A Primer on ***Negotiated*** State Incentives

First – Why Incentives Make Sense

Here are the reasons incentives make sense.

- First, incentives benefit everyone: state, county and local governments, the recipient corporation, new employees and more.
- Second, incentive projects are tax creation projects. When corporations get awarded incentives it is because the state expects to have significant new taxes that will come about due to the corporation's project.
- Third, incentives make sense for in-state governments as they keep between 85-95% of all new taxes. The corporation only gets a "fair" share of perhaps 5-15% as the entity driving the project.
- Fourth, incentives make sense as almost all incentives are performance based meaning if the corporation does not fulfill its promised investments and employee hiring plans, it will get nothing, or at best, a pro-rata share.
- Fifth and last (…as to why incentives make sense), all discretionary incentives that are awarded to corporations are only awarded after a thorough, precise and professionally administered sets of processes, checks and balances.

On to some specifics…

Second - Who Benefits

Here are the specific beneficiaries when incentives are awarded to a corporation:

- a provider of the incentives, a state for instance as it gets new investment, job growth, new taxes, etc.
- a recipient, such as a corporation as with lower investment costs return on investment is enhanced, making an investment possible that wouldn't have sufficient ROI otherwise
- an employee, hired by a corporation which gets a job, wages and benefits
- an employee, hired as the result of the expansion of jobs in the area, also getting a job, wages and benefits
- the citizens of the area affected some of whom work for the corporation or get indirect jobs such as at contractors to build the new buildings or suppliers of other goods and services to the corporation

Third – Budgeted Versus “Foregone” Revenue

The most important idea to understand about incentives offered by state, county and local governments to corporations is that incentives are a sharing of incremental tax revenues.

The government projects the future tax revenues by year and by category based upon commitments by the corporation. It then shares a small portion usually called the “incentives package” with the corporation.

Contrary to most news stories published about government incentives, seldom are economic incentives corporate charity, giveaways or gifts and seldom are they a large percentage of the future taxes which benefit governments and citizens. Governments have processes and oversight to ensure this. More about that later.

Each incentive project is all about creating tax revenue streams for governments. Think of incentive projects as describing a series of mostly corporate planned, future actions centering around investments and jobs. While these actions are planned to benefit the corporation, its employees, suppliers, and stockholders, it also will generate tax revenues for the governments and citizens involved. There are local taxes (city and county) and state taxes.

Usually, the promised corporate described actions cover three forward years. These economic projects are presented as specific proposals to the governments by the corporation which is considering them. These proposals describe potential planned investments by year in buildings and equipment as well as planned jobs and wages by year by position. From now on the word “state” will be used to describe all three government entities: state, county and local governments. Federal level incentives are not included and will be the subject of an upcoming white paper.

For most incentive projects the states require significant data from the corporation before considering incentive projects and their potential awards. This is all done on a highly confidential basis due to the significant competitive nature of business and the requirement that future, corporate actions and plans not be made public and thus available to competitors.

Once the state has the required information on the project, it can estimate the potential impact on in-state tax revenues. These tax streams occur at many levels:

1. at a corporate level are corporate income taxes, franchise taxes, property taxes, sales taxes, etc.
2. at the personal level are personal income taxes, property taxes, sales taxes, etc.
3. taxes levels are both direct and indirect:
    a. Direct are the investments and jobs created by the project’s direct corporation investment and associated jobs.
    b. Indirect are the investments and jobs created indirectly by the corporate investment and jobs. Examples of indirect include the construction companies that build the expanded building, the suppliers who provide electrical and air conditioning and heating, the cleaners down the street, the food store and department stores and their clerks and managers, landscapers, etc.

Fourth - Incentives Shared Are Usually 5-20%

When one reads a news piece on how a corporation, that is planning to relocate to a state or expand in the state, gets incentives valued at $10 million, one often perceives that the corporation is getting this huge windfall and in-state governments are getting very little. Seldom is this correct. Also misunderstood is that the incentives are provided with the announcement and come in the form of a large check. This is very unusual and when it happens is only a small portion of the total incentives offered.

Most incentives will only be shared in the future and only when the corporation fulfills its promised actions. Once those investments or jobs are completed, and proved to the state, only then are the incentives issued perhaps in the form of a check as a reimbursement of specific expenses or in the form of a tax certificate to offset current or future taxes.

Most governments are willing to share with the corporation to make the planned action happen. The sharing is usually somewhere between 5-20% of the future tax and other financial benefits to the state and its citizens that will come about because of the corporations planned actions. The flip side is the government and the citizens utilize 80-95% of the new tax revenue streams.

On small projects this is a roughly calculated amount while on larger projects there often times will be an economic impact study to determine what the tax revenue streams will be and what part should be shared with the corporation and at what level (state, county or city-local) the sharing should occur. Normally these studies become public record documents and are shared and discussed in public hearings where those impacted get a chance to comment on the proposed incentive package.

Fifth - Incentives Are 99% Performance Based

As noted above, almost all incentives are performance based. This means if the corporation does not make the planned investment or add the proposed jobs it will receive nothing. To the extent that the company does receive some incentives and then backtracks on its commitments, there are "clawback" provisions in the agreements so the government entity that provided the incentives can get them back.

Based upon experience, in less than 5% of the incentives awarded is there a component that is upfront before performance and based upon promised performance. And, even then, there are claw backs in the agreements with the corporation to protect the state and the citizens for providing the upfront incentive. As noted above not only must the corporation perform but they must prove they performed by providing, per contract with the state, the required documentation. For jobs created, it will be the number of jobs created, the average wage per job and a description of the responsibilities or the titles of the jobs created. In most instances, these jobs must remain for a period of anywhere from 3-15 years.

Sixth - Each State and County Is Different

Each level of state government has a person or persons designated as their representative to attract and retain corporations and employment they create, maintain, and hopefully grow.

The economic development professionals are usually people who have chosen this field as a career or part of their career path. They may be educated in business or economics or accounting.

And each government entity has a legislatively reviewed and approved process for:

1. Finding new corporations to attract or existing to grow or maintain
2. Determining the employment and tax streams associated with these projects.
3. Offering and managing programs and award levels to ensure a fair, balanced and objective process is followed.

As a final note in this section, each project that may get an award has significant upfront documentation requirements including investment, employment, wage levels, etc. for a 3 year forward period. Usually this data is evaluated at 3 levels and often over a period of 2-6 months depending on the state, county or local government, before an incentive award is made.