



The Poverty Institute

at Rhode Island College School of Social Work

Principles for Economic Development Incentives

In recent years, officials in Rhode Island and other states have undertaken numerous efforts to promote job creation, offering both direct subsidies to specific companies and indirect subsidies such as credits, exemptions and deductions that lower business tax burdens. While economic incentives surely have a place in any state's economic development strategy, research indicates that business incentives, and tax incentives in particular, are not very cost-effective tools of job creation. Furthermore, incentives are costly to taxpayers -- though if properly targeted may pay for themselves over time in the form of higher sales and personal income tax collections. When offering incentives, officials should recognize that incentives are not entitlements. They impose a cost on the public and can provide recipient firms with a competitive advantage over other firms. Incentives should therefore be regarded as a reward for businesses that improve the economic climate of the state, by creating high-quality jobs in stable or growing industries likely to generate positive spillovers for the local economy. To ensure that they are effective, incentives must have provisions built in to ensure accountability.

We propose that officials employ the following principles in determining when to offer tax breaks and other economic development incentives.

I. Job Quality Standards

1. Incentives should benefit employers who raise state standards, not those who lower them.

The Rhode Island mean wage was \$17.76 in 2002. The median wage was \$14.42. Firms paying mean and median wages below these levels lower the average job quality in the state.

2. Job quality standards should specify a floor value for wages and benefits.

Official benchmarks like the federal poverty level recognize that jobs paying low wages leave workers unable to meet basic needs. Furthermore, most employees want full-time, year-round jobs that provide such benefits as health insurance, paid sick leave, pension contributions and vacation time. Incentive agreements should specify a minimum compensation level for the lowest paid employees of the recipient firms. Jobs that offer anything less than the minimum be worth having (since any job might be better than no job), but they are not worth contributing state dollars to create.

3. Job quality standards should specify a median value for wages and benefits, not simply an average payroll cost.

When the total corporate payroll is divided by the number of employees, the resulting average can be significantly skewed by a few very highly compensated company executives. To avoid this, employment standards for tax incentives should specify median compensation figures for all employees of the recipient firms.

4. Employment standards should explicitly incorporate changes in the cost of living.

Incentives are often written into the tax code, where they become entitlements that eligible employers can access indefinitely. Or they are written as contractual agreements between individual employers and the state that may remain in effect for many years. Writing standards in nominal dollars weakens potential benefits to the state's workers, since dollars lose value over time due to inflation. It is preferable that job quality standards be tied to some measure that moves with the inflation rate. Setting wage standards as a multiple of the federal poverty level, which is adjusted each year for inflation,

or as a multiple of the state median wage, which tends to rise in nominal terms with living costs, ensures that incentives maintain or increase employment standards in the state over time.

II. Accountability Standards.

1. Incentives should include provisions for monitoring performance, ensuring compliance with performance standards, and reimbursing taxpayers for costs if goals are not met.

It is not enough that firms promise to create jobs in return for incentives. Development incentives create an on-going cost for the state and firms that receive them should be subject to ongoing monitoring. Monitoring compliance should include, at a minimum, annual self-reports, spot checks and analysis of payroll records by the EDC or other independent public agency. Penalties for non-compliance should include restitution of prior benefits, forfeiture of future benefits, tax fraud charges or bans on receiving future government aid or contracts

2. Incentives should pay for themselves over time.

The purpose of tax incentives is to create jobs and generate economic activity. Yet economic activity itself imposes demands on state and local services - for transportation, water treatment, schools, public safety, etc - necessitating that the government have stable and adequate revenue sources. When devising incentives, responsible officials should create a benchmark and timeline to ensure that the cost of incentives will be fully recouped and not create a long-term net drain on state revenues. At a minimum, the additional personal income taxes and sales taxes generated by recipient firms should exceed the cost of incentives. In no case should the cost-per-job for the state surpass the wages paid by recipient firms.

3. Information on the costs and benefits of incentives should be available to the public.

Private firms have a legitimate business interest in concealing proprietary financial information from competitors. This concern must, however, be balanced against the public's interest in ensuring that public funds are expended effectively.

Public disclosure should include, at a minimum, an annual report detailing the number of recipient firms and value of incentives received. Officials charged with monitoring incentives should be able to document the number of jobs created each year as well as the mean, median and minimum compensation of employees in recipient firms.

The Poverty Institute works to promote economic security for low- and moderate-income Rhode Islanders and equitable tax and budget policies through policy analysis, education and advocacy.

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