired or trained and pay levels are consistent with the incentive agreement.


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