Study Shows Failures in Incentives Programs

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Article:

Last month may have marked the beginning of the end of North Carolina's uncritical embrace of fiscal incentives. The General Assembly has authorized the drafting of legislation that would curtail targeted incentives at the state level in favor of a general reduction in the state's corporate tax rate.

The legislators' decision was based on a new report from the Center for Competitive Economies at UNC-Chapel Hill. The study, which analyzed tax returns and other state records, reviewed four state incentive programs: the William S. Lee Act (known formally as Article 3A and since replaced by Article 3J); the Research and Development Tax Credit; the Job Development Investment Grant (JDIG); and the One North Carolina Fund.

The study found that a relatively small share of the tax credits for which businesses have qualified have actually been claimed. From 1996 through 2006, more than $2 billion of tax credits were generated under the Lee Act, but companies claimed only 30 percent of that. The researchers acknowledge the existence of barriers to receiving credits, but they interpret the low use rate as evidence that incentives have fallen short of their objectives.

Another shortcoming involves the state's goal of favoring the poorest counties. The more economically distressed the county, the higher the available tax credit or grant per project. The UNC-CH study found, however, that most incentives have gone to businesses in the richest counties. For example, projects in those counties have accounted for more than 80 percent of JDIGs. Clearly, the state's incentive programs haven't improved conditions in its poorest counties.

The ultimate goal of any economic policy is the creation of good jobs. During the 1990s, companies receiving Lee Act credits increased their payrolls faster than the state's labor force grew. But since 2000, the payoff of incentives has dropped off, and now there is no improvement in job growth.

Delving even deeper into the data, the study looked at employment growth at companies before and after receiving tax credits. For companies receiving credits for job creation, the rate of job growth didn't increase after the credit. For companies receiving credits for capital investment, job growth was nonexistent after the credit. Most of the shortcomings identified by the UNC-CH researchers involve the Lee Act and Article 3J.

Since 1996, those programs have accounted for the vast majority of state incentives. But in recent years, economic-development officials have preferred discretionary programs such as JDIG and the One North Carolina Fund, which are more flexible and easier to target to emerging high-tech industries and (in principle) poor counties.

The researchers argue that the Lee Act/Article 3J program is a blunt instrument that needs to be eliminated. In its place, they propose an across-the-board reduction in the state's corporate income tax. The cost of lowering the corporate tax would be covered by the savings from discontinuing Article 3J.

The study makes other recommendations as well, but taken as a whole, they won’t warm the heart of a diehard opponent of fiscal incentives. To be sure, replacing Article 3J with a lower corporate income tax is a move toward less targeting and discretion in economic policy. But expanding JDIG and the One North Carolina Fund is a move in the opposite direction. And the pending legislation would say nothing about incentives granted by cities and counties.

The UNC-CH study won’t put an end to fiscal incentives, but it may help state officials use them with a more critical eye.