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How states evaluate tax incentives and use evaluations to inform policy

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Agenda



- Why evaluate tax incentives?
- National context for evaluation
- Incentive evaluation best practices
- Strategies for policymakers
- How states have used evaluations to inform policymaking

Why evaluate tax incentives?

Why evaluate tax incentives?

- One of states' primary economic development tools
- Collectively cost states billions of dollars per year
- Evaluation is a proven way to improve the effectiveness of tax incentives

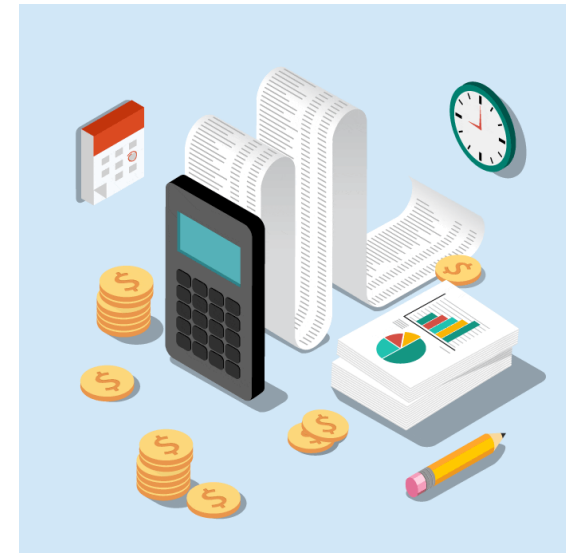


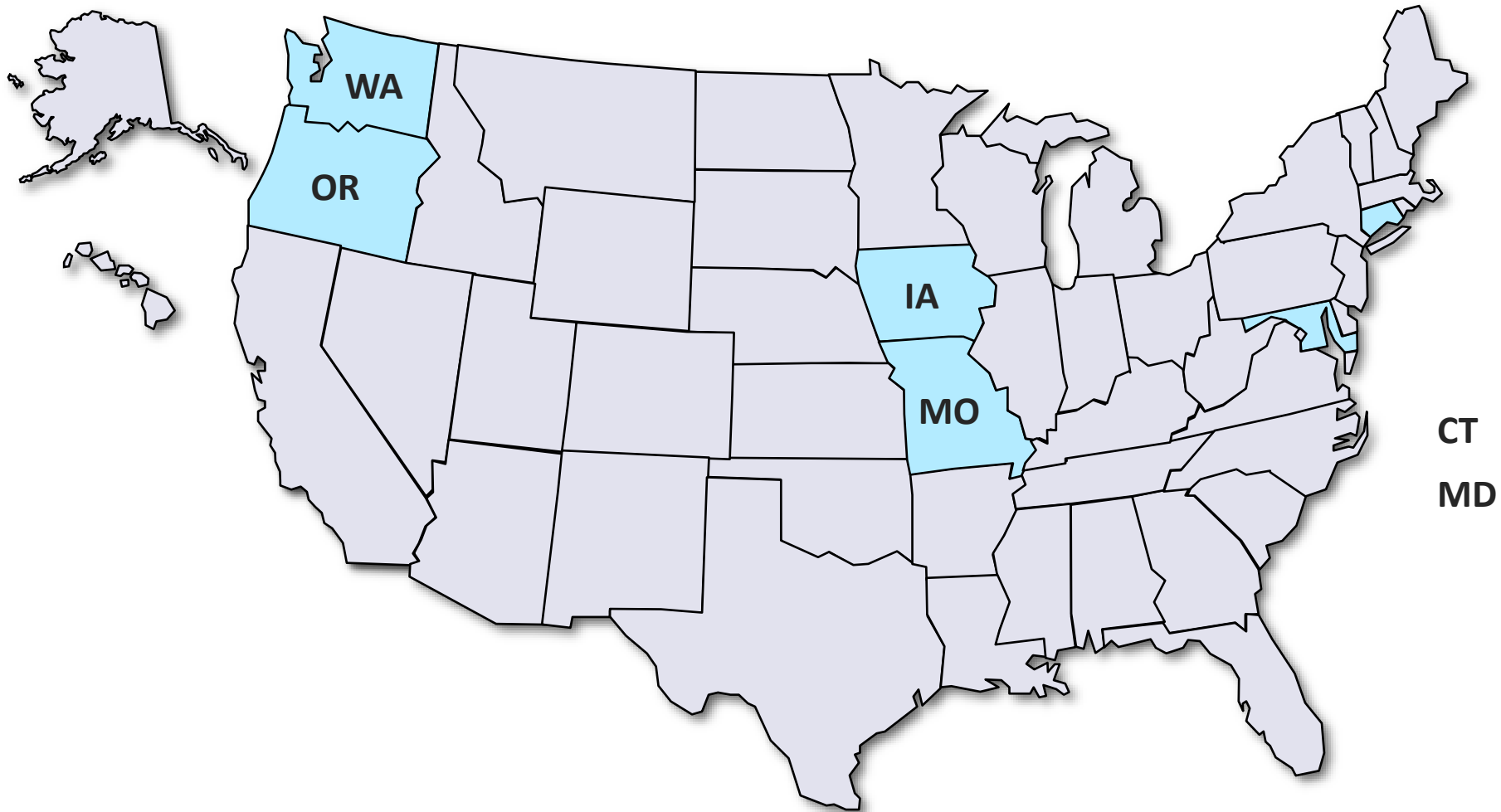
Image source: <https://www.debt.org/tax>

With evaluations, states can...

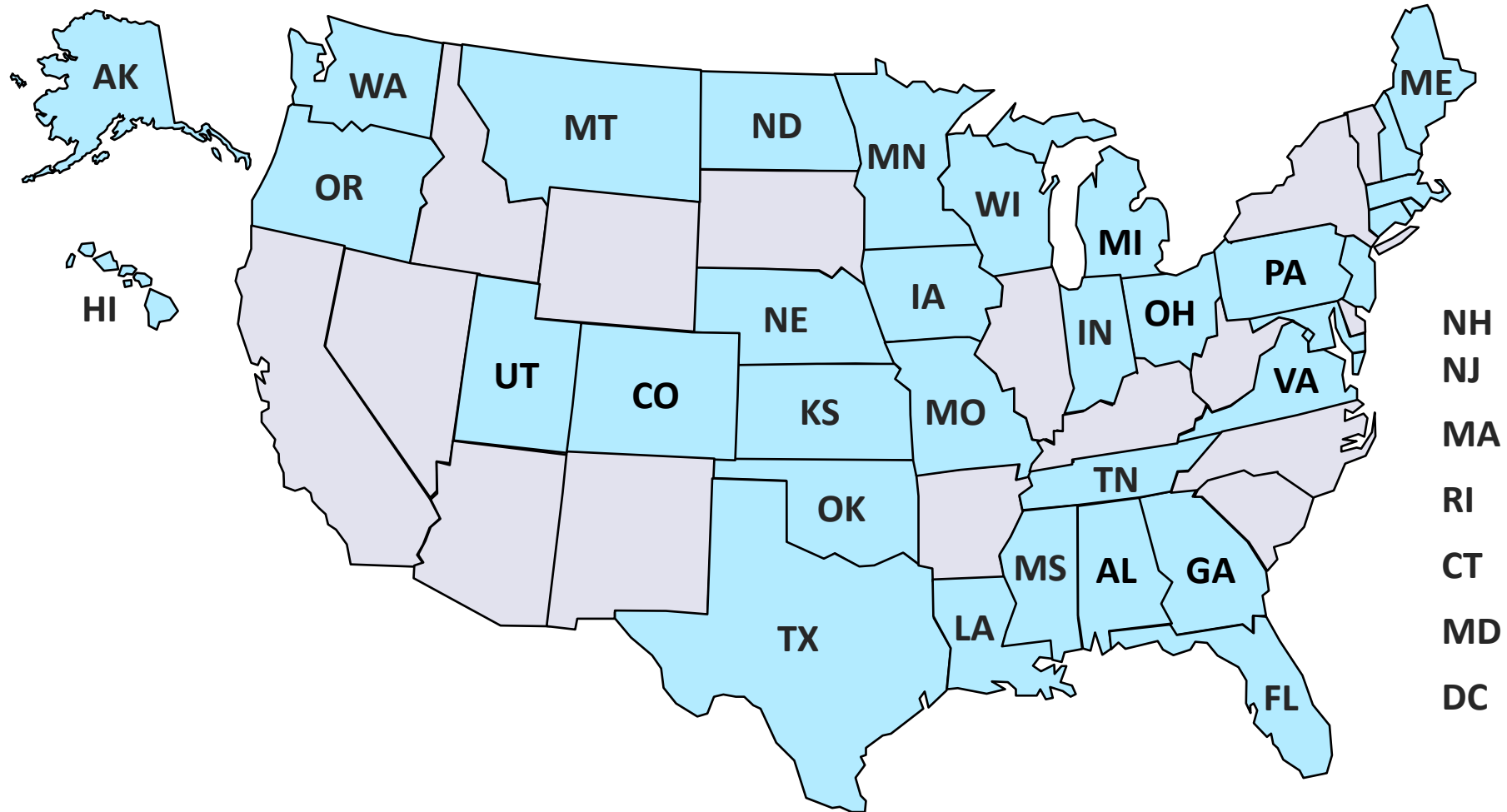
- Identify programs that are working well, so that the state can invest in them with confidence
- Make subtle changes to incentives to increase their return on investment
- Repeal or replace ineffective or obsolete incentives
- Analyze whether incentives are serving the needs of beneficiaries
- Have a more constructive conversation about incentives

Evaluation in the states

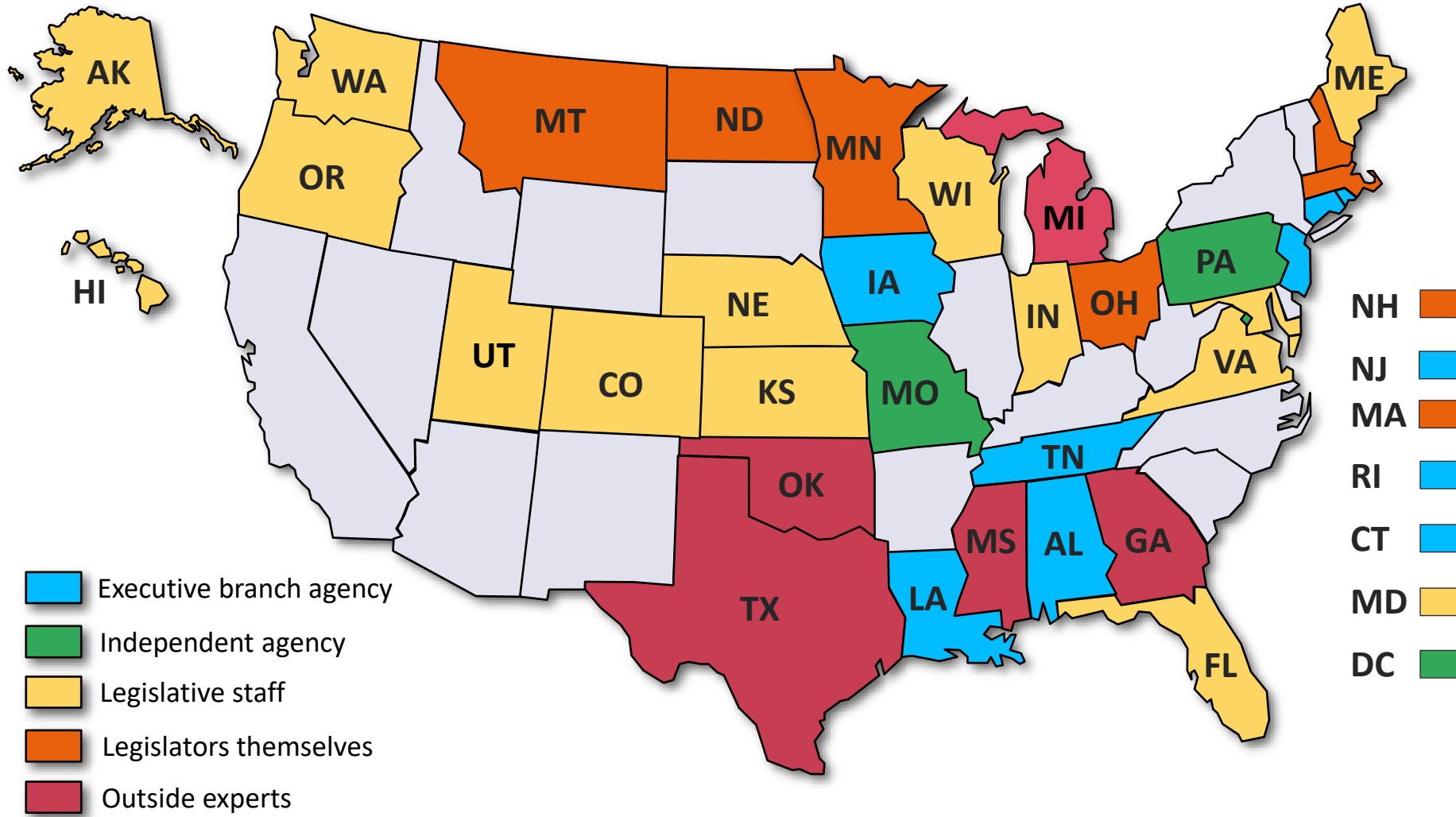
The changing landscape of incentive evaluation – pre-2013



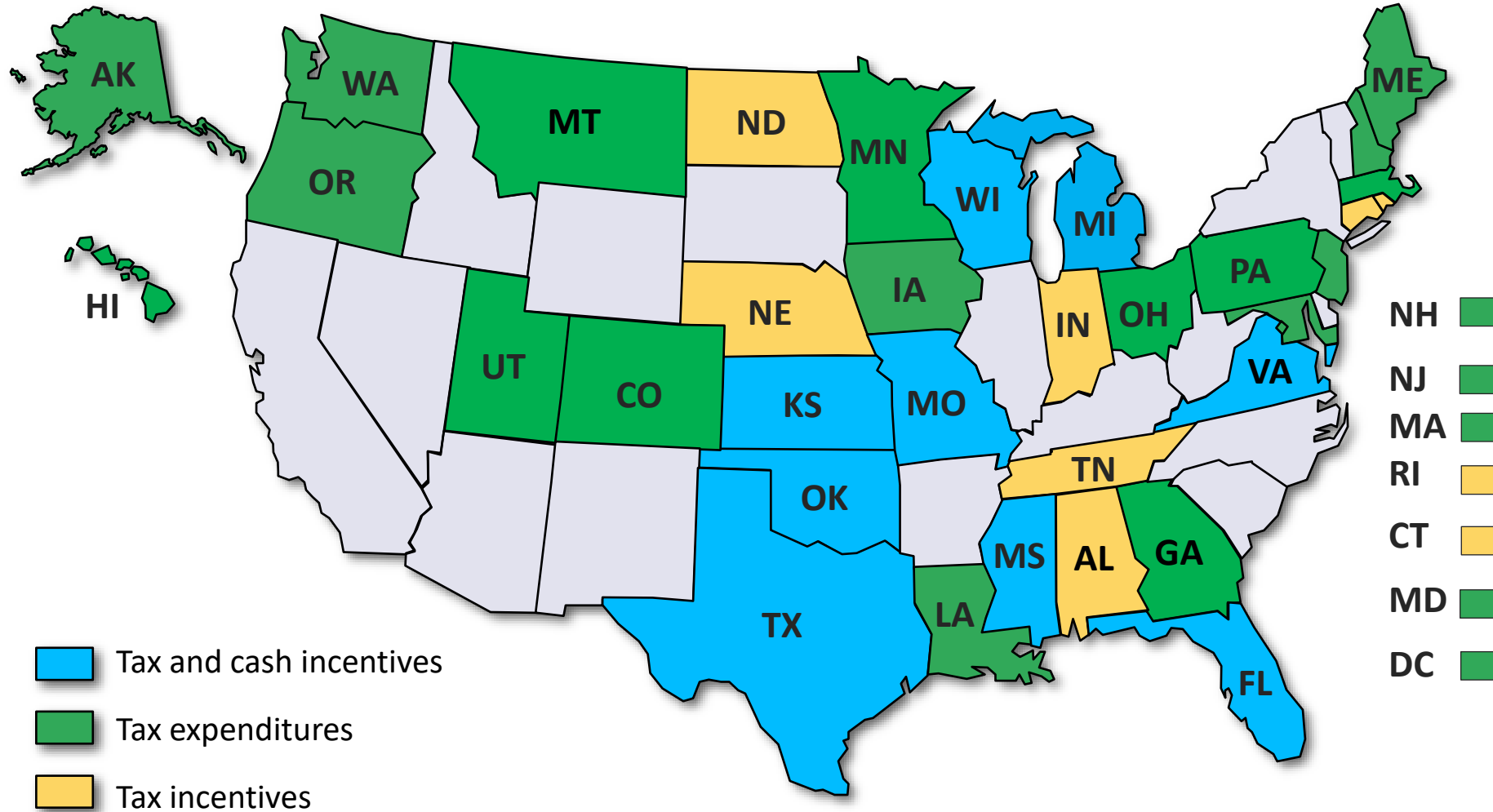
The changing landscape of incentive evaluation – 2022



State evaluation offices



Scope of evaluations



Staffing considerations



It varies

- Who – evaluation office
- What – scope of review
- How often – length of review cycle
- Where in the process – just starting or established
- How much – level of detail

Dialogue and flexibility are key

Incentive evaluation best practices

At minimum, evaluations should include...



- A description of the incentive, including its history and goals
- An assessment of the program's design and administration
- Estimates of the expenditure's economic and fiscal impacts
- Policy recommendations

Other criteria to consider



- **Displacement** – to what extent does the expenditure benefit certain taxpayers at the expense of others?
- **Leakage** – does the expenditure benefit non-state residents?
- **Timing** – how does timing impact the level of fiscal risk and economic return to the state?
- **Opportunity costs** – are there trade-offs related to expenditure costs?
- **“But for”** – does the credit change taxpayer behavior?

What is the “but for” question?



- To what extent does an incentive influence business decisions?
- Does the incentive reward businesses for activity that would have occurred anyway?
- Activity rarely is 100% attributable to incentive
 - Ranges from 0% - 100%
- State evaluators have developed clever methods to estimate incentive impact

Strategies for policymakers: connecting evaluation findings to policymaking

Models for connecting evaluations to policymakers



- **North Dakota:** Legislators as evaluators
- **Rhode Island:** Gubernatorial recommendations
- **Oklahoma:** A commission that includes executive branch officials
- **Numerous states:** Designate a specific legislative committee to hold hearings on evaluations

Models for connecting evaluations to policymakers



- Matters for legislative consideration
- Decision points
- Tax credit review worksheets

Questions policymakers may consider:

- Is the program designed to achieve its intended goals?
- Does the program duplicate another in the state?
- Are those eligible for the program aware it exists?
- Are there programs offered in other states (at what level)?
- What are the consequences if the program is modified?
- Is the program's purpose still relevant and is the cost justified?
- Are program eligibility requirements appropriately defined?
- Is the program administered efficiently?



How states have used evaluation findings to inform policy decisions



District of Columbia

Qualified High Technology Companies (QHTC) program

- In 2019 and 2020 the city council reduced the program, directing over \$35 million to other priorities
- 2018 Office of the Chief Financial Officer report found significant design concerns



Maine



Major Business Headquarters Expansion Program

- Newly enacted in 2017 with a delayed implementation until 2020.
- Included a 'sunrise' analysis.
- The legislature amended in 2018 based on evaluators' review of the program's design.



Maryland

Job Creation Tax Credit

- 2016 Department of Legislative Services evaluation found certain design and administration features were limiting effectiveness
- In 2017, the General Assembly implemented five recommendations from the report



North Dakota



Angel Investment Tax Credit

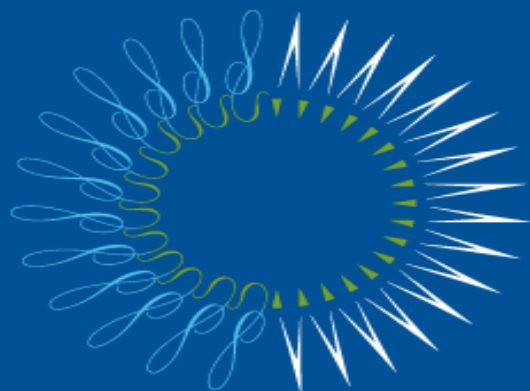
- Evaluation identified a flaw in program design: credits awarded to companies located outside of the state
- Reformed program improves targeting of credits to businesses located in ND

21st Century Manufacturing Workforce Incentive

- Evaluation identified a gap in the state's economic development programs
- Recommended creating an incentive to assist businesses in modernizing their manufacturing processes
- New incentive created in 2019

Conclusion

- Evaluating tax incentives is increasingly common
- Evaluations have led to policy changes that are designed to help programs better meet their goals or redirect spending
- Minnesota's tax expenditure evaluation law reflects best practices for states



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Questions?

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