Government Tax Incentives for Business Decisions

Research Questions
This research aims to:
- Investigate the core motivations for incentive decisions
- Gauge how successful tax incentives are at achieving their goals
- Evaluate the Ames business and tax incentive environments
- Explore how governments may improve the efficacy of their incentive decisions

Methods
This research divides the landscape of tax incentives into two sides of the economics lens and the political lens.
The research into these questions was done through:
1. Reviewing the academic literature
2. Studying professional reports of political groups like think tanks
3. Analyzing current examples of incentive projects
4. Investigating the Ames incentive environment through a case study
5. Conducting two interviews with Ames business leaders and one interview with a member of the Ames Economic Development Commission

Background
Tax incentives target the needs of the government’s jurisdiction to encourage behaviors and outcomes (AEDC).

Example Outcomes:
- Job growth
- Job training
- R&D
- Capital investment
- Infrastructure development
- Sustainability initiatives
- Urban renewal
- Recovering blighted areas
- Locating decisions

These incentives take a few different forms but generally fall into two buckets of reducing the tax liability for a company or by providing tax dollars directly to the company.

Government funding provided to companies is most often seen in reimbursements for expenses, cash grants, or in tax increment financing that takes increases in property taxes resulting from development and invests those taxes paid into the project in infrastructure development or as cash to the project.

Example Reductions:
- Property Tax Abatements
- Income Tax Abatements
- Sales Tax Exemptions

Example Funds:
- Tax Increment Financing
- Job Training Reimbursements
- R&D Grants

Figure 1: Estimated total amount of local and state incentives in USD (Brookings)

Figure 2: Business Cases for Tax Incentives (CGD)

Why are Tax Incentives Given?
Economic Reasons:
Businesses respond to their environment – incentives help businesses to invest in targeted outcomes by improving the feasibility of the investment. That investment will then develop the local economy, expand the tax base, and bring new jobs.
To ensure that these incentives are given efficiently, governments use the “but for” litmus test (Brookings). That is, governments target their aid towards businesses that would not otherwise choose to invest in their jurisdiction (Brookings). This assurance requires measures of due diligence on the part of the government to ensure that businesses are forming decisions based on the tax and incentive structure of a jurisdiction and not taking advantage of the tax incentives for investments that they would already make. Figure 2 highlights the optimal case for governments to provide incentives.

Political Reasons:
Elected policy makers are first and foremost responsible for improving the standard of living of their constituents. This job has both the concrete deliverables like improving infrastructure and providing jobs to the community along with more abstract measures of feeling like their lives are improving under the elected leaders’ guidance (Brookings). Tax incentives offer a solution for politicians to improve both the concrete and abstract parts of their constituents’ lives.

Improving Effectiveness of Tax Incentives
Teach voters about the trade-offs made from incentive decisions (Jensen).
- Voters learn more about governance decisions
- Better hold elected officials to higher standards in their incentive decisions

Improve the transparency of the tax and incentive system are given (CGD).
- Offers stronger cost-benefit analysis for each incentive decision
- Helps to cut wasteful incentives
- Target advanced industries for specialization of economy

Move tax incentive decisions from elected officials to appointed officials (Jensen).
- City managers use more oversight for incentive decisions
- Align incentives for officials with constituents’ interests

Ames Case
The Ames tax incentive environment involves partnerships between Ames’ businesses, local nonprofits, and the local government all coordinating with the state and federal governments. Together, Ames created an environment in which businesses thrive, industries are advanced and growing, and incentive decisions have appropriate oversight and rigor.

Successes:
- Target’s specialized and advanced industries – incentives for the research park and industrialized jobs
- Job training through partnerships with DMACC
- City manager to make more effective allocation decisions

Areas for Improvement:
- Voter teaching and outreach efforts into tax incentive decisions

How Successful are Tax Incentives?

Economic Results:
The success of incentives depends on their individual implementation. Instead, governments should focus on a broader checklist for their incentive decisions:
- Specialize in advanced industries (Brookings)
- Target export-oriented companies and industries (Brookings)
- High-growth industries (CGD)

Additionally, incentives are also efficient when targeting areas of market failures by underinvesting in:
- Job training
- R&D
- Underprivileged areas

Political Results:
Voters consistently reward politicians for tax incentive decisions regardless of the efficacy of the incentive (Jensen). Politicians claim credit for positive business choices when incentives are given (Brookings). Politicians also claim that they did their best when incentives are offered and businesses do not act in their favor (Brookings). This leads businesses towards wasteful use of incentives (Brookings).

Conclusions
Tax incentives are complicated, opaque, and under researched. While they offer help to businesses, they also create market distortions that may bring inefficiencies. However, there is no denying the good that tax incentives bring to communities that use them with discipline when combined with a business-friendly environment. When the system for providing incentives is created with a high degree of transparency while aligning the interests of politicians, voters, and businesses, tax incentives are an effective tool for spurring investment in the community.