

Do Tax Breaks Boost Growth?



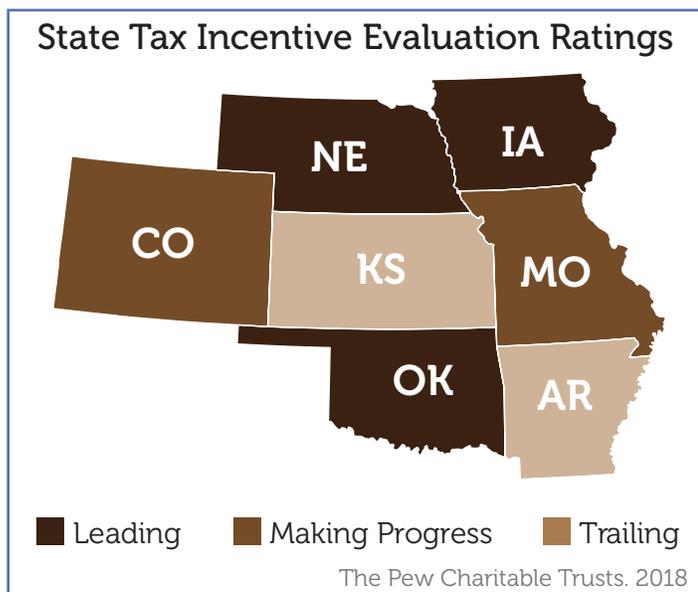
Kansas spends tens of millions on economic incentives annually, but without regular evaluation of the programs, it is difficult to know whether they meet their intended goals. Several proposals from lawmakers would help increase transparency around economic incentives and their effects.¹ Increased transparency about the cost, impact and goals of economic incentives can lead to stronger, more evidence-based policymaking.

Report shows Kansas trailing other states in tax incentive evaluation.

A report from Pew Charitable Trusts² measures states on their evaluation process for tax incentives. A majority of states have enacted policy to evaluate tax incentives. In our seven-state region, all states except Kansas and Arkansas are either leading and making progress. Kansas is out of step, nationally and regionally, by not developing policy to mirror best practices.

Understanding the Ratings

- **Leading states** have well-designed plans to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices. (12 states)
- The states that are **making progress** have made a plan by enacting a policy that requires regular evaluation of major tax incentives. (17 states)
- The **trailing states** lack a well-designed plan to regularly evaluate major tax incentives. (22 states)



Evaluations can tell us what types of incentive programs work.

Through the evaluation process, states can determine which incentive programs are working well. For effective programs, the evaluation process documents their success and could encourage policymakers to maintain or increase investment. For ineffective programs, policymakers can make adjustments to improve the program or redirect the funds to other programs. The evaluation process looks for prospective changes and does not punish current recipients but identifies opportunities to improve moving forward. The evaluation process can lead to better policy and investment in the state.

- **Find opportunities to strengthen the program:** In 2016, Maryland policymakers were deciding whether to continue a historical preservation credit. The legislative staff evaluated the program, recommended potential improvements to the tax credit, and identified strengths of the program. As a result, policymakers continued the program for an additional five years, while making adjustments based on the feedback.
- **End wasteful spending:** In Florida, the Enterprise Zone Program ended after the evaluation process found a weak return on investment compared to other incentives.³

Evaluations can tell us what types of businesses are getting incentives.

- By increasing transparency and examining business tax incentives, policymakers can gain a better understanding of how business tax incentives are distributed. A Good Jobs First report⁴ found the Promoting Employment Across Kansas (PEAK) program overwhelmingly favored big businesses.⁵ Of the money allocated by the PEAK program, 81 percent of the deals, and 95 percent of the total funds, went to big businesses.
- While big businesses benefit the most from economic development incentives, the size of the business does not affect job creation. Nationally, nearly all net new jobs created are from businesses that are less than five years old.⁶ Policymakers should support the firms responsible for job creation.

Evaluations can tell us if tax incentives create jobs.

- Research evaluating the PEAK program shows there is no noticeable difference in job creation between firms that received PEAK incentives and similar firms that did not receive PEAK incentives. The study also found “firms relocating to Kansas, with or without incentives, do not experience job growth at higher rates than existing firms.”⁷
- Many of the firms receiving PEAK incentives are not creating jobs but instead transferring jobs across the border between Kansas and Missouri.⁸ One study examining two counties in Kansas and one county in Missouri found this border war of moving jobs across states lines created a net gain of 414 jobs to Kansas, at a cost of roughly \$340,000 per job.⁹

Problems in evaluating tax incentives include data limitations and lack of transparency. There is a balance between evaluation and protecting confidential information. Luckily, programmatic evaluation can be done without revealing confidential information, such as tax returns.

It can also be difficult to measure the effectiveness of tax incentives. How can you determine whether a business moved to the state, or grew, solely because of the tax incentive? If companies receive incentives when they are already planning an expansion, is the incentive truly responsible?¹⁰ Lawmakers should consider these measurement problems as they develop evaluation tools.

How should we evaluate tax incentives?

The Pew Charitable Trusts, through its research on economic incentives, offers the following suggestions to states¹¹, suggestions echoed by the Kansas Legislative Division of Post Audit report.¹²

- Make a plan to evaluate the results of all major incentives on a regular schedule.
- Measure the impact of these programs using high-quality evaluations.
- Inform policy choices with evaluation findings to improve the effectiveness of tax incentives.

Kansas is not meeting any of the best practices outlined by The Pew Charitable Trusts and the Kansas Legislative Post Audit report. Several bills currently working their way through the Legislature represent a productive first step in meeting these best practices.

The evaluation process should be conducted by a nonpartisan, neutral committee. The best evaluations come from programmatic bodies, with economic analysis expertise, that have the authority to make policy recommendations. In Kansas, the ideal institution to

conduct the evaluation would be the Kansas Legislative Post Audit, to be reviewed and acted upon by the Kansas Legislature.

Evaluation of tax incentive programs can accomplish three things. First, the evaluation will help shed light on the success or failure of these programs. Second, the evaluation will help policymakers be good stewards of Kansas’ resources and identify the most effective ways to bolster job creation. Third, the evaluation process creates a regular schedule for review of tax incentive programs, which provides stability for developers and investors, as they can predict when programs will be reviewed. Regardless of whether you support tax incentive programs, the evaluation process can provide needed insight. If the program is working well, then the evaluation process will help educate stakeholders about the strength of the program. If tax incentives are found to be ineffective, policymakers can make needed fixes and engage in other approaches to encourage job growth and entrepreneurship across the state. However, evaluation of these programs can only be done effectively if the desired outcomes of each program are clearly defined.

The Kansas legislature should develop evaluation processes for tax incentive programs to increase transparency, measure effectiveness, and ensure a return on investment of economic development tools.

Measuring Incentives Against Non-Incentives

It is important when assessing tax incentive programs to compare the results of the programs with the potential results of other policies that were not implemented. Indicators to consider include revenue, net new job creation, and cost effectiveness.¹³ In addition, an evaluation comparing incentive programs should have information about incentives given, as well as incentives not given.¹⁴ A control group of non-incentive firms is necessary because, to understand the effect of the incentives, you need to have information about similar firms that did not receive incentives to compare results. This evaluation can be done “after the fact for program evaluation, or prior to implementation by using existing firms as a benchmark to evaluate an incentive program.”¹⁵

SOURCES

¹ See HB 2752; HB 2753; SB 448.

² The Pew Charitable Trusts. "How States Are Improving Tax Incentives for Jobs and Growth." 2017. <http://www.pewtrusts.org/en/research-and-analysis/reports/2017/05/how-states-are-improving-tax-incentives-for-jobs-and-growth>

³ The Pew Charitable Trusts. "How States Are Improving Tax Incentives for Jobs and Growth." 2017. <http://www.pewtrusts.org/en/research-and-analysis/reports/2017/05/how-states-are-improving-tax-incentives-for-jobs-and-growth>

⁴ LeRoy, Greg, et. al. "Shortchanging Small Business: How Big Businesses Dominate State Economic Development Incentives." Good Jobs First. 2015. <https://www.goodjobsfirst.org/short-changing>

⁵ Defined as a business with greater than 100 employees, or a company of any size that is not independently and locally owned, or has 10 or more establishments.

⁶ Haltiwanger, John, Ron S. Jarmin, and Javier Miranda. "Who Creates Jobs? Small Versus Large Versus Young." The Review of Economics and Statistics Vol. XCV: 2. 2013. https://www.mit-pressjournals.org/doi/pdf/10.1162/REST_a_00288

⁷ Jensen, Nathan M. "Evaluating Firm-Specific Location Incentives: An Application to the Kansas PEAK Program." Ewing Marion Kauffman Foundation. 2014. <https://www.kauffman.org/what-we-do/research/2014/04/evaluating-firm-specific-location-incentives-an-application-to-the-kansas-peak-program>

⁸ Jensen, Nathan M. "Evaluating Firm-Specific Location Incentives: An Application to the Kansas PEAK Program." Ewing Marion Kauffman Foundation. 2014. <https://www.kauffman.org/what-we-do/research/2014/04/evaluating-firm-specific-location-incentives-an-application-to-the-kansas-peak-program>

⁹ Wiens, Jason. "Entrepreneurship's Role in Economic Development." Ewing Marion Kauffman Foundation. 2014. <http://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/entrepreneurships-role-in-economic-development>

¹⁰ Jensen, Nathan M. "Evaluating Firm-Specific Location Incentives: An Application to the Kansas PEAK Program." Ewing Marion Kauffman Foundation. 2014. <https://www.kauffman.org/what-we-do/research/2014/04/evaluating-firm-specific-location-incentives-an-application-to-the-kansas-peak-program>

¹¹ The Pew Charitable Trusts. "Economic Development Tax Incentives." <http://www.pewtrusts.org/en/projects/economic-development-tax-incentives>

¹² Legislative Post Audit Committee. "Kansas Tax Revenues: Reviewing How Other States Inventory and Evaluate Tax Credit and Exemptions." 2017. <http://www.kslpa.org/assets/files/reports/r-17-015.pdf>

¹³ Wiens, Jason. "Entrepreneurship's Role in Economic Development." Ewing Marion Kauffman Foundation. 2014. <http://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/entrepreneurships-role-in-economic-development>

¹⁴ Jensen, Nathan M. "Evaluating Firm-Specific Location Incentives: An Application to the Kansas PEAK Program." Ewing Marion Kauffman Foundation. 2014. <https://www.kauffman.org/what-we-do/research/2014/04/evaluating-firm-specific-location-incentives-an-application-to-the-kansas-peak-program>

¹⁵ Jensen, Nathan M. "Evaluating Firm-Specific Location Incentives: An Application to the Kansas PEAK Program." Ewing Marion Kauffman Foundation. 2014. <https://www.kauffman.org/what-we-do/research/2014/04/evaluating-firm-specific-location-incentives-an-application-to-the-kansas-peak-program>



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