An Evaluation of North Carolina's Economic Development Incentives

North Carolina General Assembly

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Overview

- Results of UNC's analysis of state's incentive programs for General Assembly
- Incentives impact on the state's economy
- Suggestions for improving programs

Background

North Carolina General Assembly
Joint Select Committee
On Economic Development Incentives

- Hired UNC for 18th month study
- Used "portfolio approach" to determine which incentives achieve the greatest return. Focus on
  - Quality Job Creation
  - Distressed Areas Benefit
  - NC Competitiveness
- Studied Lee Act, JDIG, and One NC Fund

NC Economic Incentive Types

Statutory Incentives

- **Tax credits** to qualifying businesses for job creation, training and investment
- Lee Act and Article 3J

Discretionary Incentives

- **Cash grants** to new and expanding businesses for job creation and/or retention
- Job Development Investment Grant (JDIG)
- One North Carolina Fund

Incentive Portfolio Adjustment Recommendations

- Expand JDIG/One NC with increased amounts targeted to distressed counties
- Eliminate Article 3J tax credits effective 2010
- Retain Research and Development Tax Credit
- Reduce corporate taxes to competitive neutral rate
- Increase research and marketing budgets for proactive targeting of growth firms
- Institute legislative oversight function for economic development programs

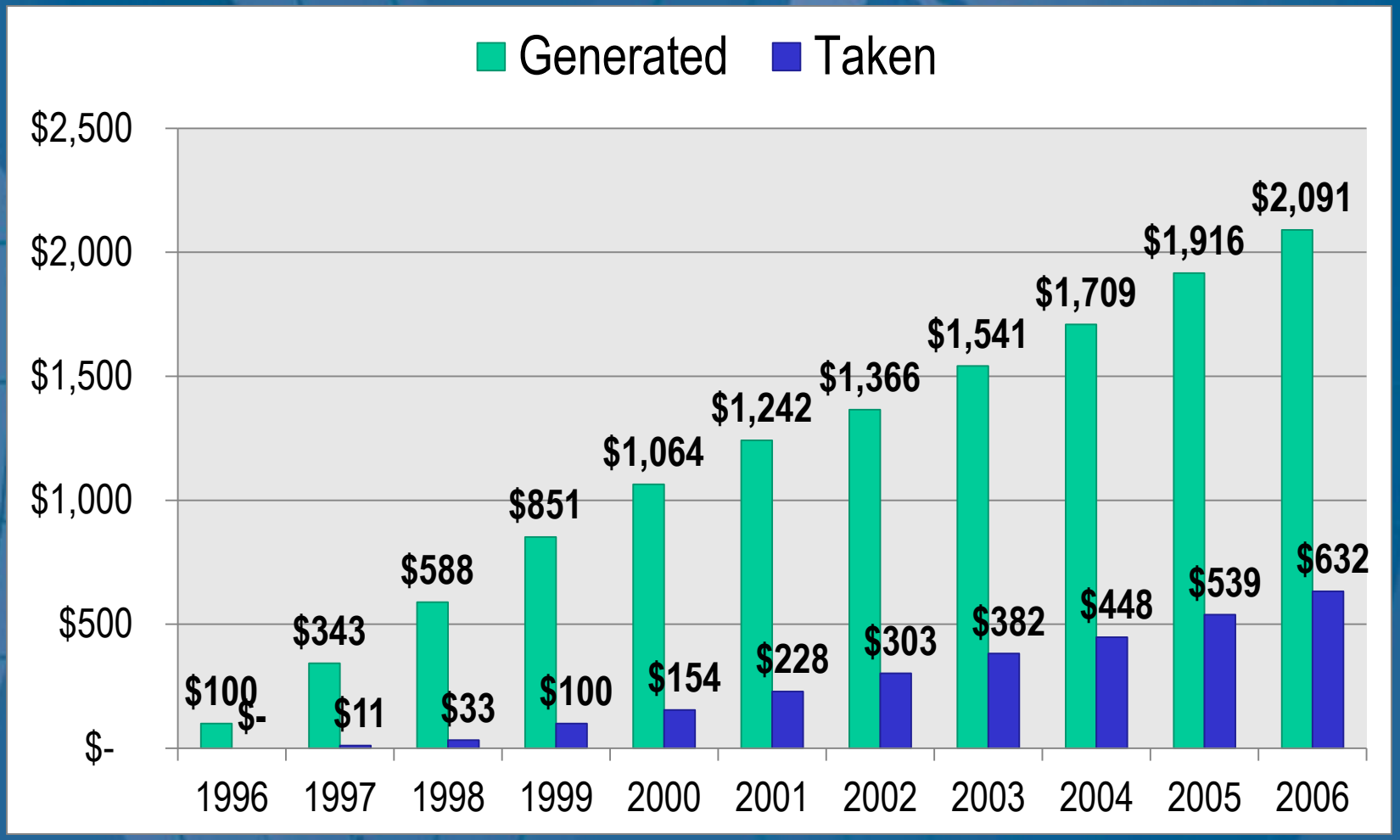
William S. Lee Act Tax Credits

- Existed from 1996 to 2006. Replaced in 2007 with Article 3(J).
- Five tiers based on economic prosperity. Tier 1 (poorest) to Tier 5 (wealthiest).
- Tax credits up to 50% of tax liability for job creation, machinery and equipment investment, and R&D investment.
- Larger credits in lower (i.e. poorer) tiers; credits can be carried forward into future tax years.

Assessing the Tax Credits

- General Assembly passed legislation authorizing UNC to access confidential quarterly employment histories and tax returns for 5,000+ incented companies receiving incentives.
- Pre/post incentive quarterly employment and wage history for each incented firm (250,000 data points)

Tax Credit "Costs" Have Exceeded $2 Billion



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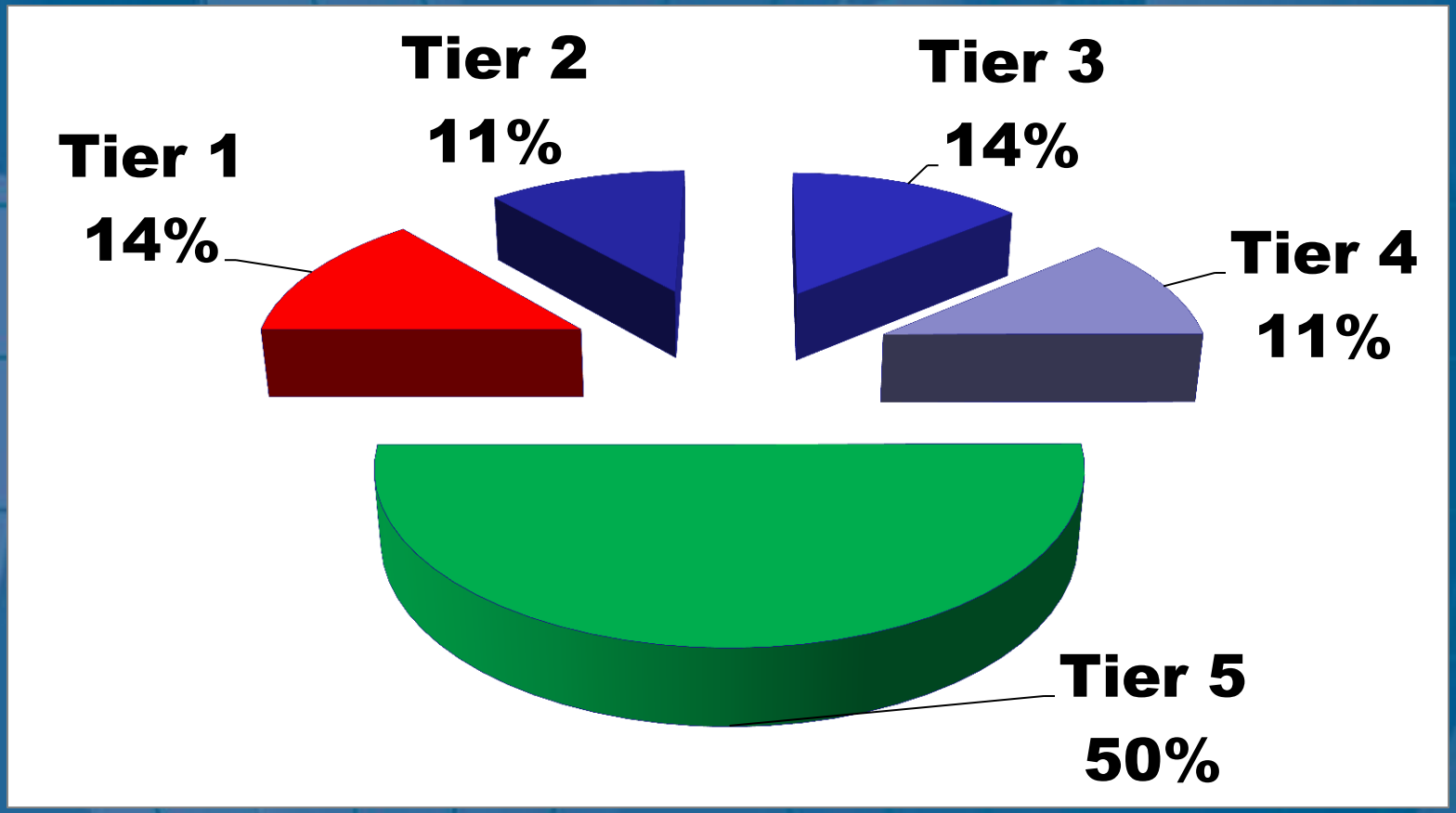
All Lee Credits - 2002-06
$875 Million



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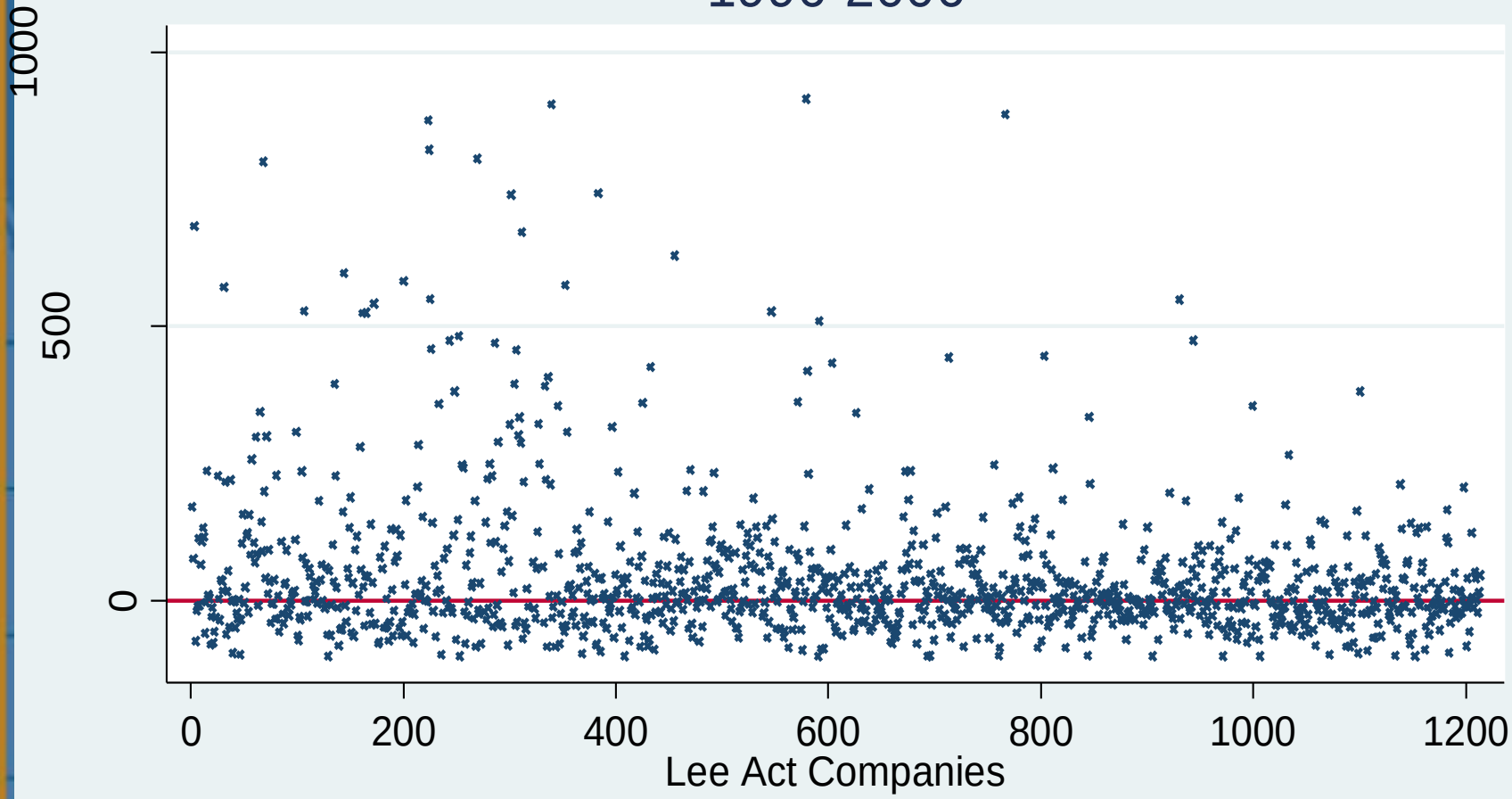
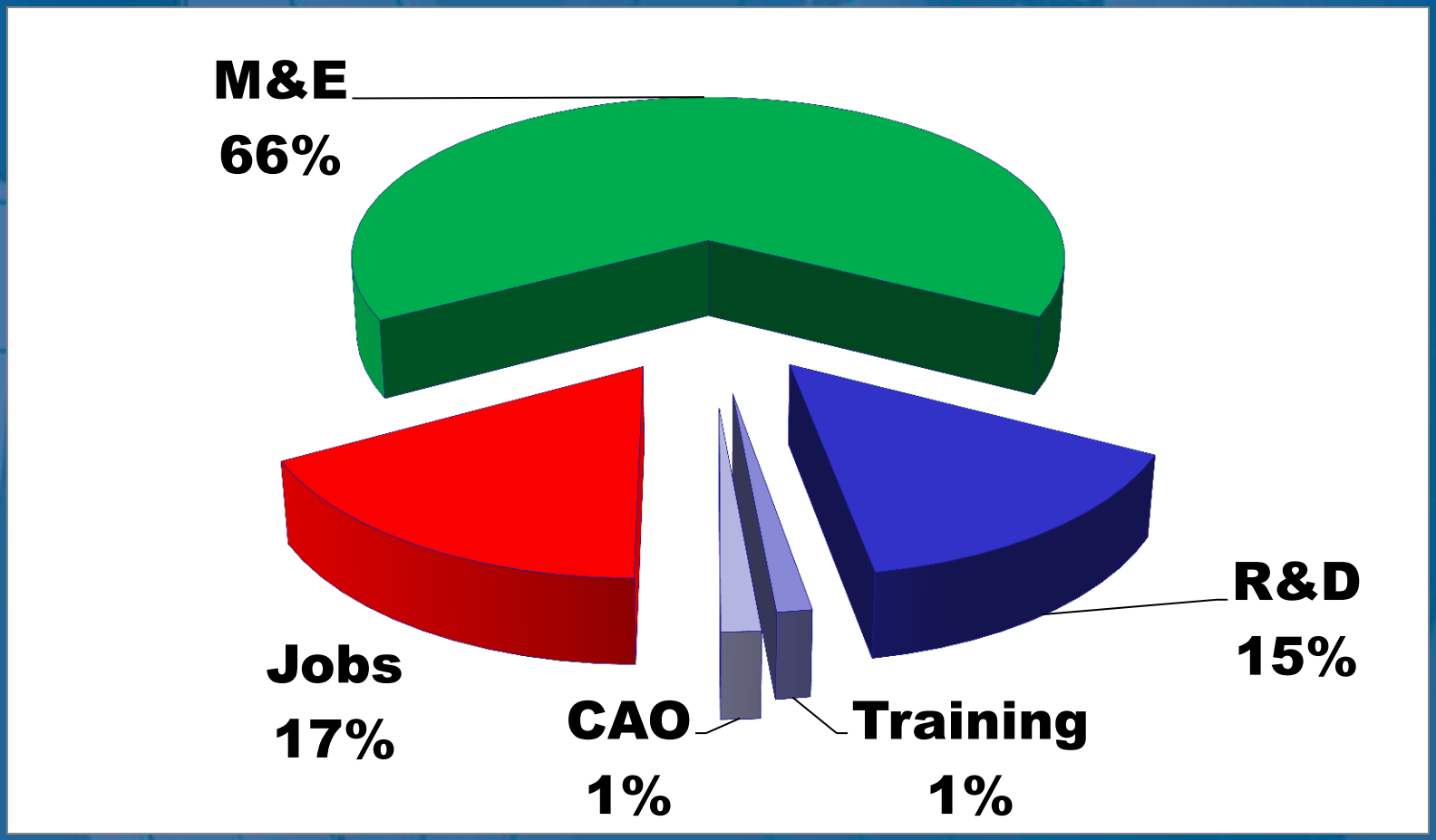
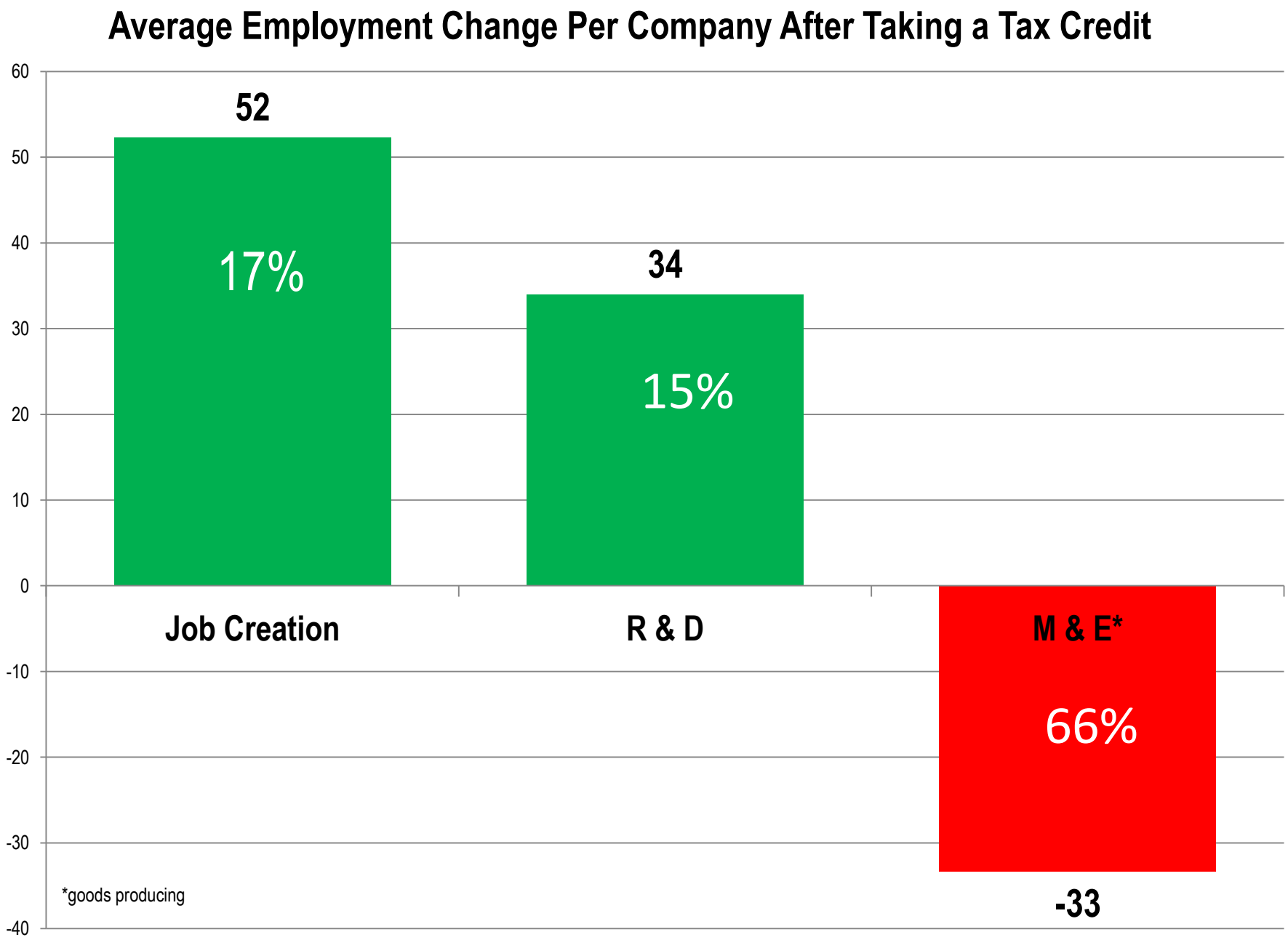
Employment Growth Rate: Lee Act Companies with Single Location 1996-2006



1. 37 companies with growth rate greater than 1000% are eliminated from graph
2. 697 (57.46%) companies' growth rates from 96 to 06 are positive
3. 501 (41.30%) companies growth rates from 96 to 06 are negative
4. 15 (1.24%) companies' growth rates from 96 to 06 are zero

Lee Credits
1996-06 = $2.1 Billion




Average Employment Change Per Company After Taking a Tax Credit
60
50
40
30
20
10
0
-10
-20
-30
-40
52
17%
34
15%
-33
66%
Job Creation
R & D
M & E*
*goods producing

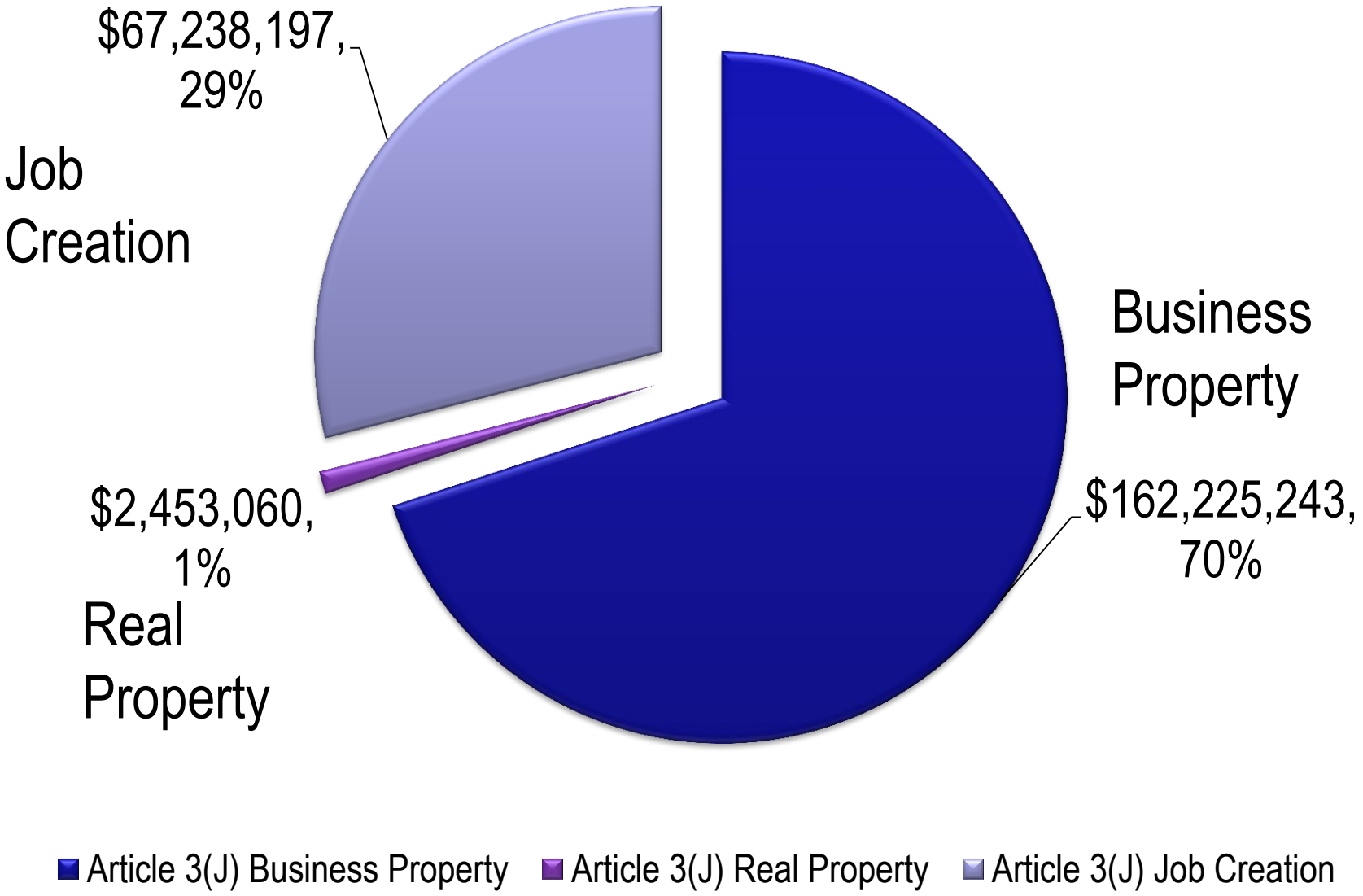
Summary

- 2/3 of credits go to (M&E) resulting in net job loss
- Lee Act--half go to wealthiest counties. Similar results for business property investment under Article 3(J)
- Only 1/3 go to job creation and R&D with positive employment growth

Article 3(J)

- Article 3(J) replaced the Lee Act in 2007.
- Reduced tiers from five to three
- Few substantive program changes to impact our results on the ineffectiveness of tax credits
- Outcomes from Lee Act are comparable

2008-2010 Article 3(J) Credits Generated: $232 Million



Article 3(J) Job Claims

- 12,689 new jobs from job creation tax credits. Represents 29% of tax credits claimed.
- This is not **net** employment gain.
- This only represents employment from job creation tax credit.

Article 3(J) Job Claims

- What effect does the 70% of credits given for business property have on employment?
  - We don't know because it isn't tracked!
  - Lee Act experience suggests it has a **negative** effect on employment. Companies claiming the credit are shedding jobs.

Article 3(J) Job Claims

- Lee Act study found M&E lead to employment loss.
- It is reasonable to assume the **net** effect on employment from Article 3(J) is negligible and maybe negative!

Tax Credits in Context

- NC's Labor Force: 4.5 million workers
- NC lost nearly 300,000 jobs during the Great Recession. We need roughly 30,000 jobs per year for the next decade to replace the lost jobs during the Great Recession.
- NC needs another 40,000-50,000 new jobs to keep up with the growth in the labor force.
- **Where are we going to find 80,000 new jobs annually for the next decade?**

Tax Credits in Context

- NC's Labor Force: 4.5 million workers
- Article 3J Job Creation, 2008-2010: 12,689
- **Job creation tax credits created jobs for 0.28% of the labor force.**

What do companies want?

- UNC/ECU survey found executives preferred lower tax rate to selective tax incentives
- Rate reduction positive effect on more firms
- Most companies getting a tax credit were unaware. It was an accounting function!

Incentive Portfolio Adjustment Recommendations

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Creating a Good Incentive Policy

- Reward companies that are creating jobs
- Especially for hiring displaced workers and existing residents
- Focus discretionary incentives on areas with greatest need
- Improve the business climate for all companies