Subsidy Reform Commission

State Representative Karen Clark
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1997 CORPORATE SUBSIDY REFORM COMMISSION REPORT

FEBRUARY 6, 1998

Report of the 1997 Corporate Subsidy Reform Commission

Background

In 1997, the Minnesota legislature established a Corporate Subsidy Reform Commission to evaluate selected subsidy programs and tax laws for the following:

(1) public purpose; including jobs, wages, and other economic development benefits;
(2) criteria for award; and
(3) accountability and enforcement mechanisms used to facilitate the achievement of the public purpose.

The Commission was also directed to evaluate whether these subsidies and tax laws impede competition or provide preferential treatment to private enterprises.

Because the Commission considered all types of private enterprises, the phrase "business subsidy" has been substituted for "corporate subsidy" for purposes of this report.

Members of the Commission

Representative Karen Clark, Co-Chair Senator John Hottinger, Co-Chair
Senator Ellen Anderson
Alexa Bradley, Co-Director, MAPA
John Compabosso, Director of Marketing, Kraus-Anderson Construction Company
Donna Ehlenz Sanders, Business Development Coordinator, Longfellow Community Council/Longfellow Business Association
Commissioner Jim Girard, Department of Revenue
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Representative Rob Leighton
Senator Becky Lourey
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Definition of Business Subsidy

In examining the different forms of financial assistance and tax laws that affect businesses, the Commission recognizes the need to define a business subsidy. For purposes of this report, the Commission used the following definition:

> "Business subsidy", as used in this report, is any grant, contribution of property, infrastructure or services, any loan at rates below those commercially available to the taxpayer, any reduction or deferral of any tax or any fee, any guarantee of any payment under any loan, lease or other obligation, or any preferential use of government facilities given to a business. As defined here, "business subsidy" refers to any business irrespective of legal ownership, this includes a for profit corporation, a partnership, a limited liability company, or sole proprietorship.
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> A subsidy does not include:
> (1) any subsidy that is generally available to all businesses or to a general class of businesses. A general class of businesses includes groups based on line of business (e.g., manufacturers), size (e.g., small businesses), location (e.g., businesses in a city or region), or similar general criteria.
> (2) public improvements to buildings or lands owned by the state or local government that serve a public purpose and do not principally benefit a single business or defined group of businesses at the time such improvements are made;
> (3) redevelopment of blighted buildings or brownfields when the property is sold at 80% or more of appraised market value based on comparable local property;
> (4) assistance provided for the sole purpose of renovating or bringing up to code old or decaying building stock and when such assistance is matched by the business using private sources; and
> (5) assistance provided to organizations whose primary mission is to provide job readiness and training services when the sole purpose of such assistance is to provide those services.

Subsidies Not Considered by the Commission

Because business subsidies can cover a wide scope of tax provisions and direct spending programs, the Commission decided to limit its considerations in this first study. Excluded from the study are:

- subsidies for housing
- subsidies for pollution control or abatement
- tax reductions resulting from conformity with federal tax law
- subsidies for energy conservation
- general changes in social insurance programs — workers compensation and unemployment compensation
- benefits derived from regulation
- indirect benefits derived from subsidies to education institutions
- financial assistance awarded through special legislation (e.g., direct appropriation for financial assistance for professional sports stadiums)

The above exclusions may be important to examine at a future date because they may, in fact, constitute significant business subsidies.

The Commission took testimony from experts in economic development and from members of the general public. In recognition that different communities may hold different opinions toward business subsidies, the Commission held hearings in several different locations across the state. Besides the capitol, hearings were held in Austin, Minneapolis, Spring Lake Park and Duluth. The testimony added to the richness of the discussion by covering a variety of topics including tax increment financing (TIF), brownfield clean-up, job and wage goals reporting for the business subsidy, livable wages and evaluation techniques in economic development.

In making these recommendations, the Commission acknowledges that some state and local units of government may already practice the recommendations set forth in this report. However, the recommendations may still provide guidelines to some units of government that have not implemented the following principles and techniques.

Recommendations

The Corporate Subsidy Reform Commission recommends that the award of business subsidies must meet a public purpose. Business subsidies should be awarded through a public process which includes a statement of the public purpose, the development of clear criteria for the award, and the establishment of accountability measures.

The Process of Awarding Business Subsidies

Public Purpose for the Assistance

In developing a business subsidy program or tax incentive, the Commission recommends that state and local units of government develop a specific statement of what constitutes public purpose. These public purposes should include at least two of the following:

- enhancing economic diversity
- creating high quality job growth
- providing for job retention, where loss is imminent and demonstrable
- stabilizing the community
- increasing the tax base

Developing a Set of Criteria

The Commission recommends that state and local units of government develop criteria for awarding business subsidies. The goal of these criteria is to determine why the project is in the public interest and to provide documentation on why the subsidy is needed. State and local units of government should require a written statement which includes the following criteria designed to meet those questions:

Enhancing Economic Diversity

- In what ways does the project improve the mix of businesses in the area so as to:
  (1)allow the area to participate in fast growing industries;
  (2)protect the area from adverse economic consequences caused by slow growth or declining industries that are dominant in the area; and
  (3)provide essential consumer services, or develop a network of local suppliers to businesses within the community where they otherwise do not exist?

Creating High Quality Job Growth

- How many new jobs will be created and what will they pay?
- How do wages proposed to be paid compare to community wage levels?
- How many jobs will be created with opportunities for career advancement, educational opportunities, or occupational training?
- What are the projections for additional job growth at the project over the nest two to five years?
- What are the fringe benefits that are payable for the jobs particularly identifying whether there is child care, health care and pension coverage?

Providing for Job Retention, Where Loss Is Imminent and Demonstrable

- After collecting the necessary documents, is there substantial evidence that the company will have to shut down involuntarily?
- After collecting the necessary documents, is there substantial evidence that the company has received an offer to move to another state or community that is attractive enough that a reasonable person would seriously consider a move for business reasons?
- What potential negative effect would the subsidy have on other competing businesses and overall area job quality?

Stabilizing the Community

- How will the project constitute a significant investment in an area that: (1) has not historically received similar investments; (2) is a blighted area; or (3) is an economically depressed area?
- How will the project stimulate other investment in the same area or create spin off businesses and jobs in the area?

Increasing the Tax Base

- How will the project uniquely affect the property tax base for all taxing jurisdictions, both short term and long term and both directly and indirectly?
- How will the project affect other local business and individual property tax bills?

Accountability for the Subsidy

The Commission recommends that state and local units of government shall provide a mechanism for holding recipients and themselves accountable to the subsidy agreement.

Public Notice and Hearings (Disclosure). State and local units of government should be required to provide public notice of all business subsidies. Summary notices of proposed subsidies should be published in local newspapers of general circulation and should identify the location at which information about the subsidy (including a copy of the subsidy agreement) is available. Published notices should be sufficiently conspicuous in size and placement to distinguish the notices from the surrounding text. When possible, governmental units should make the required information available on the Internet as well as in hard copy format. Newspaper notices should also provide for a reasonable comment and response period.

In addition the Commission recommends that state and local agencies hold a public hearing before awarding a business subsidy. At a minimum, public hearings must be held for subsidies exceeding $100,000 for local projects and $500,000 for state agency projects.

Reporting Requirements - Business Reports to Local Units of Government. Businesses which receive subsidies should report at least annually to the unit of government providing the subsidy. The reports should compare goals to results in each of the following categories:

- the type, purpose and amount of subsidies
- jobs created by job title
- hours worked and hourly wage
- number of jobs in each of these hourly wage categories
- description of benefits provided

The Commission recognizes that the reporting requirement will not allow an evaluation of those criteria which may be unrelated to jobs, wages and benefits. The Commission finds that these criteria are important in evaluating the potential to fulfill the public purpose of a business subsidy, but an ex-post evaluation should remain at the discretion of the state or local unit of government without a requirement in state statute.

Enforcing the Subsidy Agreement

Penalties for Non-Compliance. The Commission recommends that the development agency enter into a business subsidy agreement with each business that is given a subsidy. The agreement should provide a financial penalty for the business for noncompliance. The financial penalty should equal, at least, the business subsidy plus interest. The rate of interest should be set by statute and should vary with market conditions. The financial penalty could be prorated to reflect partial fulfillment of the agreement.

The Commission recommends that grants be awarded as forgivable loans. A forgivable loan conveys the financial benefits at the beginning of a project, while imposing a repayment obligation or lien until the anticipated public purposes are met. The lien or repayment obligation is reduced and finally eliminated when the goals have been met.

It may not be practical to structure some subsidies as forgivable loans, e.g., conveyance of property, TIF or other preferential treatment. In these cases, the Commission recommends that the subsidy agreement specify the benefit the business is receiving to facilitate recapture of the subsidy. If the business subsidy involved conveying property at less than a fair market price to the business, or other in-kind benefits, then the value of these plus interest should be added to any other business subsidies. The subsidy agreement should specify the terms of the financial obligation to repay.

If a subsidy benefits more than one business, for example improvements in a TIF project, then the development agency should assign a proportion of the subsidy to each business that signs a subsidy agreement. The proportion assessed on each business should reflect a reasonable estimate of the business share of the total benefits of the project. Interest is to be calculated separately on these amounts. If the subsidy agreement does not specify a proportion of the business's benefits, state law should provide a default rule that allocates the benefits to the individual businesses.

In addition to its obligation to repay the benefits, a business that fails to meet the terms of its subsidy agreement may not receive other business subsidies from the state or local government units. State statutes will provide how long the business is ineligible for these subsidies.

Penalty for Bidding Between Local Units of Government. The Commission recommends that a financial obligation be imposed on a local government that induces a business to relocate from another Minnesota community. Inducement occurs when the primary reason for the relocation is an offer of loans or grants from another local unit of government in Minnesota. The financial obligation equals a proportion of the present value of the expected payroll of the business for a time period to be set by statute. The proportion shall be stated in statute and the expected payroll equals the average payroll paid by the business in previous years. The number of years to compute the average will be set by statute. This obligation is to be paid to the community from which the business relocated. Businesses that leave a local government remain subject to any obligations under previous business subsidy agreements.

Enforcement for State and Local Governments. The decisions of each local authority regarding the granting of business subsidies must be approved by the local elected body.

Refinements to Existing Law

The Commission recommends the following changes in current law and programs.

Wage and Job Requirements (Minn. Stat. § 116J.991)

Under current law, state and local units of government that award assistance for economic development must report the project to the Department of Trade and Economic Development

(DTED). For purposes of the statute, assistance is a grant or loan in excess of $25,000 or TIF. In 1997, the department released the first report. Members of the legislature and state agencies discovered that some local units of government did not report any information even though it seemed unlikely that the local unit of government did not award a grant, loan or TIF project.

The Commission took testimony over the wage and job reporting requirement law. In light of that testimony, the Commission recommends that state and local units of government continue to comply with the reporting requirements. Also, the Commission offers several suggestions for clarifying the law.

Reporting Requirements

- Replace the definition of "assistance" with the definition of "business subsidy" used by the Commission and the words "state or local government assistance for economic development or job growth purposes" with "a business subsidy".
- Clarify the date for reporting requirements. The recipients shall file: (1) their job and wage goals at the time the subsidy is first given; (2) progress reports by January 10 of each year for the previous year; and (3) within 30 days after the deadline for meeting the initial goals.
- If the business does not submit its report, the business receives a warning. If it fails to provide a report a second time after being provided with notice, then it must pay a $100 penalty each day up to the date the report is actually filed.
- A local unit of government that fails to file a report with DTED before a date set in statute shall receive a written warning from the Commissioner. If after 90 days, the Commissioner does not receive a report, the local unit of government shall lose authority to grant business subsidies until it complies with the law.
- The report from the local government shall include: (1) the amount of subsidies by type and public purpose; (2) the number of full and part-time jobs within separate bands of wages; (3) the benefits paid and listed separate from wages paid; (4) the date when the goals will be reached; (5) the person filling out the form; (6) a contact person with a telephone number and the date in which the form was completed; and (7) an overall summary of the data in a way that is useful to the public.

The State Agency Authorized to Prepare the Report

- The Commissioner of DTED shall be given the authority and enforcement mechanisms necessary to collect individual reports and make them available to the public. In addition, the department shall publish a compilation and summary of the individual reports.

Items to Be Included by DTED

At a minimum, the following items shall be included in the summary:

- total amount of subsidies awarded in each region of the state

- the distribution of subsidy amounts by size of subsidy
- distribution of subsidy amounts by month, quarter, or some other classification scheme
- distribution of subsidies by type and by public purpose
- percent of subsidies that did not meet its goals
- total dollar amount of subsidies that did not meet its goals
- of the subsidies that did not meet its goals, the percent that were not enforced
- the number of full and part-time jobs within separate bands of wages
- the benefits paid by separate bands of wages

Additional Exemptions or Requirements Placed upon Businesses Receiving Subsidies

- Clarify the two year time period that a business has to satisfy job and wage goals. The beginning of the two years starts on the day the business first receives the benefit of a subsidy.
- For any business subsidy, 90% of the jobs shall have compensation totaling 110% of the federal poverty level for a family of four including wages, scheduled bonuses, health and dental insurance, child care, training programs certified by DTED and pension benefits. Any "small employer" as defined by Minn. Stat. § 177.24, shall be exempt from these requirements. The wage standards do not include business subsidies totaling less than $25,000.
- DTED shall provide information and training on reporting requirements to local units of government.

Several members of the commission, including appointees of the Governor, have long been opposed and continue to be opposed to having living wage requirements in statute. Commission members agree, that in most cases, however, it makes little sense in the present economy to provide incentives for jobs paying less than 110% of the poverty level, and that program guidelines should be established by development agencies to assure the pursuit of the highest-quality jobs.

Tax Increment Financing (Minn. Stat. § 469. 174 to Minn. Stat. § 469.179) and Economic Development Authorities (Minn. Stat. § 469. 090 to Minn. Stat. § 469.1081)

In many of its hearings, the Commission took testimony from citizens expressing concerns over problems with the implementation and structure of the TIF laws and other activities of local economic development authorities. The Commission recognizes that the 1997 Legislature authorized a 12-person legislative task force to oversee the recodification of tax increment and local economic development authority statutes. The Commission further understands that the recodification is a complex process which will not be completed until the beginning of the 1999 session.

The Commission took only limited testimony on current TIF and economic development authority statutes, the various changes in the laws since 1990 and the impact of those changes. In light of the complexity of TIF and its overlapping authority with economic development statutes, the existence of a legislative task force directly involved in recodifying the statutes, and the lack of detailed testimony and analysis of the law and its recent amendments, the Commission is reluctant to make firm recommendations about changes in the statutes at this time.

The Commission recommends, however, that changes be made to the TIF and economic development authority statutes to implement the general recommendations contained in this report. In addition, the Commission urges that the tax increment financing task force consider the following suggestions which were raised during public hearings:

- Place a percentage limit on the amount of tax capacity that a local unit of government may encumber through tax increment districts, this may result in a more equitable distribution of property tax payments for local government services.
- Require that any new TIF district include a cost benefit analysis.
- Find ways to insure enforcement of the "But For" test. One possibility is to require the "But For" test include a statement regarding why public money is needed for the project and the distribution of benefits from the project.
- Distinguish between redevelopment districts that sell land at market rate from those that sell land below market rate.
- Require an annual report on the status of all TIF districts be provided at the municipality's Truth in Taxation hearings that would cover bond payments, anticipated tax receipts at completion, increased valuation of property involved, and new TIF projects under consideration.
- Require claw backs on failed tax increment projects. The auditor should be given the authority to enforce the agreement.
- Require local units of government to close the TIF district after the TIF district pays for the project or restrict TIF pooling to exceptions defined by statute.
- Require sign off by other units of government (county and school district) or require cities to consult with other units of local government in making TIF decisions.

Special Legislation

The legislature often awards economic development subsidies through direct appropriation or special legislation. The Commission recommends that the legislature should examine the use of these economic development subsidies and may even require that such subsidies pass an independent cost-benefit analysis.

The New Abatement Law (Minn. Stat. § 469.1812 to Minn. Stat. § 469.1815)

The Commission acknowledges that there have been serious concerns expressed regarding the new abatement law and recommends that the legislature set a sunset date for the law. The Commission also recommends an evaluation of the effectiveness of this program as an economic development tool in comparison to other tools such as TIF.

A Study of Tax Expenditures

The Commission recommends that the Legislative Auditor conduct a study of selected tax expenditures evaluating each program for its public purpose and effectiveness. In the future, new tax expenditures should contain a statement of public purpose within the statutes

The Bidding War Between the States and Local Units of Government

The Commission finds that competition for businesses relocating to a new jurisdiction can create a dilemma for state governments. Across the nation, businesses are able to pit state governments against one another by promising to locate in the state that offers the most attractive economic development package. The bidding between states is detrimental to state governments because it diverts income away from other opportunities, or from the state's taxpayers.

The Commission recognizes that only minor measures can be taken by state governments to end the bidding war between the states and local units of government. The state may also choose to place more funds in infrastructure development or pollution abatement and less money on direct subsidies to businesses.

Only the federal government can end the bidding war between the states. For that reason, the Commission supports federal legislation that would classify any targeted subsidy that provides preferential treatment to a business as taxable income to businesses.

Funding for the Recommendations

The Commission recommends that sufficient funds be appropriated by the legislature to fund the oversight suggestions that will be carried out by DTED and the Department of Revenue.