

Joint Select Committee On Economic Development Incentives

UNC Economic Incentives Analysis
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Background

- | NC began economic incentives in mid 1990s
- | Multiple prior assessments
- | Joint Select Committee on Economic Development Incentives formed in 2007
- | Hired UNC in December 2007 for \$300,000 to examine incentive performance
- | Final report due January 2009
- | Work with legislature through 2009 session

Key Legislative Questions

- | What is an economic incentive?
- | What is economic incentive success?
- | How have incentives been used?
- | Which incentives achieve the greatest return?
- | Have incentives significantly benefitted the economy?
- | Are there changes and/or alternatives that better achieve economic priorities?

NC Economic Incentive Types

Statutory Incentives

- | Tax credits to qualifying businesses for job creation, training and investment
- | Lee Act (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

Incentives Performance Measures

Quality Job Creation

- | Initial and long-term employment, wages, sustainability

Distressed Areas Benefit

- | Employment and reemployment

NC Competitiveness

- | Economic significance, diversification, value added, strategic coherence

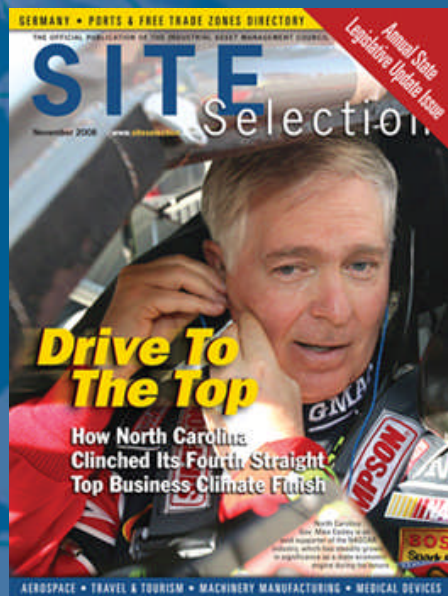
NC Incentives Portfolio

1996 - 2006: \$2 billion in economic incentives

- | 5,000+ incented companies
- | Constitute “portfolio” of investment strategies
- | Incentives – like investment types – can vary widely in their return
- | Recipients – like portfolio companies – differ in their performance
- | Which incentives /companies best achieve NC’s economic development priorities?

NC's Economy is Big

- | Population of 9,061,032 (10th)
- | Workforce of 4,600,000
- | GSP of \$400 Billion (9th) passing GA, VA, MI, MA since 2003
- | NC would be 23rd largest national economy
- | A big economy is hard to affect
- | Even great success can be insufficient



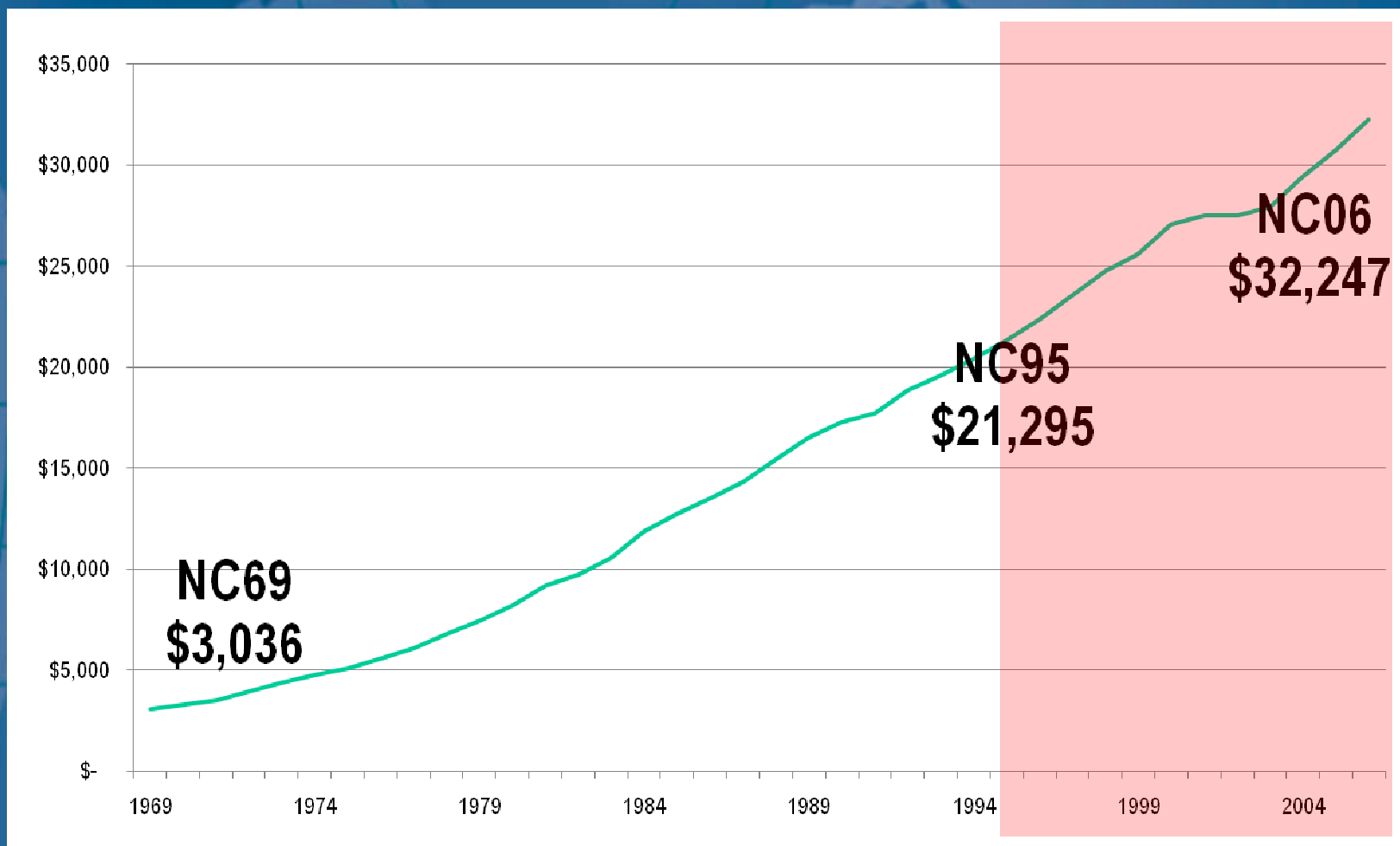
North Carolina Ranked “Best Business Climate” 7 of last 8 years by *Site Selection* magazine

Site Selection's 2008 Top State Business Climate Rankings

Overall Ranking	Executive Survey	2007 NP Rank	2005-07 NP Rank	Rank per Million	Rank per 1,000 Sq. Mi.	Final Total
1 North Carolina	2	4	4	9	5	30
2 Tennessee	6	3	6	2	2	37
T3 Alabama	5	13	13	7	15	68
T3 Texas	1	5	1	28	30	68
5 Indiana	8	11	14	10	6	73
6 Florida	4	9	10	29	12	76
7 Ohio	17	1	2	8	1	80
8 Virginia	14	8	7	13	7	91
9 Illinois	18.5	2	3	11	3	93
10 Georgia	3	18	11	31	23	95

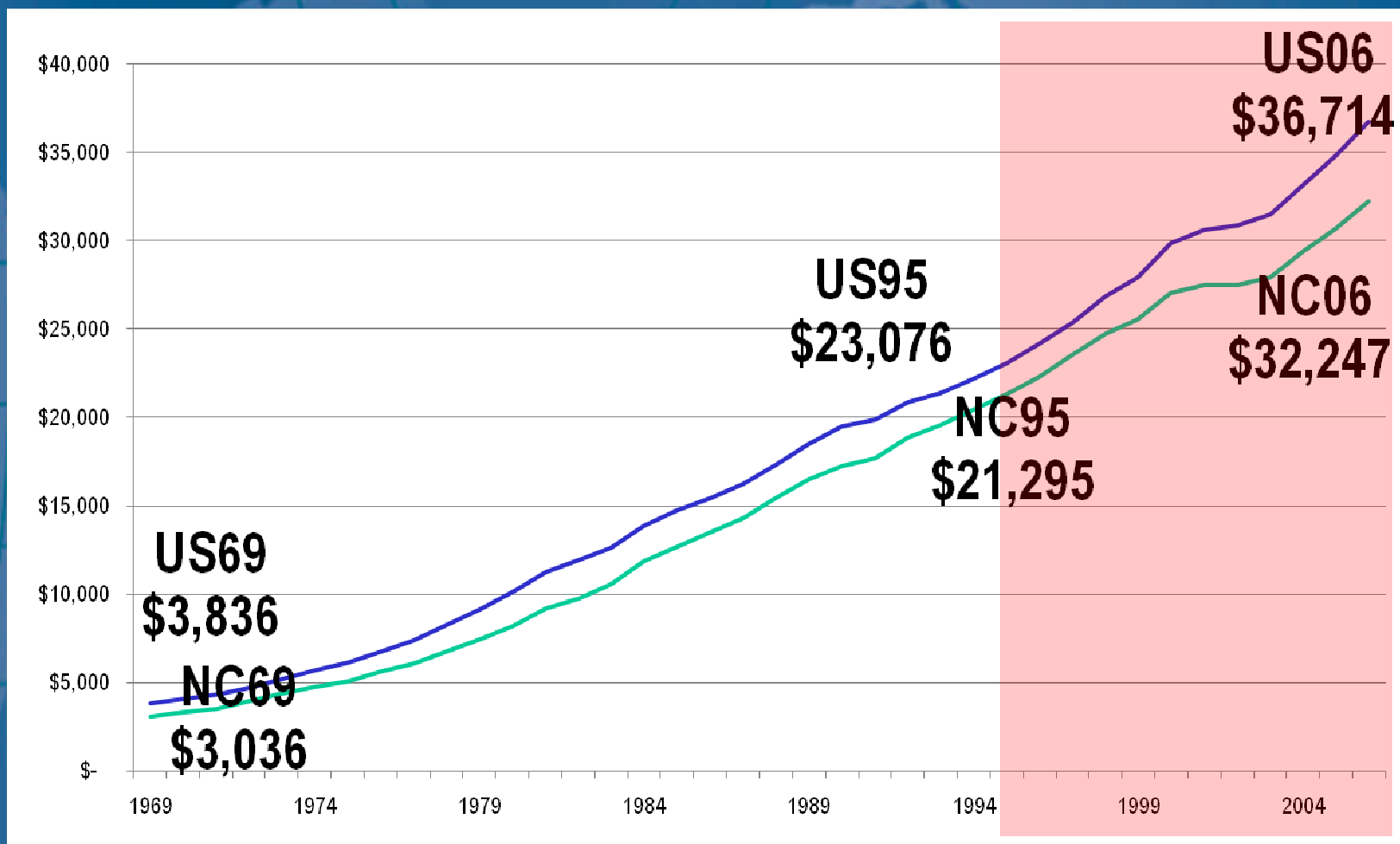
NC Per Capita Income

Growth from 1969 to 2006



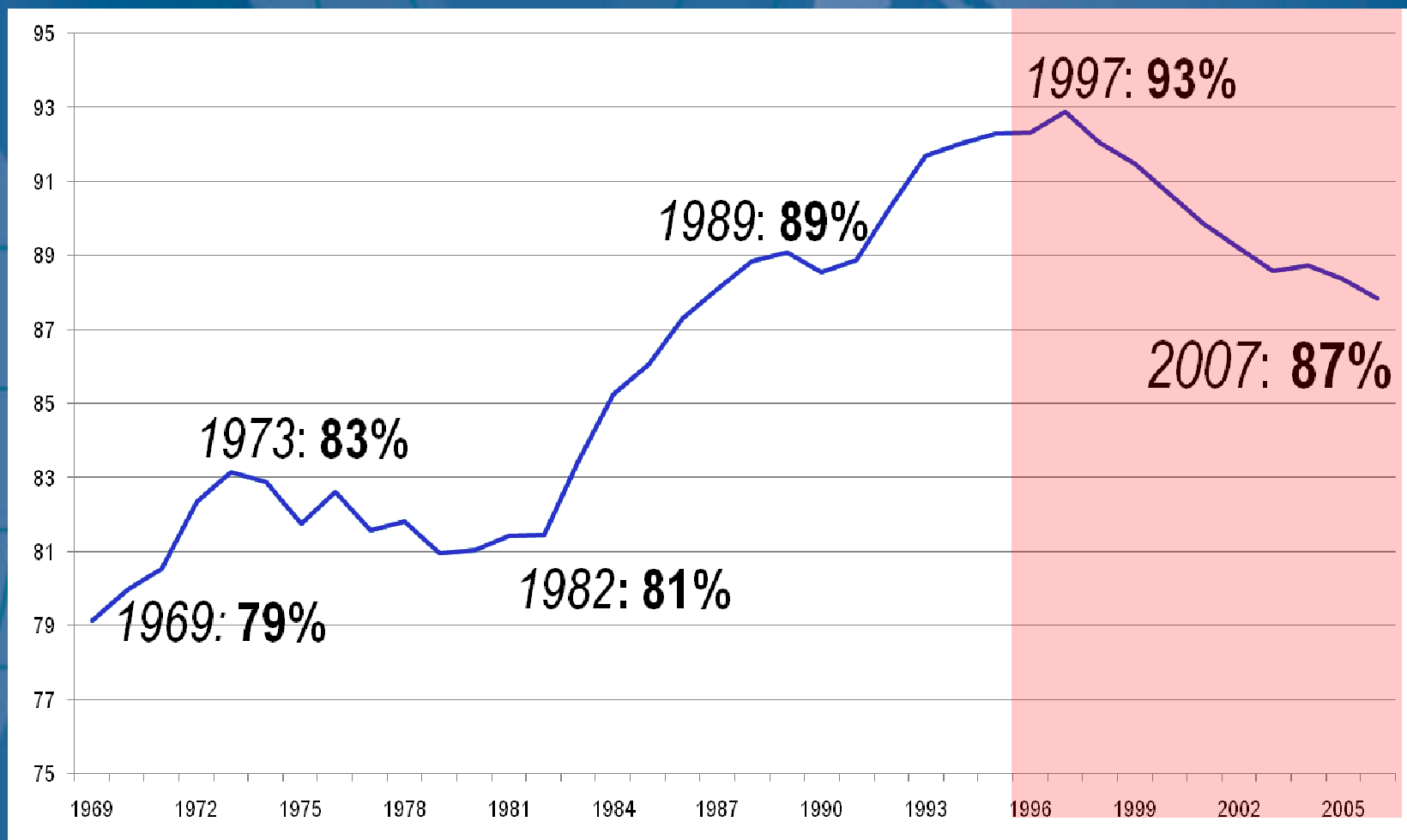
NC Per Capita Income

NC vs. US Gap Growing



NC Per Capita Income

From 93% of US in 1997 to 87% in 2007



NC Economic Development

Our capacity to effect NC economy is limited

- | NC has 500,000+ businesses
- | 1% job gain = 90,000 new jobs
- | Direct ED assistance possible to only a few thousand companies
- | Targeted incentives to a few dozen firms/year
- | Those incentives must have large impact to make any real economic difference

NC Incentive Data Assessment

Methodology
Jason Jolley

Incentive Data Assessment

- Prior studies have been limited due to data confidentiality issues.
- Detailed examination of the NC experience require acquisition of confidential data rarely used in other academic studies.
- Successful execution required cooperation from state agencies.
- Legal hurdles existed to data acquisition.

Primary Data Needs

1. Every incented firm 1996-2006 characterized by location, ownership type, and industry
 - Department of Revenue tax filings
 - Department of Commerce records
2. Pre and post incentive quarterly employment and wage history for each incented firm from 1990-2006
 - Employment Security Commission
 - 250,000+ records
3. Research augmentation through
 - Case studies of incentive recipients
 - Surveys of company executives—incented and non-incented firms

Data Acquisition Challenges

- Legal barriers initially barred access to primary data on incented companies
- Legislative remedy provided UNC confidential access to tax returns
 - University counsel and assistant attorney general negotiated transfer of records to UNC
 - Confidentiality agreements were signed and data stored in secure location
 - Hard and electronic copies from 2002-2006
 - Electronic copies from 1996-2001

Data Acquisition: Surveys and Case Studies

- East Carolina University Center for Survey Research administered a random survey of company executives
 - 465 non-incented NC companies
 - 150 companies incented by the Lee Act
- UNC System Advisory Panel assisted in survey design
- Case studies of 60+ incented companies

Data Analysis

- Confidential DOR information: FEINs for incented companies and SSNs for new hires
- ESC Labor Market Information utilized
 - FEINs from Lee Act companies
 - FEINs (provided from NC Commerce) from JDIG and One NC Fund.
- Pre/post incentive quarterly employment and wage data from 1990 to 2006
- Database of 250,000 data points.

Data Analysis

- Examine pre/post employment utilizing panel data and interrupted time-series approaches
- Data analysis targets:
 - machinery and equipment tax credit correlation with future positive or negative employment performance
 - lagged employment growth associated with R&D tax credits
 - incented firms employment relative to peer industry average, regional industries, and NC state average?
 - differentiated correlation with job growth by industry, firm size, location

Data Analysis

New Hire Employment Lineage

- UNC transferred SSNs for new hires to ESC Labor Market Information Division for a sample of Lee Act companies.
- ESC is determining
 - whether these individuals were recipients of unemployment insurance in previous quarters.
 - if these individuals show previous employment in North Carolina

Data Analysis: Surveys

- What factors influence NC's business climate?
- Were incentives really important to incented companies?
- How important are alternatives, such as lower taxes?

Data Analysis: Case Studies

- What should be NC's priorities for economic development?
- How important were the incentives?
- What role did consultants play?

Economic Development Performance

- Data from ESC, DOR, and DOC are available for continued monitoring and measurement of North Carolina's economic development performance.
- Objective analysis is challenging, but provides state with an opportunity to annually benchmark and assess performance of state economy and economic development programs.

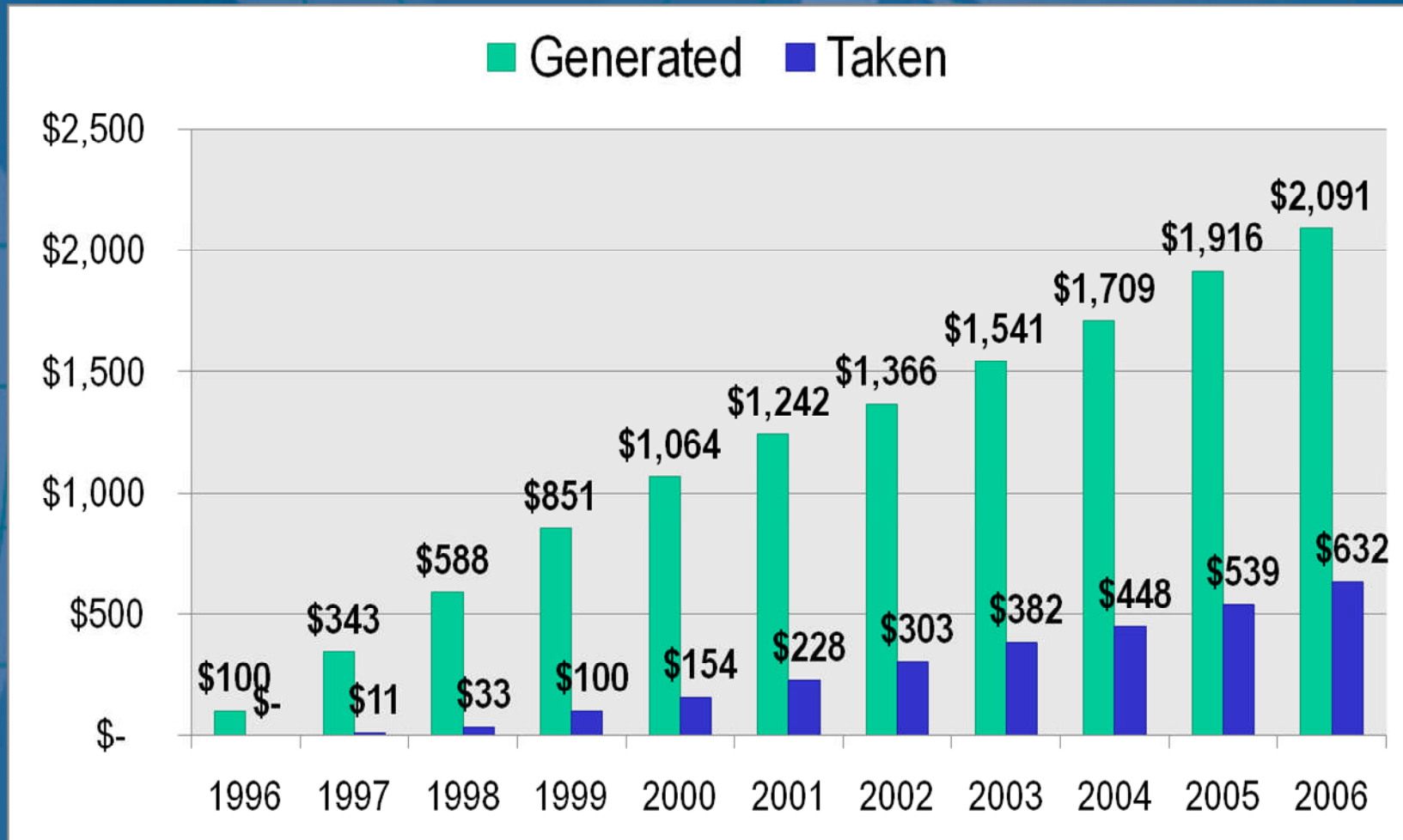
UNC Analysis Findings to Date

Incentive Portfolio Activity

Not What You Think

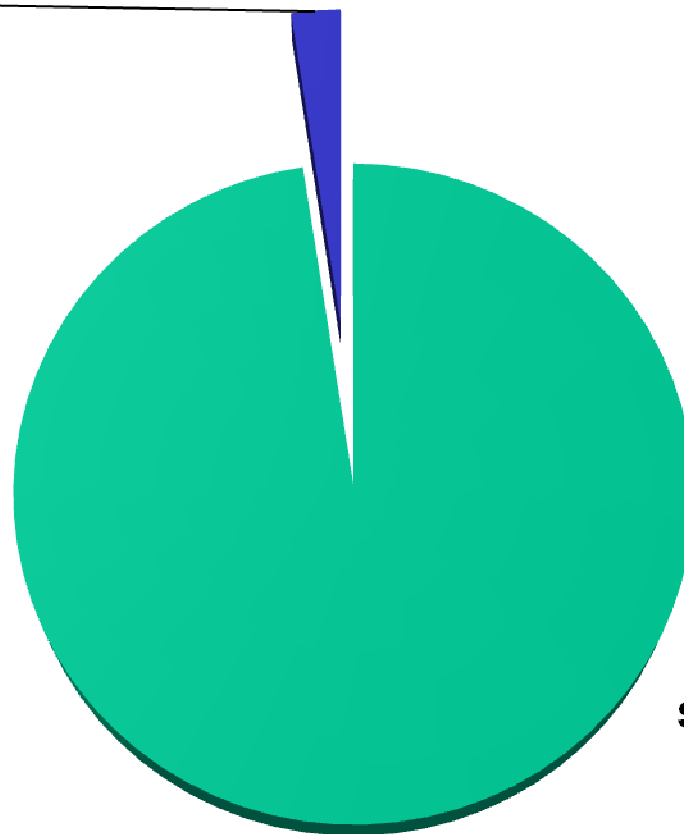
- | While incentives exceeded \$2B in 2006, those “costs” are overstated
- | High profile discretionary (2%) incentive deals are far rarer than statutory (98%) tax credits
- | Job creation usually an indirect outcome
- | Most incentives are for investments, not employment

Incentive “Costs” Over \$2 B



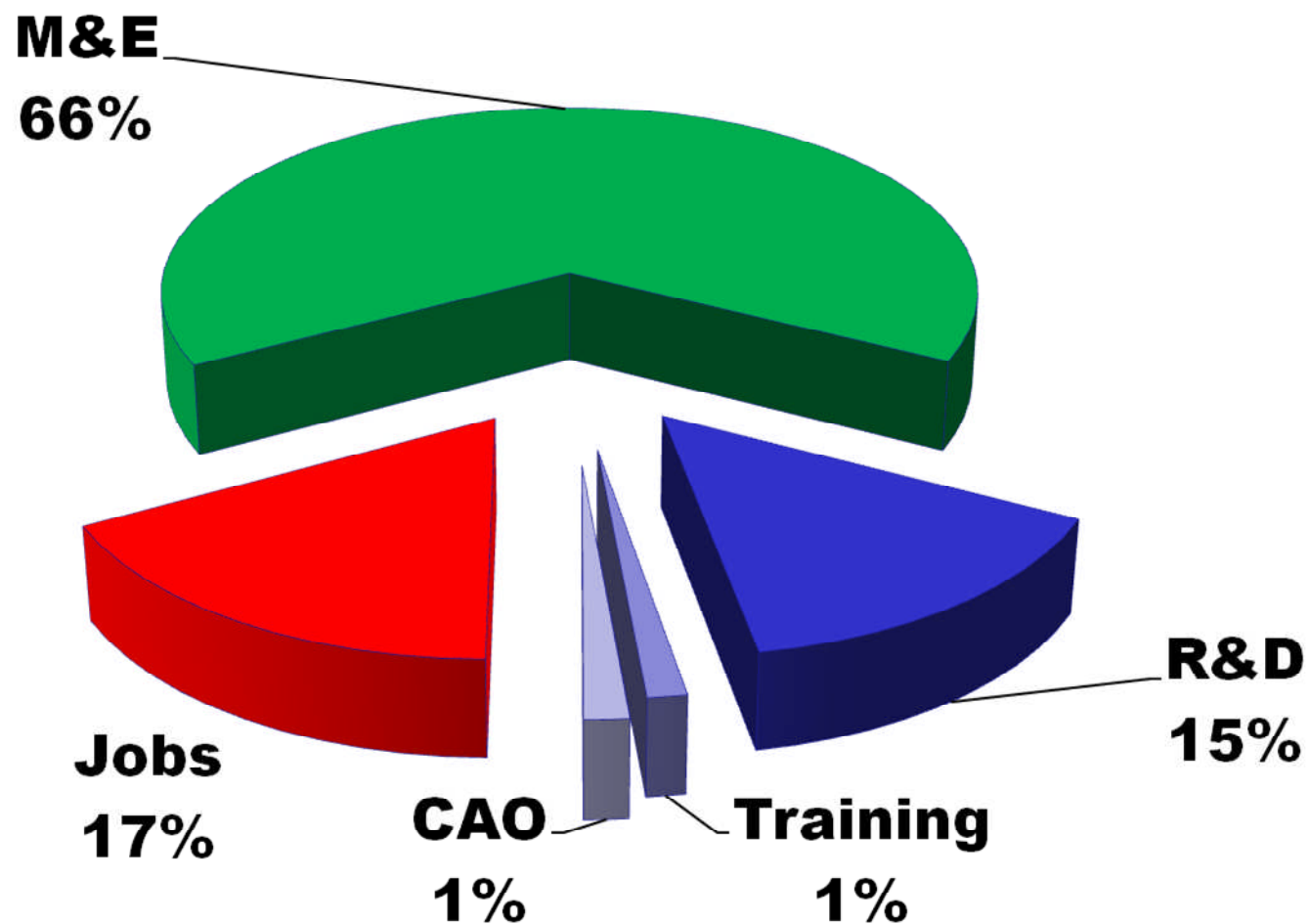
Incentive Portfolio Allocation

**Discretionary
Performance
Grants**
2%



**Statutory Tax
Credits**
98%

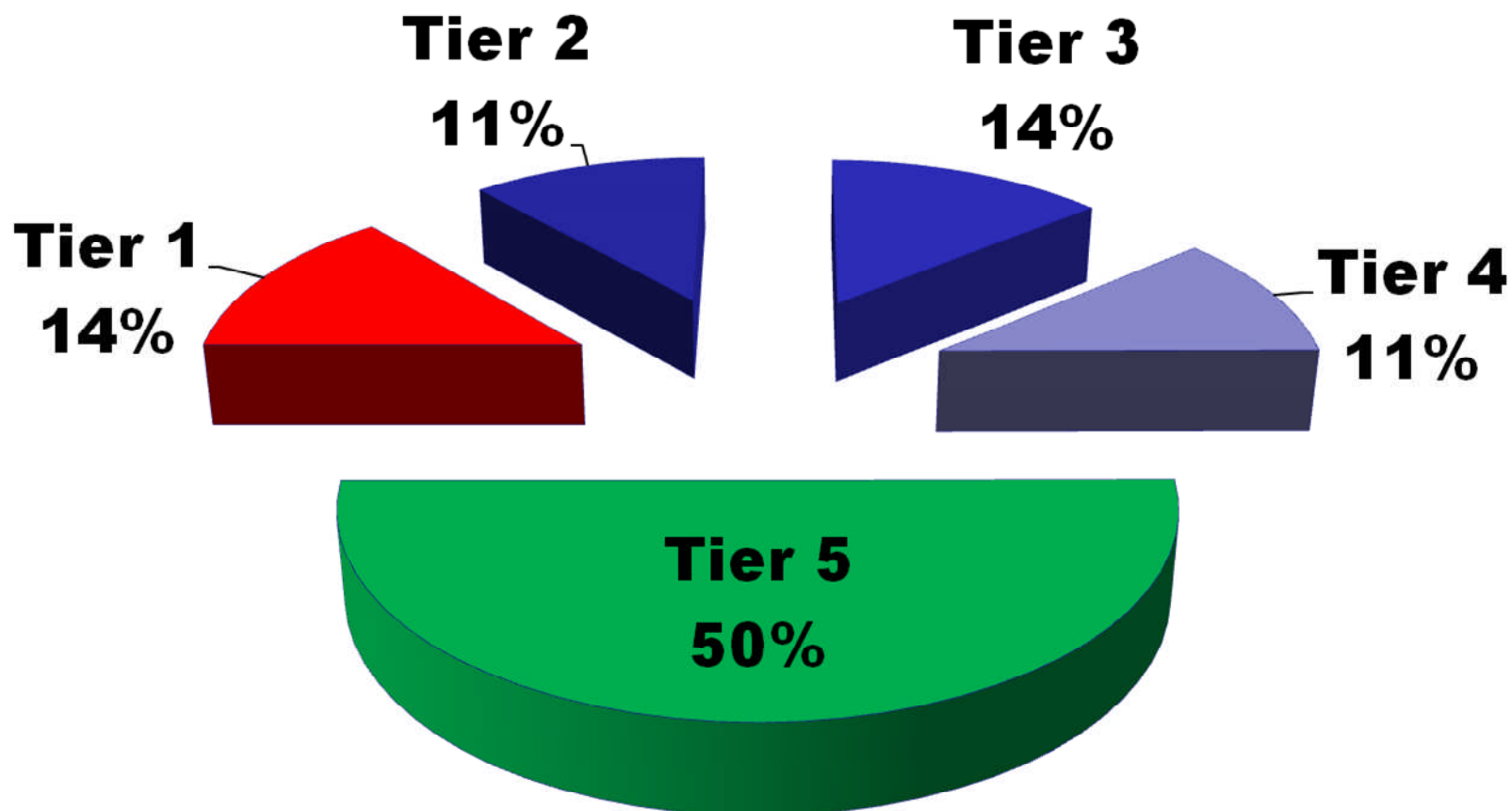
Tax Credits = \$2.1 Billion



Most Incentives Follow, not Lead

- | Initial tax credit incentives were limited to poorest counties; later expanded state-wide
- | Majority of incentives go to companies in the least distressed (Tier 5) counties
- | Fewest go to most distressed (Tier 1) counties
- | Allocation reflects existing industry distribution rather than directing economic activity

Tax Credits - 2002-06



Incentive Amounts Skewed

A few get most, most get a few

2002 to 2006:

- 1,967 companies received \$875 million
- 46 (2%) received total \$523 million (39%)
- 860 (44%) received less than \$25k each
- Effectiveness of small amounts logically suspect

Decisiveness Often Questionable

- National surveys indicate incentives are relatively low in importance in location decisions
- Survey of NC incented and non-incented ranked incentives 12th and 13th respectively
- 62% of surveyed NC executives unaware of incentive receipt
- Ignorance moots decisiveness issue

Site Selection Factors - 2008

1. Highway access
2. Labor costs
3. Energy availability/costs
4. Skilled labor
5. Occupancy costs
6. Available Land
7. Corporate tax rate
- 8. INCENTIVES**
9. Environmental regulations
10. Tax exemptions

Structure May Negate Effectiveness

Performance-based and long-term

- | Both virtue and vice
- | Involve long utilization periods
- | Compliance can be complicated
- | Performance can be difficult to verify
- | Audits invalidate high percent of claims

Incentives are Most Persuasive When ...

- | Other location factors are relatively equal
- | Prospects are highly mobile (and more are)
- | Tailored to companies' specific priorities
- | Benefits are front-loaded and cash
- | Before the auction starts
- | The company executives know they got them

Incentives Do the Most Good When ...

- | Company employs local residents, especially displaced workers
- | Location has excess capacity in local infrastructure, minimizing public service outlays
- | Company has catalytic “mother ship” effect
- | Company is in growth mode dependent on local advantage
- | Company is a headquarters in an export industry

Necessary (?) but Insufficient

- | Incentives serve a very narrow range and number of companies
- | Incentives do not make up for inadequate infrastructure and workforce
- | Incentives can hurt perception of the NC business climate for non-incented firms
- | Incentives don't fix "uncompetitive" tax levels

Best Incentives Create Opportunities

Tools best used proactively and strategically

- | Strengthen existing industrial clusters
- | Target firms with best match for labor market
- | Seed new industry clusters in emerging sectors
- | Solicit promising growth HQs in target clusters
- | Know what you need, know who they are

Findings Suggest Options

- | Discretionary incentives are superior to statutory tax credits in numerous ways
- | Up-front incentives more persuasive
- | Retainable assets minimize “claw back” needs
- | Incumbent (re)employment emphasis increases economic benefit
- | Net economic benefits greatest in distressed counties
- | Tax changes superior to some incentives

Final Steps

- | Meetings with economic development stakeholders on incentive findings and options
- | Develop final incentive revision recommendations
- | Report results to Joint Select Committee in January meetings
- | Assist in legislative process through July 2009