Testimony to:

Senate Committee on Finance

Senate Committee on Commerce, Economic Development and Small Business

Senate Committee on Investigations and Governmental Operations

Effectiveness and Oversight of NYS Business Subsidies and Tax Incentives

Presented by

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My name is Ken Pokalsky and I testifying today on behalf of The Business Council of New York State, Inc. We are New York's largest statewide employer association, representing approximately 3,500 private sector employers across New York, in all major business sectors, with about 80 percent of our members small businesses with 100 or fewer employees.

As always, we appreciate this opportunity to speak with members of the Senate Finance, Commerce and Investigations Committees, today on the topic of the effectiveness of economic development incentive programs in meeting their stated goals, and on better mechanisms for evaluating the cost-effectiveness of these programs.

In our testimony today, we address those questions, and provide additional input on issues related to any evaluation of the state's overall economic development efforts.

Promoting Economic Growth – We believe that well designed and well implemented incentive programs are an important component of New York State's economic development efforts. And we also believe that the state's programs are generally well designed, well-implemented and provide a reasonable degree of information to the interested public.

Even so, we recognize that legislation, despite best efforts, often fail to address important factors and can result in unintended outcomes, and many groups, including economic development proponents, have raised appropriate concerns about certain programs and specific program elements.

As example, the Empire Zones program as initially adopted included several major shortcomings (the opportunity for "shirt-changing" projects being the most significant) that were quickly identified (including by the professional economic development community) and generally eliminated through the program through subsequent statutory amendments. Subsequent amendments also made the program benefits more closely tied to job creation and job quality.

We remain open to consideration specific concerns about program designs and/or implementation, and proposed amendments designed to improve programs effectiveness or efficiency.

Importantly, we often stress that when considering "economic development," it is essential that the Administration and Legislature consider more than tax credits and other incentive programs. The state needs to do a better job of considering how a wide range of public policy initiatives -- including but not limited to labor, environmental and energy initiatives -- impact the state's economic climate and economic competitiveness. Said other way, we have often seen the beneficial economic climate impact of new programs and reforms more than offset by significant new costs, mandates or restrictions.

The Business Council partners with the Siena Research Institute on its annual survey of Upstate Business CEOs, and its most recent 2020 survey shows that upstate business leaders are increasingly concerned about the state's economic competitiveness, and their own ability to survive let alone continue to invest and grown. And, importantly, they point to state-imposed "headwinds" – including labor law mandates and other regulatory requirements and state-imposed costs – as adding to their challenges.

Even when programs impose new costs, mandates or restrictions on employers, there are often alternative approaches that can mitigate the compliance burden while still achieving the underlying policy objectives.

Likewise, it needs to recognize that the effect of state economic development expenditures, whether through grants or tax expenditures, are not only the offset of state and local taxes, but they call

also help counterbalance the overall impact of state policies on employers' decisions on where to deploy capital and locate jobs.

NYS Economic Climate - New York's business climate – the overall resource, costs and regulatory climate on which businesses make investment decisions are based – is expensive and challenging.

A few examples:

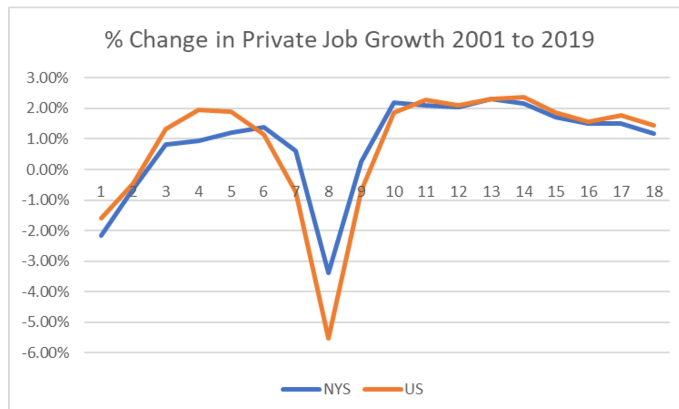
- New York's combined state and local tax burden on business is second highest of any state (behind only North Dakota) and 114 percent above the national average, on the basis of the amount of taxes per private sector employee, and 41st highest (behind mostly small rural states or states with significant extractive industries) and 27 percent above the national average based on business taxes as a share of total in-state economic activity, according to the Council on State Taxation's report, "Total state and local business taxes, State-by-state estimates for FY20", issued in October 2021. In 2021 was one of the few U.S. states to enact significant tax increases on corporations and higher earning individuals (including owners of pass-through entities.)

  Interestingly, the COST study also includes a unique assessment of the ratio of business taxes paid compared to governmental benefits received by businesses. It recognizes that since education spending is by far the largest category of net state and local expenditures, estimates of the tax-benefit ratio for businesses are sensitive to the allocation of education expenditures between businesses and households, and its analysis presents a range of estimates for the share of educational expenditures that benefit in-state businesses, with estimates based on assumptions that 0%, 25% and 50% of in-state education spending benefits in-state businesses. Even under this analysis, New York is shown to have a relatively high state and local tax burden, about 30 percent higher than the national average.)

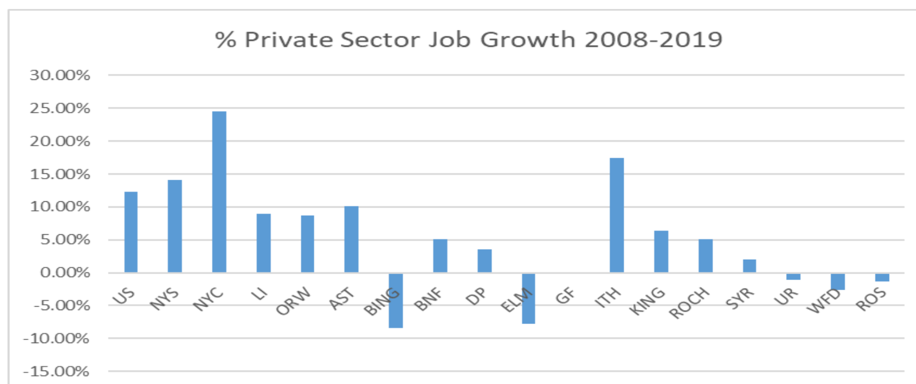
- Cost of electric power for commercial businesses is 48% above the national average, according to the October 2021 EIA Electric Power Monthly

- Workers compensation costs (premium per $100 of covered wages) are 20 percent above national average, 40th highest of any state – and getting relatively worse, with 32 states showing cost reductions of at least 10 percent over the prior four year period, according to the National Academy of Social Insurance.

NYS Economic Performance - Data shows that New York has a long-standing economic competitiveness problem. It recovered more slowly from both the 2001 slowdown and the 2009 recessions than the nation (after the 2009 recession, New York trailed national job growth rates each year from 2012 to 2019).



Moreover, job growth in New York has been concentrated in New York City, and to a lesser degree in the northern suburban counties and Long Island. Most other areas of the state had not yet, or had just barely, recovered jobs lost in the 2008 recession by the time that the COVID pandemic and recession started.



While some sectors are doing well, for others – such as manufacturing – New York continued to lose ground to the rest of the nation even during the 2010 to 2019 national recovery. Even in the state's crucial financial services sector, New York has been slowing losing ground to other states.

Economic Development Spending in Context -- We often hear statements to the effect that the state is spending (or, according to some commentators, overspending) $8 billion or more every year on economic development programs.

While we question the accuracy of that calculation, we recognize that this is still a significant expenditure category at both the state and local level. We also recognize that this calculation needs to be considered in context.

These reports typically aggregate state and local incentives (local incentives are largely but not exclusively provided by New York City and individual counties). Considering that the state budget has been near the $200 billion level (prior to being inflated for FY 2022 with one-time federal funds), that the New York City budget is in the $60 billion range, and that counties outside of New York City spend in aggregate about $26 billion (FY 2020 data from the Office of State Comptroller), at $8 billion economic development spending is 2.8% of total governmental spending. We believe that figure that is probably a high estimate, considering that not all governmental entities are

included in the denominator, and not all expenditures typically classified as "economic development" represent business incentives or subsidies (REDC awards as a prime example. Through our review of multiple region-specific award reports, over multiple years, we estimate that 15 to 20 percent of REDC awards are assistance to business. Numerous REDC awards are more properly characterized as public works spending.)

Distribution of Incentives – While not an explicit topic for this hearing, the hearing notice implies a concern about the share of incentives going to large firms, saying that "economic development incentives and subsidies [are] mostly for large businesses."

To some degree, it should be expected that economic development program costs lean toward larger employers, as larger businesses have an outsized role in the New York State economy. Based on the most recent available data (2017 US Census County Business Patterns), a relatively small number of large firms represent a significant share of the state's total private sector jobs and payroll.

Firm Size (by employment)	% of Private Firms	% of Private Jobs	% of Private Payroll
100 or more	2.7	65.2	74.4
500 or more	1.0	50.2	59.8

Even so, our review of the ESD Database of Economic Incentives, shows that the majority of projects receiving ESD-managed incentives are small businesses, with 100 or fewer employees representing 57 percent of all program participants (we used the report's data on job retention and creation as a proxy for entity size.) In addition, while the value of incentives to larger firms is larger in absolute terms, so is the level of investments made by larger firms. However, the share of project costs represented by state assistance is nearly 50 percent greater for small employers than for large employers.

Project Size (Jobs Retained and Created)	Number of Projects	Total State Assistance	Total Private Investment	State Assistance as % of Private Investment
More than 100	275	$1,874,184,673	$21,938,507,169	8.54%
100 or less	362	128,181,134	$1,048,245,619	12.22%

Claiming Benefits – Concerns have been raised as to whether New York is "getting what they pay for" through its business incentive programs.

Importantly, the major state-level tax expenditure programs in New York, including but not limited to the Excelsior jobs program, the brownfield cleanup program, the investment tax credit, and the film production credit and others are all – for lack of a better term – "pay for performance." Credits are awarded by the state and realized by the taxpayer after the targeted activity is accomplished, whether a capital investment or creation of a job and the payment of wages.

Further, for these programs, the state's return on investment is a direct function of the statutory criteria. They do not calculate or award benefits based on promised or projected jobs or investments (although project agreements may include a cap on total incentives).

Research Findings – In the limited time we had available to do so, our survey of research literature identified several studies that illustrate a positive impact of tax policy initiatives on economic development outcomes.

Most recently, the March 16, 2021 report of the Congressional Joint Committee on Taxation, "Tax Incentives for Domestic Taxation," provided both a detailed discussion of the economic theories related to impact of taxation on the cost of capital -- and therefore on business investment decisions -- as well as a review of studies related to the impact of several specific federal tax expenditure programs, including depreciation expensing and accelerated depreciation, research and development deductions and tax credits, the domestic production activities deduction (DPAD), and the advanced energy property investment credit.

For example, the JCT report said:

> - "The literature on the effects of more generous cost recovery methods and on the sensitivity of capital investment to its user costs more generally, on balance, supports the theory that investment is responsive to taxes."
>
> - "Research on the bonus depreciation provisions enacted in 2002 and 2003 found a notable effect of tax incentives on investment in capital goods."
>
> - "A recent survey concludes that research tax incentives have significant effects overall, concluding that the literature supports an estimated elasticity of R&D spending with respect to its tax-adjusted user cost of one or greater."
>
> - In discussing the ARMA clean energy incentives, it cited that "firms substitute away from fossil fuels and toward clean energy sources with sufficient incentives."
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> - "Economic studies have confirmed that corporations increased investment in response to the DPAD."
>
> - ". . . the American Recovery and Reinvestment Act's clean energy package . . . directed clean energy investments as well as overall economic activity" and that, based on incentives, "firms substitute away from fossil fuels and toward clean energy sources with sufficient incentives."

Likewise, the Tax Foundation in their 2021 annual state tax business climate index, in discussing their assessment of numerous impact studies, observed that:

> Theoretically, businesses could be expected to be more responsive than individuals to the lure of low-tax jurisdictions. . . The economic literature over the past 50 years has slowly cohered around this hypothesis. Ladd (1998) summarizes the post-World War II empirical tax research literature in an excellent survey article, breaking it down into three distinct periods of differing ideas about taxation: (1) taxes do not change behavior; (2) taxes may or may not change business behavior depending on the circumstances; and (3) *taxes definitely change behavior*. [emphasis added]

adding that:

> [this] "period three" started in the late 1980s and continued up to 1998, when the quantity and quality of articles increased significantly. . . [and] surely continues to this day.

The Tax Foundation report cites and summarizes numerous studies over the past four decades showing a significant impact of tax policy on the private sector and its business decisions.

Even so, it is fair to say that the Tax Foundation has not been a proponent of targeted tax credits and incentives, stating that, "A far more effective approach is the systematic improvement of the state's business tax climate for the long term to improve the state's competitiveness." In evaluating that objective, the Tax Foundation has given New York State very low grades, ranking New York consistently among the least-competitive states on tax policy.

Importantly, recent tax reform efforts were reflected in the Tax Foundation's rankings. After its 2015 corporate franchise tax restructuring, New York State's ranking for the corporate tax component of the Foundation's rating improved from 22nd in 2014 to 11th in 2016 (and ultimately as high as 7th in 2018). Note, however, this improved assessment was prior to 2021 legislation increasing the Article 9-A rate to from 6.5% to 7.25% for tax years 2021, 2022 and 2023 for taxpayers with taxable income over $5 million.

Public Disclosure and Accountability – We support efforts to make public data and records more accessible, in practical terms, to the interested public, and we believe that New York has done relatively well in this regard. Even so, some program's reporting systems clearly more complete than others.

The state's annual tax expenditure report, issued jointly by the Department of Taxation and Finance and the Division of Budget provides an excellent overview of tax expenditures for each of the state's many tax mechanisms, describing the nature of the expenditure, some historical cost data, as well as projections of costs for future tax years.

Empire State Development's "database of economic incentives" is user-friendly and is as detailed as, or more detailed than, similar databases developed by other states.

Empire State Development also publishes annual reports on other major incentive programs, including its Regional Economic Development Council program, the Excelsior Jobs program, an annual jobs reports (which includes an overview of benefit recovery actions) among others.

We have two recommendations regarding the ESD Database of Economic Incentives report. Under project description, the report today only indicates whether the project was a grant or a tax credit, and only indicates the general "industry" sector in which the project is classified, e.g., "construction," "public administration," or "manufacturing."

This limited presentation limits the ability of the public to understand the nature of specific projects and the purpose of the state incentive.

First, some categories, such as "construction," contain a mix of private sector and governmental projects, but one can only assume which category the project falls in by looking at the project recipient name.

Second, it is interesting to note that less than half of the projects listed include job retention and creation data. We assume this is due to fact that the criteria of the program being used is not based on jobs, but there is no such indication in the report.

For these reasons, we recommend that the report indicate the nature of the recipient, i.e., government entity, non-profit or business, and what specific program the grant or tax credit is offered. The addition of these additional project descriptions will help clarify the scope and purposes of economic development incentive projects administered by ESD.

Brownfield Program – The participant's list for today's hearing includes a brownfield program practitioner with extensive experience both in doing projects under the state's program, and with advocacy shaping the program, with whom I have worked for many years. While I will generally defer to her expertise, we would like to provide some comments on what we believe is a well-functioning, well-documented program.

Almost by definition, the program has been effective and impactful, bringing more than 500 formerly contaminated and mostly un- or under-utilized sites through protective cleanups and back into economic use. And the program is well documented and information on projects is readily accessible through the DEC and DTF websites.

The state's current brownfield redevelopment credit database, covering the period 2005 to 2020, includes financial data on 916 project-years (meaning that the report includes multiple lines for projects receive credits in more than one tax year.) The data shows $17.6 billion in private sector spending on site cleanup and redevelopment, with total credits of $2.7 billion. This means that for every dollar of credit produced $6.35 in private sector investments, for an overall credit to cost ration of 15.7 percent. Importantly, more than half of these projects, and more than 40 percent of all expenditures, were in prioritized "environmental zones," defined as areas that have elevated levels of poverty and unemployment.

The DEC provides extensive information on brownfield sites (as well as on sites undergoing cleanup under other programs), and its "Environmental Site Remediation Database" provides a detailed description of brownfield sites, onsite contamination, and other project information.

Importantly, the program has undergone several significant reforms since its inception, in large part to assure the program was cost-effective for the state. As example, in response to several early projects that represented "unintended consequences," projects now have an overall benefit cap based in part on the level of site cleanup expenditures required.

As a final point, we are supporting multiple modifications to the state's brownfield cleanup and redevelopment credits to assure the continuation of this important program, including but not limited to extending the tangible property credit period from 130 to 180 months after issuance of a certificate of completion, expanding the ability to claim site preparation credits, and extends the deadline for program acceptance to the end of 2027 and the deadline for securing certificates of completion to the end of 2031. An initial proposal is presented in S.7210 (Kennedy)/A.8228 (Peoples-Stokes), with an updated proposal still under development.

As always, we appreciate the opportunity to discuss significant public policy issues with members of the state legislature, and we look forward to any questions or comments you have on our testimony today.

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