

## What are development subsidies and how do they work?

Development subsidies are money, tax breaks, and in-kind benefits given to companies to offset the costs of opening or expanding a new facility. Subsidies take many forms, from reduced tax rates, to cash grants, to cheap loans, to name a few.

Some people call subsidies "incentives," but that's not really accurate. An incentive motivates someone to do something they would not have done otherwise. A mountain of evidence suggests that development subsidies are often abused by companies that would have done exactly what they did anyway. "Subsidy" is also a more accurate description of what an aid program does when designed and used well: taxpayers subsidize companies to cover the additional cost of building where they serve a public purpose but could not afford to locate without public assistance. Subsidies of this type have what's called a "but for" clause that companies must meet, proving that but for help from the subsidy, the project would not happen at the site.

There are many types of development subsidies, and they reduce development costs in a variety of ways. Some of them reduce taxes; others are given as cash; still others save companies money by reducing the cost of construction or of borrowing capital. Common subsidies include:

Tax abatements reduce or eliminate the taxes a company pays to state and/or local governments. Commonly used abatements include property tax abatements, sales tax exemptions, and inventory tax abatements.

Tax credits reduce or eliminate state corporate income taxes by allowing a company to deduct a certain percentage of a specific kind of expense dollar for dollar from what it would normally owe. Examples include credits for research and development, spending on new equipment, and employing hard-to-hire workers.

Industrial Revenue Bonds (IRBs) reduce the cost of borrowing money. When local governments issue bonds, the interest on the bonds is tax-free. Companies get what amounts to a low-interest loan.

Infrastructure assistance lessens the price of construction by shifting the cost of improvements or expansion of roads, sewers, water lines, and other utilities to local governments. Improvements may be made on the project site (i.e. bulldozing existing structures or preparing land) or off-site (i.e. adding a stoplight to reroute traffic or rebuilding a bridge to accommodate heavy trucks).

Grants are subsidies given as cash to companies. Usually grants must be used for a specific purpose, such as worker training. Some states and cities award grants for general use.

Land-price write-downs reduce the cost of purchasing land. A development authority (the quasi-governmental arm of state or local development departments) typically buys the land and then transfers it to a private developer for a price below the authority's acquisition cost. The local government may also pick up the tab for the exercise of eminent domain, demolition and clearance, and/or environmental cleanup.

Tax-increment financing (TIF) uses the property tax collected on the increased property value of a new development (and in some places the newly-generated sales tax) to pay for infrastructure, land acquisition, or other costs of the development.

Enterprise Zones (a.k.a. Empowerment Zones, and by state-specific names such as Michigan's Renaissance Zones or New York's Empire Zones) are geographically designated, economically-depressed areas in which companies can get multiple subsidies (usually property tax abatements, inventory tax exemptions, and various corporate income tax breaks, including employment tax credits).

Many of these programs are paid for through tax expenditures, tax revenue that the state (or city or county) does not collect as a result of the subsidy. Others are direct expenditures, money that the government allocates in its budget, for anything from printing stamps to buying land to enable a hospital to expand. Tax expenditures far exceed direct expenditures for economic development, and are rarely tracked. Direct expenditures are part of the budget and must be approved by the city council or state legislature every one or two years.

Subsidy programs also fall into one of two categories depending on how companies qualify for them. Entitlement subsidies are automatically available to any company that meets a certain set of criteria. For example, if a job training tax credit specifies that a manufacturing company qualifies for a \$2,000 tax credit for each new employee it trains, then any manufacturer that meets that requirement is entitled to claim that subsidy when it files its income tax return.

Discretionary subsidies are awarded on a case-by-case basis through individually negotiated deals between governments and companies. There may be no specific criteria that a company must meet, or very broad, loose criteria that give officials a lot of discretion in determining whether a company gets a subsidy, or how large a subsidy. Examples include property tax abatements, tax-increment financing, and land-price write-downs.

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