Executive Summary

In their quest to strengthen their economies, particularly in the wake of the Great Recession, states continue to rely heavily on tax incentives, including credits, exemptions, and deductions, to encourage businesses to locate, hire, expand, and invest within their borders. Yet half the states have not taken basic steps to produce and connect policy makers with good evidence of whether these tools deliver a strong return on taxpayer dollars.

Research by the Pew Center on the States concludes 13 states are leading the way in generating much-needed answers about tax incentives' effectiveness. Twelve states have mixed results. The other 25 states, along with Washington, D.C., are trailing behind.

Although no one knows the total, policy makers spend billions of dollars annually on tax incentives for economic development, and use of these investments appears to have grown substantially since the 1970s. Today, every state has at least one tax incentive program, and most have at least several. Frequently, they are used as part of a bidding war between states over firms seeking to relocate or expand. If one state offers a tax credit, others often feel compelled to match it or risk being left behind.

But no state regularly and rigorously tests whether those investments are working and ensures lawmakers consider this information when deciding whether to use them, how much to spend, and who should get them. Often, states that have conducted rigorous evaluations of some incentives virtually ignore others or assess them infrequently. Other states regularly examine these investments, but not thoroughly enough.

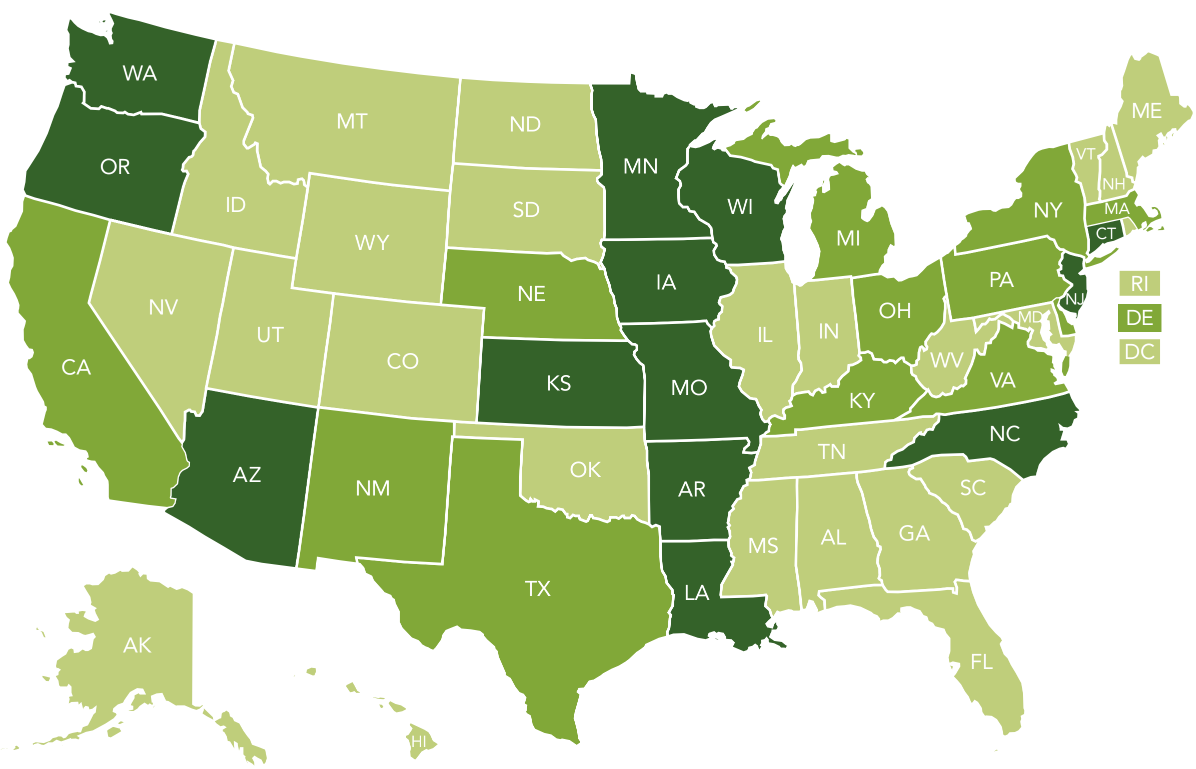
The good news is that a wealth of promising approaches exists for lawmakers to emulate.

Evaluations are most valuable when they improve policy choices. Some states are leaders because of the scope of their assessments: They have reviewed all major tax incentives and have taken steps to integrate the results into policy and budget deliberations. Oregon, for example, gives its incentives expiration dates, or "sunsets," which force lawmakers

Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth

Overall: How are states doing?

13 Leading the way	12 Mixed results	26 Trailing behind
States meeting both criteria for scope of evaluation and/or both criteria for quality of evaluation.	States meeting only one of the criteria for scope and/or quality of evaluation.	States not meeting any of the criteria for scope or quality of evaluation.



SOURCE: Pew Center on the States analysis to examine them periodically. Arizona, Iowa, and Washington also are trying to ensure their evaluations become part of the policy-making process.

Other states have distinguished themselves through the quality of their analysis. In Connecticut, a study of the Job Creation Tax Credit provided evidence that the investment had benefited the state, and in Wisconsin, policy makers scaled back the state's film tax credit after an evaluation found it to be highly ineffective. The best evaluations also highlight opportunities for improvement. Louisiana's economic development agency discovered that one tax incentive it previously credited with creating more than 9,000 jobs had produced a third of that number. By taking a closer look, the agency identified a number of ways the incentive could be strengthened, many of which were adopted by state officials. Minnesota changed a particular incentive when a more thorough evaluation concluded it cost five times as much per job as the state previously believed.

Pew reviewed nearly 600 documents and interviewed more than 175 government officials and experts to examine how—and how well—states gauge the effectiveness of their tax incentives, if they do so at all. We also sought to identify promising approaches to doing it right.

In assessing state practices, this study does not take a position on whether tax incentives for economic development are good or bad. Rather, we examined the effectiveness of each state's evaluations, focusing on whether, and to what degree, they do the following:

1. Inform policy choices
2. Include all major tax incentives
3. Measure economic impact
4. Draw clear conclusions

Tax incentives cost billions of dollars every year, and states rely heavily on them to promote economic development. Policy makers should know whether these tools deliver a strong return on investment. Regular, rigorous, and comprehensive evaluations of tax incentives are critical to their ability to do so.

Four criteria for effective evaluation

Effective evaluations:	What states can do:	A leading example:
Inform policy choices	Build evaluation of incentives into policy and budget deliberations to ensure lawmakers use the results.	Under a new Oregon law, tax credits expire every six years unless lawmakers extend them. During budget deliberations in 2011, legislative leaders set a spending cap on expiring incentives, driving policy makers to rely on evaluations to make tough choices about which incentives should continue, why, and in what form.
Include all major tax incentives	Establish a strategic and ongoing schedule to review all tax incentives for economic development.	In 2007, Washington began a 10-year process to review every tax incentive it offers. Today, nonpartisan analysts work with a citizen commission each year to analyze a particular group of incentives and make recommendations on whether and how they should change. Lawmakers review the recommendations at hearings.
Measure economic impact	Ask and answer the right questions using good data and analysis.	In calculating the number of jobs a tax incentive was creating, Louisiana's economic development agency took into account that some businesses receiving the incentives competed with other businesses in the state. The agency concluded that some newly created jobs merely displaced existing positions.
Draw clear conclusions	Determine whether tax incentives are achieving the state's goals.	In 2010, Connecticut's economic development agency assessed the state's major tax credits, using sophisticated analysis techniques. The agency concluded that although some incentives were not meeting the state's goals, others were beneficial and cost-effective.