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The Legislative Performance Audit Committee met at 1:30 p.m. on Friday, November 15, 2013, in Room 1524, at the State Capitol, Lincoln, Nebraska, for the purpose of conducting a briefing on Evaluating Tax Incentives. Senators present: John Harms, Chairperson; Annette Dubas; Bob Krist; Heath Mello; Dan Watermeier; and John Wightman. Senators absent: Greg Adams.

SENATOR HARMS: Good afternoon and welcome to this briefing of the Legislative Performance Audit Committee. My name is John N. Harms. I serve as the Chair of the committee. Today we're here briefly...we're here to have a briefing in regard to the Audit staff on a report released this week regarding the evaluation of tax incentives. And following that, we'll have Robert Zahradnik, a policy director with the Pew Center on the States. Robert has been active in the center's recent work on evaluating tax incentive programs in the states and he'll share his insight. And we're very fortunate to have him here. He's extremely knowledgeable and we're excited about working with him. As many of you know, the Performance Audit Committee has been working for about a year in regard to this particular project. And this last summer, we have joined along with the Tax Modernization Committee to begin to look at this. And what our hope is, is to simply simplify this to make sure that this program is much more transparent and the areas are all working. And if they're not, then we would like to move to improve those to make it better. It's not to kill the program or to get rid of the program. It's just very simple that we want it to be more transparent and making sure that it's working. Before we get started, I would like to ask our committee members to kind of introduce themselves, if they would, please. Starting to my right, Senator Krist.

SENATOR KRIST: Bob Krist, I represent District 10 in Omaha, Bennington, and unincorporated parts of Douglas County and I'm on the Performance Audit Committee.
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SENATOR HARMS: Next to him will be Senator Mello. Senator Mello will be joining us. I think he has a hearing right now. He's introducing some legislation but he'll be here in just a few minutes. []

SENATOR WIGHTMAN: Senator John Wightman, I represent District 36 which is Dawson and Custer County, primarily, a little bit of Buffalo County. []

SENATOR HARMS: This is Martha Carter. Martha is the head of the Performance Audit Committee and does a great job and we're very proud to be associated with Martha. So thank you very much, Martha, for being here. My name is John Harms. I am from the 48th Legislative District, that's Scotts Bluff County. []

SENATOR WATERMEIER: I'm Dan Watermeier, District 1 which is southeast Nebraska. []

SENATOR HARMS: And Dan is our Vice Chair of this committee. And next to Dan would be Senator Adams, and I'm not sure he's going to be here. If he does, it will be a little bit later today. []

SENATOR WIGHTMAN: He will not. He left our last committee meeting to go to a funeral, I think. []

SENATOR HARMS: Okay, he's gone. Thank you. []

SENATOR DUBAS: Senator Annette Dubas, District 34, I represent Nance, Merrick, Hamilton, and portions of Hall County. []

SENATOR HADLEY: I'm Galen Hadley and I'm Chair of the Revenue Committee so I don't know why they put me up here except to shoot at me. I represent Buffalo County. []

SENATOR HARMS: And I'm happy to introduce Diane Johnson who is our clerk today. And we appreciate all the work that she does. Thank you very much for taking time, as colleagues, to be here today. After the presentation, if you...if there's any senators here that would like to come up and testify, we welcome you to do that. There's an open seat for that. It's a live mike and we would like for you to have your questions recorded and also the discussion we might have here at the table. I'd like to go through just a couple of quick ground rules. First, turn off all your cell phones. Second, this briefing is open to the public but we will not be taking public comments at this time. And third, the briefing is being recorded so we will ask our presenters to please state their names and spell their last names. With that, I would invite our Audit staff to start the briefing and please introduce yourself. []

STEPHANIE MEESE: Hello, members of the Legislative Audit Committee and Senator Hadley. My name is Steph Meese and that's M-e-e-s-e. And with me today, is Kate Gudmunson and that's G-u-d-m-u-n-s-o-n. And Kate and I were the auditors on this report. And we've actually, as Senator Harms said, we've been working on this topic for the last year for the office. Kate and I are here today to give you a brief overview of our latest report on tax incentives which is entitled Measuring Success: Effectively Evaluating Nebraska Tax Incentive Programs. I just want to start today by expressing our gratitude for the help we received from the Pew Center on the States. They were amazing to work with and incredibly helpful in researching and drafting this report. In our report, we outlined a process for legislators to follow to improve the evaluation process for the state's tax incentive programs based on a structure suggested by Pew. Three key program concepts are at the core of that structure. Goals which are measurable statements of what the program is intended to achieve, metrics which are the quantifiable measures to be used to determine how well a program is achieving these goals, and benchmarks which 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 there's progress being made toward

that goal. Discussion of these concepts will need to occur to establish better evaluations of these programs. Our report does not make policy recommendation. Instead, the concepts described above are explored in detail to lay the groundwork for such discussions to happen. At this time, I'm going to hand it over to Kate. And she's going to go over goals and metrics as well as kind of give an overview of what's being done in other states to review tax incentives there. []

SENATOR HARMS: Kate, before you start that, Senator Mello has now joined us. Thank you, Senator Mello. []

KATHRYN GUDMUNSON: (Exhibit 1) Okay. So I'm going to walk you through, basically, the findings of our report. And you'll actually have a handout that kind of covers what I'm going to talk about in a little bit less detail. The first section of our report is in goals. And so we looked at the existing goals for our tax credit program. So we looked at the Advantage Act and its related programs, including rural development, microenterprise, and research and development. We also looked at the Beginning Farmer Tax Credit and the Angel Investment Tax Credit. What we considered existing goals were those that were either stated as findings in the statute or that were discussed by legislators during hearings or floor debate. We also included suggested goals from a stakeholder survey. We didn't get a lot of responses to the survey but we considered them valuable. They were from people that knew the programs well. And we wanted to look at what they considered to be appropriate goals for these programs. So from that review, we came up with a fairly long list of goals and some of them came up repeatedly. So the ones that came up repeatedly were things like increasing investment in quality jobs; increasing development in rural areas and economically depressed areas; increasing small business support; retaining graduates; and bringing new businesses to the state. So we actually discussed this with the Pew Center staff and they suggested looking at some kind of broader, overarching goals and seeing some of the smaller ones as strategies for achieving those goals. So our two overarching goals are to increase investment in high-quality jobs cost effectively and to increase

development in rural and economically distressed areas. Then the strategies that we would put underneath that would be things like increasing high-technology jobs or increasing manufacturing, as those just go under the heading of quality jobs. We also reviewed academic literature to look for any kinds of incentives that have been useful in achieving these sorts of goals. And though we didn't find a lot in that area, we did find some useful policy ideas that are included in the report. For the next section, we looked at metrics. So as Steph said, metrics are how to actually measure if you're achieving those goals. So we looked at potential metrics that we thought the Legislature might use to measure the goals that we have. We discussed them with the Pew Center. We also discussed them with our stakeholders and included both the suggestions of our own staff, the Pew Center, and the stakeholders in this list. So the complete list is on your handout. And underneath each potential metric, I just put the basic question that that metric would answer. So each of the metrics does not apply to a specific program but some of them are better used for some programs than others and that's occasionally noted in the report. And they're also not meant to be used as, like, a singular measure of whether the goal is being achieved, but in combination with each other. There's also the possibility that there's metrics we have not thought of. So it's not a complete list, it's just the ones that we've developed at this time. And lastly, we looked at what other states are doing to evaluate their tax incentives. So to start with, we took the list that the Pew Center considered leading the way in using tax incentive evaluation to inform policy decisions in their Evidence Counts report. So we took those four states plus Rhode Island, which recently revamped their evaluation process. And Bob will go over that in more detail and look to what they did. And all of these states have an ongoing evaluation of their tax incentives that they look at and a schedule ranging from every three years to every ten years. And the evaluations are performed either by legislative staff or executive branch divisions. And then other attempts that they had are things like aggregate caps and sunsets on incentives. So now, we'll go back to Steph for the next steps on this report. []

STEPHANIE MEESE: Tax incentive evaluations may not be able to fully answer the

questions of what a business would have done in the absence of an incentive. But there's 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 Performance Audit Committee working in conjunction with the Revenue 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, 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 can range from something as simple as replacing "better" with "higher paying" to developing a series of factors that must be met, such as creating X number of jobs at Y percentage and at least Z percentage of industry average wage. Or they could specify, beyond salary, the benefits that the job must offer. 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 meeting those goals, which Kate kind of touched on. 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 these 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 the project is located. Finally, the committee, again working with the Revenue Committee, may wish to consider introducing legislation to require periodic evaluation of these programs and authorizing an entity to conduct them. Several states have recently developed entities with their legislatures such as joint committees or task forces to undertake this responsibility. And that's all we have as an overview for the report. Are there any questions? []

SENATOR HARMS: Do you have any questions you'd like to ask? That's the first time I've ever been in a committee where it was pretty silent here. []

STEPHANIE MEESE: I think it's just because we described it so well. []

SENATOR HARMS: Yeah, I think you're probably right. []

SENATOR HADLEY: Senator Harms. []

SENATOR HARMS: Yes, Senator Hadley.

SENATOR HADLEY: I appreciate your work. And, actually, I made quite a few notes all the way through. And I'll try and...I'll have some time next couple of weeks to type those up and get them to you. I think one of the key metrics is the first one. But I'd like to expand that to talk about forgone due to incentives or revenues lost if we don't have incentives because the reverse of the coin is, if you do not have incentives, how much do you lose because companies go elsewhere.

STEPHANIE MEESE: Uh-huh. Yeah, that's very interesting. []

SENATOR HARMS: Thank you, Senator Hadley. Do we have any other questions you'd like to ask? I have several I'd like to ask, if I can. Okay? []

STEPHANIE MEESE: Yeah. []

SENATOR HARMS: Have you given any thought to the overall structure of how we're going to put this together in regard to...I just want...I'd like to make sure that people understand that it isn't going to be this committee who's going to develop all of the metrics and the goals and the benchmarks. Could you maybe explain a little bit how that might work? []

STEPHANIE MEESE: Bob is actually going over a lot of that about what other

states...how they structure their evaluation process. Is that kind of what you're talking about? []

SENATOR HARMS: Yeah. I'm just curious about what you're thinking about in regard to our own state and the issues that we have here. []

KATHRYN GUDMUNSON: I think...we looked at some different options for that but it's kind of up to you. []

STEPHANIE MEESE: Yeah. []

SENATOR HARMS: Martha, would you like to try to answer that? []

MARTHA CARTER: Can I comment? For the record, it's Martha Carter. Senator Harms, I don't think that we have gone too far as a staff in thinking about that because we're going to need some direction from the committee. I think the basic idea that we had so far that's in the report would be to have the committee introduce some legislation to keep the discussion going. Now, it would most likely go to the Revenue Committee and that would be important to have continued discussions with the Revenue Committee. But I don't think we've really gone very far with what the appropriate structure would be. []

SENATOR HARMS: Okay. Are there any other thoughts or questions you'd like to ask? Well, I think it's a good report; and I think it's important that we continue with this process to make sure that we have the right kind of metrics, the right goals, and the right benchmarks because I think in the discussions that we've had with our colleagues throughout the last few years is that, they would really like to have things be a little more transparent so that the dollars that we're using to attract companies or to have companies expand, that it's being used appropriately and that it's really truly needed. And whether or not they would do this on their own without us or not, I don't know. But I

know that that will be worthwhile. And I think that anytime you can make programs like this more transparent, I think the better off we'll be. So again, it's not the intent, I don't believe, of our committee to completely dismantle this. It's just to make sure that we have things that are measurable and that we know that our money is being spent appropriately. So do you have any other comments, anyone else, before we continue? Okay. Would you like to introduce Robert? []

STEPHANIE MEESE: Yeah, absolutely. Following today is Robert Zahradnik from the Pew Center. Robert is the policy director for Pew's work on state fiscal health and economic growth. And he supervises initiatives that help states improve their return on investment from economic development tax incentives and better manage revenue projections and volatility. Robert holds a Bachelor of Arts degree in Communications from Penn State University and a Master's of Public Administration from George Washington. []

SENATOR HARMS: Robert, please join us. Thank you for coming. And thank you for being a part of this. And also, thank you for helping us when we started looking at what our options were and the program itself. And without your help, it would have been much more difficult for us. So thank you very much. []

ROBERT ZAHRADNIK: (Exhibit 2) It's been our great pleasure to work with the staff of the Legislative Auditor. And we're definitely looking forward to continuing working with you. Just for the record, my name is Robert Zahradnik. I'll spell that, it's Z-a-h-r-a-d-n-i-k. And I'm with the Pew Charitable Trust. And I'm here to talk with you today about evaluating tax incentives for economic development. And just to take a step back, when states want to spur businesses to create jobs and make new investments, tax incentives are often the primary tool they reach for. Every state has at least one tax incentive intended to promote economic growth and most have several. And these incentives take several different shapes. Some aim to promote economic growth within particular communities. Others seek to grow key industries or types of jobs. But

regardless of these differences, the stakes are high. Policymakers spend billions of dollars a year on tax incentives. Clearly, they don't want to miss opportunities to create economic growth that lead to more jobs and higher earnings and brighter prospects for the Americans they serve. And I'm going to try to use technology successfully. Excellent. At the same time, policymakers must consider the trade-offs. A dollar spent on tax incentives is one that's not available for other investments that can spur the economy in education, transportation, and other areas. And it's these high stakes that drove our interest in tax incentives at Pew. Across many issues, we found that the government delivers better results when policymakers base their decisions on solid evidence, invest in programs with strong returns, and choose solutions that work over the long term. With these interests in mind, Pew released two reports last year focused squarely on tax incentives. The first asked, do state policymakers have the evidence they need to determine whether tax incentives are delivering a strong return? And the second asked, are policymakers effectively managing the fiscal risks of tax incentives? Grounded in this research, Pew has identified policies and practices that puts states in a position to answer "yes" to both of these questions. And now we're working directly with lawmakers and staff and other stakeholders to implement these policies. So today I want to talk to you about our recommendations for ensuring state tax incentives deliver a strong return on investment. And then I'd welcome your questions and comments. The overall picture revealed by our research is that lawmakers frequently rely on incomplete, conflicting, or anecdotal information when they make decisions about offering tax incentives. Closing this knowledge gap and improving tax incentive transparency is a top priority for policymakers in states across the country. But how? Our recommendations fit into four principles that help states design effective and accountable economic development strategies. And no state has mastered all these steps yet, but we found that individual states are making real progress in certain aspects of this. And I can talk about some of the best practices that we found so far. So states should go beyond collecting and aggregating numbers reported by those receiving incentives. That's an important first step, but you really need to go further to understand the economic impact. So Pew recommends that state efforts to evaluate tax

incentives be guided by four principles: First, all tax incentives should be reviewed regularly according to a strategic schedule. Second, evaluations will draw clear conclusions based on measurable goals. And this is a lot of the work that's been covered by the most recent Audit report. Rigorous evaluations will determine the benefits and costs. And finally, evidence from evaluations will inform policy choices. States that design an evaluation process based on these principles give policymakers the facts and opportunities they need to ensure that tax incentives deliver a strong return on investment. So now, I'd like to discuss putting these principles into practice and some of the important policy decisions that arise from each one. So the first practice is that...the first principle is all tax incentives will be reviewed according to a strategic schedule. And the key decision point is how to determine the schedule. Any decision about frequency comes with trade-offs between resources, timeliness, and the depth of the analysis. So some ideas for setting an evaluation schedule include: ensure evaluations are ready in time for budget and policy decisions. One reason we got interested in this issue is because we found the tax incentives were not getting the same level of scrutiny as other kinds of budget decisions. They weren't part of the appropriations process. So it makes a lot of sense to try to incorporate the evaluations into the budget process. Next, consider grouping tax expenditures with similar goals together. That way you can sort of do apples to apples comparisons of different types of tax incentives and also allow for flexibility in case needs and priorities change over time. Our research showed that ten states have policies requiring regular evaluations of tax incentives, Arkansas, California, and Nebraska are performing incentive reviews annually. Delaware examines its incentives every two years while Connecticut and Rhode Island do once every three years. Arizona, Iowa, Oregon, and Washington have set review cycles ranging from five to ten years. And I think we found that really to do a thorough and comprehensive evaluation, annually may be too frequently. So it's certainly, you know, reasonable to consider a time frame that's longer than that. Next, evaluations will draw clear conclusions based on measurable goals. This is the second principle. And conclusions provide lawmakers with choices that they can consider and act upon. For example, in the state of Washington, evaluators concluded that an

incentive meant to provide temporary relief to state's beef processors was obsolete. The industry was no longer suffering the consequences from the mad cow disease outbreak years earlier and policymakers agreed to end the program. This was a case where an evaluation kind of pointed to a policy that was, essentially, obsolete. Analysts can also draw conclusions about ways an incentive might be improved. An example here from Louisiana, Louisiana's Quality Jobs program pointed out that the rules governing the tax credit allowed employers to claim it while not providing employees the level of health insurance policymakers had intended. In response, Louisiana's economic development agency updated the program's rules to require companies to offer better coverage and to provide new employees with coverage within 90 days. And that kind of conclusion might not have been reached if there hadn't been a sort of regular review of the program. And to arrive at clear conclusions, evaluators must ask questions about what the tax incentive is really trying to achieve. And along those lines then, policymakers need to set clear and measurable goals, goals that link, ideally, to a state's economic development strategy and that evaluators can use as a yardstick when determining whether an incentive has worked. So now, I turn to a specific example from Nebraska. In this...this is from the legislative findings of the Nebraska Advantage Act. And it states--and I'm sure you're all familiar with this--"The policy of this state to make revisions in Nebraska's tax structure in order 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." And this statement raises several interesting questions that can lead to sort of more measurable goals. For example, are there specific economic sectors the law is targeting? What kind of jobs? Are we looking for high-paying jobs with benefits? With what level of benefits? What's the price that we're willing to pay for these benefits? And finally, how much of the new investment do we expect to result from the incentive? Do we have a sense of how effective we think this incentive is going to be? The answer to these and other questions affect how the evaluators assess the program and the conclusions they try to reach. Sometimes lawmakers' goals are not clear when an incentive is created or their objectives for an existing program evolve over time, which is

perfectly reasonable as the economy is also changing. In these situations, policymakers and program analysts can work together to define or revise goals at the outset of an evaluation process. When North Carolina's General Assembly commissioned a study of the state's tax incentives, policy leaders worked with evaluators to identify three primary goals. In their case, it was creating quality jobs, benefiting distressed areas, and making the state more economically competitive. And within each of those broad goals, lawmakers and evaluators identified relevant measures of success. Selecting measures of success is another important decision point. Each state needs to ask the question, how will we determine the metrics used in tax incentive evaluations? Here's a few ideas for addressing this question. First, metrics should reflect the goals of the incentive. If an incentive is supposed to produce high-quality jobs, for example, you might want to measure the wages of the jobs created or whether they offer health insurance. But it wouldn't be adequate to only count the number of jobs because that doesn't give you a sense of the quality of the jobs. Metrics should also place the benefits of the tax incentives in the context of their costs. The decision to use tax incentives involves a choice about how to utilize scarce state resources. As a result, metrics usually provide the most insight on the results of tax incentives when they combine fiscal costs and economic benefits. So instead of just thinking about the number of jobs created, you might measure costs per job or the cost of each additional dollar of earnings for Nebraska residents which, essentially, is getting at both jobs and the wages of those jobs. Next, states can require legislative guidance on goals and metrics for new, expanded, or extended tax incentives. For example, Vermont requires that all tax expenditures have a statutory purpose. Expenditures without a purpose can't be implemented. A pending bill in the District of Columbia provides an interesting model for setting metrics. In this case, the legislation would require the office conducting the evaluation to report the metrics that will be used in the evaluation to the District's legislature before the evaluation is conducted. In this way, the legislators are on board with how the program is going to be measured before they actually get the final evaluation because you don't want folks to be surprised when they see the evaluation. And finally, given the vast number of ways that incentives can be designed, there's no

universal set of benchmarks that can be used to determine the success of every program. So a comparative approach to benchmarks can be very valuable. With this approach, some key questions to consider include: Is the incentive getting better results than its own past performance? So sort of a time looking over the history of the program. And is it more effective than other economic development strategies that the state is pursuing? So sort of comparing across the portfolio of economic development policies, which ones are performing better than others. So now we're moving to the third principle. Rigorous evaluations will determine the benefits and costs of the tax incentive. Applying this principle means asking and answering critical questions about the economic impact of the incentive. So the first important question and maybe the most difficult is, to what extent did the incentive affect the choices businesses made? Tax incentives provide economic benefits to states to the extent that they encourage businesses to do something they would not have done otherwise. But almost all tax incentives at least partially reward what businesses would have done anyway. High-quality evaluations take this factor into account rather than assuming that every job and every investment happened because of the incentive. At the same time, isolating the economic impact of the tax incentive isn't easy. Unlike in a lab experiment, there's no control group where you can see what would have happened if the incentive hadn't been offered. And you shouldn't expect an evaluation to tell you with absolute precision what happened because of an incentive as opposed to what would have happened anyway. However, states have found clever ways to estimate cause and effect. And it's helpful for you to understand how other states have done that and get a sense of what you can expect from these kind of assessments. So let me give some examples. First, there's an extensive academic literature around the extent to which state and local taxes affect business activity. Since tax incentives seek to change businesses' behavior by lowering their taxes, the literature has helped evaluations estimate to what extent business activity was caused by the incentive. This is the approach the Minnesota legislative auditor took when evaluating one of the state's incentives. The evaluation used academic literature to estimate that 21 percent of the new jobs at participating businesses were the result of the program. By using that

estimate rather than simply assuming that every job was created because of the incentive, they ended up with a much more realistic forecast of the program's benefits. Another approach is to place the size of the incentive in context. The question of cause and effect really comes down to whether or not the incentives are large enough to matter. Are they large enough to really spur a company to invest more in either workers or in capital? Evaluations have considered the size of incentives in relation to the businesses' overall costs to determine to what extent it's reasonable to think they actually change behavior. In Oregon, for example, economic consultants were studying the tax credits for renewable energy projects like wind farms and solar farms. The consultant examined what return on investment would make various projects financially viable based on the insight that whether an energy project makes sense for a company depends on the amount of energy it can produce, the cost of producing it, and the price that buyers will pay. Then, using financial models for representative companies of different size and different types of energy production, they studied whether the incentives were large enough to likely change projects that would not have made financial sense into ones that were viable, essentially trying to identify was there a gap in the financing that the incentive was able to fill. They identified some types of projects where the incentives likely made a difference and others where they just weren't big enough to likely have an impact. Moving to the next question, were existing businesses affected by the incentive? An example...here's a good example from Louisiana. Businesses benefiting from the state's Enterprise Zone program reported creating a total of 9,000 jobs. But an evaluation by the Economic Development Department found that the new jobs in hotels, restaurants, retail, and healthcare were mostly displacing existing jobs. After taking this displacement into account, the agency estimated that the program was creating only 3,000 new jobs. So this really comes down to, you know, are you incentivizing export-type businesses or are you incentivizing businesses that are going to directly compete with businesses that are already in your state? In which case, you're just, potentially, putting other folks out of business that are benefiting from the incentive. And the third question to think about is, do the benefits of the incentive outweigh the negative effects of the tax increases or spending cuts needed to offset it?

The story of Massachusetts' film tax credit shows why this question is so important. According to an evaluation, the film incentive created more than 1,600 jobs in 2009. But the program's $70 million price tag had to be offset by cuts elsewhere in the budget. The evaluation estimated that those cuts would cost the state more than 1,400 jobs, leaving Massachusetts with a gain of 222 jobs for the $70 million investment. The subsequent evaluation reviewing the film credits' 2010 results, reported a net gain of just 20 jobs for a similar level of investment. To help ensure evaluations can measure economic benefits, there are a few up-front decision points to consider. First, who will provide the analysis? Often, states look to a respected, nonpartisan office with the appropriate technical capacity to handle this. Next, what methodologies will be used? And this goes to, sort of, how are you going to measure the economic impact? And I've already noted several examples where states have demonstrated the ability to take this on. And we can certainly help in kind of connecting whoever does it here to those states that have done a good job. And third, how can the necessary data be collected and made available? And data challenges are definitely common but not insurmountable. And here are a few approaches that have worked in other states. In some instances, states have ensured that evaluators can analyze the state's own sources of information. For example, states have given evaluators access to employment data and tax data that otherwise wouldn't have been available. They have also encouraged different state agencies to work together on gathering data. Oftentimes, economic development involves, you know, it could be a labor department, tax department, economic development department, each having their own sets of data that have to kind of come together to do a rigorous evaluation. And finally, another strategy is to require businesses to provide adequate data as a condition of receiving the benefit. This approach, for example, helped Massachusetts when they did their evaluation of the film tax credit. With film tax credits, one key data question is to what extent the production dollars would go to salaries and actors and directors, many of whom live out of state and are likely to spend their money out of state as opposed to people in businesses locally. Massachusetts required production companies to provide detailed budgets on their spending and these budgets allowed the evaluations to estimate how much money

from the films was being spent in Massachusetts and how much was being spent elsewhere. So the fourth principle is ensuring evidence and conclusions from evaluations are connected to the policy process. The goal here is not to just produce evaluations that just kind of sit on the shelf. We want these to really be actionable from a policy standpoint. And one challenge facing most states is that lawmakers do not routinely review tax incentives. Likewise, after an incentive is enacted, its costs really get examined alongside other spending when lawmakers write the states' budgets. We're stuck, but you can see it. Oregon has devised a way to fight this tendency. To encourage regular review of all incentives, state leaders passed a law to make all tax credits expire after six years unless lawmakers extend them. And this approach worked. In 2011, legislative leaders set a spending cap on expiring incentives that drove policymakers to rely on evaluations to make tough choices. They decided which incentives should continue and in what form. Lawmakers allowed several incentives to expire, extended others for another six years, and significantly reformed one tax credit that had grown to be far more expensive than intended. Notably, these changes received widespread support of the legislature and from the governor; there were only three dissenting votes. Other models for connecting evaluations to the policy process include Washington State which has a strategy that combines citizen input, expert analysis from the legislative auditor, and annual hearings by legislative leaders. Since 2002, Arizona's joint legislative income tax review committee has met once a year to consider corporate and personal income tax credits. By law, all existing credits and any new credits the legislature creates must come before the committee every five years. The panel makes formal recommendations to the full legislature. And a final model, Iowa's Legislative Tax Expenditure Committee has a schedule for reviewing tax incentives every...on a five-year cycle. Iowa's committee is required by law to report the return on investment the state is getting from tax incentive programs. It has the power to offer recommendations but, unlike Arizona, it is not required to and has not done so yet. So in closing, I just want to talk about some momentum that's been happening in other states adopting these principles. In July, Rhode Island lawmakers approved the Economic Development Tax Incentive Evaluation Act of 2013, making their state one of

the few to regularly measure the benefits and costs of tax credits, deductions, and exemptions meant to grow jobs and businesses. Rhode Island's law includes requirements to create a strategic evaluation schedule, to produce evaluations that measure the benefits and costs of each incentive, and draw clear conclusions. Rhode Island's law also requires the governor's budget proposal include a recommendation to continue, reform, or end a tax incentive program after each review, connecting evaluations to the policymaking process. Several other states took steps toward greater evaluation this year. A few other examples: Florida adopted a policy that requires state economists to conduct more rigorous studies to see what benefits business tax incentives create. Maine established a tax expenditure review task force with a mandate that includes drafting legislation that creates a process for ongoing review of all tax expenditures. And that review task force is in the process of wrapping up its business by the end of this year. And in Washington State, all new tax preferences are required to have a ten-year sunset, an explicit statement of legislative intent, and identified metrics to help evaluate their impact and effectiveness. To wrap up, use goals to help policymakers master all the tasks and tools I reviewed today, the tools needed to make tax incentives fiscally sound and economically effective. We want you and your peers to have the facts you need to design sound policies and to ensure you are neither missing important economic opportunities nor creating more risk than your budget and constituents can afford. We're grateful for the opportunity today to share these important lessons and examples with you and hope you find these developments encouraging. We look forward to talking with you and your staff about your interests and priorities and how our efforts may contribute to your success. Thanks and I welcome your questions. []

SENATOR HARMS: Robert, thank you very much. Do we have any questions you'd like to ask? Senator Hadley. []

SENATOR HADLEY: Senator Harms. Robert, thank you for coming. []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR HADLEY: You started out with the statement, spend billions of dollars on tax incentives, I think that's what you said. []

ROBERT ZAHRADNIK: Yes. []

SENATOR HADLEY: Aren't you presupposing then that businesses will not come without the incentives when you make that statement? Because in Nebraska, if you...to me it's not spending a dollar if a company meets the goals of...what have we had, $4 billion or $5 billion, $2 billion or $3 billion of additional investment. We've created 8,000 jobs with the Advantage Act and we don't count that as revenue anyplace. So aren't we in a system where all we do is count the costs and not what these jobs give to the state, what the additional investment gives to the state? []

ROBERT ZAHRADNIK: So...and that's a good point. I think that the data on how much tax incentives cost, one, is not great to begin with. A lot of states don't do a great job of tracking the cost. The $1 billion is a rough estimate across all 50 states of the fiscal impact of the revenue forgone associated with the tax incentive. And now to your point, there's the question of...this kind of goes to the "but for" question. And there are those two extremes. If all the activity would have happened anyway, then all the money being spent is an expenditure. And if none of...and if the tax incentive, you know, led to all the economic growth that happened related to the incentive, then you would have a significant offset to that cost. I think the reality is somewhere in the middle and it's likely that that $1 billion figure could, you know...billions of dollars, some of that could be offset by economic activity. The real point is that most states don't really have a handle on, you know, how well these incentives are working to know what the real net fiscal impact of the policies are. []

SENATOR HADLEY: Could I follow up and... []

SENATOR HARMS: Yes. []

SENATOR HADLEY: A couple of things. I was on the Revenue Committee when we did enact sunsets, 2015, 2016, all of our tax incentives sunset, go out of (inaudible), have to be renewed through the entire Legislature. A yearly report from the Revenue Department on all of the people who have qualified, the ones that have gone through. And...I'll ask the question. Are we unique in our performance-driven repayments to companies? Unless they meet the specific goals that they signed up to do... []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR HADLEY: ...they do not get any of the amount of forgone revenue. Is that unique in the United States? []

ROBERT ZAHRADNIK: I'll say Nebraska is on the sort of front end accountability in ensuring that companies perform, you know, fulfill the obligation that they're stating up-front. Nebraska is sort of...is ahead of the pack in the design of the system in terms of up-front accountability, which is definitely...which is a good thing. Then the flip side is...and that's really company specific. Is each company fulfilling its responsibility to the state for the number of jobs it said it would create associated with the incentive? Then there's...the flip side of that is the programmatic evaluation of is this program delivering on the overall goals that, you know, from an economic standpoint that you, as legislators, are trying to achieve? So it's certainly a well-designed system from an accountability and compliance standpoint. []

SENATOR HADLEY: Okay. Thank you. []

SENATOR HARMS: Thank you, Senator Hadley. Are there any other questions? Senator Mello. []

SENATOR MELLO: Thank you, Chairman Harms. And thank you, Robert, for your testimony. Senator Hadley mentioned an area or a language that we hear a lot when it comes to involves tax expenditures which is the "but for" clause. In your research, have you seen...have other states experimented with that "but for" clause which is requiring any kind of disclosures from interested parties or companies having to sign documents or state publicly that they would not be doing X but for that specific expenditure incentive? Is there...that's something we hear an awful lot about and we know that there's not an exact science to it. But trying to see what other states do would be very helpful. []

ROBERT ZAHRADNIK: Sure. And I'm less familiar with what states do on the front end and I can certainly get back to you on that. I think, you know, equally challenging is when you're trying to take a look back and evaluate a program. And assuming you have data on, you know, how many jobs companies reported and how much the state spent, then, you know, how do you get a handle on how much of those jobs, you know, can be attributed to the incentive versus would have happened anyway? And I noted, you know, there is academic literature that evaluators can look to. There's an evaluation in Connecticut that essentially did a sensitivity analysis, made assumptions. Let's assume 20 percent, 50 percent, or, you know, 80 percent of the jobs were because of the incentive and let's see what the results look like. Another approach from a recent evaluation was from Kentucky which, essentially, calculated...okay, if we did something else, if we did a corporate income tax cut, let's model how many jobs that would have created. And then let's figure out what is the...what percent of the jobs that an incentive is creating would need to be attributed to the incentive for it to work as well as this alternative policy. And then to see if that percentage is plausible, you know. So for example, if you're going to cut your corporate income tax rate by a percentage point, that creates a certain number of jobs. And that means that for the incentive to create the same number of jobs, at least, say, 40 percent of the jobs had to be directly because of the incentive. And then it's a question of, is 40 percent a reasonable number? And there

is some academic literature on what is a reasonable expectation for how well an incentive is performing. But I think to the broader point, I don't think either extreme is true. I think this is the challenge; for the most part, this falls in the middle. And also, getting to the question of the right number of jobs, you know, you do need to think about this displacement issue. Are you, you know, are you essentially incentivizing firms that are then competing against other businesses that aren't getting the incentive and maybe losing jobs? And then the opportunity cost. You know, if you're having to pay for an incentive, it might not be a direct connection, but with a balanced budget, if you've got $100 million going out the door, that's, you know, that's $100 million you're not spending or a tax increase had to pay for it, that also has a job impact. So coming up with a solid net job figure and then making some...getting some plausible understanding of how effective the incentive is, I think just moves states a lot closer to getting a better handle on that issue. []

SENATOR MELLO: Thank you. Real quick, on the effectiveness side, the Performance Audit staff may have informed you that Nebraska has a unique kind of economic modeling software... []

ROBERT ZAHRADNIK: Uh-huh. Uh-huh. []

SENATOR MELLOW: ...our TRAIN model which provides various kinds of economic modeling. There are other kinds of, obviously, economic modeling services software out there that you can go...that the two of us could go buy off the shelf if we wanted to after today's hearing. []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR MELLO: What have you seen other states utilize and processes on the effectiveness side of trying to quantify the actual amount of economic activity and the actual number of jobs created through the incentive that...you know, which is always, I

think, part of the discussion and debate... []

ROBERT ZAHRADNIK: Sure. []

SENATOR MELLO: ...is the jobs that would have been created without the incentive versus those who would have been created with the incentive? What kind of software or modeling techniques can you share with us that other states have utilized that may be different than ours and may be a best practice? []

ROBERT ZAHRADNIK: I think, I mean, the general statement is, there's no silver bullet model necessarily. And I think the thing to understand is the role that an economic model plays in a broader evaluation. The models other people are most familiar with, the off-the-shelf, are the...there's a REMI model and there's an IMPLAN model. These are models you can buy off the shelf. And they...I think, sometimes the way those are used or misused is people think that you can make a lot of assumptions and it will give you a number and that's the answer. Most of the time, those models are...essentially, they're estimating the indirect and induced effects of any kind of economic stimulus, whether it's a tax incentive or additional spending. And that gets to the concept of the multiplier. The notion that, you know, when you put money in the economy and you create a certain number of jobs, those jobs lead to related economic activity through suppliers and other means. And my point here is that the multiplier is only one piece of the puzzle. When you're doing an evaluation, you know, you need to try to wrestle with the "but for" question. You need to try to wrestle with the displacement question. You need to try to wrestle with the opportunity cost question. Certainly, multipliers are a piece of it but it's not the whole story. And you also sort of...and it also may...you want to consult economic literature because there are a lot of very...oftentimes, you'll get studies that have very high, inflated multipliers because it's a way to really sort of...it really makes things look a lot better. And so...and a model is only as good as the inputs. So I think you could find any model and if you're making bad assumptions or you're not putting good data into the model, you know, it's a garbage in, garbage out situation. So,

while models are important, they're only one piece of the puzzle. There are many states in our review that did some really interesting evaluations without using any kind of model. They just made some interesting evaluation and analysis that (inaudible) analysis without the use of a model. So it's not something that would prevent an evaluation from happening if you didn't have the right model. []

SENATOR MELLO: Okay. []

SENATOR HARMS: Thank you, Senator Mello. Do we have any other questions that we would like to ask? Senator Hadley. []

SENATOR HADLEY: Senator Harms. Another question: Does the willingness of a state to--from a risk tolerance--enter into this? Because if we err by giving incentives, we have data that shows we've created jobs, we've created capital investment from companies. But if we cut back on incentives, can we take the risk that we don't get growth in Nebraska, which is critical for growth in population, growth in companies, and such as that? So I guess I'm asking... []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR HADLEY: ...does a state's risk factor enter into it? How much are we...if we're going to err, which one can we live with? []

ROBERT ZAHRADNIK: Sure. And I think...and it's a great question because...and I think there are two kinds of risk. Right? There's...and this kind of goes to your earlier question. There's the direct fiscal risk. If you're going to do a tax incentive that has a fiscal impact and if you are incentivizing activity that would have happened anyway, then that's just money out the door. So that's a fiscal risk. On the other hand, if an incentive is working the way you want it to and it is incentivizing economic activity, then that's a missed opportunity if you don't do it. So everything goes back to this "but for"

question. If, you know, if you're doing an incentive and you know that 40 percent to 50 percent of the activity...that the incentive led to 40 percent or 50 percent of the activity, you know, is that a good enough deal for the state? Or does it need to be 60 percent or 70 percent or can you live with 30 percent? So I think it's a risk but it's a risk on both sides. It's either a risk that maybe you're not doing enough for your economy. On the other hand, if the activity would have happened anyway, then it's a fiscal risk because you're, essentially, rewarding behavior that would have happened anyway. []

SENATOR HADLEY: And then, just one last question as a follow-up. Our Advantage Act, I believe, was a 2005, 2006, somewhere in that era, which means it's basically six, seven years old. Is that a long enough time to really do in-depth because we have some programs that run 15, 20 years before they...before we really find out what happened? So how do we handle a program that's just been around six years and try to make evaluations of whether it's successful or not? []

ROBERT ZAHRADNIK: I think, I mean, I think six to seven years and if it's, you know, if you put a process in place where...you give it another couple of years. I mean, you know, having five to ten years of data, at least, is a good starting point to get a sense of how well the program is...and if...and I think it doesn't hurt to do that evaluation and if you feel like you need more data then, you know, maybe there's some tweaks to the program and then you say we're going to revisit this. And I think that's what helps having a recurring schedule. If you're going to do it every three years or every five years, as time goes on, you have more and more data and maybe the story changes. Particularly, the economy changes. That's the other factor. So I think it's possible to get a nice...a decent look at a program after six or seven years. But, of course, more data is always better. []

SENATOR HADLEY: And one last thing. You mentioned to me when we talked yesterday afternoon that Utah is really kind of trying to get a handle on, basically, the dynamic issues in this. And I hope you will help us keep up to date on what Utah is

doing out. And, as you know, I think Utah and Nebraska are two of the leaders in economic development. Or at least let's say...we'll not pat ourselves on the back... []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR HADLEY: ...but Utah is certainly a leader in economic development. Is that a fair statement? []

ROBERT ZAHRADNIK: Well, I mean, particularly in this case, it's an innovative attempt to try to understand the...essentially what they're doing is an economic impact statement that accompanies a fiscal note. But the economic statement is advisory and it doesn't have to be as precise. So it can provide a range of potential economic impact. That way, at least, legislators have more information. They...I mean, the fiscal note is the official score. But then this other statement gives them some sense of how the economy may react to a particular policy change. And that's an interesting approach. []

SENATOR HADLEY: Well, we would certainly appreciate any help you could give us on that. Thank you. []

ROBERT ZAHRADNIK: Sure. []

SENATOR HADLEY: Thank you. []

ROBERT ZAHRADNIK: Yep. []

SENATOR HADLEY: Thank you, Senator Harms. []

SENATOR HARMS: Thank you, Senator Hadley. Do we have any other questions? Robert, I have just a couple of questions. []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR HARMS: When you look at our program overall--and I know you've taken a pretty good look at it and evaluation--when you look at us, how do we actually compare out with other states? I mean, are our problems similar or are we approaching this in the right manner and are the issues, basically, the same? I just...I don't know how we compare. []

ROBERT ZAHRADNIK: Sure. And back when we did Evidence Counts and we did sort of a 50-state look at how states...how well states evaluate, Nebraska kind of came in in the middle because it was...there was some evaluation going on but it wasn't connected to the policy process. And there are definitely some improvements to be made in terms of measuring economic impact in a more rigorous fashion. But...so it wasn't one of the bottom but there's room for improvement. And that's...and to be honest, our Evidence Counts report was...we were trying to meet states where they are. So we were trying to be as, in some ways, generous as we could. If we found a decent evaluation that a state had done, you know, we would give them credit for doing a quality evaluation, even if it was an one-time effort. But our...what we'd like to see and what we think can improve policy, is this more regular, rigorous evaluation that is connected to the policy process and can really make a difference in terms of how legislators and the executives think about economic development and the best way to use resources. And nobody is really there yet but we're hoping that Nebraska and others can sort of take the lead. []

SENATOR HARMS: Thank you. There seems to be more questions now, and all across this great nation, about this type of program and measuring this type of program and the amount of money that it's taking. Do you think this is being created at all by the economy and what's caused people to say, you know, can we afford to do these sorts of things? I mean, what's your views about that? []

ROBERT ZAHRADNIK: I think the...I mean, obviously, the Great Recession was a

hugely disruptive event. And particularly at the state level, it placed fiscal and economic issues at the forefront. And the fact that the recovery has been fairly slow, you know, states are going to continue to kind of struggle to kind of get by. And it just places a higher premium on every dollar that's going out the door. And just, I think, whether it's tax incentives or any other type of program, just better understanding and having better evidence about what's working and what's not working and really targeting resources toward the most effective programs. I do think there's a greater awareness of that. And I think we're encouraged to see legislators taking a closer look at how best to evaluate and understand how well programs are working. []

SENATOR HARMS: Well, thank you. Do we have any other questions that you'd like from committee members? Now I'd open it up. Do we have any senators here that would like to ask any questions? We have an open seat. Please come forward and ask your questions while Robert's here. And if you'd like it for a matter of record, we'd like to have you go ahead and testify. Is there anyone here that would like to do that? Senator Schumacher, welcome. []

SENATOR SCHUMACHER: Thank you, Senator Harms. I just have one question that came to mind in... []

SENATOR HARMS: Senator Schumacher, would you just spell your last name so we...okay, thank you. []

SENATOR SCHUMACHER: Oh, okay. S-c-h-u-m-a-c-h-e-r, and I represent District 22 in the Legislature. One question. When you're evaluating states, is there any tool that's been developed to take a program in, say, Nebraska, see if there's a similar program in Oklahoma and a similar one in Georgia, and then see how they are performing and determine from that whether or not it's a program that's having the effect or whether or not it's the weather that has the effect, for example? []

ROBERT ZAHRADNIK: Uh-huh. Right, right. There's one example comes to mind. There was a program...an evaluation that was done in Iowa on a research and development credit that essentially compared states that had that type of program to states that didn't, to draw some conclusions about how much of a difference the credit was making versus other factors. So...and that was done through Ph.D. economists, you know, using regression analysis. It's a more sophisticated approach and it does require, you know, it does require the programs to be similar enough that you can sort of...you're, essentially, trying to control for the impact of the program versus other things. That's one example I can think of. I think in a lot of other cases, just because the program design is often so different...I mean, I don't know that there's anything exactly like the Advantage Act. There are things that are similar but not exactly the same. It does get more difficult depending on the type of the program. But there is at least one example of that type of assessment being done. []

SENATOR SCHUMACHER: Okay. And I have one other follow-up question. []

SENATOR HARMS: Yes, Senator Schumacher. []

SENATOR SCHUMACHER: One of the things with our incentives that apparently is permitted is that a company has got the ability to basically take the withholdings of income tax from its employees and keep them in order to offset the credits that they've earned. It's a little different from offsetting the tax liability of the company. Assuming that those employees would have been here anyway and would have been employed, does that...is that a different kind of loss of revenue or a different kind of cost than one would have saying that the company wouldn't be here? []

ROBERT ZAHRADNIK: Yeah. I'm not...that's a very Nebraska-specific question. What I can say is, I know different states have structured sort of the way that the benefits are received. Some make credits refundable as a way...if you don't have tax liability, then the state will, essentially, send you a refund. Others have used transferability where you

can transfer the credits. There are different mechanisms that states have used. We haven't assessed those in a rigorous way so I can't say for sure kind of what the implications of that are. But it's an interesting question and we can look into it further and get back to you. []

SENATOR SCHUMACHER: Thank you. []

ROBERT ZAHRADNIK: Uh-huh. []

SENATOR SCHUMACHER: Thank you, Senator Harms. []

SENATOR HARMS: Do we have any other questions? Do we have any other senators who would like to ask a question? Please come forward. We've got an empty seat and a mike. Well, seeing none, Robert, thank you very much. []

ROBERT ZAHRADNIK: Thank you. []

SENATOR HARMS: We appreciate your time and coming out and visiting with us about your expertise. And this officially closes this hearing. Thank you. (See also Exhibit 3) []

ROBERT ZAHRADNIK: Thank you. []