

Missing the Target? The Distribution of Ohio's Economic Development Tax Incentives

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Background

- Numerous justifications for providing local economic development incentives (efficiency and equity arguments)
 - Address market failures
 - Labor immobility, wage rigidity, imperfect information, negative externalities
 - Address social goals
 - Increased concentration of poverty, revitalize communities
 - Respond to changing economic conditions
 - Deindustrialization, trade
 - Respond to incentive competition from other jurisdictions

Findings from Academic Research

- The good news
 - Elasticities of economic activity with respect to business taxes is around -0.2 to -0.3
- The bad news
 - Incentives work best where they are the least useful – locally
 - Benefits are often smaller than touted
 - Jobs created may not be high paying

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Why Examine Tax Incentives?

- Unlikely for any single state to unilaterally eliminate business tax incentives. Tax competition seems to be increasing among state and local governments
 - Given that, how should a state best implement its incentive policies ?
- Theory argues that, even if incentives are zero-sum in terms of job creation, there can be efficiency gains if job growth is shifted from lower to higher unemployment areas and/or market failures are addressed

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Concerns about Tax Incentives

- Even if initially well-targeted, can lose focus over time
 - Political spread to economically-unjustified places
 - Allure of “justified” places reduced
 - Even if limited to “economically-justified” places, resources become too thinned out
- May be worse than zero-sum if
 - The incentivized new jobs would have occurred anyway
 - Most of the new jobs go to in-migrants
 - Front-loaded incentives go to firms that don’t stick around once the abatements phase out
 - The opportunity cost is ignored
 - Increased taxes on others
 - Reduced expenditures on useful services

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Ohio Business Tax Incentives

- Myriad of economic development programs
 - 13 separate business tax incentive programs
 - Many other programs to spur business innovation and commercialization, clean up brownfields, and train workers
- New efforts to focus policy
- Tax Reform
 - Phasing out **tangible personal property tax** & **corporate franchise tax**, reducing **individual income tax**, phasing in **commercial activities tax**

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We Examine 2 Local Abatements

- **Enterprise zones (EZ)**
 - Local community exemptions on real and personal property taxes for substantial investments
 - Up to 75%/10 years in municipalities
 - Up to 60%/10 year in unincorporated areas
- **Community Reinvestment Areas (CRA)**
 - Municipalities can designate areas lagging in property investment to receive property tax exemptions
 - Up to 100%/12 years for remodeling
 - Up to 100%/15 years for new construction

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We Examine 1 State-wide Incentive

- **Job Creation Tax Credits (JCTC)**
 - Refundable tax credit against the Corporate Franchise Tax (formerly)/Commercial Activity Tax (currently) for businesses that make capital and labor investments in the state
 - More generous for more jobs/higher wages/more fixed-asset investments
 - Credits based on a percentage of state income tax withholdings for all new employees

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Evidence on Ohio's targeting

- We seek to examine how Ohio has been targeting its incentives by looking at EZs, CRAs, and JCTCs
- Regress incentives on
 - Pop Density, Unemployment, Poverty Rate, % Minority, HS Graduates, Housing Values, Establishment Growth Rates, Presence of a major highway
- Measure incentives based on
 - Number, Value, and per-employee/establishment
- Examine industry targeting

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Data

- 1990 and 2000 Decennial Census
 - Information on characteristics of the population
- Ohio's ES202 database (2000 & 2007)
 - Information on the number of business establishments, size class, employment, wages, and industry
- Ohio Department of Development
 - Information on programs (1996-2004): EZ, CRA, JCTC
- County subdivision is the unit of analysis

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State failing to track new jobs

Sunday, September 14, 2008 3:42 AM

By Mark Niquette
THE COLUMBUS DISPATCH

During the past decade, the state has given companies more than \$1.7 billion in tax breaks, loans, grants and other incentives to expand or locate in Ohio.

In exchange, the businesses promised to create nearly 200,000 jobs.

How many jobs actually were created?

The state can't tell you.

In fact, officials say that, without examining their files on a project-by-project basis, they can't say which companies met or didn't meet signed contractual commitments for job creation, retention or training in exchange for the help from taxpayers.

Leaders at the Ohio Department of Development blame antiquated computer systems but insist that each project is carefully reviewed and that action is taken if job promises aren't kept.



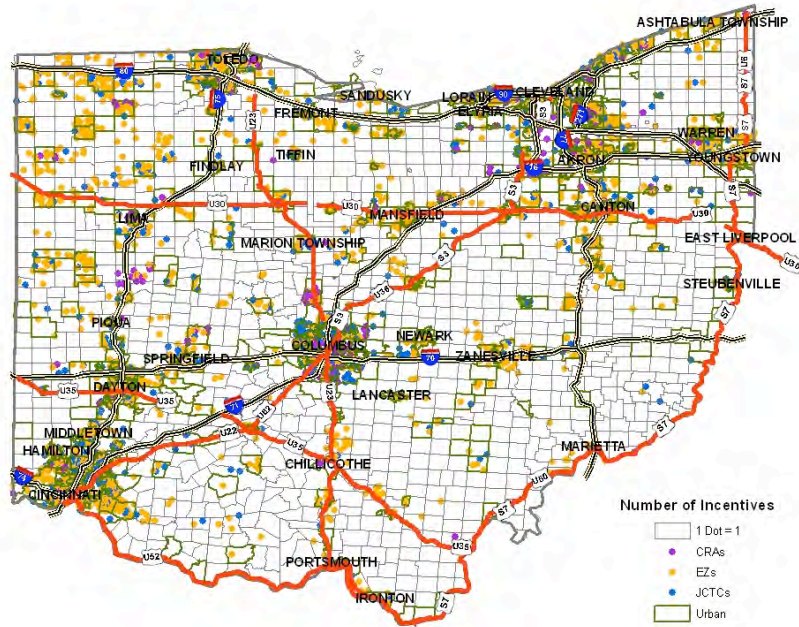
CRAIG HOLMAN | DISPATCH

The huge Kroger distribution center in Delaware was given \$1.16 million in incentives in 2002 to create 276 jobs.

Graphic

- Tracking state assistance

Web Extra



Estimated Value of “Potential” Incentives

- EZs & CRAs
 - Multiply investment by exemption rate and the property tax rate for the year
- JCTC
 - Based on income tax withholdings for new employees
 - Agreements specify number of new employees, % of withholdings eligible for the credit, and length of agreement
- All incentives converted to 2008 dollars

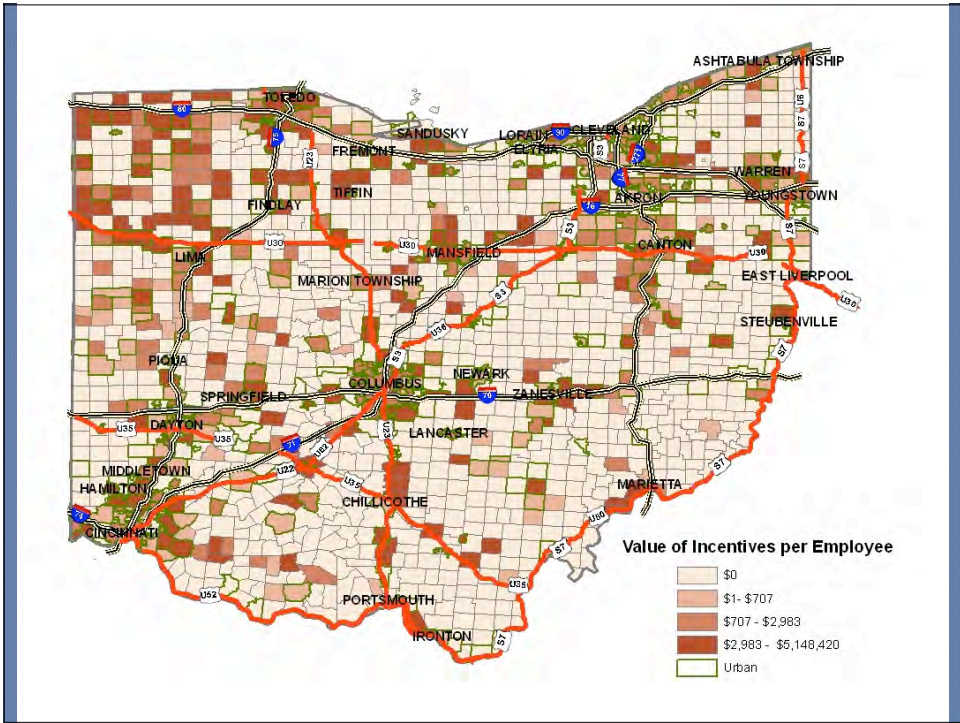
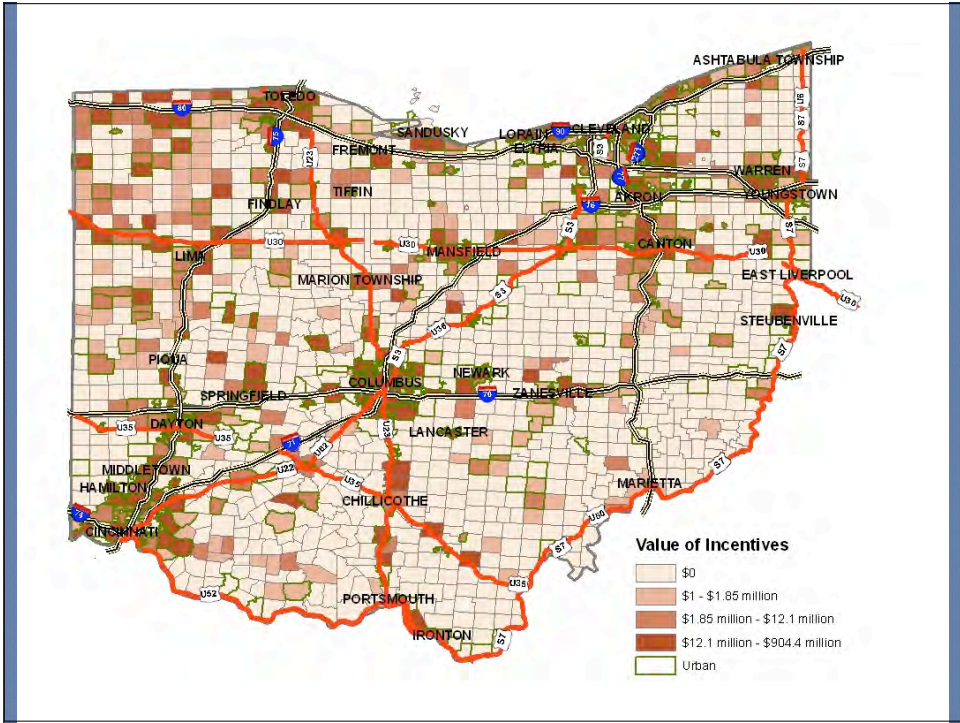
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Table 1. Variable Means – County Subdivisions

| Variable | Overall | Urban | Rural | Big 8 |
|--|------------|-------------|-------------|------------|
| Census variables | | | | |
| Population 2000 | 7,287.0 | 18,176.8 | 2,095.0 | 297,588.9 |
| % Population Change (1990-2000) | 6.05% | 5.84% | 6.44% | -1.62% |
| % of Population Non-white (2000) | 15.79% | 18.98% | 2.57% | 41.07% |
| % of Pop. with Less Than HS Degree (2000) | 11.41% | 11.27% | 11.96% | 14.15% |
| Household Median Income (2000) | 42,674.3 | 42,222.3 | 44,551.3 | 34,293.7 |
| % Change in Median HH Income (1990-2000) | 43.86% | 43.11% | 46.93% | 55.79% |
| % of Population Unemployed (2000) | 5.26% | 5.48% | 4.35% | 7.88% |
| % Change in Unemployment Rate (1990-2000) | -23.32% | -21.04% | -33.49% | -18.43% |
| ES202 Variables | | | | |
| % Total Wage Growth (2000-2007) | 32.06% | 23.28% | 68.64% | 18.16% |
| # of Establishments 2007 | 2,284.4 | 2,821.9 | 48.4 | 8,573.3 |
| % Growth in Establishments (2000-2007) | -4.19% | -4.24% | 9.01% | -5.21% |
| Department of Development Variable | | | | |
| Number of Incentive Agreements | 27.8 | 34.3 | 0.8 | 97.4 |
| Constructed Variables | | | | |
| Value of Incentive Agreements (in millions) | \$107.2 | \$132.2 | \$3.2 | \$415.5 |
| Value of Incentives per Establishment (2007) | \$64,106.2 | \$48,859.58 | \$127,573.7 | \$52,803.0 |
| Value of Incentives per Employee (2007) | \$3,196.9 | \$2,050.5 | \$7,969.3 | \$1,868.6 |
| Sample size | 1,560 | 503 | 1,057 | 8 |

Big 8: Columbus, Cleveland, Cincinnati, Toledo, Akron, Dayton, Youngstown, & Canton

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Summary of Regression Results

- **Number of incentives**
 - Urban places more likely to get more incentives (pop density and highway indicator)
 - Some evidence of targeting distress
 - % minority, lower housing values, poverty rate
 - Some evidence of not targeting distress
 - Lower unemployment rates, lower % of population without HS diploma
- **Incentives per thousand employees**
 - Only housing values significant

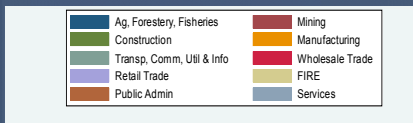
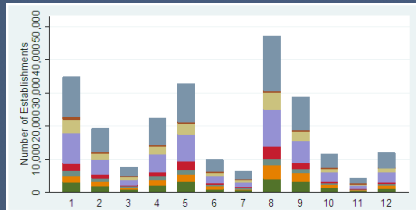
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Summary of Regression Results

- **Value of Incentives**
 - Pop density and highways again significant
 - Poverty rate and % minority also significant
- **Value of Incentives per employee**
 - Regression fails the F-test

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Industry targeting

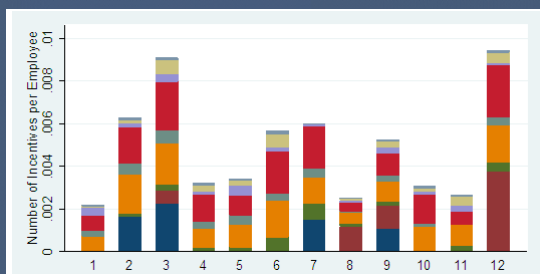
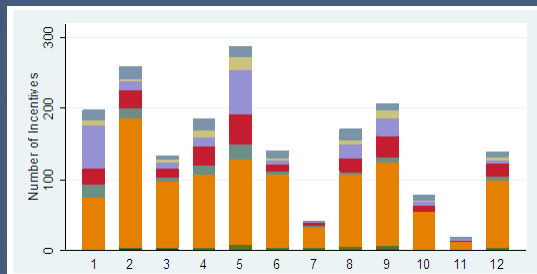


Industry

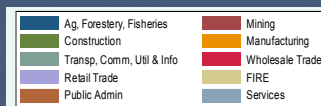


Manufacturing represents 7% of establishments, 19% of employment, and 26% of wages

Industry targeting



Manufacturing represents 58% of the number of incentives, but a much smaller fraction of incentives per employee



Industry

Summary

- While there is some evidence tax incentives are targeted at distressed areas, once the intensity of the incentives per size of the place is controlled for, no targeting is evident
- While manufacturing receives the most incentives in terms of numbers and dollars, the incentives per employee is less pronounced

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Conclusions

- If the goal is to redistribute economic activity to meet equity and efficiency goals, any incentives offered should be more targeted towards distressed areas
- If the goal is to be effective as possible at growing firms, it is unclear how incentives should be targeted

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Tables

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Table 2. OLS Regression Results: Number of Incentives

| Variable | Number of Incentives | | | Number of Incentives per Thousand Employees | | |
|--|----------------------|------------------|------------------|--|------------------|------------------|
| | Total | CRA&EZ | JTC | Total | CRA&EZ | JTC ^a |
| Population Density 2000 (Ln) | 1.803 (.000) | 1.434 (.000) | 0.369 (.000) | -0.089 (.574) | -0.163 (.159) | 0.075 (.407) |
| Unemployment Rate 2000 | -0.109 (.032) | -0.084 (.045) | -0.025 (.030) | 0.048 (.520) | -0.010 (.835) | 0.057 (.300) |
| Poverty Rate 2000 | 0.112 (.059) | 0.078 (.072) | 0.034 (.054) | -0.096 (.016) | -0.058 (.003) | -0.038 (.240) |
| Percent Minority 2000 | 0.172 (.022) | 0.139 (.015) | 0.033 (.091) | 0.003 (.777) | 0.004 (.632) | -0.001 (.742) |
| Percent without High School Degree 2000 | -0.160 (.000) | -0.129 (.000) | -0.031 (.001) | 0.006 (.882) | -0.004 (.914) | 0.010 (.543) |
| Median Housing Value (thousands) 2000 (Ln) | -2.558 (.002) | -2.427 (.001) | -0.131 (.505) | -1.393 (.003) | -1.183 (.002) | -0.211 (.256) |
| Percentage Change in Number of Establishments (2000-2007) | 0.009 (.059) | 0.006 (.113) | 0.003 (.007) | 0.035 (.274) | 0.003 (.656) | 0.033 (.306) |
| Major Highway Indicator (=1 if highway present) | 1.023 (.001) | 0.762 (.003) | 0.261 (.000) | 0.602 (.131) | 0.684 (.033) | -0.083 (.662) |
| Constant | 5.563 (.164) | 6.365 (.053) | -0.802 (.424) | 8.000 (.001) | 7.508 (.000) | 0.492 (.581) |
| R ² | 0.168 | 0.170 | 0.115 | 0.032 | 0.011 | 0.046 |
| N | 1540 | 1540 | 1540 | 1540 | 1540 | 1540 |

Notes:

P-values are in parentheses below the coefficients.

^aRegression not significant at the 10% level.

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Table 3. OLS Regression Results: Value of Incentives

| Variable | Total Value | Value Per Employee ^a |
|---|--------------------------|---------------------------------|
| Population Density 2000 (Ln) | 3,701.962 (.016) | -2.403 (.059) |
| Unemployment Rate 2000 | -396,546.800 (.186) | -366.855 (.803) |
| Poverty Rate 2000 | 431,342.600 (.057) | 36.915 (.865) |
| Percent Minority 2000 | 631,231.100 (.017) | -363.046 (.223) |
| Percent without High School Degree 2000 | -50,260.470 (.894) | 2,002.348 (.307) |
| Median Housing Value (thousands) 2000 (Ln) | 2,872.051 (.902) | 14.040 (.735) |
| Percentage Change in Number of Establishments (2000-2007) | 1,624.731 (.945) | -53.935 (.519) |
| Major Highway Indicator (=1 if highway present) | 8,176,548.000 (.001) | 16,710.110 (.122) |
| Constant | -1,636,955.000 (.730) | -19,624.570 (.366) |
| R ² | 0.066 | 0.008 |
| N | 1540 | 1540 |

Notes:

P-values are in parentheses below the coefficients.

^aRegression not significant at the 10% level.

Tax Law Changes under Am. Sub. H.B. 66*

| Tax Year | Commercial Activity Tax | Tangible Personal Property (TPP) Tax | | | Corporation Franchise Tax*** | Individual Income Tax |
|----------|---|--------------------------------------|---|----------------------|------------------------------|--|
| | | Inventory | Manufacturing Machinery & Equipment (M&E) | Furniture & Fixtures | | |
| 2005 | 7/1—12/31 .06% (23% x .26%) | 23%** | Existing—25%** | 25%** | 100% x tax liability | 4.2% cut across all brackets from 2004 rates |
| 2006 | 1/1—3/31 23% x .26% 4/1—12/31 40% x .26% | 18.75% | New M&E: not taxable Existing—18.75% | 18.75% | 80% x tax liability | 8.4% cut from 2004 rates |
| 2007 | 1/1—3/31 40% x .26% 4/1—12/31 60% x .26% | 12.5% | New M&E: not taxable Existing—12.5% | 12.5% | 60% x tax liability | 12.6% cut from 2004 rates |
| 2008 | 1/1—3/31 60% x .26% 4/1—12/31 80% x .26% | 6.25% | New M&E: not taxable Existing—6.25% | 6.25% | 40% x tax liability | 16.8% cut from 2004 rates |
| 2009 | 1/1—3/31 80% x .26% 4/1—12/31 .26% | No Tax | No Tax | No Tax | 20% x tax liability | 21% cut from 2004 rates |
| 2010 | .26 | No Tax | No Tax | No Tax | No Tax | 21% cut from 2004 rates |

*This chart is not a comprehensive summary of all tax changes. **Same as 2004 rates. ***Certain companies, such as financial institution, will continue to pay the full net worth tax.