The Use of Incentives in Economic Development

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Introduction:
Competition among states and cities for new business projects is nothing new. Economic development incentive use accelerated as the federal government cut back on economic development programs in the late 1980s early 1990s. The impact of the recession during that period resulted in plant closures, lay-offs, fewer new jobs and increased global competition. Elected officials were under immense pressure to do something about economic development and thus, the incentive bidding wars began.

Today, the fervor for new jobs among states and regions has grown increasingly competitive, contentious and costly. It has been described as the “new war between the states.” At one time, in South Florida, it could also have been accurately described as the war between the counties or even the war between the cities. Largely through the efforts of The Beacon Council, this incentive “war” has greatly lessened, though on occasion it still does happen. Since the late 1990s, informal agreements between the three South Florida counties have reduced or eliminated this inter-county competition.

The use of incentives has now become the subject of widespread media debate. Articles in the past in publications such as *TIME* magazine and the *Baltimore Sun* have examined the use of incentives in cities around the nation. *TIME* magazine profiled several development projects around the country where incentives were used excessively, including the Mercedes-Benz plant in Alabama where incentives in excess of $200,000 per job were awarded. The recent series of articles in the *New York Times* has served to raise the issue to public view once again.

Critics of incentives claim the use of state and local incentives have little, if any effect on business location decisions. They argue that:

- State/local taxes are small percentages of total business costs.
- Surveys of businesses usually indicate that state/local incentives are not the most important location factors.
- Incentives subsidize businesses for activities they would have undertaken anyway.
- Not risk free- sometimes promised jobs do not appear – or company relocates from a community that recruited it. Businesses locate to highest bidder.
- Bidding wars are initiated between jurisdictions.
- Incentives are another form of corporate welfare

In order to fully explain economic development incentives, I will address the following five questions.

1. What are incentives?

- Incentives are mostly back-end tax refunds based on performance. In Florida, participating businesses pay their taxes up front and receive partial refunds — if and when they live up to benchmarks outlined in the contract they're required to sign when they apply for this benefit. The benchmarks are based on the number of jobs created, amount of capital investment, average wage paid, and the type of industry being incentivized. **Recently, the Pew Center, a non-partisan institute based in Washington, D.C., said Florida did a good job of capping incentive payouts.**
- In 2010, the state legislature passed a law limiting how much money can be given to attract entertainment projects. Overall, Florida's incentives will total about $125 million this year which is roughly the same as last year, according to the *Orlando Sentinel*.
- If a company fails to meet the established requirements, it forfeits its refund. Meanwhile, our community enjoys the benefit of new jobs and capital investment.
- It can be almost anything. Many location consultants view incentive packages as a buffet table from which they can just load up their plates.
- Incentives can be and are defined broadly as everything from subsidized job training and employee relocation assistance to tax credits and utility rate write-downs. Incentives can be as simple as new signage or a traffic light. They can also be a pledge to expedite permitting approvals. Financial incentives remain an important factor in the site selection business no matter what anyone tells you.
- In Florida, they're audited to ensure businesses live up to their end of the bargain.

2. Why Use Incentives at All?

Most economists believe the most important locational factors for a company is access to markets, skilled and educated workforce, transportation and raw materials. In the past, state and local taxes were not necessarily a major factor.

Recent research and practical experience shows that changes in the economy and tax structure have modified this. While traditional location factors still exert an important influence, the list of locational determinants has been expanded to include state and local taxes, education and/or job training, business climate, labor skills, state and local physical infrastructure, and/or quality of life issues such as housing, arts and culture, and stability and effectiveness of local government.

While business survey after business survey reports that incentives are far down on their list of important locational factors, it is usually the first thing location consultants ask about. A new industry of consultants for hire, now referred to as location or site selectors who negotiate or advise companies on getting public incentives has developed. They list incentives as one of the key location decision factors.

Job training, tax and non-tax incentives can become a key decision factor. It can be the glue that seals the deal in the location decision process. If all traditional locational factors are considered equal, incentive packages can and do make the crucial difference.
We have all read and heard about various horror stories on incentive use. The recent *New York Times* article as well as the past articles in *Time* magazine mentioned earlier, gave readers an in-depth look at what can happen when incentive use is not controlled.

Depending on the article, incentives are either portrayed as corporate welfare with greedy corporations leaving scorched earth as they pillage communities for their own benefit or as the savior and foundation of public/private partnerships that will grant the economic development dreams of local officials. In reality, they are neither. The public policy debate on incentive usage is healthy and has encouraged in the past reform and scrutiny of their use.

Incentive usage is undergoing a transition from free for all giveaways to carefully negotiated contracts with measured accountable results. The reality is, incentives are not going away. Corporate site selectors usually zero in on incentives rather quickly as they review possible locations. Although surveys may report otherwise, consultants say that incentives have moved to the top of the list, along with location and labor. These consultants are hired specialists who negotiate incentive packages with the public sector. They have top lawyers, accountants, finance and real estate people who will negotiate with a frontline economic development staff member. It is critical that the public sector have the knowledge and a competent staff available to represent the public's interest in the incentive negotiation. "The lion and the lamb may lie down together but the lamb isn't going to get much sleep."

3. How Should Miami-Dade County Use Incentives?

As President and CEO of The Beacon Council, Miami-Dade County's official economic development partnership, **we do not advocate the wide use of incentives as the principal foundation of our economic development policy**. The Beacon Council discourages a strategy that uses development incentives as the main factor in expansion and relocation decisions. But I do believe, there are situations where incentive packages are necessary and can be put to effective use. **It should be noted that last fiscal year, only 19 percent of our total projects included some type of inducement incentive.** However, there are certain principles that we adhere to:

- Use of incentives should be analyzed in relation to the status of the local economy, public policy objectives, unemployment rate, job growth and urban redevelopment, etc. The incentive must have a proven Return on Investment (ROI) for the County and/or the State.

- Companies threatening to leave can spark escalating bidding wars between jurisdictions. This can lead to predatory forms of competition. Bidding wars between neighboring jurisdictions should be avoided. Let me provide some history and cite some examples:

In South Florida, the use of incentives has sparked controversy in the past. The County in concert with The Beacon Council has adopted a policy that requires incentive projects to have a positive ROI tax benefit for the County. The only exceptions have been when we have advocated incentive usage at a one to one ratio to induce job productivity investment in TUAs (Targeted Urban Areas) and Enterprise Zones.

In early 1997-98, Broward County, had been trying to use state funded incentives to lure companies from Miami-Dade County. Corporations such as a major retailer and an aviation company were solicited to relocate their businesses to Broward although no new net jobs were created, and state funded incentives were proposed as part of the relocation package. In the case of the retailer, the new headquarters was already on its way to being built when the company tried to get incentives as a basis for the move (hard to justify a "but for clause" when the building is already under construction). Upon learning of this, The Beacon Council quickly took action by urging the Florida Governor and Legislature to pass a law prohibiting the use of state incentives to induce a company to relocate within the state (except under very narrow criteria). At The Beacon Council's request, the state incentive package for these companies was denied. This caused quite a media frenzy, which the national media watched very closely.

When thwarted in their efforts to use state incentives, Broward county municipalities often resorted to using locally funded incentives to induce Miami-Dade companies to relocate (i.e. Channel 6, Aviation Sales and Southern Wine and Spirits, etc.)
As a result, The Baltimore Sun newspaper ran an article chronicling the demise of their incentive packages. The reporter who did the story commented that in Baltimore this practice of luring business from one county to another without creating any net new jobs, has been going on for years unchecked by state and local officials. Our goal, in Miami-Dade County has and continues to be to build opportunities for the entire South Florida region. Rather than merely competing against each other, we must work to complement each other in order to achieve mutual benefit. We should and do collaborate and cooperate. We are happy to report that for the most part, the predatory practice of using incentives to induce companies to relocate between South Florida counties has ceased.

In the final analysis, the best incentive is improving the regional product while spotlighting what is good about Miami-Dade County. We cannot overlook what ails us. We must continue to improve our educational system. That's why it's imperative to follow the One Community One Goal (OCOG) plan to provide the best educational system possible as it is the foundation for the County's future economic growth. Corporations need to know that a community has the necessary number of skilled workers to support their operations. Company executives also demand quality education for their children. At the same time, we must also market our educational institutions and programs that we have: we must strive to achieve lower crime rates, low taxes and efficient business friendly government. We must continue to improve our infrastructure – good roads, efficient transit, airports, seaport, etc. This is why recent improvements at PortMiami, Miami International Airport and our transportation system have been so important. These are the basic requirements needed to keep local companies here, while attracting new companies. We must continue to improve the locational competitiveness of our TUAs (Targeted Urban Areas).

We must streamline the permitting process so that to get a building permit takes no longer than it does to construct the building. We must focus on improving the process required to establish or expand a business within our County. This is especially true for small business enterprises. A major incentive for companies would be a simplified and accelerated permitting and regulatory environment. In the final analysis, these are real business incentives.

- There is an arms race mentality, which often forces policymakers to believe they must match the development incentives a competing locale offers. This race is fueled by site selectors, lawyers, lobbyists and politicians and the companies themselves.
- Tax and other development incentives should be used judiciously and only if appropriate accountability safeguards are part of the agreement. Incentives should result in net new jobs, capital investment, new taxes or the revitalization of an area.

Therefore we require:

a) Economic impact analysis of each project and briefing reports on the project to be analyzed as part of the incentive review process.
b) Targeted rate of return for development incentives: We view these as investments in our community. Projects should meet our targets and analysis on the public benefit issues such as goods/local services to be purchased, total taxes and utilities paid, amount of payroll, salary levels in targeted industries as identified by OCOG, minority hires, etc.
c) Incentive packages must be performance based and self-amortized. We must require that incentive packages are tied to the amount of dollars and jobs the project will generate. (ROI must be posted)
d) The establishment of mechanisms for enforcing accountability. Legally binding performance agreements/resolutions must be used that identify number of jobs, taxes, amount of investments, etc.
e) The use of clawbacks for any incentive advances when needed.
f) Incentive adjustments to reflect any changing business conditions or non-performance.

I also strongly believe that there should be separate responsibility for negotiating and evaluating incentive deals.

a) People who sell developers on projects (such as The Beacon Council) should not directly approve fiscal contracts. Development contracts must have independent review and approval by the mayor, local county commissioners, auditors and/or local city officials. The State of Florida also independently reviews incentive applications when state funding is involved. In Miami-Dade, the current process is that The Beacon Council develops the initial incentive agreement with the prospect. Our work, in turn, is presented to the public sector to be reviewed independently by the Mayor's office and County Commission and ultimately, the public. They should have a clear explanation as to who gets what, and who pays for it. This may be cumbersome but you must have public review and high accountability standards if we want continued public support. We believe that the state incentive application must be modified or better vetted to identify any and all past legal criminal conduct of the company applying for the incentive.
b) Incentives should play only a limited and supportive role within our overall economic development policy.
c) Incentives play a supporting role in any development portfolio. They are a supplemental act, not the main show. The best incentives for any corporation should be available skilled and educated workforce, technology, location, infrastructure and quality of life, etc. If they are simply engaged in an incentive bidding war, do we really want this company?
d) Development incentives should be used to create net new jobs, create new taxes, retain existing jobs that broaden our economic base, or to foster and retain development in a blighted or economically depressed area. Infrastructure improvements can be the best type of incentives. This is especially true in the Targeted Urban Areas (TUAs). Get rid of contamination in an area (Brownfield), fix the lighting in an area, upgrade water and sewer, or improve the roadways – those are incentives that will remain irrespective of whether the company remains. Although many site selectors will tell you these are really not incentives, if required infrastructure were not in place, they would just move to a site that has these things in place. This is why we proposed and advocated creation of economic development fund as part of General Obligation Bond (GOB) programs. The majority of the funds should be directed for major impact projects. However, we believe the regulation requirements and approval process needs to be streamlined. The GOB economic development funds need to be awarded on a realistic timetable for eligible projects.

Our goal is to build opportunities for the entire South Florida region. Rather than competing against each other, we must work to complement each area in order to achieve mutual benefit. We should also be focused on county-wide regional investments.

4. What else should be considered part of an Incentive Package?

- Urge that jobs (when possible) go to those people of low-to-moderate income, unemployed or underemployed provided they have the **necessary skills and training.**
- Require a certain level of capital investment as the Qualified Target Industry Tax Refund incentive (QTI) and Targeted Jobs Incentive Fund (TJIF) incentives do.
- Discourage incentives in deals that merely move projects from one part of the city (or County) to another.
- Look and evaluate the incentives being offered by the competing locals.
- Discourage local/county/state incentives to relocate company within the South Florida Region
- Encourage sustainable development via additional incentive bonus

5. What Types of Incentives Are There?

<u>Federal Incentives</u>
For the most part, the federal government has gotten out of its incentive role for economic development – gone are the days of Economic Development Administration (EDA) and Urban Development Action Grant (UDAG)s. However, funds targeted for "community development" can creatively be utilized for economic development incentive packages.

Available Federal Incentives Include
- Worker Relocation Assistance
- Community Development Block Grant (CDBG)s
- Section 108
- DoD – Base Conversions

<u>State Incentives</u>
There is a sense that the State of Florida lags behind the other locations in the amount/type business incentives they provide – it's a throwback to the day when it was viewed that sun/sand was enough of an incentive. In reality, the State of Florida is often evaluated on being in the "middle range" of the states offering financial inducements.

- We recommend the minimal use of tax-payer funded incentives to relocate companies within the state, especially those locales with interdependent economies. We should also strive to eliminate use of locally and state funded incentives to relocate companies within State of Florida. Most economic development professionals would just as soon eliminate the use of publicly funded incentives. We would welcome national tax policy which would have the net effect of eliminating the use of public incentives as inducements for companies to relocate from one locale to another within the U.S.A. The reality is, given the global economy, even if incentives between states are eliminated, we still need to compete internationally. Incentive requests will not be eliminated when multi-national companies from international locales come seeking the best financial deal.

The Beacon Council and Miami-Dade County have also created the Targeted Jobs Incentive Program (TJIF). This is a local initiative patterned after the State of Florida Qualified Target Industry Tax Refund Program (QTI) has proven to be a very effective local incentive. It can be listed separately or as a companion to the State "QTI" program. Given that the state pays 80 percent of the QTI incentive (the local government pays 20 percent), we try to first utilize the QTI as the preferred incentive.

<u>Available State Incentives Include:</u>

- Qualified Target Industry Tax Refund Program (QTI)
- Capital Investment Tax Cut (CITC)
- Quick Response Training
- Economic Development Transportation Fund
- Sales/Use Tax Refund
- High Impact Performance Incentive (HIPI)
- Brownfield Bonus Incentive
- Quick Acting "Closing Fund"

There are some state incentives which support economic growth in economically disadvantaged areas, such as the enterprise zone program. We believe state incentives based upon current Enterprise Zones should be improved. The current Enterprise Zone program is ineffective. To that end, we have proposed a major overhaul of the program. The proposed Enterprise Zone legislation we drafted would have a major positive impact on inducing job producing investments in the TUAs.

<u>Other Potentially Available Local Incentives Include:</u>
Miami-Dade County offers only standard traditional business incentives such as:

- Industrial Development Bonds (IDBs)
- Free Trade Zones – now expanded
- CDBGs (Target Neighborhoods) – Federally funded
- Section 108
- Enterprise Zones
- GOB Infrastructure Funds
- Target Job Incentive Fund (TJIF)
- Tax increment financing (TIF)s, Community Redevelopment Agencies (CRA)s

Even this menu of layered incentives does not always give us any competitive advantages in the marketplace. Often we are "outbid" by competing locales such as Georgia, Texas and the Carolinas. The offer of free land and buildings by Panama and other Latin American countries also at times puts us in a competitive disadvantage. Sometimes it is necessary to develop innovative programs which are specific to a project. If a political jurisdiction is going to compete via the incentives game, be prepared. One needs to know what you’re doing or you will be taken advantage by those who negotiate on behalf of the company.

The business of economic development locally, regionally, state, and nationally has become much more competitive and creative in the use of incentives – not all of the areas we compete against adhere to the principles I have previously outlined. I would not advocate nor support trying to buy jobs, or a relocation announcement via heavy use of incentives. However many political jurisdictions do just that. **We do not advocate “upfront” cash payments of incentives.** We believe all should be performance based and after the fact. However, incentives – if utilized properly with tight safeguards and criteria applied not only to new to market companies but those that are already here and looking to expand – can be a valuable tool to help meet companies’ needs and expectations. I firmly believe the best incentives are quality education, excellent location, unparalleled quality of life, skilled and educated workforce and a superior airport and seaport to name a few.

TOP TEN LISTS

Approaching the Issue of Incentives – Top Ten for Private Sector

I am often asked by private sector representatives, how the issue of incentives should be approached. To that end, I’ve developed my own “David Letterman’s Top Ten List” of what to do when trying to negotiate an incentive package with the public sector. Some of these suggestions can be attributed to Mark Barbash, former executive director, Columbus, Ohio Countywide Development Corporation. I’ve modified them to meet specific circumstances here in Miami-Dade County.

10. Approach the Discussion as a Negotiation:
Economic development professionals are charged with protecting their tax dollars. We are concerned that any incentive package must meet the needs of specific businesses, but doesn’t give away the store. Companies should not demand, threaten or give classic lines like “give us your best deal.” Our best deal is nothing! Now, let’s talk about what the company’s specific needs are. Bring the decision makers to the table. Don’t waste time going to meeting after meeting. We need people at the table that can speak and act on behalf of the company.

9. There is No “Free” Money:
All incentive programs have quid pro quos placed on them by legislators, policy-makers and voters. The first thing is that the company must finance part of the project. If they don’t want to put up the money, why should we? The company must be willing to take risk. They must be willing to guarantee the deal. The better the guarantee, the more willing we will be to create an incentive package. The company must be willing to provide financial information background and informal legal info. The company must be honest and complete in their disclosure. They must be willing to go through the

regulatory maze and comply with government requirements – “strings.” They also need to accept that any package will be ultimately subject to public disclosure, debate and public accountability.

8. Research the Incentive Programs in Advance*:*
Know in advance the loan/grant amounts, where the enterprise zones and tax increment fund districts are and have some working knowledge of how these programs operate. Know what can be and can’t be done. Don’t ask us to do what we cannot do.

7. Define the cost as Early as Possible:
For us to make a realistic proposal, we need to know project costs, hard costs: construction, equipment, etc. Its hard costs: construction, equipment, etc. It’s hard to hit a moving target. You would be surprised at the number of companies who meet with us on incentives that can’t give us reasonable estimates on the size of the project, construction costs, machinery, utility usage and timing.

6. Be Specific About Your Financial Goals:
We can be flexible and creative if we know what the targets are. They need to be realistic: What do you want? Why do you want them? When do you want them? Let us figure out a way to make it happen.

5. Give Us the Time to do Our Job: (Corollary)
“Timing Is Everything.” Nothing will turn off a government agency more than walking in the door and announcing to us that we have two weeks to get a legally binding commitment. No agency can work that fast. Remember, it takes a minimum of six to eight weeks just to get through the county commission process and that is if there are no complications, which is rare for any deal.

We do not recommend putting incentive proposals before the county commission on an emergency basis. If you insist on getting an answer before that, then the answer is usually no. In addition, we need to review with the mayor’s office, commission chair, district commission, chair of Economic Development Committee (EDSS) committee, state and federal agencies and other entities where appropriate. We may need government agencies approval for the funds for infrastructure and permit issues, as well. County/city staff review will be required if road, sewer, environmental and/or water issues are part of the deal. Then and only then will we go to the commission. If confidentiality is also an issue we will need to meet with the Mayor and with each commissioner individually. A confidential number from the State must also be assigned. In addition, we will not introduce legislation unless we feel there is a reasonable chance of passage.

4. Recognize That the Use of Taxes is the Most Difficult of Incentives:
While tax incentives may be the most popular, they are also the most controversial. For example, please know the difference between tax abatement and tax increment, CRA and GOB.

3. After You Talk to the Chamber, Your Broker, Your Developer and Elected Officials, Talk with the Economic Development Professionals:
Office holders are elected partially on the basis of bringing jobs to a community. Some are eager to please, but are not necessarily up to date on the legal parameters of how incentive programs work. Also, some may be negative and rule out any incentives, but they may not represent the majority, some may say no because it's easier and safer until the project is explained to them. Don't try to negotiate an incentive package with your elected officials. Do not try to negotiate incentive packages with brokers, developers, etc. They do not speak for the county/state and they may not be knowledgeable about what is available. A recent example of this concerned a businessman getting very angry and stating that he had talked to everyone at the local chamber. He asked why he had to now negotiate with The Beacon Council and get County and State approval. The answer is simple – because they write the checks. Don't assume something is not possible – ASK! Do not try to "end run" the economic development professional by going directly to the political leadership.

2. Don't Remind Us About Shortcomings of Our Incentive Package in Comparison to Other Regions:
We are very much aware of what we have to work with; don't over emphasize the comparison between our incentive package and our competitors. We will not get into a bidding war – if that's what is driving the deal. We will be competitive based upon a company's business needs, companies job-producing investment leads and our ability to meet those needs, but again, we will not get into a bidding war.

1. Jobs and Economic Growth are Everything:
If a project doesn't create net new jobs or keep existing jobs and taxes, then why do it? Also, how many jobs vs. incentive dollars per jobs are there? What type of jobs, salary levels, etc. is there? These are key parts of our analysis. What is the ROI?

Approaching the Issue of Incentives – Top Ten for Public Officials

I am often asked by public officials, how the issues of incentives should be approached. Thus, I've developed my own "David Letterman's Top 10:" for public officials as well.

10. Limit use of development incentive to strategic uses: Constantly review current economic conditions. (i.e. unemployment rate and job growth rate.) Have an economic development game plan. Know what your priorities are and what you are willing to provide to achieve them.

9. Establish target rate of return for development incentives: Know the economic impact of a project. What is the ROI?

8. Continue State's role to enforce accountability, such as legally binding performance:

a. Revisions
b. Clawbacks
c. Penalties
d. Recalibrations
e. Noncompliance

7. Separate the responsibility of negotiating and evaluating incentive deals. If a meeting with a prospect to review a proposal is scheduled in advance, do not cancel the meeting.

6. Require periodic review of all tax incentives (sunset provisions).

5. Require fiscal analysis for all tax incentives

4. Encourage regional collaboration, not regional competition

3. Know all costs and benefits of incentive programs

2. Have trained, competent professionals develop and review incentive proposals or don't get into the incentive game. Do not allow developers, companies, consultants, lobbyist, etc. "end run" your economic development professional. This usually results in a "bad deal" for the County. There are several examples where poorly structured deals could have been avoided had they first been vetted by economic development professionals.

1. Keep your focus on real incentives: low taxes, good infrastructure, excellent education, low crime, affordable available housing, competent, honest, stable, government, good transportation and good "quality of life" … in essence the recent One Community One Goal recommendations. Creation and/or retention of jobs, capital investment and a growing tax base are everything.