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Diminishing State Budgets and Public Scrutiny Contribute to Uncertain Business Incentives Climate

Although some state and municipal governments have scaled back their incentives offerings, monies are still available for the “right” projects deemed to benefit their constituencies.

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The past few years have certainly come with their fair share of challenges for both corporations and government agencies alike. As a result, an intense focus and scrutiny on government incentives has surfaced on numerous fronts.

As a site selection consultant, I hear many questions about government incentives — sometimes from a company trying to understand how government incentives can assist with getting its project off the ground or approved by an executive board; other times from a state or municipal government agency trying to understand how to best position itself to be competitive with its neighbors in vying for the attention of active projects that are seeking a new home. Regardless of the entity seeking an answer, the question is somewhat similar: “What is the expectation for government incentives?”

Government Budgets Under Pressure

To best answer such a question, it would seem prudent to try and understand the pressures on governmental budgets, since the ability to offer incentives is typically directly tied to these figures. To get a quick snapshot view of this intense pressure on government budgets, we first need to look at the federal tax collections.

Generally, the federal tax collections represent a rough estimation of state tax collections; additionally, municipal budgets rely heavily on state funding, which relies on federal funding. For these reasons, when tax collections are down at the federal level, state and municipal budgets also suffer.

The picture isn’t pretty. When adjusted for inflation, the federal government took in more than $400 billion dollars less in 2009 than it did in 2000, a decline of approximately 18 percent, putting a significant strain on state and local budgets. According to The Tax Policy Center (a joint venture between the Urban Institute and Brookings Institution), 46 states faced shortfalls when passing their fiscal year-end 2011 budgets, and 17 of those states faced shortfalls of greater than 20 percent. The news doesn’t get any better at the local level, where nearly 90 percent of city finance officials reported difficulties in meeting their fiscal needs in 2009, and 75 percent of city officials reported that overall economic conditions worsened in 2010, particularly in the western United States.

And, when state budgets suffer, municipal budgets suffer as well. According to the National Council of State Legislators, 14 states cut funding to municipalities in 2010 and 2011, putting an enormous amount of pressure on these municipalities to cut costs and services while raising revenue through property taxes and local sales taxes to make up for the lack of state support.

While there is a tremendous amount of pressure being applied to government agencies to boost revenues, there is an equal amount of pressure on the corporate side to reduce costs. Internal approval for projects is subject to more management scrutiny than ever before, particularly on the cost side. This has led to an increased awareness of the availability of government incentives and an internal focus to ensure that incentives are being vetted entirely before proceeding forward with a project — especially for one with any sort of scale. So with an increased focus and desire to receive government incentives on the corporate side, and the difficulty in providing funding to support these programs on the government side, the potential for disconnect exists; i.e., corporate expectations do not align with funding reality.

Stepped Up Attraction and Retention Efforts

In reaction to this intense pressure on government agencies to raise revenue, some would argue they should increase taxes and decrease incentives; however, this view seems somewhat shortsighted.

Many states have embraced the idea that incentives are an extremely powerful tool that can help in business attraction and retention. In fact, with companies of all sizes in dire need of these subsidies in order to push their projects through the approval process, some states have instituted programs to step up their business attraction/ recruitment efforts, including western states that previously were considered to hold extremely conservative views when it came to offering business incentives.

On the retention side, the appropriate use of incentives to help “stop the bleeding” — by preventing a company from downsizing or relocating — has been endorsed by states and municipalities seeking to maintain their current tax bases. Under intense scrutiny to apply funds that were normally dedicated to incentive programs to other areas of government spending in an effort to plug holes in the overall budget, other states have had to fight to justify maintaining their current programs. And other states have succumbed to this pressure, reducing or cutting their incentive programs, either partly or entirely.

Let's look at some specific cases on the state level to get an idea of the different types of incentives a company may find when investigating prospective locations for a project.

Job Creation Incentives

In the first quarter of 2011, Arizona passed sweeping legislation designed to completely revamp and power up the state's incentive toolkit. Replacing the old Enterprise Zone Tax Credit, the state now provides a Quality Jobs program that can provide as much as $9,000 per employee for job creation projects. Even more importantly, the state added a "deal closing fund" to its arsenal. Arizona Governor Brewer has a funded program that comprises $25 million to be used at her discretion for projects that provide a net benefit to the state. The fund also allows for the reconstitution of the training grant program, which is considered one of the best U.S. models of such programs. This trio of incentives — plus included tax reform — now gives Arizona a major competitive advantage over many other western states.

Idaho has also passed a new tax credit program designed to promote job-attraction projects (beginning with employees hired after April 15, 2011) — both from companies that are growing internally and from those locating or re-locating to Idaho from out of state. This incentive is worth up to 6 percent of a qualified employee's wages for a full year. Two characteristics of the program make it stand out: First, the credit is refundable; i.e., if a company does not have the tax liability to use the credit, it will still receive cash. Secondly, the program doesn't have any major hiring thresholds; i.e., the incentive begins to accumulate with the hiring of one incremental individual statewide. This, coupled with the state's flexible training grant program, has provided a strong foundation for recent major announcements, e.g., Allstate and Chobani.

Retention Incentives

Kansas has been staring down the bad economy for a couple of years now, passing some of the most aggressive incentive legislation seen over the past few years in 2009. With the passing of the withholding tax rebate PEAK program, Kansas rewarded businesses that move into Kansas from an out-of-state location with an incentive worth up to 95 percent of withholding taxes collected for a period of up to 10 years. In the 2010 and 2011 legislative sessions, the state enhanced the PEAK program by relaxing the qualification requirements and enabling its use by in-state growth projects and then by retention projects, making it a very versatile and powerful incentive tool.

Other states that already have strong business attraction programs in place have also stepped up their incentive offerings on the business retention side in order to "maintain their front yard" and ensure that the tax base they have in place today stays there, and the potential for organic growth and future expansion is as ripe as it can be. For example, with an already strong business attraction tool in place, New Jersey's Governor Christie turned his focus to a struggling retention incentive that had been in place but was underutilized for years. The overhaul of the program in early 2011 included relaxing the qualification requirements as well as increasing the maximum value of the incentive from $2,250 per job up to a whopping $13,500 per job! In addition, proposed legislation that is gaining traction would institute an even better job-retention program.

Ohio also took a major step toward bolstering its incentive toolkit by adding a job-retention program to its existing job-creation incentives. Originally signed into law in March of 2011 to help American Greeting with a retention/relocation project (the company received $93.5 million to relocate from Brooklyn, Ohio, to Westlake, Ohio, according to an AP story), the retention program also assisted Bob Evans Restaurants and Diebold during 2011.

Some Struggles

While the above examples can boost companies' expectations for incentives in today's tough economic climate, not all states have been as aggressive. Some state legislatures have had to defend themselves from those opposed to incentives — not just newly proposed programs but, in some instances, even existing programs.

For example, the South Carolina legislature came under intense fire for the way it handled an incentive deal for online retailer Amazon. In April 2011, the legislature under Governor Haley pulled back from what supposedly was a handshake deal between former Governor Sanford and the retail giant that would have allowed for the company to forgo collection of sales taxes for in-state customers. In response, Amazon stopped construction of its fulfillment center in Spartanburg County, prompting the legislature to reverse course in May and vote to compromise to offer the sales tax advantage. This did not happen easily. This case truly pitted the philosophical debate behind government incentives against the economical one, and in the end economics prevailed.

And Illinois has continuously been defending its incentives programs against fierce public opposition. The state has a longstanding attraction/ retention incentive program based upon the withholding taxes collected from employees of eligible businesses. When the state legislature voted to raise taxes, many companies used this as a springboard position to approach the state for retention incentives. With companies like Sears, Motorola, Caterpillar, and Continental Tire all approaching the state for retention incentives and threatening to leave, many called the program into question and asked if it truly was being used as a positive tool for state competitiveness.

And finally there have been some states that have not been able to weather the storm, pulling back on many of their economic development tools. Some have abandoned programs altogether, while others have put heavy handcuffs on their existing programs. New York abandoned lucrative programs in favor of new programs that packed a much smaller economic punch. However, there are still incentives available when push comes to shove. Case in point: An aerospace products company has just decided not to move 1,000 jobs out of Upstate New York after getting a $20 million package of state aid to help replace a factory damaged by flooding in the summer of 2011. State and local authorities say Amphenol Aerospace will build the new plant near its current site in the Delaware County village of Sidney, a community near Binghamton.

Even traditionally incentive-friendly states like North Carolina have limited their use of their primary incentive tools. Currently North Carolina only awards 25 Job Development Investment Grant programs per year, which seems quite small given the size of the state. Nonetheless, Governor Perdue should be given credit for her veto of a bill that would have eliminated all of the funding from the three grant-based incentive programs that North Carolina uses to attract new jobs to the state. This sent a clear message that North Carolina was still able to be competitive when needed.

Case by Case

In sum, companies and government agencies need to adjust their respective expectations on a case-by-case basis. For a state or local government agency to assume that every competing location is being aggressive may not be accurate; and companies should not assume that their deals will automatically qualify them for state or local benefits or that governments are no longer offering financial incentives.

Now, more than ever, a company must navigate the incentive waters carefully, ensuring that they are educated with respect to a particular agency's problems and recent responses to the reduction in their primary revenue funds. This is particularly true for a company with a brand-recognizable name, as the public sentiment toward incentives is cautious, wanting to ensure that these giveaways of taxpayer dollars are being used appropriately to better the lives of the citizens of their area.