



WHITE PAPER

South Carolina Policy Council

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Three Steps Toward Transparency: Protecting Taxpayer Investments in South Carolina's Economy

It goes without saying our political leaders should treat public tax dollars with the same care and consideration they would their own finances. This maxim has never been more necessary when we consider the state's recent experiment with government-driven economic development. As illustrated by the Boeing incentives package, there is little transparency regarding the financial details of these agreements, as well as the process by which lawmakers approve such incentives.

While the merits of publicly financed economic development programs will continue to be debated, there should be agreement on both sides of the question that state funded economic development plans deserve the same degree of scrutiny and deliberation that would accompany any prudent private investment. Such scrutiny dictates that taxpayer-backed investments be subject to comprehensive public debate and careful financial analysis. Once provided with this information, taxpayers can then make an informed decision as to whether to invest in additional economic development projects or instead fund critical governmental functions. Likewise, beneficiaries of state tax dollars should be compelled to show what return on investment will be produced, as well as be held accountable for failing to meet clear job creation and investment benchmarks.

In order to provide for such transparency and dialogue, the state should enact the following three reforms:

- 1) Reform the process by which economic incentives legislation is passed by the General Assembly.
- 2) Create standardized application and reporting mechanisms so that the public can more easily track and monitor economic development assistance.
- 3) Hold recipients of state aid accountable for meeting specific and measurable job creation/investment targets and provide for ongoing oversight.

Step 1: Reform the Legislative Process

Economic development legislation should be crafted in a deliberative manner subject to full public review and debate. Toward that end, the most important reform the state could implement would be to separate the process of crafting economic development legislation from the actual granting of such incentives. At least in theory, economic development

legislation is not written for a specific company. As we saw with the Boeing deal, however, this theoretical distinction rarely holds up in practice.

A better policy would be to implement the state's economic development program according to a multi-step process that detaches the development of economic development legislation from the crafting of specific deals for select companies. In other words, economic development legislation should not be written on a piecemeal, case-by-case basis.

The best way to encourage a thoughtful approach to economic development is to facilitate full and open public debate regarding economic incentives policies. At the very least, such dialogue will increase the likelihood that the state's economic development efforts are being conducted in a transparent manner. Alternatively, such debate may reveal, as many economists have concluded, that state-driven economic development is a poor substitute for lowering taxes and other reforms aimed at stimulating free market competition. In either case, reforming the manner by which the General Assembly passes economic development legislation is a necessary first step in evaluating whether such incentives are effective. The following four reforms would be a good start:

Require stand alone legislation. It is essential that economic incentives legislation be considered on its own merits, as opposed to being rolled into the annual budget or passed as an omnibus bill, such as H 3722.

Subject to a recorded vote. In spite of new rules requiring more recorded votes in the General Assembly, the vast majority of bills are pushed through on anonymous voice votes. Currently, only legislation on the contested calendar is subject to a recorded vote. Requiring recorded votes on the second and third reading of all economic incentives legislation would enable citizens to hold their elected representatives accountable for making sound investments with taxpayer dollars.

Subject to a waiting period. One of the primary problems with recent economic incentives legislation, such as the Boeing deal, is that many legislators are not given time to read and evaluate the bills they are asked to vote on. Instituting a mandatory 5-day waiting period between the time a bill appears on the calendar and its second reading would give legislators the opportunity to cast an informed vote.

Subject to independent analysis. Finally, lawmakers must be given all the facts needed to determine whether the state's economic incentives policies will actually pay off for taxpayers. Currently, the Board of Economic Advisors (BEA) does not provide dynamic cost-benefit analyses that would show the long-term effect of taxpayer-funded incentives on new business and job creation growth. Rather, the BEA limits its analysis to short-term gains or losses in state revenue collections, as illustrated by this economic impact statement on the Boeing deal. In addition to any data provided by the BEA, legislators should also be provided (prior to second reading) with a dynamic cost-benefit report demonstrating the pros and cons of the proposed investment strategy, including the

impact on existing taxpayers and businesses. This supplemental analysis should be conducted by an independent economist who is not a publicly paid employee, unless that economist is an employee of a public four-year university.

Step 2: Create Standardized Approval and Reporting Mechanisms

As indicated above, the best way to depoliticize the state's approach to economic development is to separate the legislative approval of such policies from the actual receipt of economic development aid. Instituting a formal application process, subject to public review, would achieve this end. In effect, this application would serve as a contract between the state and the recipient of taxpayer aid. As such, the application should explain why public assistance is necessary and what benefits taxpayers can expect to gain from the proposed investment. In turn, the state should implement an ongoing monitoring process that requires annual progress reports from aid recipients and provides the public with an annual investment report showing taxpayers what return they are getting on their money.

Require a formal application process subject to public notice and hearing. Prior to receiving more than \$100,000 in cumulative tax incentives/subsidies over a five year period, companies should be required to file a written application made available to the public through the Department of Commerce website. Once the application has been received and public notice given, the request should be subject to a waiting period of at least 30 days during which the public may offer comment both online and via a public hearing. Such applications should include a statement of public purpose that includes measurable job creation goals that must be met within a specific timeframe. The application should also contain the following information:

- A statement as to why a taxpayer-funded subsidy or exemption is needed, with special attention as to why the project has failed to attract sufficient private investment.
- A list of all incentives and subsidies being applied for and the immediate source of funding.
- An analysis (see below) detailing how the project will affect employment, including the impact on regional employment and wage levels.
- Specification of repayment requirements and penalties should the recipient fail to meet job creation and investment targets.

Require an independent cost-benefit analysis. In addition to a cost-benefit analysis conducted in relation to general economic incentives legislation, each application for an incentive/exemption that exceeds \$100,000 over five years should be accompanied by an independent cost-benefit analysis conducted by an economist not currently employed by the state (other than a four-year university). Among other factors, the report would take

into account the impact of subsidies/exemptions on competing firms and local employment trends. The analysis would be paid for by the company seeking taxpayer assistance and would be made available to the public.

Require annual updates from aid recipients. If a company does apply for and receive public incentives funding, reporting requirements should continue as long as the funding/exemptions remain in effect. Accordingly, the state should require recipients to submit an annual statement explaining how they are using state funds and what the impact of these funds/exemptions is on job creation. This report should include a summary of jobs created (or lost), broken down by full-time, part-time and temporary positions by wage group. In turn, the Department of Commerce should review the annual report and determine if the provisions of the subsidy agreement have been adequately met and take steps to enforce any contracts that are in default. Annual reports, as well as resulting reviews and the results of any subsequent enforcement actions, should be made publicly available.

Issue an annual unified economic development report. In order to determine whether the state is getting a solid return on its investments, taxpayers and legislators must know how much state and local governments are spending on economic development. Accordingly, the Department of Revenue, in conjunction with the Department of Commerce, should issue an annual economic development report that details all state and local expenditures for economic development, including targeted tax credits. The report should also include:

- The name of each company that received any tax credit, exemption or subsidy, along with the total amount received.
- All uncollected state and local tax revenues resulting from any tax credit or exemption provided by state or local governments.
- The number of jobs created by the firm receiving the credits or subsidies, with a breakdown of the cost in tax dollars per job.
- The full cost, including ongoing and future interest payments, of any subsidies backed by state or local bonds.

Step 3: Hold Recipients Accountable and Provide for Ongoing Oversight

One of the most glaring problems with the state's economic development efforts is that taxpayers, and even rank-and-file legislators, are rarely told how much such deals will end up costing. Analysis by *The Nerve* investigative reporter Rick Brundrett, for instance, found that the Boeing incentives package will cost at least \$500 million to create some 3,800 jobs. Yet, notes Brundrett, "The true total cost to taxpayers remains unknown – and may never be known because of state privacy laws." In order to provide for full transparency, the cost of the Boeing deal should have been capped. Likewise, state

economic development assistance contracts should include enforceable repayment mechanisms if measurable job/investment targets are not met.

Cap costs. As opposed to open-ended commitments, the state should cap economic incentives programs by dollar amount and time period. This would increase transparency, enabling legislators and taxpayers to know exactly what the upfront costs of any one incentives package will be. Perhaps one of the best ways to manage costs, as well as provide for more accountability, is to structure economic development subsidies as forgivable loans. If job creation and other targets are not attained, the loans must be paid back with interest.

Cap costs per job. As an additional safeguard, subsidies should not be awarded in cases where the cost per job exceeds the average per capita income in South Carolina. Such costs could be determined by dividing the amount of the incentives by the number of full-time and pro-rated part-time jobs required under the application for public aid.

Enforce incentives agreements. Taxpayer-funded incentives deals are contracts and should be enforced as such. Companies that fail to meet job target and other goals should pay back incentive loans (see above). Another option is to grant prorated credit for partially meeting job/investment targets, but assess a penalty for failing to fulfill the agreed upon targets in full. Recipients that default on incentives agreements should be barred from receiving additional public aid.

Sunset tax incentives/exemptions. In order to encourage state leaders to determine whether particular economic incentives strategies are working, all such legislation should sunset after 5 years. Likewise, targeted tax incentives and breaks should sunset after 5 years. After this period, the incentives/exemptions would be subject to reauthorization and verification according to the legislative process outlined above.

What Are Other States Doing?

With economists and taxpayers increasingly questioning the wisdom of government-driven economic development policies, some states are beginning to provide for additional transparency and accountability for public economic development assistance.

Minnesota. The North Star state has perhaps the best economic incentives transparency legislation in the nation. Minnesota law requires that:

- State and local business subsidies be granted on the basis of objective, measurable criteria regarding job creation and wage goals – and not on a case-by-case basis.
- Proposed subsidies exceeding \$150,000 (local) or \$500,000 (state) be subject to public notice and hearing.

- The state Department of Employment and Economic Development publish a biennial summary report detailing: the total amount of subsidies awarded; who the recipients were; subsidy types and public purpose; and percent of firms that reached and did not reach job and wage targets.
- If job creation goals are not met, recipients must pay back the subsidy with interest.

Nebraska. Requires the Department of Revenue to publish an annual report “containing statistics regarding investment, employment, wages and credits and refunds earned and used” in relation to the state’s primary economic development program (as articulated in the Nebraska Advantage Act). The report also includes agreements entered into under the act, as well as investment, employment and benefits earned by each industry group. Nebraska law likewise contains clawback provisions stipulating that companies receiving public aid must repay applicable subsidies/exemptions if they fail to meet agreed upon job creation/investment targets.

Maine. Maine law requires the state Department of Economic and Community Development to submit an annual comprehensive evaluation of state investments in economic development. The report must incorporate objective outcome measures and rely on independent analysis.

Connecticut. Connecticut requires companies that enter into targeted state economic development “assistance” agreements (in excess of \$1 million) to meet specific job creation and retention goals; noncompliance may trigger repayment, with interest and penalties.

Other states, such as Washington, require ongoing periodic reviews of targeted tax incentives (somewhat similar to the review currently being conducted by the Taxation Realignment Commission). Pennsylvania has an investment tracker website that enables citizens to obtain data on taxpayer-funded incentives. Several other states also have subsidy disclosure websites.

Conclusion

South Carolina has spent more than \$1 billion on economic development incentives and exemptions over the past 10 years. Thus far, taxpayers have little to show for these efforts – and worse still, little way of even determining their effectiveness. The state continues to have one of the highest unemployment rates in the nation and one of the lowest levels of personal income. Moreover, the practice of extending economic incentives to select companies has only made worse a political culture long known for tolerating backdoor deals, fiscal mismanagement and insider arrogance.

Regardless of differing views on the effectiveness of government-backed economic development policies, lawmakers on both sides of the issue should support proposals to

bring transparency and accountability to the process. Doing so would safeguard taxpayer-backed investments, as well as help ensure the effectiveness of the state's efforts to bring prosperity and jobs to South Carolina.

Nothing in the foregoing should be construed as an attempt to aid or hinder passage of any legislation.



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