# State of Oklahoma
# Incentive Evaluation Commission
# Five Year Ad Valorem Tax Exemption for Manufacturing
# Draft Report

**November 1, 2016**

**Prepared by**

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# At a Glance: Ad Valorem Tax Exemption for Manufacturing

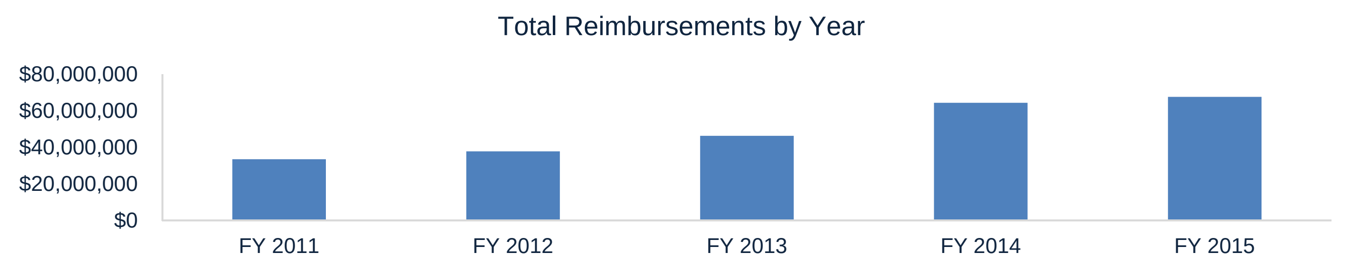
## Statute: O.S. 68 Section 2902

## Program Goals

- Induce manufacturing businesses to locate or expand within any county of the State
- Create job and wage growth within the State
- Focus on jobs with health benefits and above average wages

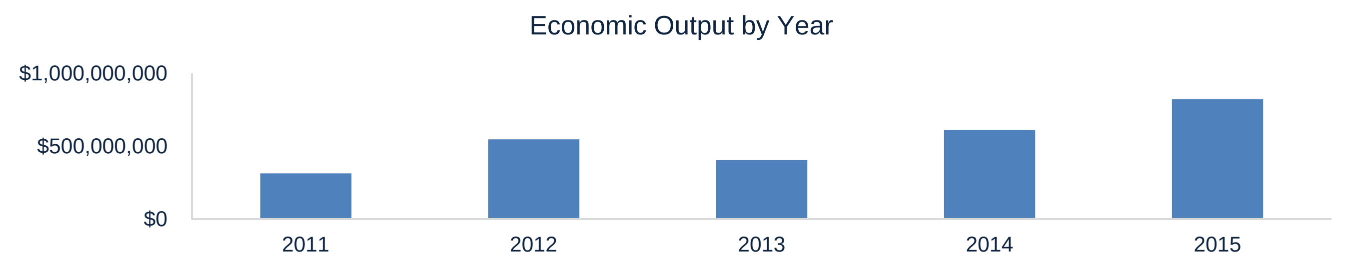
## Fiscal Impact

| | FY 2011 | FY 2012 | FY 2013 | FY 2014 | FY 2015 |
|---|---|---|---|---|---|
| **Dollar Amount** | $33,482,080 | $37,828,753 | $46,342,441 | $64,356,276 | $67,619,201 |




## Economic Impact

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **Output** | $314,761,520 | $547,638,783 | $405,662,231 | $612,766,321 | $822,001,378 |
| **Labor Income** | $92,233,525 | $149,520,621 | $114,415,253 | $164,894,411 | $221,930,526 |
| **Employment** | 1,927 | 3,025 | 2,353 | 3,323 | 4,494 |
| **Total Tax Revenue** | $6,214,492 | $10,610,107 | $7,963,267 | $11,494,073 | $15,296,111 |




## Adequate Protections for Future Fiscal Impact?

- Recent significant growth, but legislative changes should flatten the trajectory in the next few years
- The primary concern is that the Constitution provides little opportunity to limit the exemption, although eligibility requirements can be raised if the fiscal impact grows in future years

## Effective Administration?

- The need for local government involvement in the process is a complicating factor, particularly because local governments have no financial stake in paying for the exemption

## Achieving its Goals?

- Oklahoma manufacturing is performing somewhat better than the nation as a whole
- Broad use of the program among counties suggest it is meeting that legislative goal
- There has been growth in the number of jobs and reduced cost per job in recent years

## Retain, Reconfigure, Repeal?

- Retain but consider revising program eligibility requirements that have been the same in some cases since program inception

## Changes to Improve Future Evaluation?

- Increase the information available to evaluate, likely through required non-disclosure agreements

# Executive Summary

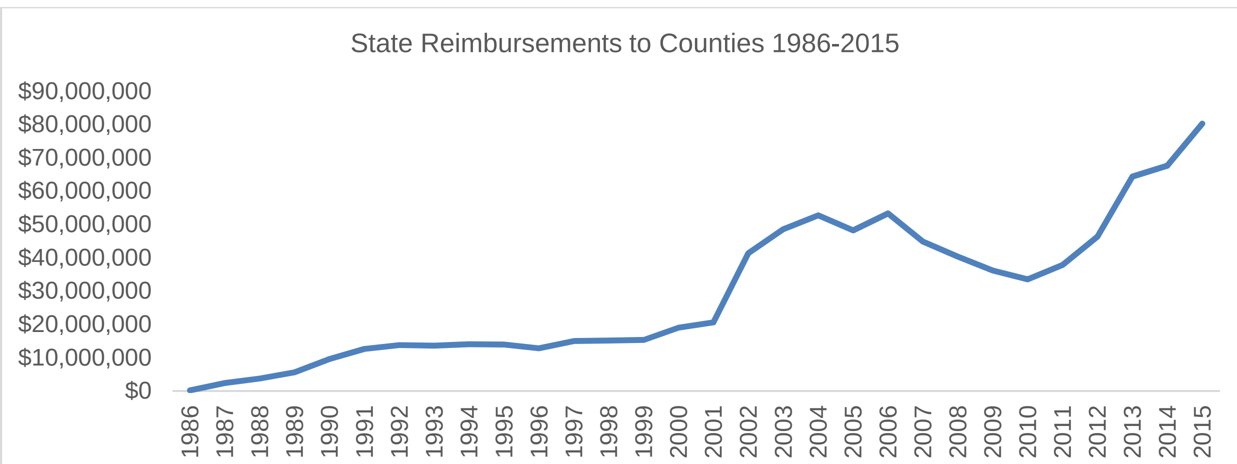
## Introduction

The United States manufacturing sector has changed significantly in the last several decades. Since its peak in 1979, employment in manufacturing has declined by 37 percent. In spite of this, the sector remains an important part of the national economy, and manufacturing output has more than doubled over the same period. In Oklahoma, the manufacturing industry makes up 9.3 percent of the state economy. While manufacturing jobs may be declining, those jobs are, on average, higher paying jobs. As manufacturing employment declines while output increases, states across the country have sought to attract manufacturing companies in an effort to retain or expand its share of this shrinking but valuable market.

The Ad Valorem Tax Exemption for Qualifying Manufacturing Concerns was added to the Oklahoma State Constitution by a vote of the people on April 10, 1985. The property tax exemption applies to all real and personal property necessary for the manufacturing of a product and facilities engaged in research and development. The exemption applies to new, acquired or expanded manufacturing facilities in qualified industries. Companies apply for the exemption through the county assessor where the facility is located, and if approved, the State reimburses the county for the amount of exempted property tax for up to five years.

## Program Background and Benchmarking

State payments associated with this incentive have increased sharply since returning to pre-recession levels in 2012.




While there are specific references to several industries in the program's authorizing statute, the Oklahoma Tax Commission summarizes program use by five property types in its annual report on the exemption: computer/data processing; distribution centers; large manufacturing; traditional manufacturing and electric wind facilities. While wind facilities have been a major contributor to the upward trend in program use in the last few years, effective January 1, 2017, wind energy facilities will no longer be eligible for the exemption.

There are several competing states that have manufacturing exemptions similar to Oklahoma's, including Alabama, Kansas, Louisiana, Mississippi, South Carolina and Texas. Each offers a full property tax exemption with the exception of Texas, which uses a taxable value limitation of up to 50 percent of total tax due on the property. Texas' incentive is unique among the group in that it is an exemption of school district maintenance and operations property tax. Most of the comparison states offer a 10-year incentive period; Oklahoma and South Carolina limit the exemption to five years.

**Fiscal Impact**

It is notable that the program experienced relatively stable levels of reimbursement through the end of the recession in FY2001. It then picked up sharply in FY2002 through FY2004, then leveled off and declined during the recession from FY2008 through FY2010. As noted, wind facilities have, as a cohort, been a primary beneficiary of program exemptions, totaling approximately 38 percent of the amount paid by the State in FY2016. These reimbursements took on a more prominent role among the five categories in FY2014 through FY2016.

The program reached a state reimbursement high point of $53.3 million in FY2007 but, during the Great Recession, fell to $33.5 million in FY2011. However, it has more than doubled from FY2012 to FY2016, when the reimbursement reached a new high of $80.2 million. It is likely, however, that the exclusion from the program of electricity generating facilities from wind energy will slow growth in the next several years.

**Economic Impact**

The economic activity from growth in manufacturing is significant, including direct (such as purchases of manufacturing output), indirect (such as supplier activity) and induced (such as household activity of new payrolled employees) effects. However, economic activity must be distinguished from state tax revenue generated by that economic activity, which is a relatively small percentage of overall activity. Because the State pays the entirety of the payroll tax exemption, those costs are significantly higher than the state tax revenue generated by the additional economic activity. However, over time (since the exemption lasts for five years), there is a reasonable likelihood that the State will 'catch up' in terms of ongoing economic activity.

There are other advantages associated with the economic impact, including the opportunity for additional local tax revenues associated with capital investment and economic activity. These, however, do not generally impact on State revenue collections.

**Outcomes**

It is often difficult to come to definitive conclusions with this sort of incentive program. While it is a significant investment, it is difficult to compare programmatic results that add (for example in 2015) about 4,500 jobs to the state economy as a whole. When those 4,500 jobs are disaggregated into a wide variety of industries and even more companies and locations, it becomes exceedingly more difficult to draw conclusions without a much more in-depth study that may have to focus on a handful of program components.

Even with these caveats, there are indications that State manufacturing employment and wages have fared better than the nation as a whole. There are also metrics that suggest the cost per job of the program is in line with other similar programs. Finally, the recent growth in some key sectors of the growing economy (such as computing) is encouraging for state economic diversification.

The cost-benefit analysis from the program also benefits from the fact that the State reimbursement is for five years while most similar state programs reimbursement for double that amount. Because of the significant capital investment, it is likely that the recipient firms will maintain their presence in the State in following years, and the State has a strong opportunity to recoup its investment in years six through ten.

**Recommendation**

One of the factors that sets this program apart from others is its inclusion in the State Constitution. As a result, it is unlikely that the program will be eliminated – and to do so would take considerable time and effort. It is a longstanding part of the economic incentive structure in Oklahoma, and there are no obvious arguments that would support its elimination. Given the use of similar programs in other states that compete with Oklahoma, it is likely that the State would experience some lack of competitiveness with other out-of-state locations if the program ceased.

At the same time, it is worthwhile to consider possible program modifications. The threshold eligibility criteria have not changed in recent years, and the value of the threshold level of investment or increases in payroll have eroded over time. However, if changes are made, they should be done in a way that is statistically valid but also sets clear parameters for the level of investment necessary to qualify for the program.

Based on its performance and long-standing acceptance, the project team recommends retaining the program. At the same time, there is additional information that should be gathered related to program use that will assist in future evaluations of the program's performance. Data that should be routinely collected from applicants and program participants on a year basis (and available for use by the Commission's program evaluators) includes:

- NAICS Code – 4 to 6 digit
- Capital investment (real and BPP)
- Existing payroll
- Net new payroll
- Existing jobs
- Net new jobs

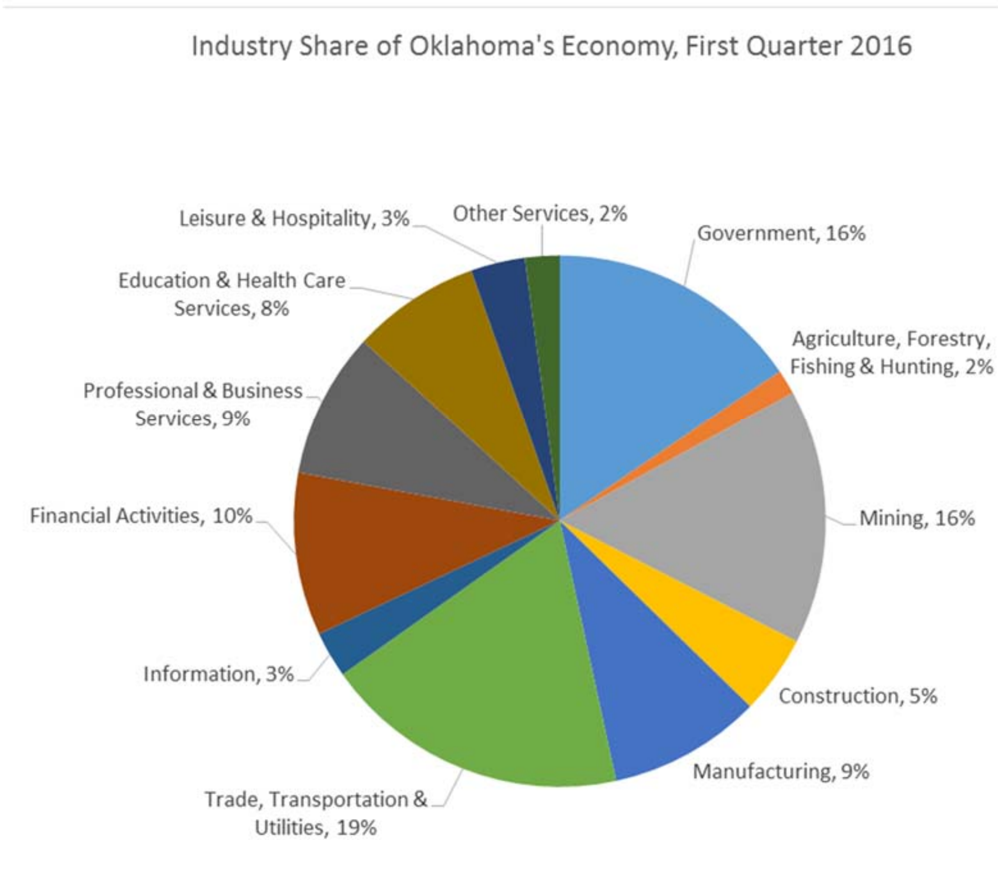
# Introduction

## Overview

The Oklahoma Incentive Evaluation Commission (the Commission) was established in HB2182, which was enacted and became law in 2015. It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The Five Year Ad Valorem Tax Exemption for Manufacturing is one of the incentives reviewed in 2016 by the Commission with recommendations to the Governor and the State Legislature.

## Introduction

The United States manufacturing sector has changed significantly in the last several decades. Since its peak in 1979, employment in manufacturing has declined by 37 percent.[1] In spite of this, the sector remains an important part of the national economy, and manufacturing output has more than doubled over the same period.[2] In Oklahoma, the manufacturing industry makes up 9.3 percent of the state economy.[3]

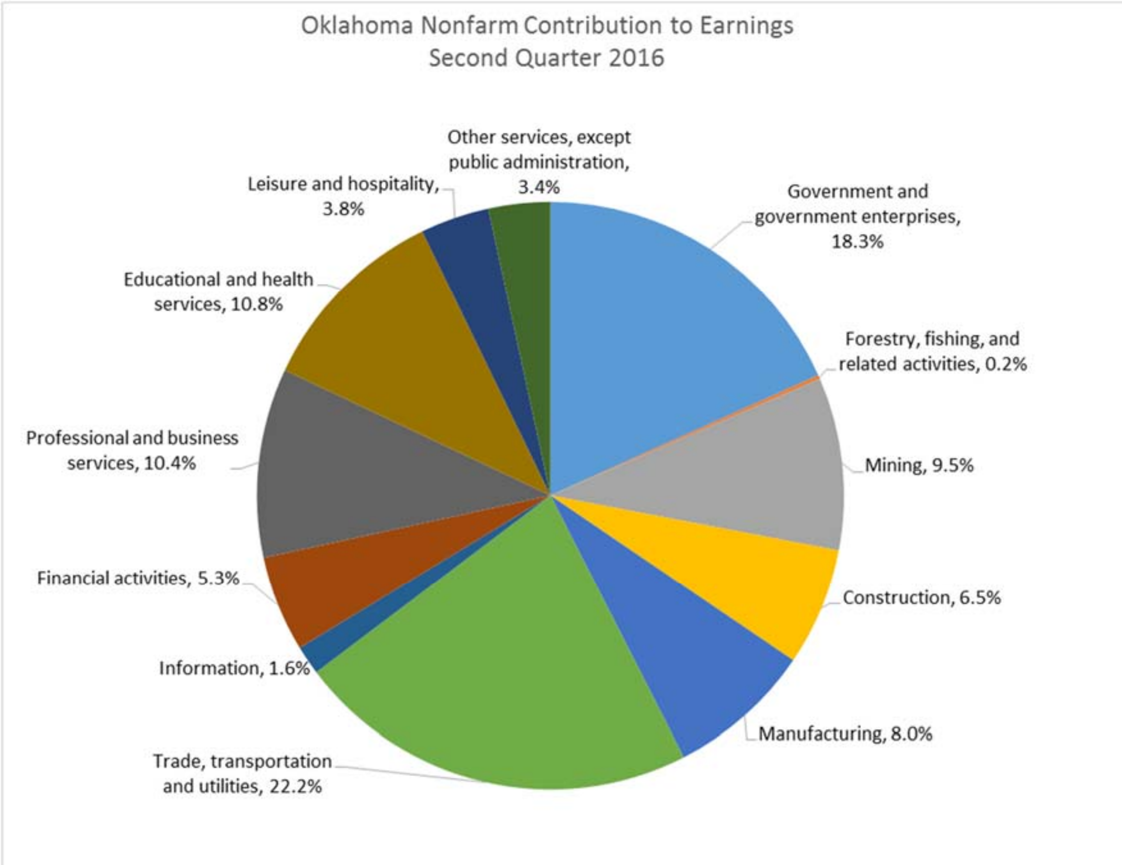



[1] US. Bureau of Labor Statistics, All Employees: Manufacturing [MANEMP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MANEMP, October 16, 2016

[2] US. Bureau of Labor Statistics, Manufacturing Sector: Real Output [OUTMS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/OUTMS, October 13, 2016

[3] Oklahoma Economic Indicators, Oklahoma Employment Security Commission, Economic Research and Analysis Division, September 2016, p. 11.

As with the trend for the nation as a whole, manufacturing's share of State earnings is smaller than its share of the overall State economy:




While manufacturing jobs may be declining, those jobs are, on average, higher paying jobs. As manufacturing employment declines while output increases, states across the country have sought to attract manufacturing companies in an effort to capture a share of this shrinking, but valuable market.

There are several benefits to attracting additional manufacturing activity. First, states can both maintain and increase employment by spurring expansion of existing facilities and new construction. Beyond employment, manufacturing investment creates valuable capital assets within the state's borders, and major investments can have a lasting impact on an area. Major facilities often attract other similar investments, leading to a clustering of similar firms that will increase productivity and wages for workers. This is often a driving force for governments at all levels to compete fiercely for manufacturing investment.[4]

The Ad Valorem Tax Exemption for Qualifying Manufacturing Concerns was a adopted as an amendment to the Oklahoma State Constitution and adopted by a vote of the people on April 10, 1985. This Constitutional amendment was posed by the General Assembly to the voters via Senate Joint Resolution 9, which was approved on March 12, 1985.

[4] Lincoln Institute of Land Policy: Rethinking Property Tax Incentives for Business, 2012

The property tax exemption applies to all real and personal property necessary for the manufacturing of a product and facilities engaged in research and development that meet the requirements set forth in the Oklahoma Constitution and State statute as established by the State Legislature.[5] The property tax exemption applies to new, acquired or expanded manufacturing facilities in qualified industries. Companies apply for the exemption through the county assessor where the facility is located. If approved, the State then reimburses the county for the amount of abated property tax.

While the program in its inception focused on what might be considered 'traditional' manufacturing of durable goods, there are other industries that qualify as well. These include aircraft repair and rebuilding, computer services and data processing, distribution and warehousing, research and development, and electric power generation. The following are the minimum qualifications for the initial year of the five-year exemption:

- Capital investment in the new, acquired, or expanded facility of at least $250,000.
- The investment must also create a net increase in annualized payroll of at least $250,000 in a county with a population of less than 75,000, and at least $1,000,000 in a county with a population of 75,000 or more.
- Basic health care benefits must be provided to employees within 180 days of employment.
- To continue receiving the exemption, a company must maintain or increase its payroll each year.

Certain facility types have special requirements and exceptions. As noted in the explanation of asset eligibility, the phrase 'manufacturing process' is important. To qualify for the exemption, assets are to be directly involved in the manufacturing process.

A notable exception to the increase in payroll requirements has existed for 'entities engaged in electric power generation by wind energy.' These facilities have been able to qualify for the exemption with a $2.0 million capital investment if the $250,000 payroll increase requirement is not met. Given that the capital cost for wind turbines are in the range of $1.3 to $2.2 million per megawatt, and two megawatt wind turbines are common, it is understandable that these facilities have been able to readily qualify for the exemption. In 2015, the Legislature (in SB 498) stipulated that applications for exemption by electric power generation by wind facilities will no longer be accepted, effective January 1, 2017.

**Criteria for Evaluation**

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In this case, the original state question that was approved by the voters and placed into the Constitution provides that:

[5] State of Oklahoma 2016 Annual Report to the Oklahoma Tax Commission, Exempt Manufacturing Reimbursements, April 14, 2016, p. i.

> "For the purpose of inducing any manufacturing concern to locate or expand manufacturing facilities within any county of this state, a qualifying manufacturing concern shall be exempt from the levy of any ad valorem taxes upon new, expanded or acquired manufacturing facilities for a period of five (5) years."

From this, it is clear that the goal is to induce location or expansion of manufacturing facilities within the State. Given that manufacturing is typically associated with paying above average wages – and that the requirements for the incentive generally require payroll growth - it seems logical to assume that criteria that measure jobs and payroll would align with the intent of the Constitutional amendment.

It also makes sense to look to the nature of the incentive: for there to be value in a property tax exemption, a business would have to have a significant amount of otherwise taxable real or personal property. This is frequently the case for manufacturing operations (as opposed to, for example, finance, insurance or professional services). As a result, it makes sense to also identify the incentive's impact on capital investment.

With this in mind, the Incentive Evaluation Commission has determined the following criteria:

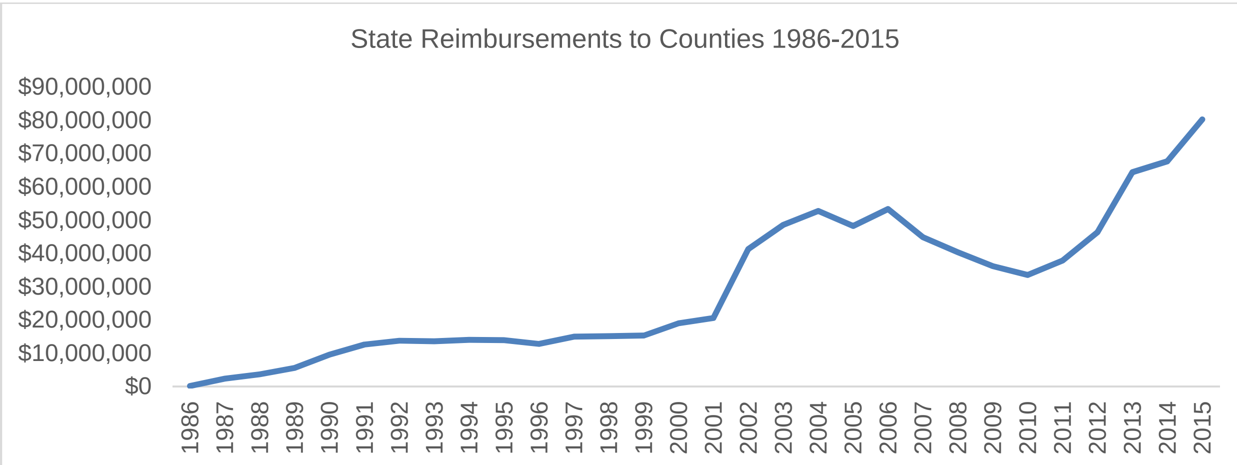
- Change in jobs associated with the exemption
- Change in payroll associated with the exemption
- Change in payroll associated with the exemption
- Change in capital investment associated with the exemption
- But-for test – change in jobs/payroll/capital associated with the exemption versus state growth rates as a whole
- Change in jobs/payroll/capital in the qualifying industries versus state industries as a whole
- Changes to state appropriations associated with facilities receiving an exemption
- Return on investment – economic activity versus financial net cost.

The criteria focus on what are generally considered goals of incentives programs (such as creating jobs and capital investment in the state) as well as more specific objectives related to this program (such as possible changes in state appropriations associated with facilities receiving an exemption). Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criteria for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

# Program Background and Benchmarking

**Background**

State payments associated with this incentive have increased sharply since returning to pre-recession levels in 2012.

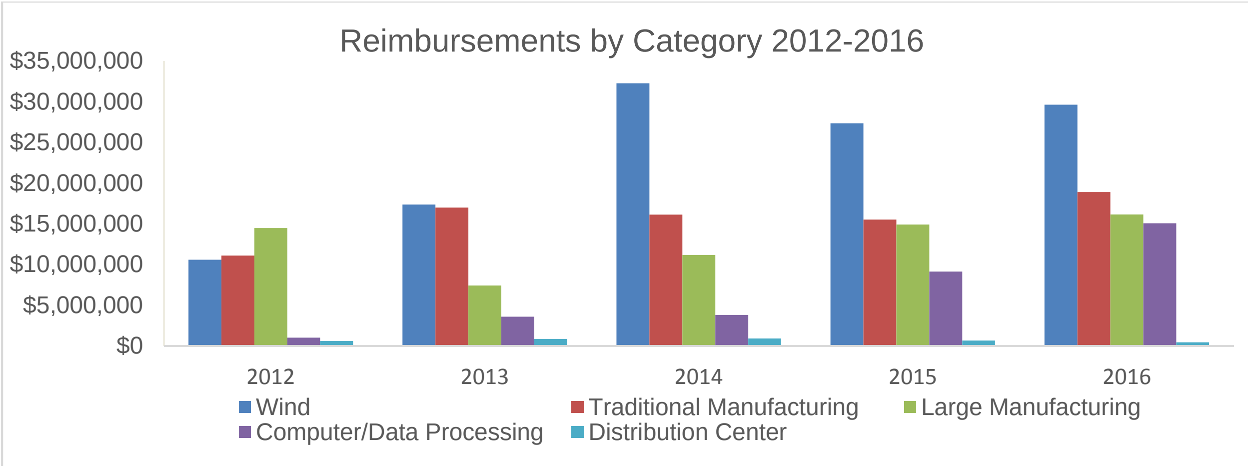



While there are specific references to several industries in the program's authorizing statute, the Oklahoma Tax Commission summarizes program use by five property types in its annual report on the exemption:

- Computer/Data Processing
- Distribution Centers
- Large Manufacturing
- Traditional Manufacturing
- Electric Wind.

Over the last five years, wind facilities have been a major contributor to the upward trend in program use. According to the data breakdown from the Tax Commission, wind facilities have received the highest total exemption amount in each of the last four years. About 38 percent of the total reimbursements paid by the state in 2016 were due to wind exemptions.

The following table details the reimbursement by category:




| Reimbursement Amounts | | | | | |
|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 |
| Wind | $10,588,038 | $17,373,296 | $32,270,226 | $27,350,423 | $29,638,916 |
| Traditional Manufacturing | $11,103,763 | $16,998,205 | $16,146,846 | $15,526,973 | $18,911,401 |
| Large Manufacturing | $14,482,954 | $7,442,909 | $11,193,353 | $14,925,728 | $16,154,521 |
| Computer/Data Processing | $1,035,616 | $3,602,276 | $3,824,362 | $9,151,410 | $15,071,134 |
| Distribution Center | $618,382 | $872,639 | $921,459 | $664,667 | $458,995 |

As noted in the previous section, effective January 1, 2017, entities that generate electricity by wind will no longer be eligible for the exemption.

**Benchmarking**

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are 'perfect peers' – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.[6] These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically starts with a look at bordering states. This is generally the starting point because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison.

However, the comparison group for certain incentives will be broader than just the neighboring states. Discussions with State internal stakeholders indicated that beyond the region, several Southeastern states are prime competitors for manufacturing entities. As a result, Alabama, Louisiana, Mississippi,

[6] The only real instances of exactly alike state incentive programs occur when states choose to 'piggyback' onto federal programs.

South Carolina, and Tennessee have been included. The following peer states were considered, and those with a comparable incentive are also noted:

| State | Comparable Program |
|---|---|
| Alabama | Yes |
| Arkansas | No |
| Colorado | No |
| Florida | No |
| Kansas | Yes |
| Louisiana | Yes |
| Mississippi | Yes |
| Missouri | No |
| New Mexico | No |
| South Carolina | Yes |
| Tennessee | No |
| Texas | Yes |

Of the 12 states, Alabama, Kansas, Louisiana, Mississippi, South Carolina and Texas have ad valorem tax exemptions similar to Oklahoma. Each offers a full property tax exemption with the exception of Texas, which uses a taxable value limitation of up to 50 percent of total tax due on the property. Texas' incentive is unique among the group in that it is an exemption of school district maintenance and operations property tax. Qualifying companies enter into agreements with local school districts to determine the terms of the value limitation.

Important differentiating characteristics among the state incentives include capital investment requirements, duration of the exemption, eligible industries, and payroll and job requirements.

A significant capital Investment is generally necessary for a property tax exemption to have value for the owner of a manufacturing facility. A required minimum amount of capital investment can ensure that the company receiving the incentive has a certain level of commitment to the new or expanded property. Oklahoma's incentive does this with its required minimum capital investment of $250,000, but minimum investment requirements are rare among comparable state programs. Kansas, Louisiana, and Mississippi have no minimum requirement. Alabama has minimums only for alternative energy producers and expansion programs.  South Carolina has a required minimum for facility additions.  Texas has minimum requirements that vary based on school district agreements.

Duration of the incentive is for up to five years in Oklahoma.  South Carolina is the only other state in the comparison group to limit the exemption to five years.  All other comparable states with a similar incentive provide a 10 year incentive period.

Eligible Industries vary across comparable programs, but each has a general focus on manufacturing. Oklahoma's incentive has emphasized three facility types outside of manufacturing (research and development, aircraft maintenance, and wind energy).  Alabama is the only comparable state to include all three of these categories in its incentive.  None of these categories qualify for Louisiana's exemption. With the exception of Louisiana, research and development is considered eligible in all comparable states.

Payroll Requirements are rare among the comparison group.  Oklahoma is the only state in the group to have a standard annualized payroll requirement for all facilities.  Texas requires certain wage targets, but does not have an aggregate payroll requirement.  Oklahoma does not have a required number of jobs unless the facility is a distribution center.  Texas has variable job requirements based on school district agreements.

Job Creation requirements are used in Texas based on school district agreements.  Alabama has requirements in place only for data processing centers, warehousing, and facilities that are headquarters. Oklahoma does not have a job creation requirement, except for distribution facilities.

The table on the following page details the program attributes for Oklahoma and similar property tax exemption initiatives in Alabama, Kansas, Louisiana, Mississippi, South Carolina and Texas.

| | Oklahoma | Alabama | Kansas | Louisiana | Mississippi | South Carolina | Texas |
|---|---|---|---|---|---|---|---|
| **Applies to** | Property Tax | State sales and use taxes; Non-educational county and city sales and use taxes; Non-educational state, county, and city property taxes; Mortgage and recording taxes to which property is conveyed into or out of a public authority, city or county government. | Property Tax | Property Tax | Property Tax | Property Tax | School District Maintenance and Operations Property Tax |
| **Incentive Type** | Exemption | Exemption | Exemption | Exemption | Exemption | Exemption | Taxable Value Limitation |
| **Cap** | None | None | None | None | None | None | May not exceed 50% of the total taxes paid on the qualified property during that year |
| **Capital Investment** | $250,000 minimum | Projects owned by utilities which produce electricity from alternative energy resources must have capital costs of at least $100,000,000 and Hydropower production must have capital costs of at least $5,000,000.<br>Expansion projects must be at least 30% of the original cost or $2,000,000 | No Requirement | No Requirement | No Requirement | Minimum of $50,000 for expansions of existing facilities only | Agreements made with local school district mandate the capital investment required, but there is no standard. |
| **Duration** | 5 Years | 10 Years | 10 Years | 10 Years | 10 Years | 5 Years | 10 Years |
| **Payroll Requirement** | Net increase in annualized payroll of at least $250,000 in a county with a population lower than 75,000 or $1,000,000 in a county with a population of 75,000 or more | None | None | None | None | None | Must pay 110% of county's average manufacturing wage |
| **Job Creation Requirement** | Distribution facilities must employ at least 100 full-time employees | 50 new jobs if the facility is a headquarters and 20 new jobs if the facility is a data processing center, 50 jobs for warehousing facilities | None | None | None | None | Varies depending on agreement with school district |
| **Includes:** | | | | | | | |
| **Research and Development** | Yes | Yes | Yes | No | Yes | Yes | Yes |
| **Aircraft Maintenance** | Yes | Yes | No | No | Yes | No | No |
| **Wind** | Yes | Yes | No | No | No | No | Yes |

Among the states with active similar incentive programs, the project team identified two states with relevant studies that are useful for comparison. These studies were done by the States of Connecticut and Texas. As previously noted, the Texas program is unique in that it applies only to school district property taxes.

For Texas, in 2010, the State Comptroller conducted an analysis of multiple state economic development incentives. These included the Texas Economic Development Act (often referred to as Chapter 313). According to the analysis, 'realizing that manufacturing has been a vital segment of the state's economy and that its ability to attract new manufacturing facilities had eroded' in 2001, legislation gave school districts the ability to attract new taxable property and create jobs through offering a tax credit and an 8-year exemption for school property taxes.'[7]

According to a 2010 report to the Legislature, the program generated 6,239 qualifying jobs proposed in the original applications for 98 active projects with $47,327 million in estimated capital investment for the life of the active projects. The report estimated total gross tax benefit to recipient companies of $1,910 million. Based on these figures, it identified $19.5 million of tax credit/exemption per active project and $306,086 of tax credit/exemption per job committed to in the original application of the active projects. The report also noted that wind farms have been significant users of the program, making up 64 percent of the active projects. Wind farms were also responsible for 27 percent of total capital investment and just 7.2 percent of the jobs committed, while receiving 37 percent of the tax benefit.

The evaluation identified the following among the program's strengths:

- The program has a sunset date
- The program has claw-back provisions if performance is below the statutory minimum
- The program encourages investments in school districts/locations that might otherwise have difficulty attracting investment
- To the extent that projects would not have located in the state without the program, it has assisted in an investment of up to $47.3 billion

The evaluation identifies the following among the program's weaknesses:

- The impact on state revenue is not capped
- The program has no limit on individual incentive amount
- The program does not require competition for awards – awards are based primarily on eligibility
- The wind projects are disproportionately benefiting when comparing job creation and capital investment

[7] To qualify, the property must be in a reinvestment zone and must be devoted to manufacturing, research and development, a clean coal project, as defined by Section 5.001, Water Code, an advanced clean energy project, as defined by Section 382.003, Health and Safety Code, renewable energy electric generation, electric power generation using integrated gasification combined cycle technology, nuclear electric power generation, or a computer center used primarily in connection to one of the other categories. "An Analysis of Texas Economic Development Incentives 2010, Texas Comptroller of Public Accounts, p. 17.

The magnitude of the Texas program – and some of its somewhat unique features – have made it a regular topic for discussion and analysis.[8] An Interim Report by the Texas House Select Committee on Economic Development Incentives (January 2015), established a framework for analyzing the project that is useful as a starting point for considering aspects of the Oklahoma program as well:

- **A clear purpose of expected outcomes.** The report identified several purposes, including encouragement of large scale capital investments in the state, creating new, high-paying jobs and strengthening and improving the overall performance of the economy in the state.

- **Metrics for achieving the outcomes.** The report identified these as the number of qualifying jobs create, the amount of capital investment committed by the companies and the amount of tax revenue benefiting the school district.

- **Timeframe for achieving the purpose.** While the property tax exemption lasts eight years (plus a tax credit that can also reach similar financial results for the recipient in the first two years), each contract establishes a timeline with expectations. According to the report, within 25 years of the agreement's start, all revenues lost by the school district during the 10-year incentive period should be recovered through the incentivized economic activity in the remaining 15 years of the period.

- **Funding limits.** The report notes that there is no appropriation from the legislature or limitation on the amount of the funding under the program.

- **Competitive and open award selection process.** To qualify, a company files an application with a school district, and the district determines whether the company will receive the benefits. There are requirements for specific industries and a minimum number of jobs to be created at a certain salary or higher, but this can be waived (and, according to the report, is waived about three out of five times). The report suggests that the verification of created jobs and conflicts of interest are areas of concern.

- **Clawbacks.** Provisions were added in 2009 that allows a school district, when companies fail to meet the requirements of the contracted agreement, to recapture an amount up to the amount of the tax benefit provided to the company.

- **Transparency.** School districts collect annual reports from the companies and monitor these reports for compliance with the agreements. The Texas Comptroller releases a report every two years with performance metrics and details for all current agreements.

- **Regular independent audits.** In 2013, the Legislature required annual audits by the State Auditor's Office. Three agreements are selected by the auditor, and the review is to determine whether the agreement(s)

[8] The program is sometimes criticized for its lack of state involvement or oversight given the fact that the benefit to manufacturers is entirely borne by the state. It is also suggested that financial 'side deals' between the recipient businesses and the impacted school district are evidence that the business did not require the entirety of the property tax benefit to locate there and the school district is not necessarily making a detached decision on the benefits of the deal. See, for example, "Free Lunch," by Patrick Michels, Texas Observer, March 14, 2016, accessed electronically at https://www.texasobserver.org/chapter-313-texas-tax-incentive/

> accomplish the purposes and intent of the program. The Auditor will also 'make recommendations relating to increasing the efficiency and effectiveness of the administration of this chapter,' The State Auditor's Office released the first of the required audits in November 2014 and the second in September 2015.[9]

It is notable that the September 2015 audit continues to suggest a need for greater program accountability and transparency – issues that were also raised in the November 2014 audit. Among the identified areas of concern are verification of information, ensuring that agreements meet all statutorily required provisions, the existence of multiple agreements for the same claimed jobs and records retention.

The State of Connecticut publishes regular reports related to its tax credit and abatement programs, most recently in 2014.[10] Connecticut State statute provides that this report include a baseline assessment of the tax credit and abatement programs enacted to encourage business growth in the state, including the number of jobs associated with the incentives, and the annual revenue generated from the incentives through employment and other activities. For State property tax abatements (which are entirely for properties located within state enterprise zones), the annual amount has varied between $14.5 and $20.3 million a year from FY2003 to FY2013 – a total of $169.8 million. The State also reports these abatements by NAICS Industry and Year.

The report uses two separate modeling approaches, one with methodology used in the previous 2010 report that covers years 2005 through 2014 and a second set of results with a new, more inclusive methodology that is only run for fiscal years 2012 through 2014.

The Connecticut study uses varying assumptions for induced investment – equal to 20, 50 and 100 percent of the value of the abatement. Not surprisingly, the results for lower levels of induced investment are less impressive. It is notable that, using the State's older methodology, the results were negative in terms of net state revenues for all three levels of induced investment.

Under the later methodology, which took another look at various factors, the report demonstrated positive net new revenue for the State at each of the levels of induced investment. While a detailed examination of the differing methodologies is outside the scope of this analysis, it is an indication that determining economic impact (and impact on revenues) is far from an exact science. It should be noted that, based on the new methodology, the report recommended continuing the enterprise zone property tax abatement program.

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[9] "Selected Major Agreements Under the Texas Economic Development Act," State Auditor's Office, November 2014 and August 2015.

[10] "An Assessment of Connecticut's Tax Credit and Abatement Programs," Connecticut Department of Community and Economic Development, September 2014.

# Fiscal Impact

### Fiscal Impact

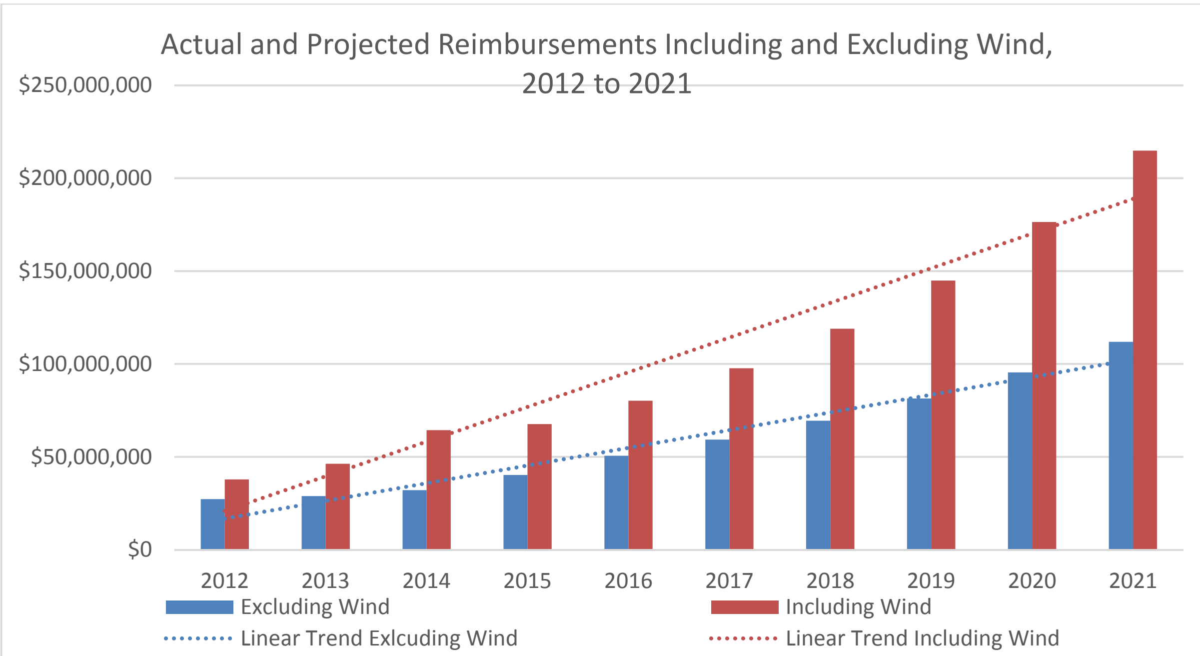
As noted in the program background discussion, payments associated with this incentive have increased sharply since the end of the Great Recession in FY2010. The following table details the fiscal impact by fiscal year:

| Fiscal Year | Reimbursements |
|---|---|
| 1987 | $143,257 |
| 1988 | $2,346,018 |
| 1989 | $3,671,120 |
| 1990 | $5,564,981 |
| 1991 | $9,573,063 |
| 1992 | $12,589,691 |
| 1993 | $13,725,074 |
| 1994 | $13,555,765 |
| 1995 | $13,974,501 |
| 1996 | $13,874,217 |
| 1997 | $12,764,587 |
| 1998 | $14,936,129 |
| 1999 | $15,065,099 |
| 2000 | $15,265,381 |
| 2001 | $18,978,365 |
| 2002 | $20,572,439 |
| 2003 | $41,306,390 |
| 2004 | $48,530,995 |
| 2005 | $52,724,671 |
| 2006 | $48,192,459 |
| 2007 | $53,294,176 |
| 2008 | $44,825,245 |
| 2009 | $40,306,068 |
| 2010 | $36,145,243 |
| 2011 | $33,482,080 |
| 2012 | $37,828,753 |
| 2013 | $46,342,441 |
| 2014 | $64,356,276 |
| 2015 | $67,619,201 |
| 2016 | $80,234,967 |

The incentive program experienced relatively stable levels of reimbursement through the end of the recession in FY2001. It then picked up sharply in FY2002 through FY2004,and then leveled off and declined during the recession from FY2008 through FY2010. As also noted, wind facilities have, as a cohort, been a major beneficiary of program exemptions, comprising approximately 38 percent of the amount reimbursed by the State in FY2016. These reimbursements took on a more prominent role among the five categories in FY2014 through FY2016.

The program has been modified by the Legislature, and, effective January 1, 2017, facilities engaged in electric power generation by means of wind will no longer qualify for the exemption. This will likely have a significant effect on the overall program fiscal impact.

To help explain this, the following chart details the projected increase in program exemptions (and, thus, state reimbursement) for the next five years using historic growth rates (the red bar) as well as with removing wind (the blue bar). When wind is removed from the data from recent years (and thus projected growth rates), the program's trajectory flattens somewhat:




Even with a major reimbursement driver removed from the program, there is prior evidence that the program has surpassed expectations in terms of the portion of state revenues that must be dedicated to it. At program inception, an Ad Valorem Reimbursement Fund was established to reimburse counties for their lost property tax revenue. The fund was supported by a dedicated revenue stream of one percent of net state personal and corporate income tax collections. While this revenue stream was sufficient to support the program reimbursements in its early years, the Fund had insufficient revenues to pay all its obligations in 2003 and has not covered the full cost of the exemptions in any year since.[11]

As it relates to fiscal impacts, there are always concerns where key aspects of a program are administered by local governments but the funding responsibility is borne entirely by the State. Given that the tax liability (local ad valorem taxes) is determined and otherwise collected at the local level, it is hard to devise a workable approach that would not have significant local involvement. It is an issue that

[11] It should be noted that the Legislature has consolidated some other county payments into this fund (Double Homestead and Buffer Strip ad valorem exemptions), which make up approximately 2.5 percent of the total funds paid to date; the shortfall in the fund exceeds the amount of reimbursement for these other county disbursements.

can lead to differing levels of motivation related to the shared responsibilities for program administration.[12]

As with the production tax credit for zero emission (largely wind) facilities, there is significant benefit that will accrue to local governments related to increased property value from the capital investments associated with projects that receive this benefit. That benefit, depending on local decisions related to budgets and levies, may only redistribute the property tax burden rather than actually increase local revenue. Those decisions generally fall outside of the discussion of state policy, at least related to this evaluation.

It has been suggested that this additional assessed value will increase property revenue for local schools – and, based on the way that state school funding is allocated among school districts, may also benefit school districts that do not have wind facilities within their district. This may well be the case, but it does not reduce the size of the State's appropriation to school aid – as with local property taxes, it may simply change how those state dollars are allocated among school districts. As a result, it is an issue with local rather that state budget impact.

One of the requirements of HB2182 is that each evaluation should determine "whether adequate protections are in place to ensure the fiscal impact of the incentive does not increase substantially beyond the state's expectations in future years." From the project team's perspective, the modification of the program to eliminate eligibility for facilities engaged in electric power generation by means of wind was a necessary and appropriate step to help ensure that the fiscal impact does not exceed the State's expectations in future years.

As noted in the chart above, with wind removed from the levels of reimbursement from recent years, the growth trajectory for the program appears manageable, at least in the foreseeable future. That said, in general, some program restrictions on levels of reimbursement (such as a dollar or state per capita or percent of general fund budget reimbursement cap) would provide even greater assurance of reliable levels of future reimbursement. It is also worth considering revisions to the qualifying criteria. The necessary levels of capital investment and change in payroll have remained unchanged for many years; the value to the state of these levels of capital and payroll investment have likely eroded at the same time that the reimbursement levels (associated with local property taxes) have grown. While useful considerations from a programmatic perspective, these types of restrictions are probably not necessary from a fiscal perspective at current levels of program use and reimbursement.

[12] In this respect, it is similar to the issues raised by the Auditor of State reports for the State of Texas' Chapter 313 program, which also relies on local administration for a state-funded incentive.

# Economic Impact

**Economic Impact of Methodology**

Economists use a number of statistics to describe regional economic activity. Four common measures are "Output" which describes total economic activity and is generally equivalent to a firm's gross sales; "Value Added" which equals gross output of an industry or a sector less its intermediate inputs; "Labor Income" which corresponds to wages and benefits; and "Employment" which refers to jobs that have been created in the local economy.

In an input-output analysis of new economic activity, it is useful to distinguish three types of expenditure effects: direct, indirect, and induced.

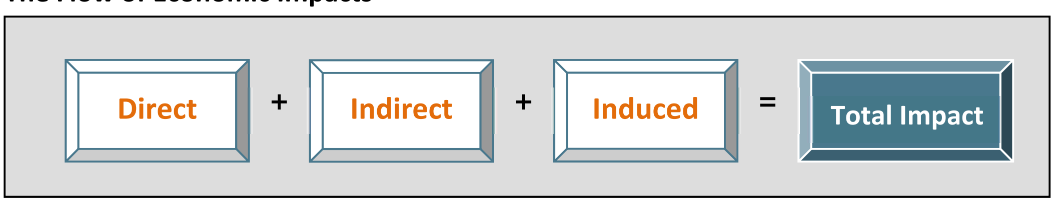
**Direct effects** are production changes associated with the immediate effects or final demand changes. The payment made by an out-of-town visitor to a hotel operator or the taxi fare paid for transportation while in town are examples of direct effects.

**Indirect effects** are production changes in backward-linked industries caused by the changing input needs of directly affected industries – typically, additional purchases to produce additional output. Satisfying the demand for an overnight stay will require the hotel operator to purchase additional cleaning supplies and services. The taxi driver will have to replace the gasoline consumed during the trip from the airport. These downstream purchases affect the economic output of other local merchants.

**Induced effects** are the changes in regional household spending patterns caused by changes in household income generated from the direct and indirect effects. Both the hotel operator and taxi driver experience increased income from the visitor's stay, as do the cleaning supplies outlet and the gas station proprietor. Induced effects capture the way in which increased income is spent in the local economy.

A multiplier reflects the interaction between different sectors of the economy. An output multiplier of 1.4, for example, means that for every $1,000 injected into the economy, all other sectors produce an additional $400 in output. The larger the multiplier, the greater the impact will be in the regional economy.

**The Flow of Economic Impacts**




For this analysis, the project team used the IMPLAN online economic impact model with the dataset for the State of Oklahoma (2014 Model).

**State of Oklahoma Tax Revenue Estimate Methodology**

To provide an "order of magnitude" estimate for state tax revenue attributable to the incentive being evaluated, the project team focused on the ratio of state government tax collections to Oklahoma Gross Domestic Product (GDP). Two datasets were used to derive the ratio: 1) U.S. Department of Commerce

Bureau of Economic Analysis GDP estimates by state;[13] and 2) the Oklahoma Tax Commission's *Annual Report of the Oklahoma Tax Commission* reports.[14] Over the past ten years, the state tax revenue as a percent of state GDP was 5.5 percent.

State of Oklahoma Tax Revenue as a Percent of State GDP

| Year | Oklahoma Tax Revenue* | Oklahoma GDP | Ratio |
|---|---|---|---|
| 2005-06 | $8,435,214,025 | $136,804,000,000 | 6.2% |
| 2006-07 | $8,685,842,682 | $144,171,000,000 | 6.0% |
| 2007-08 | $9,008,981,280 | $155,015,000,000 | 5.8% |
| 2008-09 | $8,783,165,581 | $143,380,000,000 | 6.1% |
| 2009-10 | $7,774,910,000 | $151,318,000,000 | 5.1% |
| 2010-11 | $8,367,871,162 | $165,278,000,000 | 5.1% |
| 2011-12 | $8,998,362,975 | $173,911,000,000 | 5.2% |
| 2012-13 | $9,175,334,979 | $182,447,000,000 | 5.0% |
| 2013-14 | $9,550,183,790 | $190,171,000,000 | 5.0% |
| 2014-15 | $9,778,654,182 | $180,425,000,000 | 5.4% |
| **Average** | **$8,855,852,065** | **$162,292,000,000** | **5.5%** |

Source: U.S. Department of Commerce Bureau of Economic Analysis and Oklahoma Tax Commission

* Gross collections from state-levied taxes, licenses and fees, exclusive of city/county sales and use taxes and county lodging taxes

The value added of an industry, also referred to as gross domestic product (GDP)-by-industry, is the contribution of a private industry or government sector to overall GDP. The components of value added consist of compensation of employees, taxes on production and imports less subsidies, and gross operating surplus. Changes in value added components such as employee compensation have a direct impact on taxes such as income and sales tax. Other tax revenues such as alcoholic beverage and cigarette taxes are also positively correlated to changes in income.

Because of the highly correlated relationship between changes in the GDP by industry and most taxes collected by the state, the ratio of government tax collections to Oklahoma GDP forms the evaluation basis of the fiscal implications of different incentive programs offered by the State. The broader the basis of taxation (i.e., income and sales taxes) the stronger the correlation; with certain taxes on specific activity, such as the gross production (severance) tax, there may be some variation in the ratio year-to-year, although these fluctuations tend to smooth out over a period of several years. This ratio approach is somewhat standard practice, and is consistent with what IMPLAN and other economic modeling software programs use to estimate changes in tax revenue.

[13] http://www.bea.gov/regional/

[14] https://www.ok.gov/tax/Forms_&_Publications/Publications/Annual_Reports/index.html

**Data Collection, Model Inputs, and Other Issues**

The project team performed the following steps to derive the economic and tax revenue impact:

1. The project team collected existing data and studies from State of Oklahoma agencies including the Oklahoma Tax Commission and Oklahoma Department of Commerce.

2. The annual tax incentive data provided by the Oklahoma Tax Commission was separated by the following industry sectors:
    a. Manufacturing
    b. Data Centers
    c. Distribution Centers
    d. Wind Power

3. There was not sufficient detail to determine how much of the spending on real property and personal property was new (ex. existing structure versus new structure) or was purchased from an Oklahoma vendor (ex. was the machinery purchased by applicant made in Oklahoma). Therefore, the impact of constructing the facility and purchasing equipment was excluded from the analysis.

4. The wind power projects were excluded from the analysis because no payroll data was reported in the Oklahoma Tax Commission dataset. In addition, the wind farm impact assessment can be found in the zero emission tax credit assessment.

5. The project team used the *EY 2016 2016 US Investment Monitor*[15] report to convert capital investment (specifically personal property) to direct jobs by industry. This calculation was done because the Oklahoma Tax Commission dataset does not provide information on net new output or net new jobs. Therefore, it was necessary to use capital investment to estimate annual new jobs.

**Estimated Direct New Jobs by Industry by Year Company Entered Program**

| Industry Type | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Computer | 24 | 235 | 105 | 311 | 411 |
| Distribution | 25 | 162 | 40 | 69 | 31 |
| Large Manufacturing | 688 | 440 | 468 | 513 | 459 |
| Traditional Manufacturing | 325 | 427 | 529 | 433 | 940 |
| Wind Electric Power Generation | 0 | 0 | 0 | 0 | 0 |
| Total | 1,062 | 1,264 | 1,142 | 1,325 | 1,842 |

[15] http://www.ey.com/Publication/vwLUAssets/ey-2016-us-investment-monitor/$FILE/ey-2016-us-investment-monitor.pdf

6. Because detailed NACIS code data was not available for manufacturing companies, the project team used a general manufacturing sector that reflected the midpoint of IMPLAN multipliers.

7. The following IMPLAN sectors were used to model the impact:
    a. Manufacturing - 394 All other miscellaneous manufacturing
    b. Data Centers - 432 Internet publishing and broadcasting and web search portals
    c. Distribution Centers - 416 Warehousing and storage

8. The project team calculated the annual economic impact by the year companies entered the program. For example, the 2013 economic impact reflects companies claiming the credit for the first time in 2013 (not all companies receiving the credit in 2013).

9. The project team did not produce a total annual economic impact by year for all qualifying firms. This decision allows the reviewer to assess and analyze the program by year (ex. number of companies by industry) rather than trying to disaggregate a five year figure.

10. The total economic and tax revenue impact of the program in a year would be the sum of companies in the 1st, 2nd, 3rd, 4th, and 5th (final) year of the program.

11. Based on a review of the datasets, companies do leave the program. Typically, the year 1 impact represents the largest economic and tax revenue impact.

**Annual Economic Impact of the Ad Valorem Tax Exemption by Year Companies Entered Program (not all qualifying companies)***

| Year | | Output | Value Added | Labor Income | Employment | Estimated OK Tax Revenue |
|---|---|---|---|---|---|---|
| | | | | | | |
| **2011** | Direct Effect | $189,481,559 | $54,431,214 | $51,541,538 | 1,062 | |
| | Indirect Effect | $189,481,559 | $35,812,632 | $23,309,853 | 439 | |
| | Induced Effect | $56,249,563 | $30,704,756 | $17,382,134 | 425 | |
| | Total Effect | $314,761,520 | $120,948,602 | $92,233,525 | 1,927 | $6,214,492 |
| | | | | | | |
| **2012** | Direct Effect | $305,818,829 | $79,086,483 | $68,584,783 | 1,264 | |
| | Indirect Effect | $150,692,571 | $80,734,826 | $52,775,481 | 1,072 | |
| | Induced Effect | $91,127,383 | $49,744,216 | $28,160,357 | 689 | |
| | Total Effect | $547,638,783 | $209,565,524 | $149,520,621 | 3,025 | $10,610,107 |
| | | | | | | |
| **2013** | Direct Effect | $235,243,437 | $62,687,049 | $58,068,064 | 1,142 | |
| | Indirect Effect | $100,665,811 | $53,142,527 | $34,792,111 | 683 | |
| | Induced Effect | $69,752,983 | $38,076,163 | $21,555,078 | 527 | |
| | Total Effect | $405,662,231 | $153,905,739 | $114,415,253 | 2,353 | $7,963,267 |
| | | | | | | |
| **2014** | Direct Effect | $339,576,887 | $81,114,201 | $72,883,829 | 1,325 | |
| | Indirect Effect | $172,707,037 | $92,588,656 | $60,959,231 | 1,238 | |
| | Induced Effect | $100,482,397 | $54,851,104 | $31,051,350 | 760 | |
| | Total Effect | $612,766,321 | $228,553,962 | $164,894,411 | 3,323 | $11,494,073 |
| | | | | | | |
| **2015** | Direct Effect | $458,067,997 | $108,435,729 | $99,459,190 | 1,842 | |
| | Indirect Effect | $228,690,605 | $122,326,857 | $80,678,259 | 1,630 | |
| | Induced Effect | $135,242,776 | $73,825,969 | $41,793,078 | 1,023 | |
| | Total Effect | $822,001,378 | $304,588,555 | $221,930,526 | 4,494 | $15,296,111 |

Source: TXP, Inc.

* The project team calculated the annual economic impact by the year companies entered the program. For example, the 2013 economic impact reflects companies claiming the credit for the first time in 2013 (not all companies receiving the credit in 2013).

# Technical and Administrative Issues

There are key factors that make administration of this program more complicated than most others. First, this program is required by the Oklahoma Constitution; as a result, the legislature is more limited in how it can (or cannot) modify the program. Without changing the Constitution (which is a more laborious and time-consuming process than changing state statute), there will always be a requirement that 'a qualifying manufacturing concern shall be exempt' from property tax levies on new, expanded or acquired manufacturing facilities for five years. Some of the key terms, such as 'a qualifying manufacturing concern' are also spelled out in the Constitution.

The Constitution provides two primary areas of legislative direction over the program:

1. The Legislature is to define the term 'manufacturing facility' 'in order to promote full employment of labor resources within the state;'

2. The Legislature is to enact laws to carry out the provisions of the exemption and to provide for reimbursement for local governments for revenues lost as result of the exemption

Thus, it is clear that, as long as the Constitution exists in its current form, this exemption will exist – and the State will be responsible for reimbursing local governments for lost revenue from the exemption. From the perspective of state government, this complicates the working relationship between state and local government for the program, as local governments have no real financial responsibility related to the program.

As it relates to the program administration, these are split into the following categories:

- **Application and Eligibility.** The program application has been developed and is maintained by the Oklahoma Tax Commission. It is notable, however, that the completed application must be filed by March 15 of each year with the County Assessor. The form requires information related to the program applicant to determine overall program eligibility. Among the information that must be provided is:

  - Facility physical location
  - Applicable NAICS codes and materials used
  - Employee basic health insurance carrier
  - Property owned at the facility and value claimed as a qualifying investment
  - Payroll at the facility for the year prior to the exemption and estimated for all five years of the exemption
  - Appraisal of personal property eligible for the five-year exemption (replacement cost less normal depreciation)[19]

[19] It should be noted that both tangible and intangible personal property can be used to reach the required initial capital investment of $250,000, but intangible personal property (which is not taxable in Oklahoma beginning January 1, 2013) may not be calculated for purposes of claiming the amount of the ad valorem exemption.

In turn, each County Assessor must file all applications to the Tax Commission by June 15. The County Assessor is responsible for basic determination of the validity of the application (related to the same validation done for the Homestead Exemption). Incomplete applications or applications filed after June 15th are null and void.

While the application seeks payroll information for each year of the exemption, that information must be updated and/or re-filed on a yearly basis. In that respect, the out-year payroll information is not critical to the approval of the application. In that case, it may well be that applicants are not spending a lot of time ensuring that these projections are accurate; if this is the case, it reduces the value of these projections for State estimates of future fiscal impact.

- **Administration of the Exemption**. The Tax Commission is responsible for prescribing forms and promulgating rules for the program. It also has the responsibility for verifying payroll information by using reports from the Oklahoma Employment Security Commission.

- **Program Reimbursement**. Based on claims forwarded by the County Assessors and the eligibility determination done by the Tax Commission, the claims for reimbursement by County are approved and payments made to the eligible local governments.

- **Determining Ongoing Eligibility**. The eligibility for the program is to be established by annually filing an affidavit with the Commission stating that the facility qualifies and providing necessary information (such as payroll information).

- **Program Reporting**. The program provides an annual report that includes data on historical and actual reimbursements by type of property and by county. The report also includes a listing of all approved reimbursements by county and by company, including the amount and year of the exemption.

While there is significant data available for the program, there are also parts of the data that cannot at present be provided because of State confidentiality laws, and they limit the analysis (and thus the usefulness) of the data. For example, the Tax Commission is unable to provide information about the employment and salary data submitted by companies or used in the approval process; this, of course, limits the ability to determine the types and quality of jobs that allow the company to qualify for the exemption. This also limits the ability to determine the extent to which other programs may be having an impact on the same types of jobs.

Second, there is limited availability related to the types of capital investments that qualify for the exemption. Again, this limits the ability to understand what the State is incenting in terms of investment. To use an obvious example, facilities that use wind to generate electricity are known to have little associated employment (and, in fact, that requirement is waived for this program), it is not clear how other forms of capital investment may impact on other direct, indirect and induced economic activity. Finally, the program offers no opportunity to 'clawback' reimbursements if claimed payroll levels are not met in future years – which makes the resulting future year data not particularly useful.

# Outcomes

**Introduction**

The Ad Valorem Tax Exemption for Manufacturers program is one of the larger and longstanding incentives offered by the State. It has a (relatively) clear focus on manufacturing, at least within certain segments and eligibility requirements that focus on increases in payroll with some 'quality jobs' requirements (health care benefits, average wage requirements) and capital investment as well. As a result, the outcomes will focus on how the program does on these metrics, as also developed within the Commission's criteria for evaluation.

At the same time, some of the specificity indicated within the Commission's criteria did not lend themselves to this analysis; because there are so many separate NAICS codes that are eligible (and have received exemptions), and the eligibility criteria differ so much by types of facilities and counties, it is simply not possible within the scope of this project to do the depth of analysis contemplated by some of the criteria. However, there is data available to review key metrics and Oklahoma's performance versus neighboring states with similar programs and the nation as a whole.

**Cost Per Job**

A common metric used with incentive programs is to calculate the 'cost per job' associated with the incentive, in this case, the property tax exemption. This provides some sense of the size of the 'job investment' and how long it might take to 'pay it off.'

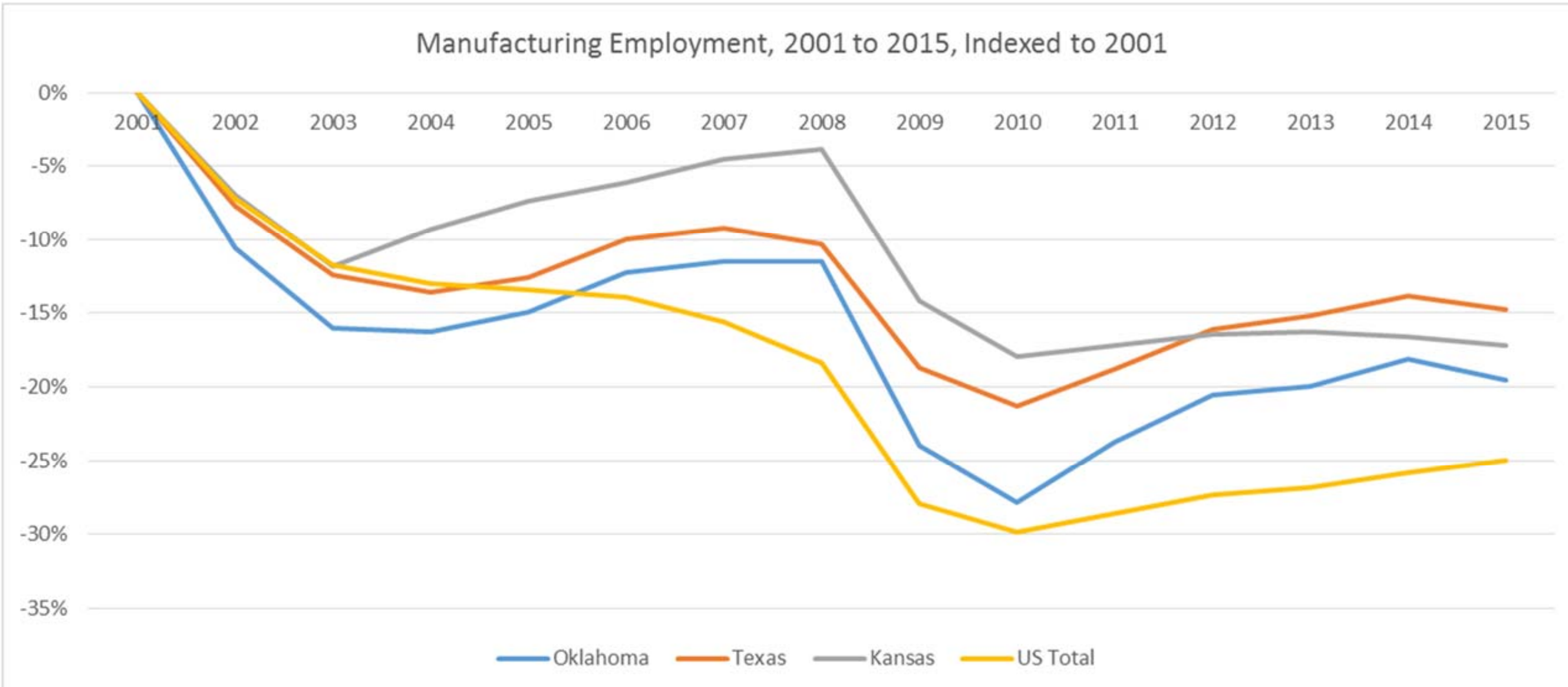
Based on the claimed jobs and reimbursement levels, the average cost per job has varied over the past five years, with no discernable trend. While the cost is certainly not insignificant, it also does not approach the levels of some incentive programs under review, nor does it reach the levels that are encountered in some other states' reviews.

| Year | Reimbursement | Jobs | Cost per Job |
|---|---|---|---|
| 2011 | $37,828,753 | 1,927 | $19,631 |
| 2012 | $46,342,441 | 3,025 | $15,320 |
| 2013 | $64,356,276 | 2,353 | $27,351 |
| 2014 | $67,619,201 | 3,323 | $20,349 |
| 2015 | $80,234,967 | 4,494 | $17,854 |

By contrast, the example provided in the benchmarking of the similar program in the State of Texas is worth noting. That study found that the program cost per job in the period it studied was $306,086 – more than ten times the cost per job to Oklahoma in the highest cost per job year included in this table.

**Manufacturing Employment**

As previously noted, nationally, manufacturing employment has been falling. The following graph suggests that Oklahoma has done better than the national average in this area although not as well as neighboring states with similar incentive programs for manufacturing industries:

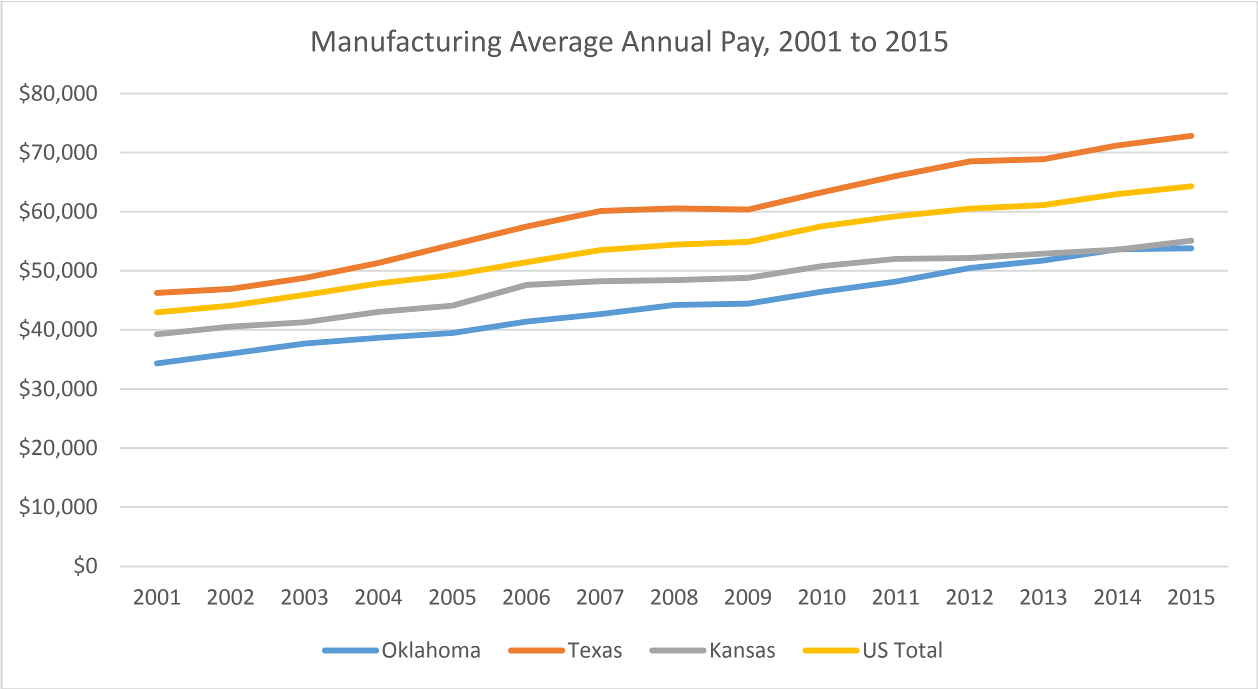



| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Oklahoma | 0% | -11% | -16% | -16% | -15% | -12% | -11% | -11% | -24% | -28% | -24% | -21% | -20% | -18% | -20% |
| Texas | 0% | -8% | -12% | -14% | -13% | -10% | -9% | -10% | -19% | -21% | -19% | -16% | -15% | -14% | -15% |
| Kansas | 0% | -7% | -12% | -9% | -7% | -6% | -5% | -4% | -14% | -18% | -17% | -16% | -16% | -17% | -17% |
| US Total | 0% | -7% | -12% | -13% | -13% | -14% | -16% | -18% | -28% | -30% | -29% | -27% | -27% | -26% | -25% |

For this graph, the y-axis values represent the percent change in total manufacturing wages in that year compared to 2001 levels. For example, the 2015 value represents the percent change from 2001 to 2015.

**Manufacturing Average Pay**

As it relates to manufacturing average pay, Oklahoma has done somewhat better with its comparison states:




| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Oklahoma | $34,329 | $35,973 | $37,680 | $38,650 | $39,462 | $41,383 | $42,659 | $44,199 | $44,427 | $46,449 | $48,163 | $50,453 | $51,724 | $53,621 | $53,792 |
| Texas | $46,241 | $46,898 | $48,771 | $51,328 | $54,402 | $57,470 | $60,109 | $60,543 | $60,351 | $63,266 | $66,032 | $68,491 | $68,868 | $71,189 | $72,829 |
| Kansas | $39,238 | $40,539 | $41,279 | $43,030 | $44,087 | $47,577 | $48,213 | $48,396 | $48,770 | $50,791 | $52,010 | $52,141 | $52,888 | $53,558 | $55,087 |
| US Total | $42,969 | $44,097 | $45,916 | $47,861 | $49,287 | $51,427 | $53,489 | $54,400 | $54,873 | $57,526 | $59,210 | $60,496 | $61,102 | $62,976 | $64,305 |

**Manufacturing Total Wages**

In this category, Oklahoma is also showing better progress than the nation as a whole:


For this graph, the y-axis values represent the percent change in total manufacturing wages in that year compared to 2001 levels. For example, the 2015 value represents the percent change from 2001 to 2015.

Of course, averages are an imperfect way to judge the direct impacts of this program. The data presented here and in the annual report on actual use suggest that it has a widespread use around the State. The criteria generally align with incentive best practices in terms of areas of focus.

There are also, without a doubt, important contributions from the program to local economies – which are, after all, what make up the State economy as a whole. Besides supporting key job generating businesses, it also (especially as it relates to requirements for capital investment) creates a larger property tax base for local governments.

One of the challenges for a statewide program evaluation is how to weigh those local benefits when it is statewide tax dollars that support the program. As already noted, the significant capital investment associated with these manufacturing facilities increases the overall assessed value of property within a taxing jurisdiction, and in some cases the change is substantial. This provides for a broader base upon which the property tax levy is applied. However, the benefits of that expanded property tax base are primarily local, and, depending on local decisions related to budgets and levies, it may only redistribute the property tax burden rather than actually increase local tax revenue. Those decisions generally fall outside of the discussion of state policy (and are mostly beyond the control of state policymakers), at least related to this evaluation.

It has been suggested that this additional assessed value will increase property revenue for local schools – and, based on the way that state school funding is allocated among school districts, may also benefit school districts that do not have similarly large facilities within their district. This may well be the case, but it does not reduce the size of the State's appropriation to school aid – as with local property taxes, it may simply change how those state dollars are allocated among school districts. As a result, it is an issue with local rather that State budget impact.

**Cost Benefit Analysis**

When comparing the costs to the benefits from a purely state quantitative perspective, the initial costs outweigh the benefits. One of the challenges for any analysis of this type is the fact that there are inevitably start-up costs that will take time to overcome – this is often the private sector issue that would prevent development without support, and it is the case for the public sector as well.

In the case of this incentive, one factor in its favor is the length of time of the incentive: five years is significantly shorter than some similar programs in other states (where the benefit may stretch for up to 10 years). The shorter the time of the incentive, the less risk (and investment) on the part of the State, and the quicker the opportunity to start recouping some of that investment in (it is hoped) corporate tax revenue. The shorter timeframe for the incentive also lessens time value of money issues. On the other hand, the fact that the State is providing the full value of the exemption should also be taken into consideration: often it is viewed as 'best practice' for local government to have some 'skin in the game' as it relates to incentives (of course, it is possible that local incentives will also be a part of an overall package).

The analysis conducted by the project team suggests that over a 10-year horizon, the average incentive related to this program will be neutral or a net benefit to the State, even without including other qualitative or local quantitative impacts.

# Recommendation

**Recommendations for the Commission: Retain**

As previously noted, the Manufacturer's Tax Exemption is atypical, in that its existence is included in the State Constitution. As a result, it is far more difficult to alter or eliminate than programs enacted by the General Assembly and placed into state statute.

Manufacturer's exemptions are widely used around the country, for logical reasons. While the manufacturing sector as a whole has seen employment contractions, industry output is still strong, and it makes up nearly one-tenth of the Oklahoma gross state product. Wages in the manufacturing sector also tend to be higher than the statewide averages.

While the requirement that the State bear the full cost of the exemption is embedded in the Constitution – and thus unlikely to change, it is notable that some of the features of the program stack up well to other state comparisons. For example, the 5-year exemption is shorter than the more common 10-year period for the exemption. In this respect, the State benefits from a shorter time for the exemption and a quicker time to recover tax revenue based on new economic activity once the exemption ends.

The program also has specific requirements related to capital investment, additional payroll and health insurance benefits – as well as requiring wages to be above certain requirements. Each of these helps ensure the program is targeted at certain levels of investment/engagement in return for the incentive.

The program has also benefitted from the recent legislative change that will limit its use going forward for electric generating facilities using wind. These facilities were a significant component of recent exemptions, and their removal will flatten the trajectory for the program going forward. Based on that change, the project team believes that, at least for the next four-year period, the exemption should be manageable.

Within the broad framework and administration of the program, the following key elements (which were described in the Texas State Auditor's report) are worth noting:

- **A clear purpose of expected outcomes.** The Constitution indicates that it is to induce any manufacturing concern to locate or expand manufacturing facilities within any county of the State. The program use, jobs created and number of counties participating would suggest that it has accomplished these outcomes – the extent of which is a discussion from the cost benefit analysis.

- **Metrics for achieving the outcomes.** Eligibility metrics focus on payroll, benefits (health insurance) and capital investment. There is also some requirement that jobs generally be non-minimum wage jobs. There was some 'mixed message' related to payroll for electricity generating facilities using wind, but that exception will be eliminated going forward in 2017. There are, however, concerns about measuring some aspects of the program related to types of jobs and types of capital investment that make this harder to determine than in some other areas.

It is notable, however, that the metrics within the program have remained in place for many years. The requirements for capital investment or additional payroll may no longer represent the magnitude of investment that should be needed for a major state incentive program. On the other hand, indexing requirements can create less certainty about project requirements and substitute unusual metrics for what are currently readily understood (and remembered) hurdles. If changes are to be made, it would make sense to make those changes in major increments spaced well apart to maintain some sense of program requirements stability.

- **Timeframe for achieving the purpose**. As previously noted, the program has a shorter window for the property tax exemption than most. There is not, however, a specific 'payback analysis' required (in terms of jobs, economic activity or revenue gains).

- **Funding limits**. This is another area where the State Constitution does not contemplate a funding limit – it requires that the program be in place and that the State reimburse local governments for the foregone revenue. The one area where the Legislature can, to some extent, limit the scope of the program is in determining what is an eligible 'manufacturing facility' – although even here the Constitution provides guidance that the definition is 'in order to promote full employment of labor resources within the State.'

- **Competitive and open award selection process.** The program is not a competitive award process; rather, those companies that meet the criteria receive the exemption.

- **Clawbacks.** There is a provision in statute that should companies fail to meet the eligibility requirements (such as around created payroll), they may be removed from the program and/or be responsible for paying back awarded exemptions. It is notable that, from year to year, there are companies that have received the exemption in earlier years (of the five year eligibility period) who do not receive the exemption for subsequent years. That said, companies that do not qualify for the program from year to year are not required to reimburse the State for the exemption they received in prior years. This is not the case in some state programs.

- **Transparency.** The program annual report provides the totals for the program by industry type, by county and, within each county, by company name, amount of the exemption and year (one through five) of the exemption.

- **Regular independent audits.** There have been prior studies conducted related to the program, including a 2006 study by the State Legislature's Incentive Review Committee. There is an expectation that the Incentive Evaluation Commission will provide an opportunity to continuous review of this and other incentive programs.

Based on this discussion, the project team recommends that the program be retained. The project team also supports the Legislature's decision to remove program eligibility going forward for facilities generating electricity from wind effective January 1, 2017.

The project team also recommends that the program be reconfigured to make it more useful for future evaluation. To do so, confidentiality requirements related to certain information should be waived by participating companies as it relates to the program evaluations conducted by the Incentive Evaluation Commission (of course, with appropriate non-disclosure agreements in place and with no otherwise confidential information subject to FOIA requests or other public disclosure). The project team would recommend that the data to be collected from applicants and available for evaluation include:

- NAICS Code – 4 to 6 digit
- Capital investment (real and BPP)
- Existing payroll
- Net new payroll
- Existing jobs
- Net new jobs