MEMO

To: Emily Thompson and John Walstad

From: Jeff Chapman and John Buhl, The Pew Charitable Trusts

Date: Feb. 11, 2016

Subject: Some initial thoughts on evaluating incentives

In response to your request, here are some quick thoughts on ways to approach some of the credits that the Political Subdivision Taxation Committee is reviewing. The general idea is that a full economic analysis would be unnecessary and even unhelpful for some incentives. Instead, by considering key questions about the effectiveness of these programs, how they are designed, and how they are being utilized, the committee may be able to identify ways to make incentives more effective.

As a place to start, we looked at the four credits most closely tied to jobs and employment. We are not taking positions on the effectiveness of these credits, but rather suggesting questions that the committee may want to ask.

Wage and salary credit

The committee could consider why a tax credit worth 1 percent of salaries has not been utilized in recent years. Is it because the credit cannot be claimed at the same time as the new and expanding business credit, which is worth more? Is this a sign that the credit is obsolete or, with modifications, could it serve one of the state's economic development goals?

Internship employment credit

Given its size and design, this program is unlikely to be having a significant impact on the state economy. But it could be achieving other state goals. One question to consider is whether the credit is encouraging companies to make significant investments in internships or whether it is simply rewarding companies that have other reasons to do so. The limits on claims per company may be worth examining when considering the effectiveness of the credit. The downward trend in claims might suggest that companies are hitting the lifetime cap and are no longer able to receive benefits under the program. Another question that might be worth asking is whether the higher education institutions are aware of this program and whether they use it as a sweetener when trying to find internships for students. Has it been useful to them? Why or why not?

Workforce recruitment credit

As with other credits, one of the key questions is how effective this incentive is at changing business behavior. If the credit is incentivizing workforce recruitment, the situation has to be as follows: A company has a hard-to-meet position that they are willing to go to great expense and effort to fill, including hiring specialized recruiters and paying signing bonuses, but ONLY if one year after filling the position they receive one a percentage of the worker's salary as a tax credit. If recruiting specialized workers is a significant problem for North Dakota' economy, one question that may be worth asking is whether providing upfront incentives to businesses would be more effective. That approach could provide assistance to businesses at the time they are paying recruiting expenses.

New jobs credit from income tax withholding

This credit has a larger fiscal impact than the others discussed in this memo, so the committee may want to study it in more depth. Nevertheless, considering key questions may provide the committee with valuable information, even without econometric modeling. For example, the committee could explore the connection between this program and other education and training programs. Would this program be more effective if it was tied more directly to community colleges? Is there evidence that firm-specific training produces career opportunities?

In thinking through how much economic impact can be attributed to the incentive, one option is to present a range of scenarios. A Virginia audit from 2012 reviewed economic literature and found that incentives sway business decisions about 10 percent of the time, meaning that 90 percent of business activity occurs regardless of whether states offer incentives. However, the study noted that the rate could be higher in certain instances. For example, while transportation and labor costs are much bigger factors in business location decisions than incentives, incentives may have more influence at the end of the site selection process—when a business is choosing between a few locations. The committee could determine under what circumstances the credit is likely to have the biggest impact and consider whether changes to the program's design could make the credit influence business decisions more often.