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Testimony of Josh Goodman
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Chairman Smith and members of the committee, thank you very much for the invitation to testify today. My name is Josh Goodman and I'm a senior officer with the Pew Charitable Trusts. Pew is a public charity that provides research and technical assistance to state policymakers across a range of policy issues. For the last seven years, we have conducted nonpartisan research and analysis on how states can improve the effectiveness of their tax incentives and other economic development programs.

Based on that research, I'm going to talk about three important strategies states around the country are using to get better results. First, states can ensure that incentives are well-designed to maximize their economic effectiveness. Second, states can design incentives with fiscal protections to make sure the programs do not cost more than expected or intended. And third, states can establish regular, independent evaluations of incentives and other economic development programs.

I'll start with economic effectiveness. Designing incentives is complicated work. However, lawmakers around the country are benefitting from a growing body of research that shows what works in economic development. This research points to some straightforward, intuitive steps to help states achieve their economic development goals.

For instance, one insight of the research is that the timing of incentives matters. Businesses generally heavily discount money that they're promised far in the future. One study showed that if you offer corporate executives a dollar ten years from now, they value it at only 32 cents today. As a result, if states offer incentives on shorter time horizons, they can potentially spend less on incentives while having the same impact.

Minnesota's Job Creation Fund is a good example of a program that follows this principle. Once the state's economic development agency approves an application, the business is required to ramp up its activities quickly. Companies must make "reasonable progress" on the projects in six months, reach capital investment thresholds within a year, and hit their job creation goals within two years. Then, businesses can earn incentives for up to five years in the Minneapolis-St. Paul metro area and up to seven years elsewhere in the state, shorter than many similar programs across the country.

Another finding from the research literature is that states should target their incentives to businesses that will grow the state's economy, such as those that sell their goods nationally and internationally. If policymakers are trying to encourage statewide economic growth, they should

avoid providing incentives to businesses that primarily serve a local market such as hotels and restaurants. These businesses compete for customers with other local businesses, so helping one business expand will generally result in job losses elsewhere in the local economy.

Next, I'll move on to fiscal protections. Across the country, states have faced two related challenges when it comes to the budget impact of incentives. In some cases, states have experienced sudden one-year spikes in the cost of incentives. In others, the long-term costs of incentives have grown beyond states' expectations and have begun to crowd out other priorities. Either way, lawmakers can be forced to make difficult choices between raising taxes and cutting spending in other areas to make up the difference.

These challenges are not inevitable, however. Our research points to several strategies that allow states to invest in incentives with confidence that they won't cost more than expected or intended. One effective approach is to set annual cost limits, or caps, on incentive programs. Caps allow lawmakers to determine how much money is available for incentives, in the same way they can adjust spending levels in other policy areas such as education or transportation as part of the annual budget process.

States around the country have capped many incentive programs, including New York's Excelsior Jobs Program and New Jersey's recently relaunched film tax credit. However, lawmakers also often raise reasonable questions about caps. They wonder whether the state will miss out on economic development opportunities if it reaches the cap before the year is over. They also wonder whether caps will contribute to business uncertainty because companies will be unsure whether incentives will be available.

The good news is that some states have designed flexible caps that help alleviate those concerns. For example, in Nebraska earlier this year, the legislature voted to place an innovative cap on the state's largest incentive. Under the amendment, the program would be capped at $125 million a year. But if the program reached the cap for the year, the legislature's Executive Board would have the option of voting to exceed it. This approach offers a way for lawmakers to remain firmly in control of spending on incentives, with the flexibility to pursue extraordinary economic opportunities.

Minnesota's Job Creation Fund shows how states can cap incentives without causing business uncertainty. Under the program, when the state enters into an agreement with a company, it places the dollars to pay the incentives in a state account—guaranteeing that the money will be there when the company fulfills its commitments.

Caps aren't the only strategy to make the costs of incentives more predictable. States have also worked to gather better data on potential costs, so budget writers aren't caught off guard. For example, Iowa's Department of Revenue forecasts the costs of each tax credit five years into the future, with the numbers updated three times a year. These projections are incorporated into official state revenue forecasts. A system like Iowa's depends on effective sharing of data across agencies. It also helps if businesses are earning and using incentives on predictable schedules, so that it's easier to know when state revenue will be impacted.

Third and finally, states should evaluate the effectiveness of their economic development programs. With incentives, the details matter. Subtle decisions—such as how benefits are structured or how states determine which companies are eligible—can make the difference between programs that achieve their goals and ones that prove to be costly disappointments. Evaluations can help you get the details right. They offer evidence of what's working and what isn't and how incentives can be improved.

Around thirty states have approved legislation requiring regular evaluation of tax incentives. In virtually every case, these bills have won strong bipartisan support. They have also brought together supporters and skeptics of incentives alike who agree on the need for better information.

This information helps lawmakers improve policy. For instance, Maine's legislature relied on an evaluation in 2018 to fix a flaw in a program that allowed state businesses to receive incentives merely for promising to create jobs. A tax credit for rehabilitating historic buildings in Maryland received strong marks in an evaluation, so lawmakers decided in 2016 to continue the program beyond its scheduled expiration date. And, in Pennsylvania, lawmakers adopted changes to incentives within months of the state's first evaluations being published under a 2017 law.

To achieve similar results, states should consider the key details for an evaluation process, including who is best positioned to assess the programs, which incentives to include, and over what time period evaluations should occur. For example, many states have adopted multiyear review schedules, an approach that helps lawmakers focus more closely on a subset of incentives each year. To ensure the studies are rigorous, they have tasked economists, auditors, and fiscal experts inside or outside of government with studying the programs.

Let me just conclude by saying that, with the expiration of major New Jersey tax incentives, you have an opportunity to make sure these programs are serving the needs of your businesses, budget, and workers. Our research points to ways to ensure that the next generation of New Jersey economic development programs is effective, accountable, and fiscally sound.

Thank you for the opportunity to discuss our research and I'm happy to answer any questions.