A fact sheet from THE PEW CHARITABLE TRUSTS | Sept 2017

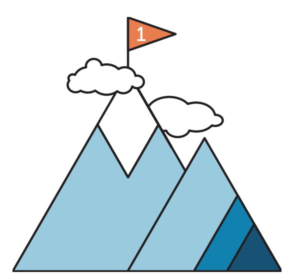
Questions for Lawmakers to Ask When Designing New Tax Incentives

Overview

Economic development incentives are one of the primary tools states use to try to strengthen their economies. Every state employs a mix of tax incentives, grants, and loans in an effort to create jobs, encourage business expansions, and achieve other goals. When lawmakers consider enacting, renewing, or extending one of these programs, asking three questions can help ensure the best outcome for the state's economy and fiscal health:

- Does the incentive have a clear and measurable goal?
- Is the incentive designed to meet the goal?
- How will we know if we are making progress toward the goal?

1. Does the incentive have a clear and measurable goal?



A clear goal helps policymakers understand how the proposed incentive is intended to benefit the state economy. This statement of purpose, in turn, helps the state assess the program and compare it to other strategies for achieving the same ends. Too often, however, goals are vague. They lack enough specific content to facilitate substantive discussion among policymakers or to provide guidance on how the results of the incentive could be measured. Instead, a tax incentive's goal should:

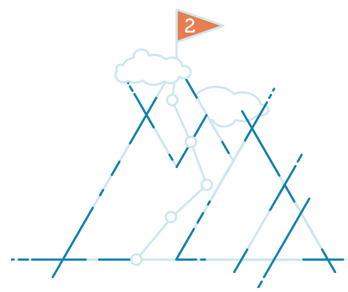
- Be placed in the broader context of the state's economic development plan to help policymakers understand whether the proposal will complement or duplicate existing programs.
- Be measurable and linked to well-defined metrics that will facilitate future rigorous evaluation.
- Explain the logical link between the tax incentive and the desired economic outcomes.

Washington State: Setting Clear and Measurable Goals

Washington state uses a standard framework called "performance statements" when considering new tax incentive programs. Each statement documents the purpose of the tax incentive, how the state will know whether it accomplished its goal, and what data evaluators will need to conduct the review. These performance statements help lawmakers decide whether to support the incentive and help the legislative auditor evaluate the programs in the future.[*]

[*] Washington S.B. 5882 (2013), http://lawfilesext.leg.wa.gov/biennium/2013-14/Pdf/Bills/Session%20Laws/Senate/5882-S.SL.pdf.

2. Is the incentive designed to meet the goal?



When designed and managed well, tax incentives can strengthen a state's economy. But poorly designed ones can cause unintended problems. New incentive proposals should be based on the best available evidence of what works. They should also include provisions to protect the state budget from potential unforeseen outcomes, such as higher than expected fiscal obligations. A well-designed incentive should:

- Encourage new hiring or investment, ensure that any economic growth resulting from the incentive won't be offset by losses to other local businesses, and make certain that benefits from the incentive stay in the state.
- Protect the state budget from costs that increase quickly and unexpectedly.[1]
- Include a plan to monitor and enforce agreements, including performance standards, with companies.

Alabama: Designing Incentives to Meet Goals

A 2017 evaluation of Alabama's Historic Rehabilitation Tax Credit, which had been eliminated in 2016, found it to generally have been a well-performing program but noted that the incentives had been distributed on a first-come, first-served basis.[*] Lawmakers used the evaluation results to restore the tax credit with modifications. The application process now includes an objective assessment to help make sure deserving projects with the strongest economic benefits receive incentives. The new program is also capped at $20 million per year, which ensures that the credit will not cost more than lawmakers intended.[†]

[*] Matthew N. Murray and Donald J. Bruce, "Evaluation of Alabama's CAPCO Credit and Historic Rehabilitation Tax Credit" (January 2017), https://revenue.alabama.gov/wp-content/uploads/2017/05/TaxIncentives_CAPCO_201701.pdf.

[†] Alabama H.B.345 (2017), http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/PrintFiles/HB345-enr.pdf.

3. How will we know if we are making progress toward the goal?

Incentives should be reviewed periodically to make sure they're working well and to identify how they can be improved. Ideally, such reviews should cover the state's full portfolio of business incentives as part of a comprehensive evaluation process. In the absence of this, new incentive proposals can include a requirement for evaluation.[2] A good evaluation plan should:

- Require that the incentive be examined regularly by nonpartisan staff with relevant experience.
- Provide evaluators with data and other resources necessary to carefully assess the economic and fiscal results of incentives, including the extent to which incentives successfully changed business behavior (as opposed to rewarding what companies would have done anyway).[3]
- Include a formal process ensuring that lawmakers will consider how they can improve the incentive based on the findings—for example, by holding legislative hearings on evaluations.

Maine: Measuring Progress Toward Goals

Maine's evaluation process follows best practices. For example, as a result of a 2015 law that requires review of all major tax incentives, the Office of Program Evaluation and Government Accountability (OPEGA) produced a robust analysis of the New Markets Tax Credit in 2017. To conduct the study, OPEGA gathered program-specific data from state agencies, interviewed incentive recipients and other stakeholders, and used economic modeling software. As a result, OPEGA was able to analyze the economic impact of the program and the extent to which results were attributable to it. The report also included recommendations to the Legislature and the agencies that administer the programs.[*] Additionally, OPEGA is required to present evaluation findings to the Joint Government Oversight Committee, which reviews them and offers recommendations for policy reforms to the Joint Standing Committee on Taxation.[†]

[*] Office of Program Evaluation and Government Accountability of the Maine State Legislature, "Tax Expenditure Review Final Report: New Markets Capital Investment Program" (March 2017) https://legislature.maine.gov/uploads/originals/final-nmtc-report-3-6-17.pdf.

[†] Maine Rev. Stat. tit. 3, §§ 998 to 1001, http://www.mainelegislature.org/legis/statutes/3/title3sec998.html.

Conclusion

Before approving a tax incentive proposal, state lawmakers can identify the program's goals and how success will be measured. Program design should be structured to ensure that it is based on best practices for bolstering the economy and that the state budget is protected. Finally, a plan for periodic review of the incentive is needed to make sure it's working well and to identify opportunities for improvement.

Endnotes

1 The Pew Charitable Trusts, “Reducing Budget Risks” (December 2015), http://www.pewtrusts.org/~/media/assets/2015/11/cost-predictability_artfinal.pdf?la=en.

2 The Pew Charitable Trusts, “How States Are Improving Tax Incentives for Jobs and Growth” (May 2017), http://www.pewtrusts.org/~/media/assets/2017/05/edti_how_states_are_improving_tax_incentives_for_jobs_and_growth.pdf?la=en.

3 The Pew Charitable Trusts, “Better Incentive Information” (April 2016), http://www.pewtrusts.org/~/media/assets/2016/04/betterincentiveinformation.pdf.

For further information, please visit:

pewtrusts.org/taxincentives

Contact: Catherine An, communications officer
Email: can@pewtrusts.org
Project website: pewtrusts.org/taxincentives