Legislative Performance Audit Committee

Committee Members:
Senator John Harms, Chair
Senator Dan Watermeier, Vice Chair
Speaker Greg Adams
Senator Annette Dubas
Senator Bob Krist
Senator Heath Mello
Senator John Wightman

Legislative Audit Office
P.O. Box 94604, State Capitol
Lincoln, NE 68509
402-471-1282

Audit Staff:
Martha Carter, Legislative Auditor
Diane Johnson, Executive Assistant
Kathryn Gudmunson, Analyst
Clarence Mabin, Analyst
Dana McNeil, Analyst
Stephanie Meese, Legal Counsel

FOR IMMEDIATE RELEASE
CONTACT: Senator John Harms, (402) 471-2802

November 13, 2013

Tax Incentive Report News Release: Specific Goals and Measurements, Periodic Reviews Recommended for Incentive Programs

Periodic review of Nebraska tax incentive programs, guided by specific program goals and measurements, would better enable policymakers to assess the effectiveness of the incentives, according to a report released Wednesday by the Legislative Audit Office.

Regular reviews and well-articulated goals and metrics would help lawmakers to identify incentive approaches that are not being used, and to determine if specific benefits outweigh program and administrative costs, the report concluded.

The report recommended the Legislative Performance Audit Committee consider introducing legislation to add precision to the relatively vague program goals language now in state law. For instance, statutory language for the major tax incentive program, the Nebraska Advantage Act, indicates a purpose of the Act is to create "better jobs." The report stated this goal should be more specifically defined—expressed, for example, in terms of number of jobs, salary levels, or benefits in addition to salaries—although the degree of specificity would be determined by the Committee and ultimately the Legislature.

In addition, if the Committee decides to establish more specific goals, it should also develop metrics to measure progress toward the goals. It should consider metrics that reflect statewide economic activity as well as micro-level measurements that describe the economy of a region where a project is located, the report recommended. Finally, the Committee may want to consider requiring periodic evaluations of the programs conducted by some entity within state government. According to the report, several states recently have developed bodies within their legislatures to conduct these evaluations.

"This report gives the Legislature a starting point for improving evaluations of tax incentive programs, and the Performance Audit Committee will continue to work with the Revenue Committee and others to introduce legislation towards that end," said Senator John Harms, chairman of the Performance Audit Committee. He added, "The Legislative Audit Office benefitted from research by the Pew Center on the States, and the Committee is fortunate to have had that additional expertise on this study."

The report Wednesday was the third in a series of reviews of Nebraska business tax incentives conducted by the Committee. The first report found the incentive programs lacked clear goals. The second report compared selected Nebraska tax incentives to incentives provided in nine other states identified as competitors.

The report is available on the Legislature's Web site, nebraskalegislature.gov., in “Reports” > “Performance Audit,” and hard copies are available in the Legislative Audit Office on the 11th Floor of the State Capitol.

Audit Office Report

Measuring Success: Effectively Evaluating Nebraska Tax Incentive Programs

Legislative Audit Office
Nebraska Legislature

November 2013

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This report is available on the Unicameral's Web site (www.nebraskalegislature.gov) and from the Legislative Audit Office.

LEGISLATIVE AUDIT OFFICE
Nebraska Legislature
Box 94604 • Lincoln, NE 68509 • (402) 471-1282

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Legislative Audit Office Report

Measuring Success: Effectively Evaluating Nebraska Tax Incentive Programs

November 2013

Prepared by
Stephanie Meese
Kathryn Gudmunson
Martha Carter

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INTRODUCTION

This is the third in a series of reports on tax incentives initiated by the Legislative Performance Audit Committee in 2012. In the first report, released in February 2013, we reviewed the performance of four state tax incentive programs: the Nebraska Advantage Act, Nebraska Advantage Rural Development Act, Nebraska Advantage Microenterprise Act, and Nebraska Advantage Research and Development Act. The key question was how the performance of each program compared with the goals established by the Legislature when the programs were created. The audit also reviewed the economic modeling program used by the Department of Revenue, which administers the programs, and described challenges in evaluating tax incentive programs.

In the second report, we compared selected Nebraska tax incentives to the incentives provided by nine competitor states—Arkansas, Colorado, Iowa, Kansas, Missouri, Oklahoma, South Dakota, Texas, and Wyoming—and provided information on ways other states evaluate and report on their tax incentive programs.

In this report, we expanded on the need for evaluation and how the Legislature can work towards an effective, ongoing evaluation program for tax incentives. We discuss each of the Advantage Act tax credit programs and also the Beginning Farmer Tax Credit and the Angel Investment Tax credit.

The Need for Evaluation

The first report's overarching finding was that the program goals originally expressed by the Legislature were too general to permit a meaningful evaluation of whether the programs were accomplishing what the Legislature intended them to accomplish. At the broadest level, the Legislature expected the tax incentives to stimulate business activity and expand the state's tax base. Additionally, for two of the programs, including the Advantage Act, which has the largest impact on the state budget, the Legislature set no limit on the programs' costs in terms of foregone state revenue. By these standards,

any activity could be deemed a success and any cost acceptable.

In response to the audit findings, the Performance Audit Committee committed to work with the Revenue Committee to initiate a comprehensive review of Nebraska's tax incentive programs to assess whether the programs are producing the results the Legislature intended and, if so, whether they are doing so at a cost the Legislature can support. The Committee also indicated that the review should identify any data the Legislature needs to make such an assessment that is not currently required to be reported and therefore not available to policy-makers.

Also during the 2013 session, the Legislature created the Tax Modernization Committee, which was charged with completing a study of Nebraska's tax system and making recommendations, if necessary, for any changes the following interim. Discussions between the leadership of the Performance Audit Committee and the Revenue Committee—whose chair was to serve as the Tax Committee chair as well—resulted in agreement that the Performance Audit Committee would continue working in the area of tax incentive evaluation and report its results to the Tax Modernization Committee.

Improving the Evaluation Process

In this report, we outline a process for legislators to follow in improving the evaluation process for the state's tax incentive programs based on a structure suggested by the Pew Center on the States. Three key program concepts are at the core of that structure:

1. *Goals*—are clear, measurable statements of what the program is intended to achieve;
2. *Metrics*—are the quantifiable measures to be used to determine how well a program is achieving its goals; and
3. *Benchmarks*—are the thresholds policymakers should set that will determine the level of performance necessary on a given metric in order to consider that the related goal is being achieved (or at least that progress is being made towards the goal).

For example, a typical goal could be to decrease unemployment in rural Nebraska (using a specific definition of "rural," such as the one in Neb. Rev. Stat. sec. 70-702 or sec. 71-409). One metric to measure progress towards that goal would be the percentage of workers in those rural areas that were unemployed for at least 6 of the past 12 months. The benchmark could be to decrease the unemployment rate by one percent annually.

This example illustrates the key program concepts necessary for evaluation of incentive programs and also suggests the kinds of questions that make these evaluations challenging. These questions include:

- Is it appropriate to credit (or criticize) incentive programs alone for changes in metrics like the unemployment rate;
- Is any single metric sufficient to capture an incentive program's impact; and
- How do policymakers decide how much progress on a particular measure is appropriate?

These are questions that go beyond the scope of this report, but they suggest the type of discussion that will need to occur to establish better evaluations of these programs. This report does not make policy recommendations. Instead, the concepts described above are explored in detail to lay the groundwork for such discussions.

Next Steps

Tax incentive program evaluations may not be able to fully answer the question of what a business would have done had it not received an incentive, but there is still value to be gained from them. Regular review of progress towards well-articulated goals and metrics can help policymakers identify the relative effectiveness of different approaches, eliminate those that are not being used, and decide whether benefits provided are sufficient to justify both program and administrative costs.

If the Legislative Performance Audit Committee wishes to pursue additional evaluation of tax incentive programs, we recommend the following next steps.

First, the Committee may want to consider introducing legislation articulating better defined program goals than those currently in statute. Using an example from Section I of this report, the Advantage Act goal of creating "better jobs" should be more specific. How much more specific is a question for the Committee to consider and could range from something as simple replacing "better" with "higher paying" to developing a series of factors that must be met, such as:

- Creating *X* number of jobs, *Y* percentage of which will pay at least *Z* percent of the industry average wage;
- Specify benefits beyond salary that the jobs must offer;
- Include a duration of how long the jobs must last; and
- Determine an "acceptable" cost to taxpayers.

Also, as suggested by the Pew Center, the Committee may want to consider articulating a relatively small number of goals and designating some of what are now considered goals as strategies for meet the goals. In Section II we note that the existing goals of increasing the presence of certain industries in the State were likely developed because of the belief that those industries would provide quality jobs for Nebraskans. Viewed in this way, one metric would be to identify whether the targeted industries are, in fact, increasing in the State, but an equally important one would be more whether quality jobs were increasing.

Second, if the Committee decides to articulate more specific goals, it should also identify a set of metrics that will be used to measure progress towards the goals. In doing so, the Committee should consider macro-level metrics that reflect the statewide economy as well as micro-level metrics that reflect the economy in the region where a project is located.

Finally, the Committee may want to consider introducing legislation to require periodic evaluations of these programs and authorizing an entity to conduct them. Several states have recently developed entities within their legislatures, such as joint committees or task forces, to undertake this responsibility.

SECTION I: Goals of Nebraska Tax Credit Programs

As stated in our February 2013 report, the Advantage Act programs do not contain specific, measurable goals. Without clear goals it is difficult to thoroughly evaluate the programs, so there is a greater risk that incentive dollars are not being used as effectively as possible.

This section identifies the broad goals for the Nebraska Advantage Act and its related programs (the Rural Development Act, the Microenterprise Act, and the Research and Development Act), as well as for the Beginning Farmer Tax Credit and the Angel Investment Tax Credit. We identified the goals stated in statute, expressed by legislators during debate when the programs were created, and implied from legislative actions such as changes from previous programs. To keep this section relatively simple, we included only a brief overview of the provisions of each program. Additional detail is available in our February report as well as from other sources.

This Section also includes suggested goals from a stakeholder survey we conducted to find out whether people who were familiar with these programs had ideas about appropriate goals in addition to those identified by the Legislature.[1] Although we received only six responses, they were thoughtful and contained a number of good examples or policy considerations regarding incentive program goals. We include the responses as examples but do not suggest they are representative of any larger population.

There are no recommendations regarding what the "right" goals are, as this is a matter for policymakers to determine.

Individual Program Goals

Nebraska Advantage Act (Advantage Act)

The Advantage Act provides a variety of benefits to companies that invest or create jobs in Nebraska, including direct refunds of sales and use taxes, exemptions from personal property taxes, and credits that may be used to: offset payroll withholding, reduce personal or corporate income taxes,

[1] We sent the survey to selected individuals and organizations who had commonly testified on incentive issues before the Legislature including the State Chamber of Commerce, the OpenSky Policy Institute, and the Platte Institute, among others. The State Chamber assisted us in distributing the survey by providing the survey to its members.

obtain sales and use tax refunds, and to obtain reimbursement of real estate taxes.

The Advantage Act goals, stated in the Act's findings, are to "encourage new businesses to relocate to Nebraska, retain existing businesses and aid in their expansion, promote the creation and retention of new jobs in Nebraska, and attract and retain investment capital in the State of Nebraska." Legislative debate focused on creating quality, well-paying jobs; legislators also spoke about encouraging rural development and targeting the specific industries of research and development and manufacturing.

Summary of Advantage Act Legislative Goals:

- To encourage new businesses to locate in Nebraska
- To retain existing businesses and aid in their expansion
- To promote the creation and retention of new jobs in Nebraska
- To attract and retain investment capital
- To encourage certain industries (generally non-retail)
- To encourage high levels of investment and job growth in specific industries, such as large data centers (Tiers 2 & 5)
- To create better jobs
- To improve transparency and reporting about the program
- To encourage research and development
- To increase manufacturing

In the stakeholder survey, it was noted that smaller Nebraska communities may not benefit from incentives that are tied to the development of large numbers of new jobs.

The stakeholders also thought that the Advantage Act goal of creating "better jobs" needs to be more specific. Some suggested minimal changes, such as defining those jobs as "higher paying." Others suggested a more complex set of goals, such as:

- Creating *X* number of jobs, *Y* percentage of which will pay at least *Z* percent of the industry average wage;
- Specify benefits beyond salary that the jobs must offer;

- Include a duration of how long the jobs must last; and
- Determine an "acceptable" cost to taxpayers.

Another suggestion was that a business be required to state explicitly that the jobs would not be created "but for" receipt of the incentive.

Nebraska Advantage Rural Development Act (Rural Development Act)

The Rural Development Act provides investment and jobs credits targeted to rural areas, which include lower population counties and cities, villages, and economically distressed census tracts; and for livestock facility modernization projects located anywhere in the state. Currently there is an annual $1 million cap on tax credits issued under this Act.

The Act was originally called the Employment Expansion and Investment Incentive Act (EEII) and passed in 1986. It was renamed when it was linked to the Advantage Act. The EEII, one of Nebraska's first general tax incentive programs, was not targeted to specific geographic areas or specific industries.

Although the scope of the Act was changed when it was incorporated into the Advantage Act, we inferred that the Legislature intended the goals—such as competitiveness, reducing unemployment, creating new jobs, and bringing new businesses to the state—should continue to apply.

Summary of the Rural Development Act Legislative Goals

- For selected geographic areas:
  - To decrease unemployment
  - To create new jobs
  - To compete with Kansas and the Sunbelt states
  - To increase investment in rural areas
- Statewide: To modernize livestock facilities

Nebraska Advantage Microenterprise Act (Microenterprise Act)

The Microenterprise Act provides a tax credit to entrepreneurs who start or expand businesses with five or fewer full-time equivalent employees in economically distressed areas.

The credit was intended to support small businesses, particularly those in areas that were "losing ground" economically, defined as areas that had experienced a population decrease over the last 20 years or were earning less than 80 percent of the per capita income. In 2013, all of Nebraska except for certain census tracts in Washington and Cheyenne counties could qualify for benefits.

Summary of Microenterprise Act Legislative Goals

- To encourage small business growth
- To encourage investment in distressed areas

In the stakeholder survey, respondents suggested removing the cap on the amount of credits businesses can receive; or possibly removing it for applicants who are veterans.

Nebraska Advantage Research and Development Act (Research and Development Act)

The Research and Development Act provides tax credits to businesses that incur research and development costs.

When the Act was adopted in 2005, Nebraska ranked very low nationally for research and development funding and was less competitive than the thirty-three states that had tax credits for research and development expenditures.

Summary of the Research and Development Legislative Goals

- To increase research and development
- To increase competitiveness with other states

Beginning Farmer Tax Credit

The Beginning Farmer Tax Credit, created in 1999, is a refundable tax credit for owners of agricultural assets who provide longer term leases for new farmers. There is also a property tax exemption for beginning farmers. This program is administered by the state's Department of Agriculture, unlike the programs discussed previously, which are administered by the Department of Revenue.

The Beginning Farmer Tax Credit Act, like the Advantage Act, has specific legislative findings in statute. These findings indicate that it was the Legislature's intent to encourage investment in new agricultural enterprises and support

continuation of agricultural industry. Specific goals cited in the findings include encouraging individuals to seek careers in the farming industry, retaining existing farm operations, promoting the creation and retention of new farm jobs in Nebraska, and attracting and retaining investment capital in rural Nebraska.

Summary of Beginning Farmer Legislative Goals

- To retain existing farm operations
- To encourage individuals to seek careers in farming
- To promote the creation and retention of new farm jobs
- To attract and retain investment capital in rural Nebraska

One of the survey respondents suggested adding a goal of increasing the percent of land owners who will lease farm land to veterans who are beginning farmers.

Angel Investment Tax Credit

The Angel Investment Tax Credit provides refundable state income tax credits to qualified investors that invest in qualified, early-stage, small businesses. It was created in 2011 to encourage high technology investment in Nebraska, particularly in rural and underdeveloped areas.

Legislative debate focused on research that indicated students and innovators leave Nebraska for states with better high technology industries, and that the rural and distressed areas of the state do not have funding options to expand businesses and retain graduates. Many start-ups are considered too high risk to secure loans from a bank or venture capital firm, and thus are left without funding. Angel investors can fill that gap, which will allow for high technology expansion in areas without a preexisting infrastructure or credit market.

The Angel Investment Tax Credit Act differed from previous tax incentive programs in that it contained comprehensive reporting requirements: this credit has more reporting requirements than other small tax credits (only the Advantage Act has more). The program is administered by the Department of Economic Development which, in odd numbered years, must report on the:

- geographic locations of investors;

- amount of investment made in each business;
- breakdown of industry sectors;
- number of tax credits issued by each project on an annual basis; and
- number of jobs created at each business.

The Department also tracks additional factors every year, including patents per 1,000 people, the number of new business start-ups, business closings, and small business innovation research grants.

Summary of Angel Investment Legislative Goals

- To encourage high technology in rural and underdeveloped areas

Overarching Goals

From the review of the individual programs, we identified objectives that appeared repeatedly, such as increasing investment and quality jobs (particularly those in the research and development, high technology, and agricultural industries); helping economically depressed and rural areas; increasing small business support; retaining graduates; and bringing new businesses to the state. The Pew Center suggested that many of these specific goals can be viewed as strategies for realizing the same broad goal. For example, the industries prioritized were likely targeted because they provide quality jobs for Nebraskans. For this reason, we focused our research on these broader, overarching goals:

1. To increase investment and high-quality jobs cost-effectively
2. To increase development in rural and economically distressed areas.

We reviewed academic literature, looking for types of incentives that have shown positive results in accomplishing these goals. Though it was not an exhaustive literature review, we found little regarding the effectiveness of incentives in meeting these types of goals. Some research suggests that other policy options, such as lowering tax rates or investing in infrastructure, may have greater returns than do tax

incentives. We did, however, find some suggestions for tax incentive/tax policy that could be useful in the evaluation of the current Nebraska tax incentives including:

- A report from the University of North Carolina Center for Competitive Economies stated that research has shown that the most effective tax incentives are those that can be tailored to address company-specific location decision factors, and found North Carolina's research and development tax credit was correlated with companies adding new jobs both before and after receiving the credit.
- A study on location-based incentives in Kentucky found that training incentives have a strong, positive effect on economic activity, more so than general tax incentives.
- Another study of location-based incentives in rural areas found that they discouraged new businesses from locating in the areas, because incentives were offset by increased property taxes, but led to increased employment in established businesses if the incentive was wage-based.
- A review of rural policies found that incentives for agriculture and manufacturing are less effective in rural areas than incentives for other types of industries, because they do not create new areas of competitiveness.
- A collaborative study from economists in the US and Canada looked at rural policy as well, and found that non-farm rural populations are rapidly growing while farm populations are shrinking due to modernization. They suggested improving linkages to urban areas and supporting entrepreneurship as effective policy ideas for rural development. This study also provided a framework for effective rural policy, including clear statements of policy goals, evaluation mechanisms, and a means to address place-specific characteristics.

In addition, our stakeholder survey contained broader suggestions that applied to more than one incentive. Some focused on the macro level, such as goals of reducing the state's unemployment rate, fostering entrepreneurship, increasing the number of college graduates who remain in the

state, and increasing the diversity of jobs available. Others focused on the micro level; for example, the relative importance of 10 jobs created in a smaller community compared to that number in a larger community.

Other stakeholders suggested that goals should target specific industries; businesses of a particular size, such as targeting a percentage of incentive funds for small businesses (defined by number of employees or income); or specific areas of the state, such as those that are economically distressed or have high poverty rates.

SECTION II: Program Metrics and Benchmarks

As mentioned in the Introduction, metrics are the quantifiable measures used to determine how well a program is achieving its goals. In addition to identifying what those measures should be, it is also important to set benchmarks which establish the amount of progress that is expected.

We do not discuss benchmarks extensively because goals and metrics need to be established first—benchmarks must be tied to the specific metrics selected. Additionally, depending on the metrics selected, the Legislature may need to require reporting of additional information by the Nebraska Department of Revenue. However, the exact information needed cannot be determined until metrics are selected.

In this section, we look at principles for developing useful metrics and suggest potential metrics for the Legislature's consideration. The Pew Center for the States helped us develop potential measures based on the goals we found for each of the tax incentive programs reviewed in this report. Our stakeholder survey provided suggestions about metrics as well.

Metrics—General Principles

The Pew Center recommends that tax incentive evaluations take three key principles into account: cause and effect, budgetary trade-offs, and the effects on non-incentivized industries. However, the Pew Center also cautions that there must be an acceptance that complete precision is impossible, because there is no way of knowing what would have happened in the absence of an incentive. Instead of focusing on absolutes, states have completed useful evaluations by looking at the results of incentives in terms of what is probable or plausible.

Cause and Effect

As we discussed in our February 2013 report, it is difficult to determine the effectiveness of incentives because it cannot be known what businesses would have done in the absence of the incentives. According to the Pew Center, perhaps the single most important step in measuring an incentive's impact is attempting to isolate the impact of that incentive—only the results directly caused by the incentive should be attributed to the incentive.

Budgetary Trade-Offs

Due to State balanced-budget requirements, money foregone through tax incentives must be recouped elsewhere in the budget, either through reduced spending or higher taxes, both of which result in the loss of some economic activity. For example, if a state chooses to put less money into education in order to balance the foregone revenue dispersed through incentives, schools might employ fewer people, which could then result in school employees spending less on consumer goods. This means that it is important to attempt to assess a tax incentive's net economic impact, which is its positive benefits to the state less the cost of the economic harm resulting from cutting spending or raising taxes.

Effects on Non-Incentivized Businesses

Finally, the growth by incentivized businesses is sometimes offset by losses to competitors, so it is important to attempt to assess the extent to which an incentive is growing the economy compared to redistributing existing economic activity.

Potential Metrics for Nebraska

The following are potential metrics we identified in our research and through suggestions from our stakeholder survey. The metrics may be applied to all programs unless otherwise noted. We are not suggesting that these are the only metrics the Legislature should consider; they are a place to start, not the final product. Discussion of metrics needs to occur as part of the articulation of more specific goals. As noted in the Introduction, it may be useful to incorporate metrics into the goals themselves.

Amount of Revenue Foregone Due to Incentives

Louisiana used this metric in a recent evaluation of their incentives. They looked at the amount of incentives—including all exemptions and credits for income and franchise taxes—businesses claimed as a portion of their total tax liability. The reviewers examined individual businesses' tax returns and, for those that used credits, calculated: the amount their tax liability would have been without credits ($5.4 billion), and the amount being returned to them through credits (about $3 billion).

Nebraska could potentially conduct a similar investigation, though the amount of exemptions might be prohibitive. To be fully comparable to the Louisiana study, a Nebraska study would have to include not only the types of tax incentives offered by programs discussed in this report, but others such as sales tax exemptions. Given the number of sales exemptions in Nebraska, that might not be possible. It would be more feasible to consider a narrower review of tax credit programs alone, but that would give a limited picture of the revenue impacts.

Comparative Investment Scenarios

An evaluation of Kentucky incentives used a metric called threshold effectiveness as a way of measuring both effectiveness and opportunity costs. Rather than trying to determine how many jobs an incentive should create, the study looked at how many jobs an alternative use of funding could create. Then, using that amount as a threshold, the study measured the incentives against it.

For example, in the 2010 Tax Burden study, the Nebraska Department of Revenue estimated that a $100 million decrease in sales and use taxes would result in $123 million in private investment and 2,615 new jobs. Those numbers could be used as a threshold for a comparison to a $100 million tax incentive program to determine which would be the better investment of state funds.

The threshold model could also be used for metrics other than jobs, such as cost per job or investment amounts. The Pew Center supports using this method. Such scenarios could be run using TRAIN, the economic modeling program used by the Department of Revenue.

Stakeholders suggested similar ideas, such as considering:

- The potential benefit from a tax incentive as compared to a potential benefit if the same amount of state funds were dedicated to another use such as reducing tax rates (directly or through new exemptions) or increasing funding for other incentives or other programs

- Use of economic modeling and academic literature to estimate the extent to which an incentive program is likely to influence business decisions.

Growth in Nebraska vs. National Averages

Goals that have been previously mentioned for the state are increasing population in rural areas; increasing new businesses; and increasing new, quality jobs. If growth in each area was used as a metric, the national averages could be used as the benchmarks. Another benchmark option would be average growth in the other Plains states so that policies can be adjusted to increase regional competitiveness.

While these types of metrics were suggested by the research we reviewed as well as by some stakeholder responses to our survey, other stakeholders believed that narrower economic indicators should be used. One suggested that metrics need to be sufficiently sensitive and narrow to detect the effects of the incentive program independent of broader economic factors. This individual gave an example of comparing economic indicators for communities or neighborhoods that include businesses that received incentives with those that have not.

Relative Impact on Small Communities

Another stakeholder suggested that in addition to reviewing economic indicators, the evaluation of incentive programs needs to consider the value of an individual project to the community in which it is located. The stakeholder gave the example of the Cargill facility in Blair, which received benefits under the Advantage Act. They believe that facility has had a positive impact on the community beyond what might be evident in the economic indicators.

Investment or Job Creation by Geographic Area

If an incentive program targets a particular geographic area, the growth in those specific areas should be used as a metric. Currently, Nebraska has multiple incentives that are intended to help rural and economically distressed areas, but not all of the programs require reporting on the extent to which the incentives are actually benefitting those areas.

Quality of New Jobs Created

As mentioned in our discussion of potential goals, it would be useful to have more specificity in goals related to job creation. A metric that could be used to assess the relative quality of the jobs attributable to the incentives is a comparison of the jobs' wage levels to state or county averages. Nebraska already has wage level requirements for most incentives, so this metric may be easily integrated into the current reporting system. Another option is to look at benefits of employment, such as the dollars-per-hour that companies contribute to employee health insurance (used in Louisiana), or training programs offered by the employer.

Cost Per Job Attributable to the Incentives

Cost per job is one of the most common metrics in tax incentive evaluation, but it is difficult to use with the Advantage Act. We used this metric in our first evaluation, but after additional research found it was not an effective measure; we would not use it again for that particular program. Research suggests that cost per job could be effectively used as a metric for smaller, less complex incentive programs. A similar suggestion—that the cost per job be used only for one time pay-outs (not for long-term incentives)—was made by one of the survey respondents.

Cost of Administration

Administrative costs associated with more complex programs like the Advantage Act are higher than for less complex programs. Additional reporting requirements and audits could require even more staff to be dedicated to the program. When the costs and benefits of a program are reviewed, the costs of administration should be considered, regardless of other metrics, as a set cost. This metric was suggested in research and by a stakeholder.

Other Metrics

Stakeholders responding to our survey made several other suggestions about specific metrics:

- Review the entities receiving incentives so the Legislature can determine whether the incentives are going where it wants them to go. The Appendix to this

report contains current data on use of the programs discussed in the report as a starting point for that type of analysis;

- Review the amount of tax credits actually used by a business rather than what is earned; and
- Work with the state Department of Labor on ways to track number of jobs in the state and ways to measure increases.

SECTION III: Examples of the Tax Incentive Review Process in Other States

Following are examples of what is being done across the country to evaluate tax incentives effectively. The states discussed in this section—cited by the Pew Center as leading the way in tax incentive evaluation to inform policy choices—have regularly-scheduled evaluations, with each incentive being reviewed on a schedule ranging from every three years to every ten years. These evaluations are performed by either legislative staff or executive branch divisions. Other attempts to increase accountability in regards to tax incentives include aggregate caps and expiration dates on incentives.

Arizona

Since 2002, Arizona has had a joint Legislative Income Tax Credit Review Committee that reviews each existing credit and any new credit every five years, as required by law. The functions of the committee are to:

1. determine the original purpose of existing tax credits;
2. establish a standard for evaluating and measuring the success or failure of the tax credits, which may include
    a. the history, rationale and estimated revenue impact of the credit,
    b. whether the credit has provided a benefit to the State including, for corporate tax credits, measurable economic development, new investments, creation of new jobs or retention of existing jobs in this State, and
    c. whether the credit is unnecessarily complex in the application, administration and approval process;
3. review the individual and corporate income tax credits; and
4. after completing the review process, determine whether the credit should be amended, repealed or retained.

The Committee is required to submit a report of its findings and recommendations by December 15 of the year that the credit is reviewed. In 2010, the Committee recommended

halting a tax credit for multimedia productions that come to Arizona, including movies, television series and commercials. The credit expired that year.

Iowa

During the 2010 session, the Iowa Legislature created a Legislative Tax Expenditure Committee. This committee is composed of Democratic and Republican legislators from both the House and Senate and will review each tax incentive program at least every five years and report on the state's return on investment.

Iowa has also established an aggregate cap for some of their tax incentive programs, including their High Quality Jobs, Enterprise Zones, and Angel Investment programs, among others. This cap was lowered from $185 million to $120 million during the recession, and was recently raised back to $185 million. The cap helps control how much money the state is committing each year to economic development incentives.

Oregon

In Oregon, a 2009 law established expiration dates for most tax credits and required credits to have a stated policy goal. Programs with similar goals were scheduled so they expired at the same time, which allows policy makers to compare the results of similar programs. The Joint Committee on Tax Credits reviews all credits before they expire and holds public hearings to get input from citizens, businesses, and state agencies.

In 2011, decisions about tax credits were made in the context of the budget—extending all expiring tax credits would have cost about $40 million, but legislative leaders told the Joint Committee that there was only $10 million available. Some credits were allowed to expire, some were extended, and some were changed to keep costs under control.

Rhode Island

Earlier this year, Rhode Island adopted a law requiring that economic development tax incentives undergo regular evaluations. The law requires regular reviews—every three years—for 17 tax incentive programs. Incentives created in the future must also be evaluated.

These reviews are to be conducted by the Office of Revenue Analysis, which is a division of the Department of Revenue. The review will measure the benefits and costs of each incentive, including its impact on the state's budget and economy. The analysis is required to consider whether the economic benefits stayed in the state or flowed elsewhere. Each report must also draw clear conclusions about how the incentive meets the goals lawmakers set for the program and how it might be improved.

Following each review, the governor's budget proposal must make a recommendation to continue, reform, or end the program. These recommendations can then be discussed during the Legislature's budget hearings, which will allow legislators to compare the results and costs of tax incentives alongside other types of state spending.

Washington

In 2006, the state of Washington established the Citizen Commission for Performance Measurement of Tax Preferences. Tax preferences include more than the type of incentive programs discussed in this report. The Washington statute defines "tax preference" as an exemption, exclusion, or deduction from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate.

This seven-member Commission consists of five appointees: two appointed by the House, two appointed by the Senate, and one appointed by the Governor; and two non-voting members, the State Auditor and the Chair of the Joint Legislative Audit and Review Committee (JLARC). The Commission develops a schedule to review tax preferences based on a ten year review schedule.

The Washington Department of Revenue has on record about 600 tax preferences; however, statute exempts certain preferences from review. These are:

- tax preferences required by constitutional law;
- sales and use tax exemptions for machinery and equipment for manufacturing, research and development, or testing;
- the small business credit for the business and occupation tax;

- sales and use tax exemptions for food and prescription drugs;
- property tax relief for retired persons; and
- property tax valuations based on current use.

The Commission meets periodically to consider citizen input and establish a schedule for review of tax preferences. The schedule is delivered to the JLARC. Subject to JLARC's available resources—the JLARC office has about 20 staff members—the Commission determines which preferences in a given year will undergo a review by JLARC staff and which will undergo an expedited review.

For each tax preference, JLARC staff evaluate whether the public policy objective is being met and provide recommendations to continue, modify, or terminate the preference. JLARC then reports its findings and recommendations for scheduled tax preferences to the Commission by August 30th of each year. The Commission reviews and comments on the JLARC report, which is then submitted to House and Senate fiscal committees for a joint hearing.

Appendix: Tax Credit Program Usage

In order to evaluate the effectiveness of existing incentives, legislators may wish to look at which incentives are being utilized currently. If an incentive is not being used, continuing to fund and promote that incentive could be an inefficient use of resources and may not help the state to achieve its economic development goals. For incentives that are being used, the amount of use should be one factor evaluated. In addition to usage, it would be important to consider other metrics as described in Section II.

Direct comparisons of the programs by usage are difficult because they vary in complexity. However, in the unique case of the Advantage Act, the tiers could be compared to one another to determine which are the most effective. Depending on the industry targeted, certain tiers might be better options than others. As the Legislature further defines the goals of Nebraska tax incentives in general, evaluating the effectiveness of each tier would be a logical next step.

Advantage Act

As of December 31, 2012, 45 businesses had qualified to receive Advantage Act benefits. Those businesses have invested nearly $3.5 billion and created 7,103 jobs over the life of the program. They have earned over $412 million in tax credits and $31 million in sales and use tax refunds.

There are an additional 150 businesses that have signed agreements to participate in the Advantage Act but have not yet qualified to receive benefits. Data in the following table and pie charts refer to both groups of businesses—those that have begun receiving benefits and those enrolled but not yet receiving benefits. For the charts, the industries shown are those that will receive benefits if all of the signed agreements are fulfilled.

Table A.1 shows the number of agreements signed by tier.

Table A.1: Number of signed Advantage Act agreements by tier. (As of December 31, 2012)

Tier	Signed Agreements
Tier 1	53
Tier 2	85
Tier 3	7
Tier 4	46
Tier 5	4
Tier 6	0
Total	**195**

The following charts indicate which industries were utilizing the incentives, by tier. Tier 6 has been excluded because there are currently no signed agreements under that tier.

Chart A.1: Tier 1 Signed Agreements by Industry

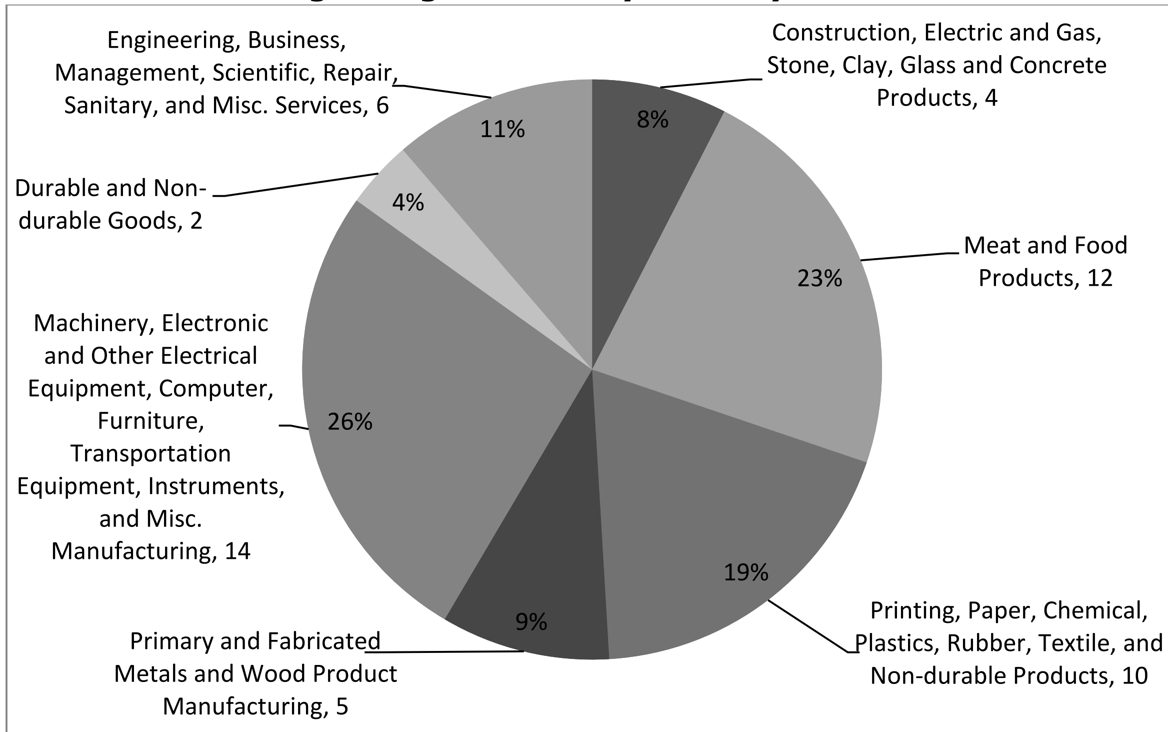


Chart A.2: Tier 2 Signed Agreements by Industry

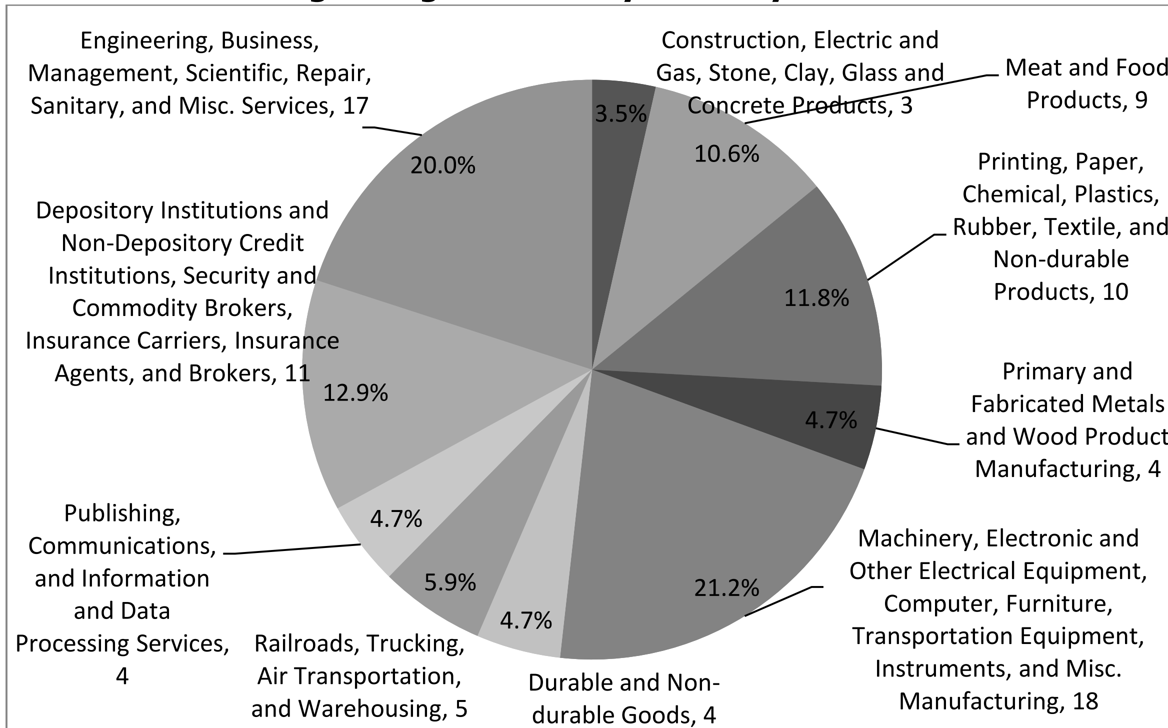


Chart A.3: Tier 3 Signed Agreements by Industry

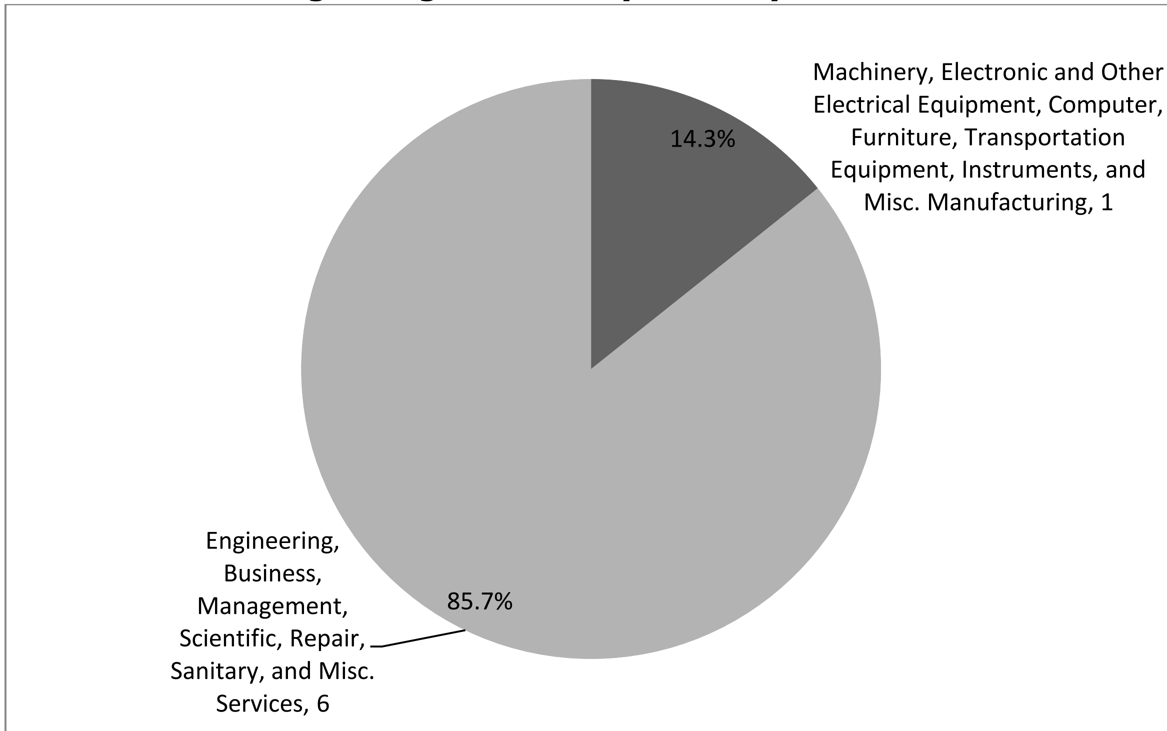


Chart A.4: Tier 4 Signed Agreements by Industry

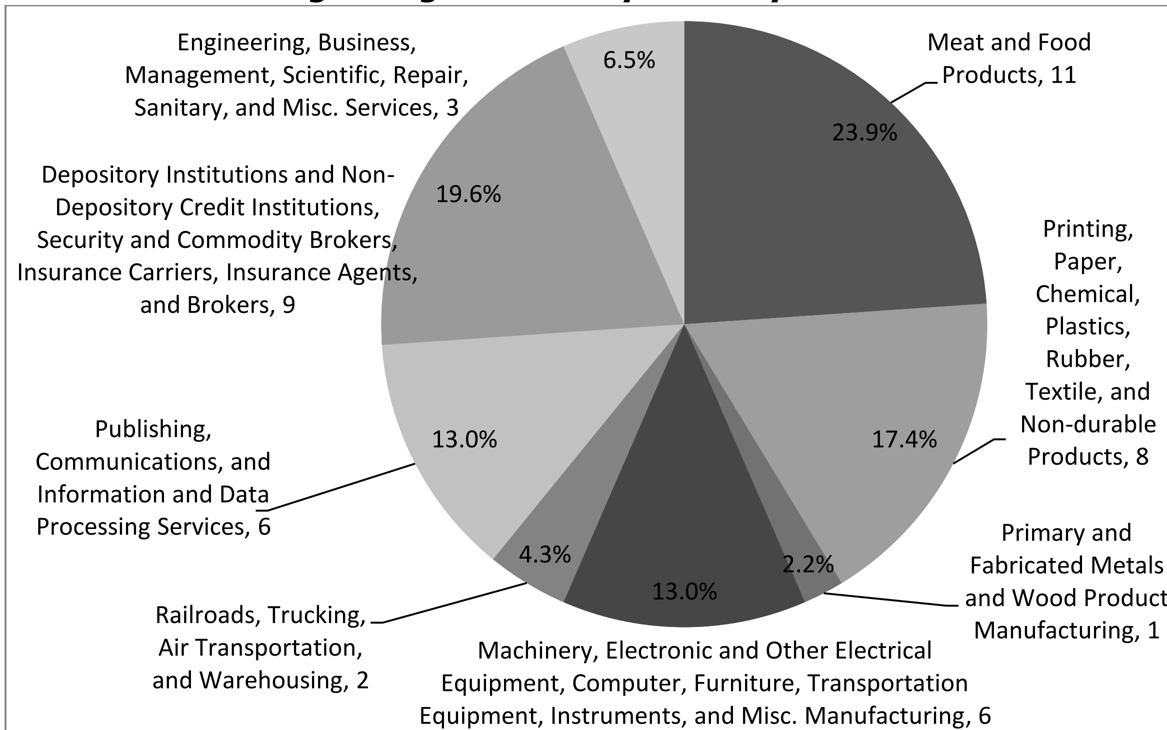
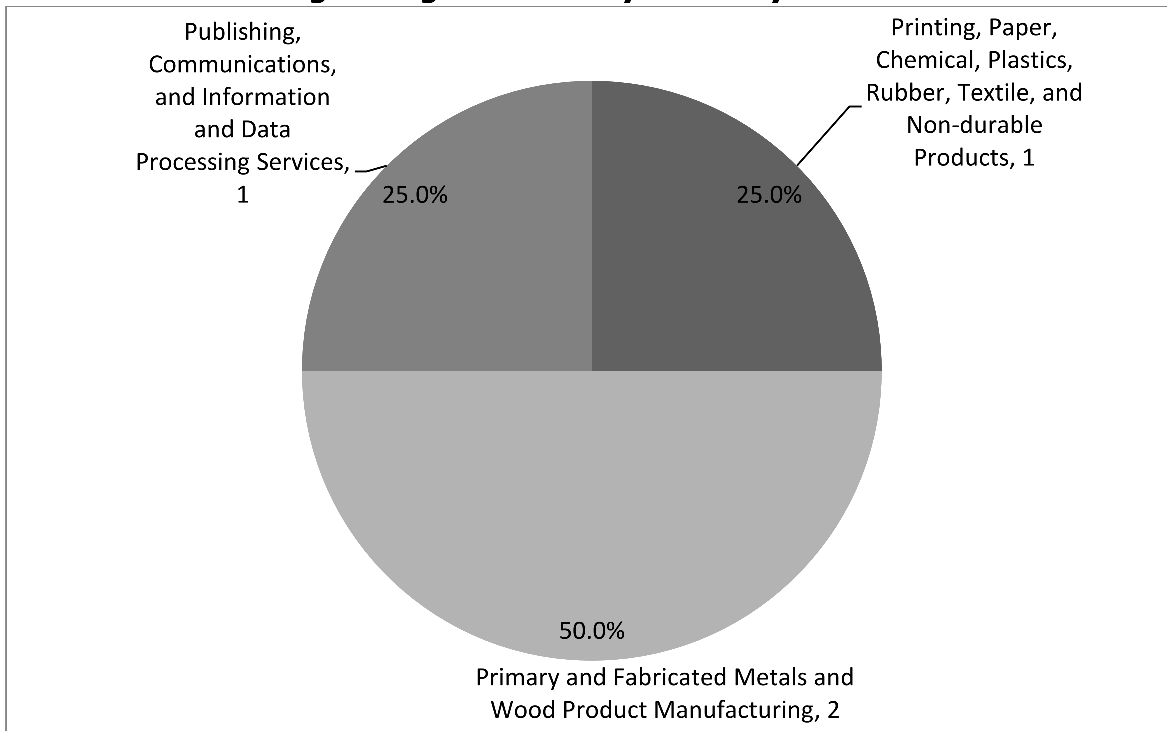


Chart A.5: Tier 5 Signed Agreements by Industry



Research and Development Act

The Nebraska Advantage Research and Development Act has consistently provided about two million dollars in income tax credits since its inception. Through December 31, 2011, 142 taxpayers have received credits under this Act. For the first two years there was less investment, but that may have been due to the time it took companies to apply and qualify early on. The Department of Revenue has issued between $2.1 and $2.7 million in credits each year since 2008, except for 2010, when it issued $4 million.

There is a sales and use tax refund available under this Act, but it has never been used. Two factors that likely explain this are that it may be easier for businesses to file for the refundable income tax credit than to collect the receipts necessary to claim a sales and use tax refund; and some purchases may also be exempt from sales and use tax, which would make the refund unnecessary.

Rural Development Act

Through December 31, 2011, 68 taxpayers have used credits from the Rural Development Act, but participation has declined in recent years. In 2009, the 34 applicants created 90 jobs and invested $28.3 million. In 2012, the six participating companies created five jobs and invested $2.1 million. Increased funding was added in 2009, but not fully used in 2010 or 2011, so the Legislature redirected some of the funds to the Angel Investment Tax Credit Act.

Microenterprise Act

The Nebraska Advantage Microenterprise Act is a limited incentive, with $2 million of credits allowed each year. Through December 31, 2011, 1,285 taxpayers have been issued credits under this Act. Since 2006, the full $2 million has been requested every year. Though the amount used is less than the full amount requested, it has always been between $1.1 and $1.8 million.

Angel Investment Tax Credit Act

The Angel Investment Tax Credit Act is a fairly new incentive, passed in 2011. In the first year, 20 businesses received investment funds. In 2012, there were 22 participants, most of which were continuing from the previous year (five were new). Of the businesses receiving credits, nearly all were located in distressed areas. Only one in 2011 and two in 2012 were in non-distressed areas.

The following table details the amount of funding requested, approved, and issued for each year, along with the amount of investment used to qualify for the credits.

Table A.2: Angel Investment Tax Credit Usage by Year

	2011	2012
Credits Requested	$4,898,000	$4,032,313
Credits Approved	$3,078,000	$3,661,215
Credits Issued	$2,319,424	$2,837,424
Total Qualified Investments	$7,401,624	$7,190,471

Beginning Farmer Tax Credit Act

The Beginning Farmer Tax Credit Act provides credits to farmers that lease land to new farmers. A “beginning farmer” can lease land from more than one person, so the number of land owners (and thus tax credit recipients) is significantly higher than the number of beginning farmers. Since 2001, $5,548,827 in credits have been issued by the Beginning Farmer Tax Credit program. These have been issued to 375 individual owners for their contributions of land to 271 individual beginning farmers.