

Slashing Subsidies, Bolstering Budgets:

How States Can Save Money by Targeting Ineffective Economic Development Programs

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Executive Summary

States that are responding to large budget deficits by targeting public employees and slashing vital public services such as education and healthcare are overlooking billions of dollars wasted each year on ineffective programs that provide subsidies to corporations. Although they were enacted in the name of job creation and economic development, these programs often fail as public policies.

As examples of such wasteful subsidies, Good Jobs First profiles ten state programs that have a clear track record of under-performance and suffer fundamental problems such as the following:

They can be very expensive. Some of the programs cost state and local governments enormous amounts of money—in some cases more than half a billion dollars a year. Here are the estimated annual costs of the profiled programs:

- Louisiana: Industrial Tax Exemptions\$745 million
- New York: Industrial Development Agencies.....\$645 million
- New Jersey: Urban Enterprise Zones\$600 million
- Massachusetts: Single Sales Factor\$302 million
- Oregon: Business Energy Tax Credit.....\$150 million
- Michigan: Film Tax Credits\$115 million
- Texas: Texas Enterprise Fund.....\$112 million
- Texas: Emerging Technology Fund..... \$58 million
- Iowa: Research Activities Credit..... \$44 million
- Pennsylvania: Keystone Opportunity Zones..... \$19 million
- TOTAL \$2.79 billion

The \$2.8 billion price tag of these programs is far from a complete tally of ineffective subsidies. The 21 states in addition to Massachusetts that have the Single Sales Factor corporate income tax giveaway are losing at least another \$1.5 billion a year. Many other states, too, have expensive enterprise zone, film tax credit, and other kinds of subsidy programs. Costly property tax abatement and tax increment financing programs are rarely tallied on a statewide basis because their costs are incurred by hundreds of local governments and school districts. Some of the cost estimates above, such as the figure for Pennsylvania's Keystone Opportunity Zones, are understated because they are not fully disclosed.

They have poor or undocumented job-creation/retention results. Most of the programs have been criticized for failing to create or retain many jobs, especially in relation to their costs. Programs such as New Jersey's Urban Enterprise Zones have actually been found to produce zero or even negative job growth. Manufacturing employment has been disappointing in Massachusetts and the other states that have adopted the Single Sales Factor system (sold as a factory job creation panacea).

They disproportionately go to large corporations that need help the least, shortchanging small businesses. In Iowa’s Research Activities Credit program, more than 80 percent of the tax breaks have been going to fewer than a dozen firms, some of them large multinational corporations.

They are going to poverty-wage employers such as retailers. Among the recipients in programs such as New Jersey’s Urban Enterprise Zones and New York’s Industrial Development Agencies have been retailers such as Wal-Mart, which are known for not paying family-supporting wages or benefits. Because of low job quality and the fact that new stores simply relocate consumer spending rather than creating new economic activity, retailing is considered a poor economic development investment.

They have poor accountability practices. Many of the state agencies running the programs do a poor job of tracking how money is spent and whether the desired outcomes are achieved. Sometimes the way performance is defined seems to be deliberately misleading. The Michigan Film Tax Credit program, for instance, counts short-term movie production jobs as if they were permanent positions. The lack of clear standards in Pennsylvania’s Keystone Opportunity Zone program caused one development official to refer to it as “legalized tax evasion.”

Other accountability problems include poor disclosure of recipient data and conflicts of interest. One of the programs—Pennsylvania’s Keystone Opportunity Zones—does not even disclose which companies are receiving the subsidies, much less whether they delivered on jobs. Others have substandard disclosure. The Texas Emerging Technology Fund has been accused of recurring cronyism involving major campaign contributors.

Given these drawbacks, reconsideration of such programs would make sense at any time. In light of the states’ current fiscal emergency, subsidy reform should be a top priority. The reason is not just the immediate cost. The failure of many of the programs to bring about significant job creation means that they are in effect exacerbating the unemployment situation, further harming state finances by depressing payroll-tax collections and heightening the need for safety-net services.

There are precedents for abolishing or curtailing subsidy programs to deal with budgetary problems. In fact, as this report is published, the California legislature is considering abolition of the state’s expensive (\$343 million a year) and poorly performing Enterprise Zone program.

Yet there are still scores of costly and often ineffective programs that remain unexamined and untouched. In fact, in some states, despite persistent deficits and past subsidy failures, diehard advocates of corporate tax breaks are proposing new giveaways.

Eliminating or scaling back these subsidies would by itself probably not solve the budget gap in any state, but it would make a significant contribution to the effort. And it makes more sense than cutting spending on proven public investments such as education and infrastructure that really do generate job creation and economic development.

Introduction

For many years, evidence has been piling up that California's Enterprise Zone (EZ) program, which provides corporate income tax credits for hiring from specified geographic areas, has been a resounding failure. In 2009, the Public Policy Institute of California concluded that EZs have made no measurable contribution to business creation or job growth.¹ The California Budget Project recently published a report finding that:

- The cost of EZ tax credits and deductions has increased by 35 percent per year on average since its inception, costing the state a total of \$3.6 billion.
- Over 70 percent of the total dollar value of EZ tax credits was claimed by corporations with assets of \$1 billion or more in 2008; 90 percent were claimed by corporations with assets of \$10 million or more. It is thus clear that the program is benefiting very few small businesses.
- The EZ program fails to incentivize the net creation of jobs because EZ credits are available for all new hires, not new jobs. In other words, businesses can claim tax credits for filling openings as a result of regular workforce turnover.²

In analyses published in March 2010 and again in February 2011, the California Legislative Analyst's Office (LAO) found that the cost of the EZ program was escalating because tax consultants were encouraging companies to file for EZ retroactively (even claiming credits for workers no longer employed by the companies)—additional evidence that the program provides little incentive to hire.³ In both reports, the LAO recommended that EZs be repealed.

Despite this preponderance of negative performance reviews and an annual cost that was projected to reach \$600 million by 2013, California EZs stayed on the books thanks to intensive lobbying by business groups and tax consultants who make a living helping firms maximize their tax breaks.⁴ As California faced a massive budget deficit, the tide finally began to turn against EZs. Shortly after taking office, Gov. Jerry Brown proposed repealing EZs as part of his budget, and the legislature is expected to vote on that measure soon.

This step would not be unprecedented. In recent years, several other states have abolished or curtailed questionable subsidy programs to deal with budgetary problems. For example:

- Colorado deferred certain enterprise zone investment tax credits for three years.
- Hawaii allowed its poorly designed and very costly High-Tech Tax Credit to expire.
- New York decided to phase out its controversial Empire Zone program, replacing it with the less expensive and more accountable Excelsior Jobs program.

- Oklahoma barred companies from claiming the Investment/New Jobs Tax Credit until 2012.
- States such as Connecticut, Kansas, Kentucky, New Jersey, New Mexico and Wisconsin reduced or eliminated their film production tax credits. Iowa drastically restricted its film subsidy after a scandal erupted over widespread mismanagement and fraud.

Yet there are still scores of expensive and often ineffective programs that remain unexamined and untouched. In fact, in some states, diehard advocates of corporate giveaways are proposing to expand business subsidies despite the considerable evidence they are not working. For example, shortly before declaring a budget emergency and launching an attack on public employee collective bargaining rights, Wisconsin Gov. Scott Walker persuaded the legislature to approve a big increase in the state's Economic Development Tax Credit.

The purpose of this report is to present examples of other programs that deserve close scrutiny. We look at ten state programs that are among the country's most wasteful and ineffective subsidies:

- Iowa: Research Activities Credit
- Louisiana: Industrial Tax Exemptions
- Massachusetts: Single Sales Factor
- Michigan: Film Tax Credits
- New Jersey: Urban Enterprise Zones
- New York: Industrial Development Agencies
- Oregon: Business Energy Tax Credit
- Pennsylvania: Keystone Opportunity Zones
- Texas: Emerging Technology Fund
- Texas: Texas Enterprise Fund

Some are astronomical in size—with annual costs of more than half a billion dollars—while others are “only” in the tens of millions.

Tax expenditures, which dominate the profiled programs, dwarf appropriations for economic development in most states. They account for most of the estimated \$65 billion that state and local governments spend on subsidies each year.⁵

What the ten programs reviewed below have in common is that they all involve the diversion of taxpayer dollars into private pockets with limited or no economic development benefits. For those who suspect that government spending is wasteful and that states need to “watch the store” more carefully, programs like these should be prime targets.

Corporate Subsidies as Budget Sinkholes

Iowa: Research Activities Credit

During the past two years, the big subsidy controversy in Iowa has been its scandal-ridden film tax credit program. With that under control, another dubious giveaway is receiving increased scrutiny: the Research Activities Credit (RAC).

State R&D tax credits are common, and they usually are not among the most controversial subsidy programs. Iowa, however, is one of only a handful of states that make such credits refundable, meaning a company receives a cash payment for any year when its credits exceed its tax liability. This increases and accelerates the cost of the program and increases the state's risk of never breaking even (other states instead allow companies to carry unused credits forward). In 2010 the state paid out more than \$44 million in such refunds.⁶

RAC has been around since 1985, but it was not until 2005 that the state began tracking the credits and evaluating their effectiveness. A 2008 report by the Iowa Department of Revenue reached some startling conclusions⁷:

- Although about 150 firms filed RAC claims each year, just ten were receiving, on average, 82 percent of the RAC dollars.
- Of the total RAC credits claimed by corporations, 92 percent consisted of cash refunds.
- An attempt to measure the economic impact of the credits was inconclusive.

Picking up on the Department of Revenue's findings, the Iowa Fiscal Partnership issued a report arguing that the state should at least limit the amount a single corporation could receive in RAC refund checks.⁸

The shortcomings of RAC were highlighted again in a 2010 report by two Iowa State University economists. They showed that, despite RAC, Iowa was failing to keep pace with the rest of the nation in creating high-tech jobs and firms.⁹

In February 2011, when the Department of Revenue released its annual RAC report¹⁰—which must now include the names of companies claiming credits of \$500,000 or more—the Iowa Fiscal Partnership resumed its criticism on the program. Noting that three large and profitable companies—Rockwell Collins, Deere and DuPont—had by themselves claimed a total of \$32.9 million from RAC while paying no state corporate income tax in Iowa, the group called the program a “fiscal scandal.”¹¹

Louisiana: Industrial Tax Exemptions

For more than 70 years, Louisiana has been awarding large property tax breaks on industrial facilities. And for many years, critics have been calling this practice—in which one centralized state board exempts companies from paying taxes to local parish governments and school districts—a costly and inequitable way of promoting economic development. The cost in lost tax revenues has been enormous. In 2009 alone, the Louisiana Board of Commerce and Industry approved Industrial Tax Exemptions (ITEs) worth more than \$745 million over ten years.¹²

In 1992 the Louisiana Coalition for Tax Justice published a scathing critique of the way the ITE program operated in the 1980s.¹³ The group found that during that decade the state provided more than \$2.5 billion in tax exemptions through ITEs, with more than half going to industrial giants such as Exxon, Mobil (before they merged), Dow Chemical and International Paper as well as major utilities. Besides subsidizing big polluting companies that did not really need them, the report found, almost three-quarters of ITE projects created no new permanent jobs; some did not even create temporary construction jobs.

The Coalition no longer exists, but the controversy over ITEs has continued. In 2002 Legislative Auditor Dan Kyle criticized the state for not adequately monitoring costs and benefits relating to ITEs and to Enterprise Zones, writing in an audit that “critical management controls, which would help prevent abuse of the programs, are not in effect for either program.”¹⁴

In 2007 St. Charles Parish Assessor Clyde Gisclair lashed out against the Board of Commerce and Industry for awarding ITEs to businesses not engaged in manufacturing, saying that the practice had contributed to a sharp decrease in the portion of corporate properties on the tax rolls. “Over the past 20 years,” he said “\$3.9 billion of fair market value has disappeared from our tax rolls.”¹⁵

ITEs are examples of the tax expenditures that groups such as the Louisiana Budget Project argue must be considered as the state addresses its current budget shortfall.¹⁶ A new coalition called Better Choices for a Better Louisiana is making the same argument. Dealing with ITE would do a lot to address Louisiana’s state and local fiscal problems.

Massachusetts and elsewhere: Single Sales Factor

What company wouldn't like to change the way it computes its taxable income so that its state income tax bill drops 80 or 90 percent, or disappears altogether? All in the name of jobs, except that no new jobs—or even retained jobs—are required. That’s Single Sales Factor (SSF), an enormous tax break that large manufacturers and sometimes other kinds of companies have won in 22 states, most recently California, New Jersey and Arizona.

Companies operating in multiple states need to assign, or apportion, a share of taxable income to each of those states. Traditionally, states agreed upon a formula that required such companies to average the share of property, payroll and sales it had in a state and

then assign that share of income to the state. So a company selling nationally with a large physical presence (e.g. headquarters and warehouse) in a medium-sized state might have 40 percent of its property, 50 percent of its payroll and 3 percent of its sales there. Those rates average 31, so the company would pay income taxes on 31 percent of its profits to that state. However, under SSF, the single factor used is sales, so the company would pay taxes on only 3 percent of its income—more than a 90 percent tax cut, no strings attached.

SSF has been consistently sold as an economic development silver bullet, but because it does not require the involvement of any economic development agencies and is often not even accounted for as a tax expenditure, it eludes notice after being enacted.

Twenty-five years ago, only two states—Iowa and Missouri—used SSF. After intensive corporate lobbying campaigns, the number of SSF states has soared. Total tax revenues being lost through SSF cannot be calculated precisely, given the lack of data in many states, but there are indications the annual cost now exceeds \$1.5 billion.

One of the states that helped to get the SSF bandwagon rolling was Massachusetts. In 1995 defense contractor Raytheon threatened to move manufacturing operations out of the state unless it got a package of tax breaks, including SSF. The company's demand for defense firms grew into a demand for all manufacturers.¹⁷ Mutual fund giant Fidelity Investments sought and won similar treatment for mutual fund companies the next year.

In Massachusetts, as in other states that have adopted SSF, the change was promoted as a way to boost or at least retain manufacturing employment. Yet in the years after its enactment, Raytheon eliminated thousands of jobs in Massachusetts. Many other manufacturing companies did the same. In a January 2000 assessment of how SSF had fared, the *Boston Globe* wrote that “there's scant evidence that the policy has worked as advertised.”¹⁸

The same goes for other states. In a detailed assessment of SSF, Michael Mazerov of the Center on Budget and Policy Priorities found that SSF states have not performed any better than the rest of the country with regard to manufacturing employment. He notes that critics of SSF label the practice “payoffs for layoffs.”¹⁹

Massachusetts is one of the states that calculate how much tax revenue is being lost each year due to SSF. For fiscal year 2010, the Department of Revenue estimates the cost at \$301.9 million.²⁰ That doesn't seem to faze business advocates. The Greater Boston Chamber of Commerce, for instance, has proposed extending SSF to even more types of companies.²¹

Michigan: Film Tax Credits

Michigan is saddled with an expensive and uncapped film subsidy program that has generated a great deal of controversy. Critics say that it has lost tens of millions of dollars for the state, overstated job creation outcomes, paid companies to actually spend out of state, and subsidized fraudulent activities.

Michigan offers a set of subsidies enabling film producers to get the public to pay up to 42 percent of a film's production costs. That is many times what a national film release might owe Michigan, but the program allows producers to sell those credits for cash to companies that do owe the state income tax. Michigan does not disclose which companies purchase film tax credits. In Oregon, the biggest beneficiary of a salable tax credit for renewable energy turned out to be Wal-Mart.²²

Film tax credits have proven to be a serious fiscal drain. In 2010, Michigan's program awarded \$115 million in subsidies.²³ The total in the three years since the program was created has been \$361 million. In 2008, \$40 million in tax credits were claimed, but they generated only \$5 million in additional state revenues, meaning that the state experienced a net revenue loss of about \$35 million.²⁴ In 2009, the net revenue loss was estimated at \$61 million. For the current fiscal year, the program is projected to reduce the state's General Fund gross revenue by \$126 million.²⁵

The Michigan Film Office (MFO) continues to paint a rosy picture by producing misleading reports bragging about creating thousands of jobs. In truth, nearly all those jobs are part-time during brief periods of production, the average duration being 23 days. If converted to a full-time equivalent (FTE) job, the numbers look dismal. The 2,350 jobs the MFO claimed were created in 2008, if measured as FTEs, drops to 216.²⁶ The 2009 figure of 3,867 jobs equates to 356 FTEs. That means the cost per job was \$189,519 in 2008 and \$193,333 in 2009. The federal government caps the cost per job created on one of its common subsidy programs at \$35,000, less than a fifth what film subsidies cost Michigan.²⁷

And not all those jobs were located in Michigan. The law is written so that many out-of-state expenditures count toward the tax credits. Almost half of the qualified film expenditures made in 2008 through the Media Production Credit were made outside Michigan. Of the \$48 million in credits claimed during 2008, about \$23 million did not contribute at all to the state's economy.

Last year, a scandal broke after an investigation by the state attorney general. Two developers involved in the subsidized Hangar 42 film studio project were eventually convicted of defrauding the state by inflating the value of property eligible for credits. Higher values allowed for a larger tax break worth more than the actual value of the property.²⁸ Additionally, a state senator's chief of staff resigned after bragging about utilizing tax incentives to make millions on the deal.²⁹

According to a state audit of the program, "any probable impact from the film incentives is likely to have a negligible impact on economic activity in Michigan. As is true for most tax incentives, the film incentives represent lost revenue and do not generate sufficient private sector activity to offset their costs completely."³⁰ These broad criticisms have been echoed by groups ranging from the Center on Budget and Policy Priorities on the left to the Tax Foundation and The Mackinac Center on the right.

New Jersey: Urban Enterprise Zones

New Jersey's Urban Enterprise Zone (UEZ) program is one of the state's most expensive economic development tax expenditures and is arguably one of its least effective job creation programs. It operates by using a combination of hiring and investment tax credits against the Corporate Business Tax, sales tax reductions and exemptions, and property tax abatements.

A comprehensive assessment of the program was released in February 2011.³¹ An independent consultant to the state found that between 2002 and 2008:

- The program produced a negative return on investment – the state generated just 8 cents in new tax revenues for every \$1 invested;
- Increases in UEZ business employment were due to factors other than state and local UEZ subsidies;
- All 37 UEZ municipalities were in the bottom 10 percent of distressed cities in the state; and
- Participating businesses demonstrated a net loss of over 2,200 jobs during the study period.

The total cost of New Jersey's UEZ program is difficult to determine for a number of reasons. There is no official annual reporting on the value of sales taxes forgone through the program, though a performance audit of UEZs issued in 2009 determined the average annual sales and use tax expenditures to be \$199 million between 2003 and 2008.³² The value of tax abatements granted through the UEZ program is described in annual reports issued by the Division of Taxation. The most recently available figure for this expenditure is a staggering \$439 million in 2008.³³ A rough sum of these various state and local tax expenditures suggest the total program cost to be upwards of \$600 million per year.

As is the case with other state enterprise zone programs, there are documented examples of local abuses and mismanagement of UEZ funds. The value of tax benefits bestowed on UEZ businesses is not tracked by the state, but a list of participating companies demonstrates that there are a number of major retailers (Target, Home Depot, IKEA, Wal-Mart) taking advantage of the program. Subsidizing retailers fails to generate new sales tax revenues because it does not create new consumer demand – it only subsidizes stores to shift low wage retail jobs to different locations. Major financial sector companies that have reaped UEZ tax benefits include Citigroup, JPMorganChase, Vanguard, and Merrill Lynch.³⁴

The UEZ program has been criticized in a series of state audits for failing to set measurable goals or track outcomes.³⁵ A performance audit issued in April 2010 recommended ending the 50 percent sales-tax reduction.³⁶ The independent program assessment issued this year advocates for its elimination based on its enormous cost to the state and its failure to produce economic growth. Looking to shore up the state budget, the Christie administration is eyeing the UEZ program for surplus funds.³⁷ The Governor's current

proposal is to recapture \$100 million in unencumbered UEZ funds that were generated by the zones, but not to repeal the program.

New York: Industrial Development Agencies

Until last year, the obvious choice for the worst subsidy in New York state would have been its costly and wasteful Empire Zone program. The state legislature voted to bar new entries into the program as of June 30, 2010 and replace it with the more accountable and less expensive Excelsior Jobs Program.

Now at the center of negative attention are the state's Industrial Development Agencies, which have been in existence for 40 years. Strictly speaking, IDAs are not a program but rather a system of more than 100 decentralized entities that award lavish state sales tax exemptions and local property tax abatements. Among the largest recipients have been Wal-Mart, IBM, the New York Yankees and a slew of Wall Street banks. New York's Fiscal Policy Institute estimates that the IDAs cost New York's state and local governments about \$645 million annually.³⁸

The IDA system has been the subject of repeated criticism by watchdog groups such as Good Jobs New York and New York Jobs with Justice (NYJWJ). An August 2010 report by NYJWJ and Urban Agenda found that as IDA tax expenditures rise, the job creation results actually get worse. For example, in 2008 (the latest year for which data were available), IDA tax breaks went up \$61 million while job creation fell by more than 30,000 positions from the year before.³⁹ Even official reports acknowledge the shortcomings of IDAs. The state comptroller's latest report on IDA performance notes that "inconsistent project monitoring continues to raise questions about the costs versus benefits of IDA job creation."⁴⁰

Watchdog groups have also criticized IDAs for not doing more to promote the creation of quality jobs and for inadequate disclosure (though groups such as Good Jobs New York have won some significant reforms in the operations of the NYC IDA). In February 2011 testimony before a budget hearing of the state legislature, NYJWJ/Urban Agenda Executive Director Matt Ryan said: "With no high road performance standards, or strong accountability and transparency measures, it is no wonder that job creation and broader economic development goals of IDAs often go unmet."⁴¹ The subtitle of the NYJWJ/Urban Agenda report calls IDAs a "failure."

Oregon: Business Energy Tax Credit

Oregon's Business Energy Tax Credit (BETC, pronounced "Betsy") was originally a traditional energy incentive program designed to promote conservation and efficiency. It was modified in 2007 to additionally subsidize manufacturers in renewable energy industries with corporate income tax credits of 50 percent of capital investment (the credits are not tied to job creation).⁴² Since new facilities and start-up companies often

have no need for income tax credits because they are not yet profitable, BETC recipients can sell their credits to “pass-through” partners that do owe Oregon income tax. The 2007 program expansion allowed wind and solar companies to each claim up to \$20 million for manufacturing and \$10 million for wind projects.⁴³

One of the biggest problems is the program’s cost. The state tax expenditure budget estimates biennial BETC spending (including energy efficiency and conservation projects) to be \$144 million. However, this figure is criticized as being grossly understated.⁴⁴ Tax Fairness Oregon, a fiscal watchdog organization, estimates that the state Department of Energy will award \$500 million in tax credits during this same period, and *The Oregonian* estimates the state’s cost at \$150 million per year.⁴⁵ Because the credits must be taken over five years, much of the cost is pushed to the future.

BETC has been the subject of various controversies. One involved reports that operators of single wind farms were dividing them up into different projects to get multiple credits. *The Oregonian* disclosed that the single largest purchaser of BETCs in the state was the giant retailer Wal-Mart, which as a pass-through entity reduced its tax bill by \$11 million after purchasing tax credits awarded to solar companies. The process of passing-through tax credits is problematic, because even credits awarded to companies that shut down production or lay off employees retain their value after they are sold.⁴⁶

Another major drawback of BETC is the fact that recipients are not required to create jobs. According to *The Oregonian*, the state has no information on the number of jobs created by recipients, with the exception of solar equipment manufacturing companies.⁴⁷ In the few cases where an estimate of job creation is provided, the performance tends to be poor. A recent award to a company called SoloPower is expected to cost the state \$129,000 per job; an earlier award to Sanyo Solar came in at \$225,000 per job.⁴⁸ BETC has become such a problem that even the director of Business Oregon, the state’s economic development agency, is advocating wholesale reform of the program.⁴⁹

Pennsylvania: Keystone Opportunity Zones

Pennsylvania’s Keystone Opportunity Zone (KOZ) program exempts, credits, waives, reduces, diverts, and abates an incredible variety of state and local taxes for businesses investing or expanding in designated areas. At the state level these include sales and use tax, personal income tax, corporate net income tax, capital stock franchise tax, and banking and trust company shares tax. Local tax benefits can be determined by the local jurisdiction, but typically relate to business gross receipts tax, net profits tax, business privilege tax, occupancy or use tax, mercantile license tax, and local sales and use tax under construction contracts. Despite the substantial cost of the KOZs, the state fails to track whether or not the program is successful at creating jobs.

The KOZ program was established in 1998 and has proliferated into 12 zones and nearly 200 sub-zone areas since then. Specific zone sunset dates are dependent upon when they were established. A major evaluation of the program conducted by the state Legislative and Budget Finance Committee (LBFC) in 2009 found that:

- The total cost of the KOZ program was not known and could not be reliably estimated;
- 70 percent of KOZ acreage had not been developed; and
- 75 percent of KOZ participants reported no job creation activity⁵⁰

Although KOZ applications are approved by the Department of Community and Economic Development (DCED), the program is primarily administered at the local level. Counties, municipalities, and regional KOZ administrators determine the locations of the zones and the duration of the tax benefits, and control and direct the development that occurs in the zones. Regional governing entities also make decisions about which local taxes may be abated or exempted in each zone and monitor business performance. This decentralized oversight structure makes KOZs especially unaccountable.

The decentralization of the program also makes costs difficult to calculate. The state discloses the price tag of KOZ tax credits, which reached a high of \$59 million in fiscal year 2008-09.⁵¹ Recently reported tax credit costs have fallen to \$19 million.⁵² These costs fail to include local tax expenditures made through the program, which likely dwarf the already substantial state tax expenditures. For comparison, total program expenditures in neighboring New Jersey's Urban Enterprise Zone program are estimated to be greater than \$600 million per year.⁵³

Although Pennsylvania's "Investment Tracker" economic development subsidy database covers most of the state's programs, it contains no information about KOZ subsidy recipients. The Legislative and Budget Finance Committee found no evidence that DCED was tracking job creation outcomes or capital investment in KOZ properties.⁵⁴ In fact, DCED records could not even accurately determine the number of active KOZ participants. Loose program guidelines have allowed KOZ tax benefits to be awarded to dubious recipients such as bars and even an adult entertainment facility.⁵⁵ The program has additionally been criticized for fueling sprawl by establishing KOZs in greenfields, pitting suburban and exurban communities against urban areas in need of reinvestment, eroding school budgets, and subsidizing the creation of poverty-wage jobs.⁵⁶ The program's lack of clear standards caused one development official to refer to the program as "legalized tax evasion."⁵⁷

Texas: Texas Emerging Technology Fund (ETF)

The Emerging Technology Fund is a controversial subsidy program intended to attract high-tech capital investments and jobs to Texas. Its features include corporate subsidies, public investment in private corporations, and grants to universities. The program is riddled with conflicts of interest, transparency problems, and a lack of evidence supporting its effectiveness.

Created in 2005 by the legislature at the request of Gov. Rick Perry, ETF is structured as a public-private partnership with a 17-member board appointed by the governor and

serving at his pleasure. To date, the fund has spent \$320 million.⁵⁸ In the 2008-2009 biennium, the cost was \$117 million, or about \$58 million per year.

Critics worried that putting millions of dollars in the hands of an entity essentially controlled by the governor would lead to conflicts of interest. It later became evident that those concerns were warranted. A series of investigative reports by the *Dallas Morning News* revealed that eight companies received \$16 million from ETF after their investors or officers made significant campaign contributions to Gov. Perry.⁵⁹ At least one member of the ETF board made personal investments in companies it had approved for subsidies. The executive director of the Texas Life-Sciences Collaboration Center stated that "there's a lot of suspicion that there's more political influence than meets the eye."⁶⁰

Two especially worrisome connections concern David Nance and Alan Kirchoff. After serving on the initial ETF board, Nance—a major contributor to Perry—founded Convergen Lifesciences, which received \$4.5 million in ETF subsidies.⁶¹ Convergen got the award from the state board even though its application had been rejected by a regional screening body.⁶²

Kirchoff, described by the *Dallas Morning News* as having “a checkered financial history,” was appointed ETF executive director by Gov. Perry in 2008.⁶³ He and ETF board member William Morrow are reported to have used information submitted by ETF applications to make lucrative private investments.

Apart from the ethics issues, ETF has been criticized by the State Comptroller, among others, for its poor quality of disclosure and lack of measurable results.⁶⁴ The only measureable outcome is the amount of capital it has attracted to the state. By that measure, the Comptroller points out, ETF looks bad. It costs the state much more to attract capital than every other subsidy program. In some instances, the state spends \$1,900 to attract \$1,000 of capital investment.⁶⁵

Ultimately, the question remains: should government spend scarce resources on a program with such unsubstantiated, sometimes dubious, results? Legislators seem to think not. Current budget bills seek to slash ETF spending and take control of it out of Gov. Perry’s hands.⁶⁶ One bill proposes axing the program altogether.⁶⁷

Texas: Texas Enterprise Fund (TEF)

The Texas Enterprise Fund, which makes big cash grants, is an example of press release economics at its worst: after ribbon-cutting ceremonies, promised job creation often fails to materialize. Critics have depicted it as a “phantom jobs” program. Worse, in an effort to quiet bad publicity, the Governor has let under-performing companies off the hook by relaxing benchmarks and not enforcing contracts, costing taxpayers millions.

TEF was created in 2003 at the request of newly elected Gov. Rick Perry. The law grants him enormous power to hand out and oversee large corporate subsidies, such as \$50 million awarded to Texas Instruments. Although much of the money for TEF is

appropriated every two years in the legislature, at least \$162 million has been taken from the state's Unemployment Insurance fund.⁶⁸ Texas had to borrow \$1.3 billion in 2009 to keep the fund afloat.⁶⁹ In the 2008-2009 biennium, the cost of TEF was \$225 million, or about \$112 million per year.

To date, the program has awarded \$412 million in subsidies to companies.⁷⁰ Over a quarter of that money, \$119 million, went to firms that failed to create promised jobs. However, the Governor's office only clawed back about a sixth of the money, totaling \$21 million.⁷¹ The poor performance was confirmed in an investigative report by Texans for Public Justice, which found that two out of every three projects that promised to create jobs failed to meet those promises by 2009.⁷² And the jobs that were created were often low-quality, with many paying less than \$27,000 a year.⁷³

Microchip consortium company Sematech was not penalized after breaking its TEF contract and locating jobs out of state. The state did not take back any of the \$15 million it gave to Washington Mutual, even though Citibank, which bought the bankrupt financial company, continues to fall short on job creation pledges. Worse, the Governor looked the other way when reports were submitted that included part-time jobs, which are not supposed to count toward benchmarks in TEF contracts.

Even members of the Governor's own party have been critical of the program. U.S. Senator Kay Bailey Hutchinson has called for an independent audit of TEF, stating: "Texans have been offered a disturbing glance into the activities of the Texas Enterprise Fund. For the first time, we have learned of taxpayer-funded contracts being canceled, changed to redefine 'success' and actually sending our money overseas to create jobs. This is unacceptable."⁷⁴

Current budget bills propose slashing TEF's funding and taking control away from the Governor. One bill would dismantle the program.⁷⁵

Conclusion

The preceding profiles of selected programs show that simply making subsidies available to companies is no guarantee that robust economic development and quality job creation will ensue. The following are the key problems that taint these programs:

They can be very expensive. Some of the programs end up costing state and local governments enormous amounts of money—in some cases more than half a billion dollars a year. Here is a summary of the estimated annual costs of the ten profiled programs:

- Louisiana: Industrial Tax Exemptions.....\$745 million
- New York: Industrial Development Agencies.....\$645 million
- New Jersey: Urban Enterprise Zones.....\$600 million
- Massachusetts: Single Sales Factor.....\$302 million
- Oregon: Business Energy Tax Credit.....\$150 million
- Michigan: Film Tax Credits.....\$115 million
- Texas: Texas Enterprise Fund.....\$112 million
- Texas: Emerging Technology Fund.....\$58 million
- Iowa: Research Activities Credit.....\$44 million
- Pennsylvania: Keystone Opportunity Zones.....\$19 million
- TOTAL.....\$2.79 billion

The \$2.8 billion price tag of these programs is far from a complete tally of ineffective subsidies. The 21 states in addition to Massachusetts that have the Single Sales Factor corporate income tax giveaway are losing at least another \$1.5 billion a year. Many states other than those detailed here also have expensive enterprise zone, film tax credit, and many other kinds of subsidy programs. Costly property tax abatement and tax increment financing programs are rarely tallied on a statewide basis because their costs are incurred by hundreds of local governments and school districts. It should also be noted that some of these cost estimates, such as the one for Pennsylvania’s Keystone Opportunity Zones, are understated because they are not fully disclosed.

They have poor or undocumented job-creation/retention results. Most of the programs have been criticized for not creating or retaining an adequate number of jobs, especially in relation to their costs. Programs such as New Jersey’s Urban Enterprise Zones have been shown to produce zero or even negative job growth. Manufacturing job performance has been disappointing in Massachusetts and the other states that have adopted the Single Sales Factor system.

They give a substantial portion of the subsidies to large corporations that probably do not need them. In Iowa’s Research Activities Credit program, more than 80 percent of the benefits have been going to fewer than a dozen firms, some of them large multinational corporations.

They are going to low-wage employers such as retailers. Among the recipients in programs such as New Jersey's Urban Enterprise Zones and New York's Industrial Development Agencies have been retailers such as Wal-Mart, which are not known for paying family-supporting wages or benefits. Because of low job quality and the fact that new stores simply relocate consumer spending rather than creating new economic activity, retailing is considered an inferior form of economic development.

They have poor accountability practices. Many of the programs do a poor job of tracking how money is being spent and whether the desired outcomes are being achieved. Sometimes the performance measures provided seem to be deliberately misleading. The Michigan Film Tax Credit program, for instance, counts short-term movie production jobs as if they were permanent positions. The lack of clear standards in Pennsylvania's Keystone Opportunity Zone program caused one development official to refer to it as "legalized tax evasion."

Other accountability problems include poor disclosure of recipient data and conflicts of interest. One of the programs—Pennsylvania's Keystone Opportunity Zones—does not disclose any information about which companies are receiving the subsidies. Others have substandard disclosure.⁷⁶ The Texas Emerging Technology Fund has been accused of recurring cronyism involving major campaign contributors to Gov. Rick Perry.

As state governments grapple with painful budget decisions in 2011 and 2012, wasteful spending such as the programs detailed here deserve the attention of taxpayers and their elected officials. Tax expenditures enacted in the name of economic development, which can be both extremely costly and very opaque, deserve the same level of scrutiny as appropriations. Programs that fail to create jobs, or to create family-supporting jobs, are a needless drag on an already-depressed economy. Public officials should look to failed economic development programs as a way to preserve funding for investments such as education and infrastructure that are proven long-term generators of economic development.

Appendix

Among the main types of state subsidies are:

- *Corporate income tax credits* – dollar-for-dollar reductions in state taxes on corporate income linked to job creation, capital investment, research and development, film/television production or other measures. The most expensive of these are refundable credits: if a company’s credits exceed its tax bill, the state pays out the difference in cash.
- *Enterprise zones* – designated geographic areas in which companies making investments are entitled to multiple tax breaks (e.g., for taxes on property and equipment).
- *Sales tax exemptions* – exemption from or reimbursement for sales taxes on the purchase of construction materials and/or equipment for new or expanded facilities.
- *Cash grants* – direct payments to companies making new investments, often from “deal closing” funds under the control of the governor’s office.
- *Low-cost capital financing and loan guarantees* – low-interest loans made cheap because the interest paid is tax-free income (loans may be treated as forgivable if a company meets and sustains certain targets).
- *Reimbursement for worker training expenses* – direct payments to companies for training costs or payments to community colleges or other institutions that do the training for employees of specific firms.

State subsidies are often bundled with other subsidies that are granted by local governments based on powers they have under state law, such as:

- *Property tax abatements* – long-term exemptions from or reductions in corporate taxes on real property (land and buildings) and/or business personal property (equipment and vehicles).
- *Tax increment financing (TIF)* – the diversion of the incremental increase in property, sales and/or other taxes generated by a project to subsidize redevelopment of a specified district that may be occupied or dominated by a single project or company.
- *Sales tax rebates* – payment to big-box retailers or retail-space developers of all or some of the increased sales tax revenue generated by their new store.
- *Infrastructure improvements* – addition of or improvements to roads, sewer and/or water lines.

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