The Florida Senate

Interim Project Report 2000-45 *August 1999*

Committee on Fiscal Resource Senator Jim Horne, Chairman

STATE ECONOMIC AND DEVELOPMENT INCENTIVES

SUMMARY

Florida's economy depends on a business friendly atmosphere. Accordingly, the Florida Legislature has offered various incentives to attract business, to create jobs, to revitalize business communities and to make Florida businesses competitive with other states, as well as the global market. While incentives are not generally the only reason for business location, the presence of incentives is an important factor. State and local incentives have become the cost of doing business for Florida because other states are offering incentives as well. This report provides an overview of the three types of business incentives that the Florida Legislature has enacted to encourage economic development in the state or to improve the state's business climate. In addition, the effectiveness of incentives, in general, is presented based on the latest literature on the subject. Finally, the report offers six criteria that can be used for evaluation of appropriate business incentives.

BACKGROUND

Florida provides many incentives for businesses to locate or expand in the state. Many of these are beyond the control of state policy-makers -- great natural beauty, mild climate, large and diverse population, and proximity to international trading partners -- but other incentives are the result of conscious policy decisions by current and former legislatures. This report provides an overview of incentives that have been enacted to assist or encourage economic development in the state, or to improve the state's business climate.

Business incentives can be grouped into three categories:

- programs that provide appropriated funds for qualified businesses that meet certain criteria, sometimes in the form of tax credits or refunds;
- tax exemptions and credits that are available to any business otherwise subject to the tax; and
- statutory distributions of state revenue to businesses which satisfy legal criteria.

Because incentives in the first category must receive annual appropriations, they are subject to close and regular scrutiny. Any incentive that does not accomplish its goal is likely to lose its support in subsequent budgets. The other types of incentives usually persist unless they are repealed by the legislature, and do not fall under the same degree of scrutiny.

METHODOLOGY

This report lists major incentives for businesses provided in the state's tax laws, based upon information from the "1999 Florida Tax Handbook" and the "Exemptions from Florida's Sales Tax: An Analysis," prepared in 1997 by the Senate Committee on Ways and Means -- Subcommittee E. It also summarizes the findings of the Senate Committee on Commerce and Economic Opportunities' 1998 "An Effectiveness Review of Florida's Economic Development Programs." The general effectiveness of tax incentives is assessed in a literature survey.

FINDINGS

Economic Development Programs Based on Appropriated Funds

In November, 1998, the Senate Committee on Commerce and Economic Opportunities published its interim project, "An Effectiveness Review of Florida's Economic Development Programs". Among other things, this report provided a comprehensive list of principal economic development programs in Florida and principal economic appropriations. Below is the list compiled by the Senate Commerce and Economic Opportunities Committee of such programs:

<u>Road Fund</u>: grants to political subdivisions to correct transportation problems that are impeding location or expansion of businesses. (s. 288.063, F.S.)

<u>Quick Response Training</u>: grants to new or expanding businesses for customized, entry-level, short term

training necessary to expand workforce. (s. 288.047, F.S.)

Qualified Target Industry (QTI) Tax Refund: tax refunds of up to $5,000 per job to new or expanding businesses in certain target industries that create at least 10 new jobs paying wages 15% higher than area or statewide average. (s. 288.106, F.S.)

Enterprise Bonds: variable rate, tax-exempt bonding financing for fixed asset acquisition projects of small manufacturers and nonprofit organizations. (ss. 288.9602 - 288.9610, F.S.)

Florida Manufacturing Technology Centers:
4 regional and 15 satellite offices providing small and mid-sized manufacturers with technical assistance and training designed to increase facility competitiveness.

High-Impact Performance Incentives: grants to induce expansion or location. Business must be in high-impact sector and must make cumulative investment of at least $100 million and create 100 new jobs. (s. 288.108, F.S.)

Small Business Technology Growth Fund: provides guarantees to encourage banks to extend loans to small businesses that are "on the margin" of traditional credit standards. (s. 288.95155, F.S.)

Qualified Defense Contractors Tax Refund: tax refunds of up to $5,000 per job created or saved to qualified defense contractors or subcontractors based on new contracts, consolidation of contracts from outside Florida or conversion to non-defense production. (s. 288.1045, F.S.)

Rural Community Dev. Revolving Loan Fund/Regional Rural Dev. Grants: loans to rural local governments and organizations supported by local governments. (ss. 288.065 - 288.018, F.S.)

U.S. Small Business Admin. Loan Program: subordinated long-term financing for major fixed assets to facilitate business expansion or retention.
(s. 288.7011, F.S.)

"Team Florida" Trade Missions: pilot program to coordinate extensive participation of business, government, and economic development leaders in targeted trade and investment missions.

Brownfields Redevelopment QTI Bonus: bonus per job tax refund to QTI-qualified businesses that locate or expand in designated areas with environmental contamination. (s. 288.107, F.S.)

Target Market Reconnaissance Trade Grants: grants to local or regional EDOs with goal of matching existing businesses with specific trade opportunities. (s. 37, ch. 97-278, L.O.F.)

Microenterprise activities: Office of Tourism, Trade and Economic Development (OTTED) authorized to contract for services designed to support the development of extremely small businesses with small capital needs. (s. 288.9618, F.S.)

Trade and Intensive Export Assistance: assistance given to small/medium size Florida business seeking to enter or expand in the international market.

Florida Export Finance Corporation: loan guarantees and direct loans to businesses for specific export transactions when exporter is unable to obtain financing from traditional sources. (ss. 288.770 - 288.778, F.S.)

Innovation and Commercialization Centers: 6 nonprofit centers providing new businesses mentoring, technology assessments, market research, etc.

Florida Trade Data Center: operates Americas Information Gateway, providing Internet-based access to information, communications, and business support. (s. 288.8155, F.S)

Black Business Investment Board: bank guarantees, loans, project financing and construction bonding services provided to black businesses. (ss. 288.707 - 288.714, F.S.)

Cypress Equity Fund: fund capitalization by investors, including State Board of Administration, that invests in approximately 10 to 15 venture capital firms, which make investments in Florida businesses.

Tax Exemptions and Credits

Florida has made it a practice to grant tax exemptions, credits and deductions to provide incentives for certain types of businesses to locate in Florida or to remain in Florida. There are over sixty such tax incentives currently in statute affecting the corporate income tax, documentary stamp tax, intangibles tax, insurance premium tax, sales and use tax , and aviation fuel tax. In addition, the Legislature has authorized a local option economic development ad valorem tax exemption. Table 1 lists all tax incentives with an annual fiscal impact greater than $5 million.

Table 1
Tax Incentives With a Fiscal Impact Greater Than $ 5 Million

Tax Incentive	Fiscal Impact (millions)
Corporate - subchapter S corporations exemption	176.6
Corporate - master limited partnership exemption	23.3
Corporate - limited liability partnership exemption	10.2
Corporate - Florida targeted jobs deduction	6.5
Corporate - community contribution tax credit	10.0
Corporate - emergency excise tax credit	33.4
Doc Stamp - international banking transactions exemption	18.8
Insurance Premium - Florida employer's salary tax credit	77.2
Intangibles - two-third of accounts receivable exemption	60.8
Fuel tax - aviation fuel employment refund	11.3
Sales tax - limits the 7% telecommunication tax to $50,000 per company	14.1
Sales tax - printing for out-of-state customer, when paper is provided	7.4
Sales tax - master tapes, records, films or video (partial)	23.2
Tax Incentive	**Fiscal Impact (millions)**
Sales tax - items fabricated for use in R&D	76.6
Sales tax - fabrication labor used in motion pictures	7.4
Sales tax - M&E purchases by new businesses	17.3
Sales tax - M&E purchased by expanding businesses & spaceport	61.0
Sales tax - certain aircraft modification services	19.9
Sales tax - newspaper, newsletters & magazines delivered by mail	16.9
Sales tax - electricity used for manufacturing	36.0
Sales tax - sale or use of satellites or space vehicles	123.3
Sales tax - labor & repair on certain M&E	10.9
Sales tax - certain items of TPP used in advertising	11.2
Sales tax - TPP used in NASA or defense contracts	12.1

The Legislature addresses tax incentive proposals each year. Availability of revenues and support generated usually determine which tax incentives become law. In 1999, the Legislature passed the following seven tax incentive bills: additional 1/3 intangibles tax reduction on accounts receivable; increase from $5 to $10 million in the community contribution tax credit; sales tax exemption for labor and repair on certain machinery and equipment; sales tax exemption for printing supplies; sales tax exemption for certain items of tangible personal property used in advertising; sales tax exemption for tangible personal property used in NASA or defense contracts; and a sales tax exemption for machinery and equipment used in phosphate mining (ch. 99-171, L.O.F.). The phosphate exemption is granted by way of a credit against the severance tax and in order for a business to qualify for the exemption, the business must meet certain employment criteria, which requires the creation of new Florida jobs.

Two important tax policy issues that need to be mentioned are Florida's constitutional restrictions on a personal income tax (Art. VII, s. 5.(b)) and on motor vehicle ad valorem taxes. (Art, VII, s. 1. (b)) These restrictions can be viewed in the same light as tax incentives. They are highly valued as incentives for businesses to locate in Florida, because of the positive tax implications they have on employees and their families.

Distributions of State Revenues

In addition to tax incentives, Florida provides for the distribution of sales and use tax revenues to certain sports facilities, to encourage such facilities to locate in Florida or to remain in Florida. The moneys must be used to build a sports facility for a new professional sports franchise or for the renovation of an existing professional sports franchise facility. Section 212.20(6)5., F.S., provides for the following distributions:

- $166,667 is distributed monthly by the Department of Revenue to each applicant that has been certified as a "facility for a new professional sports franchise" or a "facility for a retained professional sports franchise" pursuant to s. 288.1162, F.S., and $41,661 is distributed monthly by the department to each applicant that has been certified as a "new spring training franchise facility" pursuant to s. 288.1162, F.S. Distributions begin 60 days following such certification and continue for 30 years.

The following franchises have applied for and been certified to receive funds ($60,000,000) as *new* professional sports franchise facilities:

Florida Panthers (Broward County)
Florida Marlins (Joe Robbie Stadium)
Jacksonville Jaguars (City of Jacksonville)
Tampa Bay Lightening (City of Tampa)
Tampa Bay Devil Rays (City of St. Petersburg)

The following franchise has applied for certification to receive funds ($60,000,000) as a *retained* professional sports franchise facility:

Tampa Bay Buccaneers (Hillsborough County)

- $166,667 is distributed monthly for up to 300 months, by the Department of Revenue to an applicant certified by OTTED as the Professional Golf Hall of Fame. The Professional Golf Hall of Fame was certified in June, 1998.

- $83,333 is authorized to be distributed monthly for up to 180 months, by the Department of Revenue to an applicant certified by OTTED as the International Game Fish Association World Center. The International Game Fish Association World Center has yet to be certified.

Effectiveness of Incentives

Tax Incentive Literature

The relationship between taxes and economic development has been the subject of ongoing research since at least the 1950's. Most studies have focused mainly on determining whether the level of taxes in a particular state or region has any effect on the economic growth experienced by that area. A 1997 overview of this literature chose 16 of the most important contributions to this literature to draw a consensus set of findings and policy implications. The authors found:

> In summary, there are several policy lessons to be learned from interregional and intra-regional econometrics studies. First, many studies find that the level of taxes matters -- i.e., that tax variables are statistically significant determinants of economic activity -- but many others do not, casting doubt on how the literature would answer the simple question posed at the beginning of this section. (Do taxes matter?) Even when taxes do matter, the magnitude of the effect is small, and other factors are more important in explaining differences in economic activity across space. Finally, in creating an environment conducive to economic development, how governments spend their tax revenues may be more important than the level of taxes. Our overarching conclusion is that cutting taxes is not a panacea for a poorly performing regional economy. (Stephen t. Mark, Therese J. McGuire, and Leslie E. Papke, "What Do We Know About the Effect of Taxes on Economic Development? Lessons From the Literature for the District of Columbia" *State Tax Notes*, August 25, 1997.)

The empirical research on the effect of taxes on economic development has been paralleled by research into theories of tax competition among governments. A June, 1999 article (John Douglas Wilson, "Theories of Tax Competition" *National Tax Journal*, June, 1999) reviews developments in this area and finds that tax competition among governments has both good and bad aspects. Competition may induce government officials to reduce waste in government, but tax competition can lead to inefficiently low taxes and public goods levels.

Research on the effect of targeted tax and economic incentive programs is much more limited than research on the effect of overall tax levels. One reason is that state incentive programs are difficult to measure and compare. A 1997 study cited in James K Smith's "Use of Business Taxes: Part 2" (*Journal of State Taxation*, Summer 1999) concluded "no econometric study has measured development incentives entirely appropriately." and if incentives cannot be measured their effectiveness cannot be determined.

Lack of empirical evidence on the effectiveness of targeted tax incentives has not slowed debate on the issue. In his overview of the topic, "Use of Business Incentives: Part 1" (*Journal of State Taxation*, Spring 1999), James K. Smith provides the following summary of arguments for and against targeted tax incentives:

What are some arguments in favor of state tax incentives?

> Proponents of tax incentives offer a number of arguments in support of tax incentives. First, advocates note that state and local taxes represent nearly half of the total tax burden of businesses. As a result, it is understandable why state taxes play a role in business decisions. Second, state tax incentives attract new businesses to the state and encourage existing businesses to expand. This business expansion creates new jobs, which is particularly important in today's global market, since states are competing for jobs not only with each other but also with foreign countries. Third, tax incentives are cost effective and may merely forgive taxes that otherwise would not have been collected if business located elsewhere. Fourth, tax incentives have a multiplier effect that increases the revenues of in-state businesses that support the new business and its employees. Fifth, new businesses lured into the state with tax incentives may change the way the state is perceived and lead other businesses to consider moving to the state. Alabama's improved image as a result of Mercedes-Benz selecting the state for its manufacturing plant is cited as an example. Sixth, states need to offer tax incentives to be competitive with the vast majority of other states offering them. Finally, advocates assert that state tax incentives are simply the healthy workings of free market competition.

What are some of the arguments against the use of state tax incentives?

> Critics denounce state tax incentives on a number of grounds. First, they claim that state tax incentives are motivated by narrow political interests and divert money away from more important causes, such as education and infrastructure improvement. Second, businesses place much more importance on other relocation factors, such as the availability of labor and proximity to customers, than they do on state tax considerations. State tax incentives are pivotal only when a company finds sites in two or more states that are otherwise equally matched. Third, state tax incentives may reward activity that would take place even without the tax breaks. Fourth, state tax incentives are a zero-sum game in the sense that the gain of business by one state is offset by the loss of that business by another state. Fifth, state tax incentives create a destructive rivalry among state that is worse than a zero-sum game. While states collectively realize no net gain in business activity or jobs, they incur substantial decreases in overall tax revenues. Sixth, tax incentives only provide a short-term advantage for a state that disappears when other states implement similar tax rules. Other criticisms include charges that tax incentives distort economic decision making, are not cost effective, and are inequitable because they favor manufacturing and mobile businesses that can threaten to relocate.

Given the unsettled state of the debate on the issue of targeted tax incentives and the increasing use of these incentives, many policy advisors recommend that states use safeguards to ensure that businesses comply with the terms of incentive packages. These safeguards are described below in the Recommendations section.

Effectiveness of Florida Incentive Programs

In its 1998 " An Effectiveness Review of Florida's Economic Development Programs," the Senate Committee on Commerce and Economic Opportunities found that three programs are viewed as particularly effective by local economic development organizations: the "Road Fund" (Economic Development Transportation Projects), Quick Response Training, and the Qualified Target Industry Tax Refund Program. Since these are the economic development programs that received the greatest funding in the study period, it is possible that they are the programs that were most widely available. The scope of the study did not extend to evaluating the per-dollar effectiveness of various programs.

Constitutional Issues

State tax incentives that create preferential treatment for certain taxpayers run the risk of being challenged on Constitutional grounds. In particular, the Commerce Clause of the United States Constitution forbids state and local laws that unduly burden interstate commerce. Several state tax incentives have been challenged as violating the Commerce Clause, and, although decisions in these cases have created uncertainty about what standards will be applied, some practices are clearly unconstitutional.

State tax provisions that provide in-state business or activity with protections or benefits that are not similarly available to out-of-state competition have been repeatedly invalidated. Tax preferences for businesses using in-state labor or materials are virtually *per se* invalid. Beyond these clear-cut situations, though, other incentives such as property or sales tax exemptions granted to businesses for new investment in the state appear to withstand Commerce Clause challenges. If the exemption is dependent on hiring in-state workers or using in-state products, however, a challenge to the exemption is likely to succeed.

RECOMMENDATIONS

While an array of authors of current literature question the appropriateness of economic incentives, a generally prevailing theme is awareness that states are competing to attract business to their respective states. While incentives are not generally the only reason for business location, the presence of incentives is an important factor after other factors are satisfied. Availability of a educated workforce, proximity to transportation, and climate are among the reasons for locating a business. Another attraction of Florida is that we do not have a personal income tax.

State and local incentives have become the cost of doing business for Florida because other states are offering incentives as well. Critics write that many incentives are too expensive for the return; proponents write that the image created is worth the cost. An analogy is the advertising expense of a business. If a business wants market share, advertising expenditures become a significant cost of doing business. So, if we accept that incentives are a necessary expenditure in the prevailing business climate, what are some criteria for evaluation of appropriate incentives?

- **Incentives should not harm existing Florida businesses**. Attracting a new business to Florida that causes the demise of an existing business that did not qualify for the incentive does not meet the test of horizontal equity. The incentive should be broadly available to existing and new business, where applicable.
- **Accountability is not a bad word.** Incentives granted on the basis of some measurable benefit like number of new jobs, or increases in average salaries might have qualifiers similar to ch. 99-171, L.O.F. First, the incentive is not received until earned. Sales tax is paid up front but becomes a subsequent credit against severance tax. Production earns the credit rather than a subsidy. Additionally, delivery of net new jobs in Florida qualifies the business for continuance of the credit.
- **Measurable economic benefits to the state or a region are very hard to prove**. REMI and other economic models, generally, have not been able to justify most incentives. They can not isolate the impact of incentives on economic growth of the region or the state. The inverse is true as well. Quantitative analysis also can not prove they have not encouraged growth. Accordingly, when the quantitative approach falls short, **nothing is wrong with subjective consensus that an incentive feels like the right decision to make**. In cases like this, what would be wrong with a post review or a sunset provision? Work toward a cost benefit analysis.
- **Incentives should not risk constitutionality questions**. The commerce clause and equal protection provisions may be violated if an incentive harms an out-of- state business. Volumes have been written on this issue and the issue is still evolving.
- **Target incentives for areas with high unemployment, depressed economic activity and low per capita income.**

- **Continue to Invest more for the needs of in-state entrepreneurs and upgrading worker skills**.

State economic development incentives in Florida will continue to be the subject of future interim projects and reviews. Florida is a great state and a great place for businesses to locate. Incentives alone will not make Florida appealing to businesses, our other assets will attract businesses, and incentives may help businesses make marginal decisions between Florida and competing states.

COMMITTEE(S) INVOLVED IN REPORT ***(Contact first committee for more information.)***
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MEMBER OVERSIGHT
Senators McKay, Gutman, and Lee