To: Andrew Cuomo, New York State Governor & Thomas DiNapoli, New York State Comptroller
From: Alys Alley & Amanda Vitullo
RE: An Evaluation of Industrial Development Agencies: Improving Economic Development Practices in New York State

Abstract
Industrial Development Agencies ("IDAs") were created by the State of New York in order to help foster economic development within municipalities. The primary economic development tool utilized by IDAs is property tax abatements. First, we discuss the historical context under which IDAs were created. Then, we discuss the current practices and economic impact of IDA use of property tax abatements. We then examine the conditions under which property tax abatements can serve as a powerful and effective economic development tool, and explain why these conditions are so challenging to identify in practice. This paper then makes several recommendations to restructure IDAs and improve economic development practices in New York State moving forward.

Historical Context
New York's Industrial Development Agencies ("IDAs") were created in 1969 through the Industrial Development Agency Act. IDAs were classified as public benefit corporations to maintain competitiveness with 45 other states who had already taken similar initiatives.[i] The creation of IDAs was authorized with legislative intent to achieve the following goals: promotion of the economic welfare, recreation opportunities and prosperity of the State's inhabitant; prevention of unemployment and economic deterioration; promotion of industrial pollution control facilities; and, promotion of tourism and trade."[ii]

The Current State of IDAs in New York:
Each IDA is established by a special act of the State legislature as a non-profit public benefit corporation to enhance the economic welfare of a municipality and its residents.[iii] IDAs are legally empowered to buy, sell or lease property; provide tax exempt financing for approved projects; and, issue taxable and tax-exempt bonds to finance the cost of the project.[iv] According to documents from the New York State Comptroller's Office, in recent years the most popular method of IDA assistance is a "straight lease" transaction, where the IDA takes title to the "land, improvements or real property, thereby making it exempt from certain taxes."[v] In a straight lease transaction, property is leased to businesses for a nominal fee, making it exempt from property taxes as well as mortgage recording taxes. Purchases for IDA projects are also eligible for exemption from state and local sales taxes.[vi] IDAs fund their operations by charging administrative fees to businesses that obtain financial assistance for their projects.[vii] Businesses may also make "payments in lieu of taxes" (PILOTS) to the local tax jurisdiction in order to contribute some revenue for the municipality.

Each county, aside from New York City, has it's own IDA with two counties that share an IDA for a total of 56 county IDAs.[viii] There are 25 city IDAs, 26 town IDAs and 4 village IDAs and one IDA that serves both a town and a city.[ix] IDAs are governed by a board of 3-7 members that are politically appointed by the governing body of the municipality for which the IDA is established.[x] Each IDA is legally required to annually submit a financial statement to the Office of the State Comptroller, Department of Economic Development, and the governing body of the sponsoring municipality that includes data related to the number of jobs created or retained and the total amount of all tax exemptions provided.[xi]

IDA Project Selection Process
Currently, each IDA has a different process for vetting project applications. This is because the IDA Act does not specify any standardized requirements with regards to the content of the application. The IDA Act does specify that at a minimum, all IDA projects requesting $100,000 or more in financial assistance are subject to a public hearing and vote by the IDA Board of Directors. There currently exists a wide array of project selection processes and requirements developed by each individual IDA.

The New York City IDA has a 7-step process that considers the community's need, benefits of the project, demonstration of substantial capital investment, employment retention and growth, and the forecasted increase in tax revenues to the City.[xii] The project is further analyzed by staff through fiscal impact analysis in order to determine the net fiscal impact on the City based on the requested benefits and tax abatement package. Staff members analyze the real property tax exemption cost, mortgage recording tax deferral cost, and sales tax-exemption cost. These costs are compared to the projected project benefits, which include: the direct impact benefits, indirect impact/induced impact benefits and net fiscal impact.[xiii] After a public hearing, the NYC IDA Board of Directors review and discuss the project, and then vote whether to authorize the requested project assistance.[xiv] In whole, the process can take several months.

In contrast the Chemung County IDA, "routinely approve all financial assistance applications submitted by STEG (Southern Tier Economic Growth) and appear to provide little to no oversight or guidance regarding project selection, review and pre-approval."[xv] More than half of the IDA's board members also serve on the board of STEG, which creates a huge conflict of interest problem. The Chemung IDA does not establish policies and procedures to measure project performance consistency with the project application.[xvi]

IDA Use of Tax Abatements: Magnitude and Impact on Economic Development
In 2012, IDAs supported 4,521 projects worth $72.9 billion and gave $554.2 million in net property tax abatements (Table A). While this is a 14.2% decrease in property tax abatements granted from 2008, the use of property tax abatements has steadily increased since then, increasing by 9.3% from 2011 to 2012. In 2012, IDAs claimed to have created 214,102 jobs at a cost of $2,588 in property tax abatements per job (Table A). Property taxes are the largest source for local government revenue, making up 39% of all revenues received by local governments (Table B).

The manufacturing and services industries have dominated as the primary recipients of property tax abatements, making up 29.6% and 22.4% of projects in 2012 respectively (Table C). Eastern New York gives the most in property tax abatements, whereas Long Island, Capital District, Mid-Hudson and New York City give $118.1, $93.7, $89.9, and $80.8 million in net property tax exemptions respectively (Table D). County IDAs had the highest quantity of projects, comprising 61.6% of total projects undertaken by IDAs (Table E).

Ideal Conditions for Property Tax Abatements and Current Practices of IDAs

Economists have offered the following three hypothetical conditions that must exist for a tax abatement to be an effective economic development tool. If the answer to all of the following questions is "yes", then a property tax abatement is a powerful and effective economic development tool:[xvii]

<u>"Do tax rates affect a firm's decision to locate?"</u>

Although econometric research has found that tax rates do matter to an extent in firm's decisions to locate, there are other factors that are cited as more important than taxes. For example, research has found that cost and quality of labor, proximity to markets for output, access to raw materials and supplies that firms need, access to quality transportation networks and infrastructure, quality of life factors (i.e. good schools and health services), and utility costs are much more important to a firm's decision than taxes because they have a larger impact on the profits for a firm.[xviii]

Although other factors are much more important than taxes, when all of these factors are held relatively equal, such as when a firm has narrowed their location decision to a small region, do taxes matter.[xix] In these cases, lower taxes reduce the cost for the firm given the desired public services. Taxes only matter once firms have narrowed their decision to two or more locations and are indifferent between them given the level of public services and infrastructure. Unfortunately, there is no way to know when a firm is indifferent between two or more locations.

The reality for IDAs is that they are often compelled to lower their tax rate *below* that of their neighbors in order to compete for businesses. Businesses are then incentivized to inflate the importance of taxes on their decision in order to receive the largest tax incentive that they can. This is particularly the case in Eastern New York, where IDAs often compete with New Jersey for projects.

For example, a business that had previously received over $2 million in subsidies for a facility in Queens threatened to move its operations to New Jersey unless it received an incentive package for a new South Bronx location.[xx] Since New Jersey has the ability to offer the same incentives, the result is that both states "raced to the bottom" to give the highest incentive package to compete for potential developers and businesses. New Jersey offered a subsidy and tax abatement package worth $100 million, to which the New York City IDA counter offered a $128 million package of subsidies and tax abatements.[xxi]

Ultimately, no one knows if taxes were the factor that influenced the company to locate to New York rather than New Jersey, or if the business was merely taking advantage of the competing states to gain a large incentive package from New York. Many economists noted that the vast majority of the company's costumers were located in the New York area, and a move to New Jersey would not have made financial sense for the company even with New Jersey's offer of tax abatements and subsidies.[xxii]

There also exists counterproductive competition and piracy between IDAs within New York State. Many firms inflate the importance of taxes on their location decision in order to induce IDAs to compete with one another and create large incentive packages, when the firm may very well have already made their location decision and are merely taking advantage of the competing IDAs. A report from the New York Comptroller's Office notes that "piracy is commonplace" among IDAs within the State of New York.[xxiii]

IDAs have no way to know the true extent to which taxes matter in a firm's decision to locate. It's a huge gamble for IDAs to give large tax abatements to single firms, especially when the tradeoff is potentially the entire cost of the tax abatement in foregone revenues if the firm would have located to the municipality even without the tax abatement.

<u>"Do cities offer abatements only to those firms who would be certain to locate elsewhere without them?"</u>

The answer with regards to the current practices of IDAs is a clear "no." The common approaches utilized by IDAs are either to grant property tax abatements to all who request them (as in Chemung County) or to grant property tax abatements based on either political or personal reasons without consideration as to whether the abatement is necessary to tip the scales in the favor of one's own municipality. For example, the Seneca County IDA gave a property tax abatement worth millions of dollars to a casino developer *after* they were well into the development and financing process, were already granted the necessary permits, and was not considering alternative locations.[xxiv]

Project developers approach IDAs to request property tax abatements simply because they feel they can get them. In practice, it is reasonable to assume that it is nearly, if not entirely, impossible for IDA board members to be absolutely certain that tax abatements effect a firm's location decision. It is also quite possible, and currently common practice, that these same project developers can make the claim to the IDA that the abatement is out of necessity—even if it is not.

Based on analysis of IDA Uniform Tax Exemption policies, it is relatively common for applicants to provide an analysis of the costs and benefits of the project, though this is still far from providing proof that not receiving the abatement will nullify the project. Unfortunately, IDA boards are simply unable to perform such decision-making tasks, and even the most selective policy would not result in certainty and is subject to misuse.

One cannot blame the asymmetrical information issue on the fact that IDA boards are comprised of political appointees with varied experience and education levels. Even the most benevolent and educated decision maker would never have perfect information to determine if a tax abatement would be the ideal economic development tool that would tip a developer's decision to locate to one's municipality as opposed to another.

Ultimately, if the property tax abatement was not needed to attract the firm and the firm would have located to the municipality even without one, then granting one is equivalent to throwing away tax revenues that are desperately needed to fund public services for the community. Given that this is a powerful (and potentially expensive) economic development tool, its potential for misuse far outweighs any potential benefits.

“Can tax abatements be used without inducing overall property taxes for non-abated properties to rise?”

For IDAs, it depends on the way in which the tax abatement is structured. The extent to which a tax abatement would cause property taxes for non-abated properties to rise depends on whether tax-exempt property uses public services and infrastructure. These direct costs to localities can be offset depending on PILOT agreements. Some IDAs negotiate PILOT payments to help cover the cost of public services used by the property. Though even with PILOT payments, one could argue that firms are not adequately contributing to the greater tax base and supporting vital public services that benefit the community, even if said services are not directly related to the tax-abated property.

A report released by the New York State Comptroller’s Office stated that since local government real property taxes are levied on only taxable property, the more tax-exempt property there is in a jurisdiction, the greater the tax rate generally is on the owners of taxable property.[xxv] High tax rates, in turn, put pressure on officials to reduce costs through either cutting public services or by finding alternative funding options.[xxvi]

In Syracuse, for example, nearly 56% of the total property base is tax exempt.[xxvii] Of this, IDAs accounted for 17.2% of the total exempt value.[xxviii] Given that many residents of Syracuse cannot afford higher taxes, as 25.6% are in poverty compared to the state average of 10.8%,[xxix] the City cannot afford higher taxes as a result of property tax abatements granted by IDAs. Even if companies are covering the direct public services cost of their tax-abated property or are not using public services, there still exists a cost to the general community with regards to public services such as education. Although education is not directly linked to public services used by properties, there exist large social implications when a public education system is not property funded. For example, although businesses that are granted property tax abatements in Syracuse might cover their direct public services costs, these PILOT agreements may not pay for indirect services such as education. Inadequate public education funding for city of Syracuse, among other things, contributes to the fact that less than 1 in 5 students in the Syracuse City School District pass the 8th grade New York State tests.[xxx]

Conclusion: Property Tax Abatements as an Economic Development Tool

Economists say that “tax abatements are only useful if the assumption is correct that tax rates *do* affect a firm’s decision to locate, that a tax abatement is revenue maximizing as long as they are used *selectively* to attract only those firms who would be *certain* to locate elsewhere in the absence of the abatements, and relatively efficient if their use does not induce the overall property tax rates for non-abated property to rise.”[xxxi]

Under certain conditions, property tax abatements can be a powerful and effective economic development tool. Tax abatements are only effective to the extent to which they change developers’ and businesses’ decisions about developing or relocating to a particular area. There are conditions that exist in which tax abatements are effective in spurring economic development, though the reality is that it is impossible for an IDA to determine when those conditions exist due to asymmetrical information during the project selection process, making property tax abatements as an economic development tool extremely risky. When misused, property tax abatements have the potential to cause serious damage to the property tax base and, as a result, to the citizens within a locality. The misuse of property tax abatements bleeds the local governments of property tax revenue that is needed to ensure that public services are adequately funded to meet the needs of the community.

Recommendation #1: Discontinue Use of Property Tax Abatements

The best solution to solve the issues surrounding the use of property tax abatements by IDAs is to discontinue their use. Studies cited by the New York State Comptroller's Office have shown that "IDAs routinely provide support to projects that would have been completed without such assistance; existing relationships between developers and IDAs often determine which projects are granted assistance; politically connected contractors, consultants, attorneys and IDA board members similarly benefit from and determine which applications for IDA assistance are approved."[xxxii] Although the intention for IDAs is to help facilitate economic development, the practice of granting tax abatements is often counterproductive to economic growth.

Given the political pressures faced by decision makers on the local, state and federal level, tax incentives allow politicians to work under the façade that they are actively creating jobs and improving the economic outlook for communities, even when this is likely not the case and is sometimes counterproductive to economic growth. While giving tax abatements may seem like a free solution to economic development, since on the surface giving a tax abatement does not cost money in itself, giving tax abatements may have large costs to communities in the form of foregone tax revenue, mutually beneficial community wide public services, and long-term economic growth.

Rather than focus on giving tax abatements to specific firms that may or may not be influenced by a tax abatement, New York State should instead focus on improving the community characteristics that firms value the most; public services, infrastructure and industry-specific job training. Investing in these public goods is beneficial to the community both in the short and the long-term and provides a strong basis from which economic development can occur.

Recommendation #2: Restructure IDAs and Improve Analytical Capacity of Economic Developers

IDAs should be fundamentally restructured to use a different set of economic development tools. In addition to discontinuing the use of property tax abatements, IDAs should instead shift their focus to: 1) identifying key infrastructure and public services improvements needed to lure desirable industries, 2) applying for state grants and other funding streams to invest in these necessities, and 3) work with businesses one-on-one to help navigate red tape and make the stages of business development easier. We feel that a large component of funding for these activities and restructuring IDAs must come from New York State, and that funding could come from the $700 million annual economic development budget.

Providing better resources to local economic development professionals hired by IDAs is also fundamentally important for restructuring IDAs and improving economic development practices. Therefore, we suggest that New York State provide local economic development professionals with access to highly qualified individuals in the areas of economics, forecasting and business development. This will provide the analytical capacity necessary for identifying strategic industries and funding streams for human capital, public services and infrastructure.

Recommendation #3: Improve Public Services, Infrastructure and Industry-Specific Job Training Through State Grant Funding
The State of New York should work to improve public services, infrastructure, and industry-specific job training in order to create an ideal environment for economic growth. To assist IDAs and local governments in improving these services, the State of New York could create a grant or matching-grant program specifically targeted toward these three areas.

The underlying theory behind improving public services, infrastructure and providing industry-specific job training as an economic development tool is that the aforementioned public services are attractive to developers, businesses and new residents seeking to locate or relocate. The attractiveness of better public services are especially pronounced for businesses and developers when better public services lower the costs of doing business and increase productivity and profits.

Local governments with inadequate taxation and poor public services may only attract or create the type of firms that do not require quality public services, such as firms that do not need high-skilled labor.[xxxiii] Such businesses that do not require good public services are likely to create low-wage jobs that keep workers in poverty.[xxxiv] The lack of adequate public services can possibly undermine efforts to increase wages through economic development programs, since an adequate bundle of public services create the foundation from which economic growth can occur.

Many econometric studies have found evidence that increased public spending on public services such as infrastructure, education, health and public safety are positively correlated with long-term economic gains, though not all studies have found a statistically significant relationship.[xxxv] In particular, increases in spending for education, public safety and roads/transportation infrastructure are most consistently positively correlated with long-term economic growth.[xxxvi]

For businesses, increasing spending to produce better education and job training systems help increase the productivity of inputs, such as labor, and reduce quality-adjusted prices, and thus increase output in the private sector.[xxxvii] For citizens, higher quality education is also associated with higher wages and better health outcomes.[xxxviii] Infrastructure, such as roads and highways, stimulate economic activity by reducing private-sector production costs and provides an enabling environment for growth.[xxxix]

Funding for these grants and matching-grants could come from the $700 million annual economic development budget. Although much of this money is already allocated to specific grants and tax abatement programs, these programs could be restructured to better support the aforementioned public services. As we have iterated and reiterated in this paper, investing in public services, human capital and infrastructure is a far more effective economic development strategy and would therefore be a better use of these funds.

Recommendation #4: Establish Agglomeration Economies by Investing in Public Services, Infrastructure, and Industry-Specific Job Training
The ultimate goal of the economic development facilitated by IDAs should be to create self-sustaining economies, increased employment rates and increased wages. A strategic way to build a self-sustaining economy would be to establish an agglomeration economy, where firms in the

same industry benefit from being spatially close to one another. When agglomeration economies are created, public assistance is no longer required to lure in private firms. Instead, private firms seek to move to the area for the benefits they receive from the City's business environment. Investing in infrastructure can play an instrumental role spurring agglomeration economies. Eberts and McMillan[xl] state that agglomeration economies exist when "firms in an urban area share a public goods as an input to production."

Kansas City, MO, is one example where investing in public infrastructure assisted in spurring an agglomeration economy. In 2010 Google Inc. launched Google Fiber in Kansas City, which has resulted in tremendous growth for Kansas City's economy. Google Fiber offers high-speed Internet that is up to 100 times faster than average broadband speeds, and is also provided at low costs.[xli] Google Inc. cited Kansas City's existing infrastructure and business-friendly environment as the main reasons why they chose to premier Google Fiber there.[xlii] Google Fiber is causing companies, specifically tech and start-ups, to flock to the eight cities[1] around the country that received it.

For Kansas City, the presence of Google Fiber has created what CNET called "a hot bed for entrepreneurs."[xliii] While only a small number of start-ups existed before the introduction of Google Fiber, local start-up owners say that Google Fiber has "accelerated growth in the community."[xliv] Furthermore, a number of start-up companies have stated that Google Fiber's presence was enough for them to pack-up shop and relocate to Kansas City. INC.com[xlv] reported that when the CEO of SportsPhoto.com heard that Kansas City was getting Google Fiber "he packed up and moved two and half hour north [from Springfield,MO] to get in on the action."

Google Fiber's presence has played an integral role in incentivizing the relocation of existing firms. Without Kansas City having taken previous actions to invest in their public infrastructure and business-friendly environment, Google Inc. may not have chosen to premier Google Fiber there. Access to high-speed Internet greatly affects productivity in the technology industry, which ultimately attracts technology companies and start-ups. Cities that recognize the need for technology are investing in the necessary infrastructure to improve their productivity, and because of this, outside firms are benefitting from locating near other firms in Google Fiber cities because their infrastructure demands are being met.

By strategically identifying and improving infrastructure, public services, and job training for desirable industries, IDAs can also assist municipalities in establishing agglomeration economies. While not all cities are desirable for technology industries, IDAs can play a crucial role in analyzing existing industries, natural resources and existing infrastructure in an attempt to establish an agglomeration economy.

Recommendation #5: Assist in Making New York State a Business-Friendly Environment by Offering Assistance in Navigating Bureaucratic Systems

IDAs should also help firms deal with the many rules and regulations that businesses must comply with within the State of New York. Compared to other states, there is considerable "red tape" in New York State, which can be extremely intimidating and inhibiting for new businesses,

[1] Cities that received Google Fiber are: Atlanta, GA; Austin, TX; Charlotte, NC; Kansas City, MO; Nashville, TN; Provo, UT; Raleigh-Durham, NC; and Salt Lake City, UT.

particularly for small-businesses. For many firms, establishing compliance with these regulations is both time-intensive and costly. Therefore, we propose that IDAs within New York State provide better assistance to new businesses, specifically helping them navigate these highly bureaucratic systems. Essentially, one goal of IDAs should be to make the experience more business friendly and affordable.

Recommendation #6: Program Evaluation

It is essential that any economic development policy changes be tracked over time in order to establish the effectiveness of the resulting programs. We suggest that an independent study be performed over the course of 10-15 years that will analyze business development, job creation, economic outputs, and wage increases (controlling for inflation). This study should also consider other environmental factors that affect the economy and include them in the econometric model. By tracking the effectiveness of new economic development policies, New York State will be able to better evaluate the effects of discontinuing the use of tax-abatements and provide better evidence to encourage dissolving tax-abatements across states.

Conclusion

To conclude, we feel that New York State must change the functionality of its IDAs in order to improve its economic development efforts. IDAs must be restructured to focus on strategically improving public services, infrastructure and industry-specific job training. By spending public money in these areas, New York State will greater their chances of luring firms and will achieve better efficiencies than if they had offered tax-abatements. Additionally, it will greater the chances of spurring agglomeration economies. IDAs should also work with businesses to help navigate the red tape and make New York a more business friendly environment.

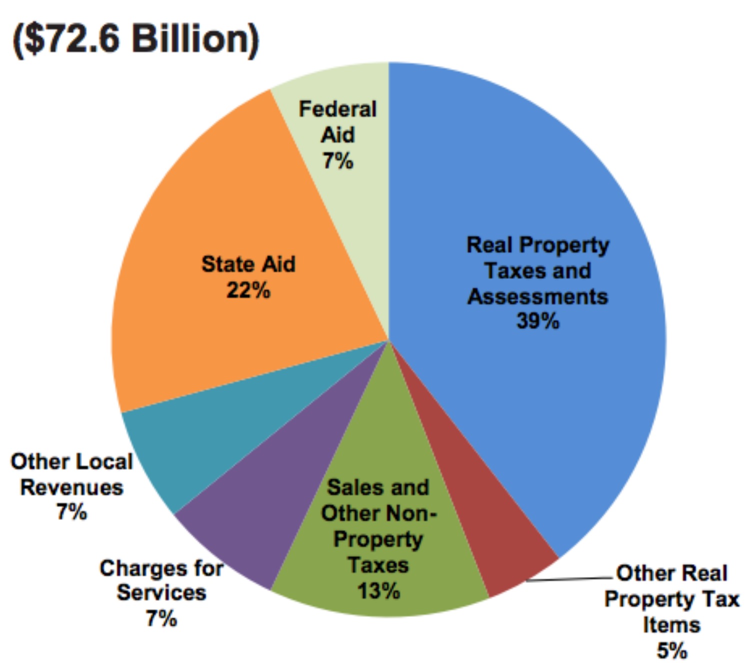
Table A

IDA Summary Statistics						
Year	IDAs	Projects	Total Value of Projects (billions)	Net Value of Tax Exemptions (millions)	Estimated Job Gain	Net Value of Exemptions Per Job Gained
2012	112	4,521	$72.9	$554.2	214,102	$2,588
2011	113	4,485	$74.2	$507.2	216,519	$2,342
2010	114	4,451	$72.9	$483.2	181,946	$2,656
2009	115	4,585	$73.6	$481.1	202,107	$2,381
2008	115	4,501	$66.0	$645.6	188,990	$3,416
Change 2011 to 2012	-1	36	-$1.4	$47.0	-2,417	$246
Percentage Change	-0.9%	0.8%	-1.8%	9.3%	-1.1%	10.5%
Change 2008 to 2012	-3	20	$6.9	-$91.4	25,112	-$828
Percentage Change	-2.6%	0.4%	10.4%	-14.2%	13.3%	-24.2%

Source: OSC, PARIS. 2008-2011 data has been revised.

Table B

Sources of Local Government Revenue, 2012



Source: OSC; excludes New York City

Table C

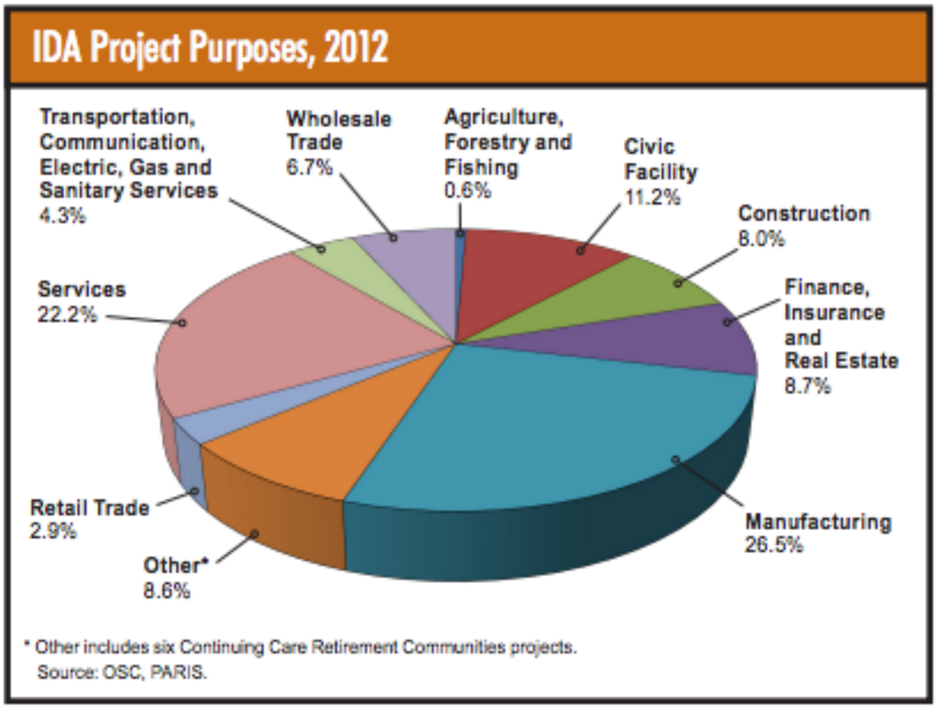


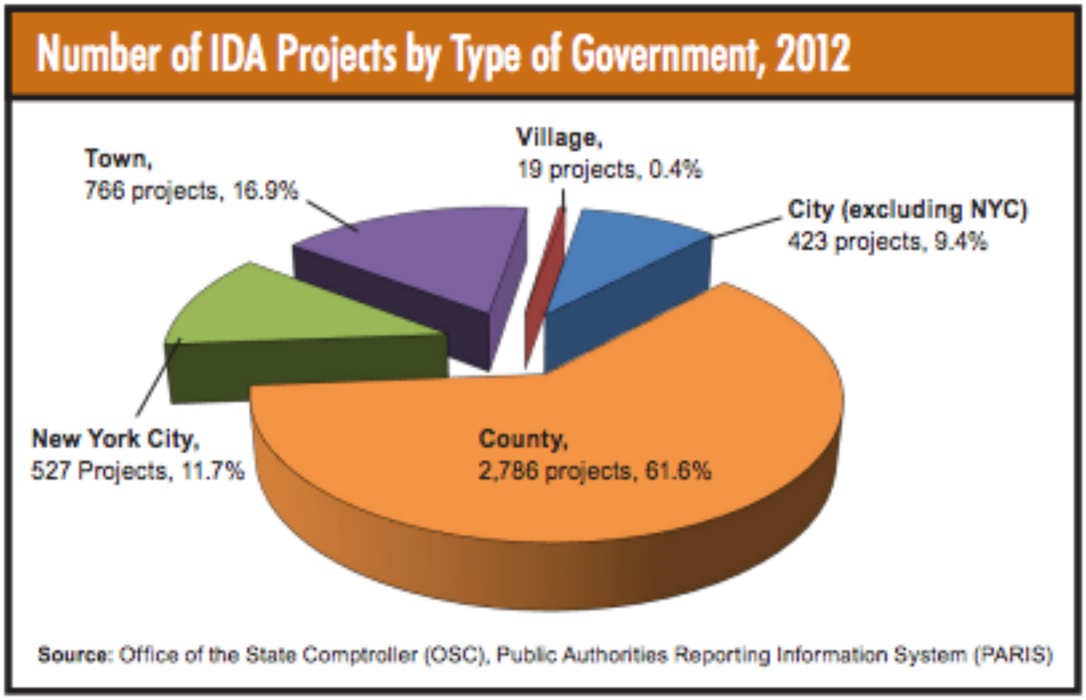
Table D

Regional IDA Statistics, 2012

	Projects	Total Project Amount (billions)	Project Amount Per Capita	Net Exemptions (millions)	Net Exemptions Per Capita
Capital District	397	$10.7	$9,904	$93.7	$87
Central NY	237	$4.6	$5,816	$11.0	$14
Finger Lakes	742	$5.9	$4,855	$50.3	$41
Long Island	734	$8.9	$3,143	$118.1	$42
Mid-Hudson	456	$10.1	$4,401	$89.9	$39
Mohawk Valley	197	$1.4	$3,236	$13.0	$29
New York City	527	$16.3	$1,999	$80.8	$10
North Country	132	$2.0	$4,627	$9.3	$22
Southern Tier	262	$3.8	$5,334	$36.9	$51
Western NY	837	$9.1	$6,483	$51.2	$37
State	**4,521**	**$72.9**	**$3,760**	**$554.2**	**$29**

Source: OSC, PARIS. 2008-2011 data has been revised.

Table E



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