Building better incentives

Indiana joins rising number of states in scrutinizing tax incentive programs to ensure they actually drive economic development

by Indiana Senate Majority Floor Leader Brandt Hershman (Senator.Hershman@iga.in.gov)

After the Great Recession, many states were forced to take a fresh look at their financial practices. This includes Indiana, which has used this opportunity to make balanced budgets, healthy financial reserves and a pro-growth tax climate part of our state's identity.

Indiana's renewed commitment to fiscal responsibility has created ideal conditions for economic development and afforded our state the ability to invest in public services such as education and infrastructure that spur further growth.

As chair of the Senate Committee on Tax and Fiscal Policy, one of my top priorities has been encouraging growth through a simpler, more transparent tax system. To achieve that goal, I've advocated that the state place heightened scrutiny on the tax incentives we offer, so that the legislature can make sure Hoosiers are getting good results from the policies we've enacted.

I've heard from people who say Indiana should pull back on tax incentives, while others want to see Indiana offer more of them to compete with neighboring states.

A common-sense, data-driven approach

Our state's approach to date reflects Hoosier common sense: We recognize that some financial incentives for employers are necessary and effectively help the economy, but we have been deliberate in establishing those incentives.

Still, any tax incentive can outlive its usefulness. Policies that were once effective in encouraging growth or attracting jobs could lose their appeal due to changes in the economy. The only way to know for sure is to be data-driven and vigilant.

In 2012, the Indiana General Assembly passed a law calling for Indiana's Commission on State Tax and Financing Policy to study all income tax credits during the years 2012 to 2013. As a result of this study, lawmakers were able to eliminate nine ineffective, underutilized tax incentives during the 2013 legislative session.

A new law in Indiana creates a permanent, cyclical study of all of the state's economic development incentives. This review will include all of the benefits claimed, the economic return on investment, and the policy goals of each tax incentive.

This was a common-sense, data-driven initiative that served as a way for Indiana to determine which tax incentives were actually helping Hoosiers and employers and which were essentially ineffective.

Due to the benefits of this type of study, Indiana enacted a law during the 2014 legislative session creating a permanent, cyclical study of all of Indiana's economic development incentives.

This review is required to include the amount of benefits claimed, the economic return on investment, and the policy goals for each tax incentive.

The motivation behind this legislation is not to raise taxes by eliminating incentives, but instead to create revenue-neutral reform that offsets eliminated incentives with smarter ones or across-the-board rate cuts.

My advice to advocates of revenue-neutral tax reform in other state legislatures is that you must earn and maintain the public's trust, verifying that you're not seeking to raise taxes.

Indiana's strong reputation as a taxpayer-friendly state has aided our efforts in reviewing and streamlining our tax system. In recent years, we've capped property taxes, eliminated the inheritance tax, and reduced income taxes for individuals and corporations.

This track record helped instill trust in legislators and the decisions we make on behalf of Hoosiers.

Be prepared for pushback

Of course, when discussions arise about the tactful elimination of state tax exemptions, there will be some pushback.

For example, during the 2014 session, I proposed a bill to phase down Indiana's corporate income tax rate to 4.9 percent — the second lowest rate in the nation. In conjunction with this proposal, I suggested eliminating a handful of Indiana's tax exemptions, though the tax cut would have outweighed the revenue gain from the exemption eliminations.

This was not well received by some groups that benefit from the current exemptions. For example, colleges lobbied fiercely to keep the College Contribution Tax Credit, even though there's little evidence that it stimulates more giving to colleges.

Ultimately, Indiana's strong fiscal position allowed us to reduce the corporate income tax even without the offset from eliminating exemptions.

This example shows that the easy part is reviewing tax incentives and exemptions to identify the excess. Reforming the system of incentives is the difficult job. Even in a state philosophically inclined to tax reform, overcoming the entrenched beneficiaries of tax incentives is an uphill battle.

However, in the future, I will continue to support proposals that attempt to rid Indiana of ineffective and unused tax incentives.

I believe that Indiana is on the right track in carefully studying and considering our already modest system of tax incentives. This legislation is just one example of the many improvements Indiana has made to our tax system to entice employers and better serve all Hoosiers.

Indiana Sen. Brandt Hershman, a Republican from Buck Creek, was first elected in 2001 and currently serves as majority floor leader.

Three strategies for successful evaluations of tax incentives

More and more states are realizing the importance of evaluating their tax incentives for economic development. The Pew Center on the States, which has studied the issue in depth, has identified three key strategies for successful evaluations:

✓ ***Develop a schedule:*** Regular evaluation of tax-incentive programs helps identify which ones are effective, and which are not working for a state. According to Pew, frequency of evaluation must balance the need for up-to-date information with the time required for rigorous analysis. Indiana, for instance, passed legislation in 2014 under which it will evaluate its incentives every five years.

✓ ***Measure the results:*** Rigorous evaluations help states determine whether the incentives actually encourage businesses to create jobs and make investments that otherwise would not have been made. They also measure how the incentives affect the broader state economy, not just the firms getting them. According to Pew, it is crucial that evaluators have experience with program evaluation or economic analysis and the ability to make impartial, nonpartisan policy recommendations. In Indiana, the General Assembly's nonpartisan research staff will perform the evaluations, while other states might place the responsibility in the hands of a university research center or the state department of revenue.

✓ ***Inform policymakers:*** The main reason for evaluating tax incentives is that it helps policymakers make more-informed decisions and ultimately improve economic development policy. Indiana, for example, is among the states that will hold legislative hearings to discuss the evaluation results and make policy recommendations based on them.

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