Joint Select Committee On Economic Development Incentives

UNC Economic Incentives Analysis

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Key Legislative Questions

- How have incentives been used?
- Which incentives achieve the greatest return?
- Are there changes and/or alternatives that better achieve economic priorities?

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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

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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

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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?

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Incentives Have Limited Effect on Corporate Locations

- National surveys indicate incentives are relatively low in importance in location decisions
- **Site Selection** magazine (2008) survey of corporate executives ranked incentives eighth
- UNC survey of NC incented and non-incented ranked incentives 12^{th} and 13^{th} respectively
- Incentives do not compensate for inadequate workforce or infrastructure

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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
- Combined with other assistance
- Before the auction starts

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Incentives Have The Greatest Economic Benefit When…

- Company employs local residents, minimizing public service outlays
- Company has catalytic effect on local suppliers
- Company is in growth mode with job creation upside
- Company is a headquarters in an export industry, creating local wealth

Updating NC's Incentive Portfolio

- Current portfolio relies too much on statutory tax credits that are less effective than in 1990s
- Majority of tax credit incented firms showing little job growth
- Investment tax credits strongly associated with job loss
- R&D credits show best correlation with job growth
- Job creation tax credits show weak effect

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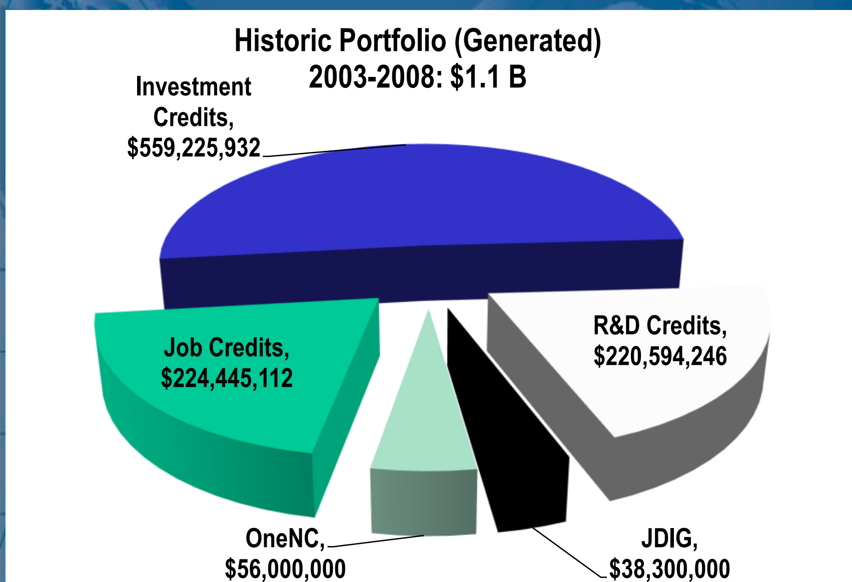

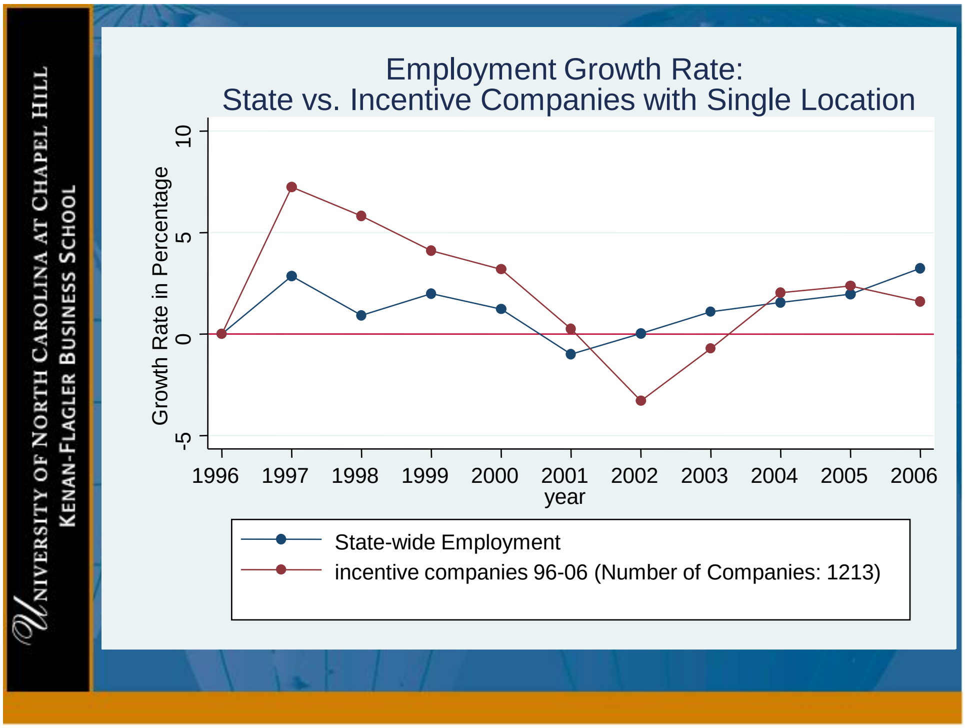
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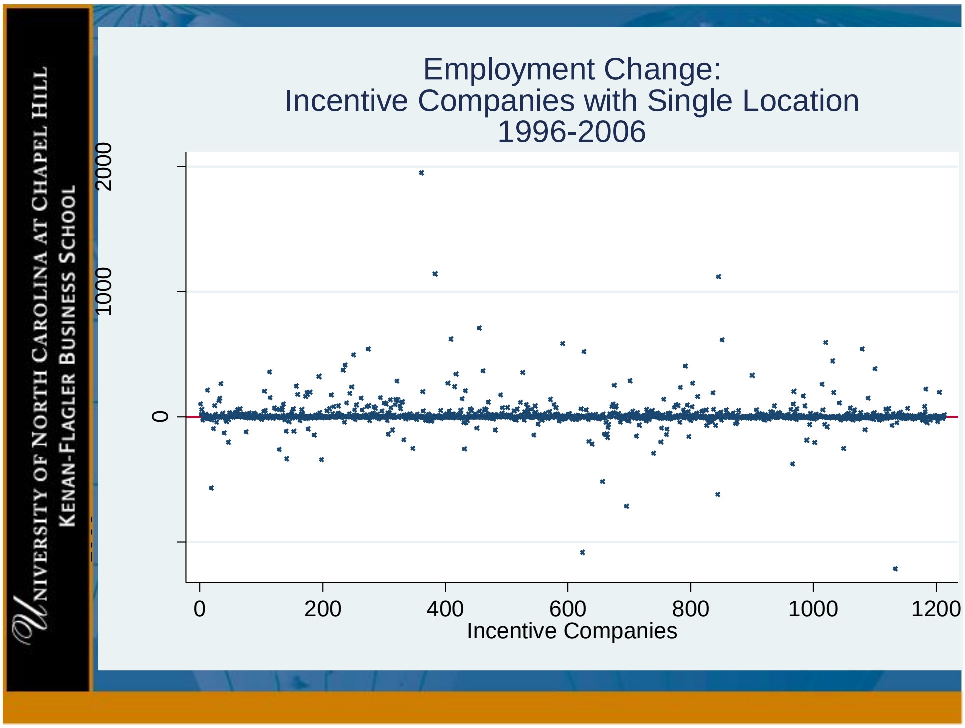
Employment Growth Rate:
State vs. Incentive Companies with Single Location
Growth Rate in Percentage
10
5
0
-5
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
year
State-wide Employment
incentive companies 96-06 (Number of Companies: 1213)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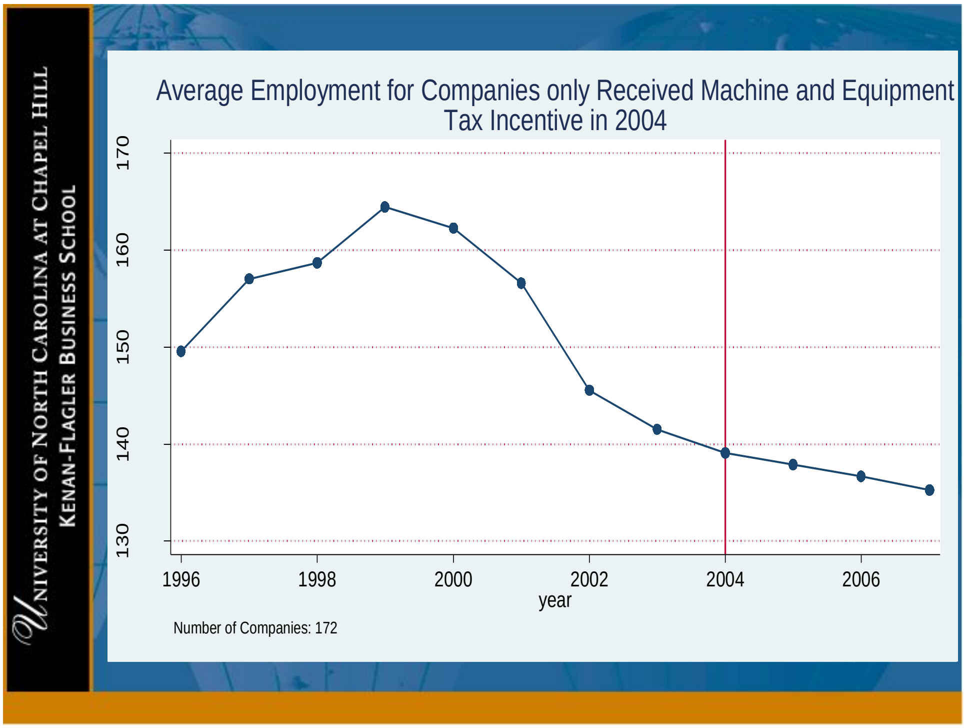
Employment Change:
Incentive Companies with Single Location
1996-2006
2000
1000
0
0
200
400
600
800
1000
1200
Incentive Companies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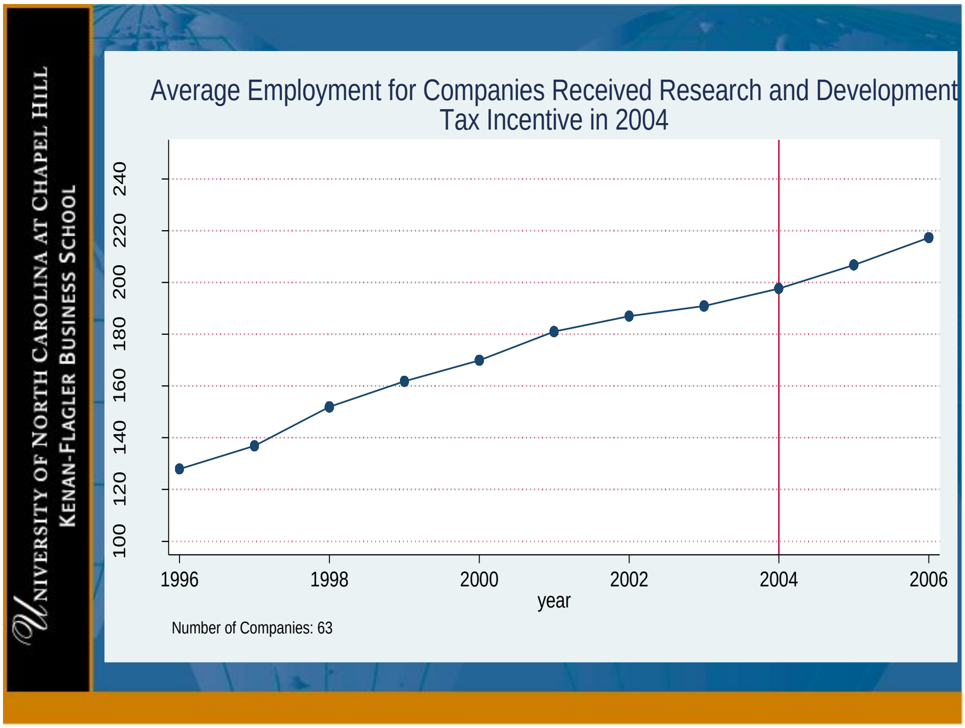
Average Employment for Companies only Received Machine and Equipment Tax Incentive in 2004
130
140
150
160
170
1996
1998
2000
2002
2004
2006
year
Number of Companies: 172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Average Employment for Companies Received Research and Development Tax Incentive in 2004
100
120
140
160
180
200
220
240
1996
1998
2000
2002
2004
2006
year
Number of Companies: 63

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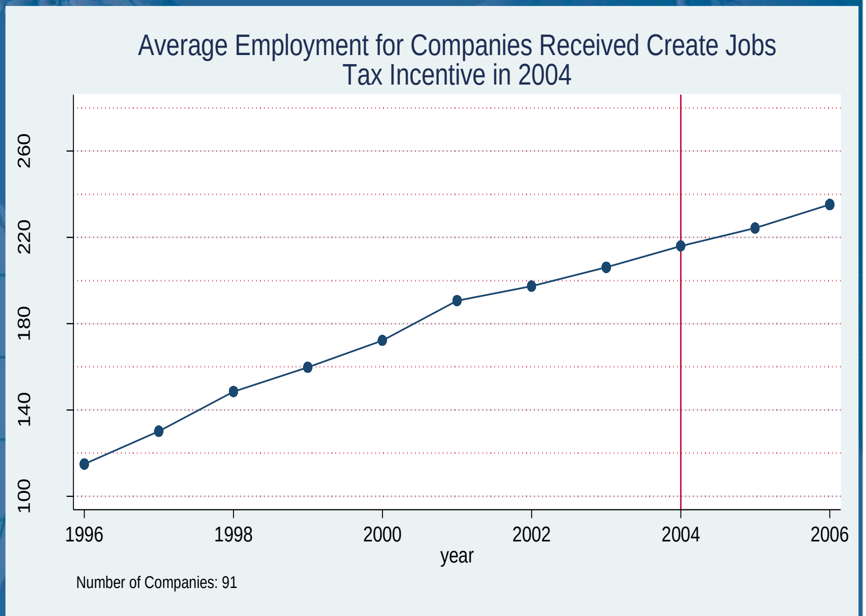

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Current Economy Favors Discretionary Incentives

- Discretionary incentive programs have flexibility to address more current market priorities
- Tax credits require profits to use
- Discretionary incentives reduce capital/credit requirements
- Performance based incentives offer better accountability and enforcement
- Greater utility for strategic, proactive targeting

The Carolina Center for Competitive Economies (C3E) Kenan Institute for Private Enterprise

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NC Corporate Tax Rate

- UNC survey found executives preferred lower tax rate to selective tax incentives
- Rate reduction positive effect on more firms
- Reallocating incentives portfolio can support corporate tax rate reduction
- Reducing current 6.9% rate to competitive neutral rate of 6.5% cost $56 million (2005)

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NC Corporate Tax Rate

North Carolina	6.90%
Alabama	6.50%
Tennessee	6.50%
Georgia	6.00%
Virginia	6.00%
Florida	5.50%
South Carolina	5.00%

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Incentive Portfolio Adjustment Recommendations

- Retain Research and Development Tax Credit
- Eliminate Article 3J statutory credits (scheduled to "sunset" in 2011) effective 2010
- Expand JDIG program with increased amounts targeted to distressed counties
- Phased reduction of corporate tax rate to competitive neutral rate of 6.5%
- Increase economic development research and marketing budgets for proactive targeting

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Retain Research and Development Credit

- Only investment credit associated with job growth
- Corresponds to federal credit
- $221 Million in credits generated 2003-2008
- Est'd $250 Million in credits will be generated and $124 Million taken during 2010-2015

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Eliminate Article 3J Credits

- Statutory tax credits have declined sharply in job creation effect
- Development of JDIG and OneNC offer more effective discretionary alternative
- Potential total savings of $574 Million in retained tax revenues during 2010-2015
- Most savings in later years

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Expand JDIG Targeting Distressed Counties

- Doubling JDIG program with increased amounts targeted to distressed counties
- Emphasize incumbent workforce utilization and coordination with community college workforce development
- Est'd additional cost of $74 Million total in 2010-2015

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Corporate Tax Rate

- Phased reduction of corporate tax rate to competitive neutral rate of 6.5%
- Est'd cost of $56 Million (2005) annual at full reduction
- Highly variable nature complicates forecasts

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Enhancing Economic Development Marketing

- Increase economic development research and marketing budgets for proactive targeting
- Collection and analysis of strategic economic status data and market opportunities
- Institute a legislative oversight function to assess economic development agencies
- Est'd $1.5 million/year

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Final Steps

- Meetings with economic development stakeholders on incentive findings and options
- Development of draft legislation for Committee consideration
- Assist in legislative process through July 2009