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ALL GO IN THE GO ZONE? The Efficacy of Post-disaster Tax Incentives

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In 2005, the federal government created the Gulf Opportunity (GO) Zone to spur Gulf Coast recovery. The GO Zone designation gave these hurricane-affected areas special tax incentives and the authority to issue tax-exempt bonds. State and federal policy makers favor such geographically targeted tax incentives believing that they stimulate economic development. However, evaluations of the success of other similar approaches show mixed results. While it is too early to assess the GO Zone directly, the performance of other federal zones offers some guidance on the overall effectiveness of tax incentive programs.

TAX INCENTIVE PROGRAMS IN NEW ORLEANS

Tax incentive programs date from the early 1980s when states began creating "enterprise zones," offering tax breaks, subsidies, and reduced regulations to attract businesses to economically depressed areas.[1] The federal government followed suit in 1993 with Empowerment Zones (EZs) and Enterprise Communities (ECs), which it awarded to select cities to "help reduce unemployment and revitalize economically distressed areas."[2] In 2001 Congress introduced the Renewal Community (RC), a variation on EZs and ECs. While RCs offer many of the same tax incentives as EZs and ECs, RCs also require localities to suspend or reduce regulations and zoning requirements affecting business development.[3]

New Orleans is home to two federal tax incentive programs—the Renewal Community (RC) and the Gulf Opportunity Zone (GO Zone)—as well as numerous state and local ones. These programs offer tax credits to and reduce regulations on businesses that locate in the zone. In addition, the GO Zone program also gives other incentives to aid disaster recovery, such as credits for debris removal and infrastructure rehabilitation.

USE OF RC CREDITS

Business usage of RC credits in New Orleans has been modest. In 2005, about 225 businesses claimed wage credits for 600 employees. New Orleans' RC report to the Department of Housing and Urban Development attributes 75 new jobs since 2002 to the wage credit, 20 to the Work Opportunity Tax Credit, and 83 to the Commercial Revitalization Deduction and estimates the total savings to businesses to be $21 million.[4] The RC report further indicates that New Orleans met its eligibility requirements by increasing the Neighborhood Watch to reduce crime, marketing credits to businesses, and expediting licensing and permitting for individual applicants, but it is unclear to what extent the government actually reduced regulations within the RC.

EVALUATION

There are two obstacles to evaluating tax incentives: a lack of data on how tax credits are spent and the difficulty of isolating the tax credit's impact on recovery from other factors (i.e., would firms have located in the zone anyway, in the absence of these credits?).

Studies of state-level enterprise zones offer mixed results. Some studies conclude zone incentives promote business development and lower unemployment. Other studies show zone incentives produce little to no change in employment, income, or growth but instead serve as after-the-fact subsidies to businesses. The structure of incentives can inadvertently favor certain industries, leading to the government "picking industrial winners and losers" in the dark.[5] States may also use credits to pick winners advertently. For example, Louisiana offers specific tax credits to the film industry.

There are few comprehensive evaluations of federal zones. In the case of EZs/ECs, poor data collection makes it impossible to determine how many businesses have claimed credits or how businesses have used them. Studies attempting to assess the overall impact of EZs in spite of limited data find some zones experienced economic growth as well as decreased poverty and unemployment, but the studies could not link these findings directly to the zone programs.[6]

There are several explanations for why tax incentive programs in New Orleans may not be effective:

Tax breaks alone do not drive business decisions. Though the overall tax climate is an important factor facing firms, evidence suggests that more than targeted tax breaks drive the bulk of firms' location decisions. Businesses often cite workforce quality and proximity to transportation networks as two of the most important factors in locating a business.

"Picking winners." It is impossible for development officials to know what products or services are necessary to stimulate investment and long-term development in normal circumstances, let alone what specific jobs or sectors will be successful in an area devastated by natural disaster. Tax incentives function as a form of industrial policy with the state targeting "favored" industries. Businesses with large amounts of intangible property (such as those in certain high-tech industries) are also ineligible for the credits even as cities like New Orleans try to use other programs to attract such industries—particularly pharmaceuticals.

Geographic specificity. The New Orleans RC is highly specific geographically. This is intended to focus development in areas of New Orleans that need renewal most. Evidence suggests this is often ineffective in practice. For example, an employee working in the RC, but living elsewhere, may not be claimed for wage credits. As a result, businesses may be discouraged from making the best hiring choices because they are trying to satisfy the program's hiring criteria.

Diversion of resources. Tax incentive programs may lead businesses to invest resources in obtaining credits rather than in productive activity. Industry specific tax incentives may also encourage "smokestack chasing," wherein states compete by offering increasingly more generous incentives. This "bidding war" (such as the tax incentive competition that occurred between Louisiana and Alabama for a ThyssenKrupp plant in 2007) creates an unhealthy precedent. The bidding war may not change the corporation's location's decision, but it does let the corporation know that it has the power to influence the rules to its own advantage.

Complexity. New Orleans has multiple redundant and overlapping tax incentive programs that create a patchwork of different area-specific credits covering a large portion of the city. Figure 1 illustrates the complexity of these numerous, overlapping tax credits. Businesses have a hard time figuring out whether, and for which credits, they are eligible. Large firms might even benefit more from credits than small firms since they can afford professional tax advice.

RECOMMENDATIONS

The GO Zone is an improvement over previous tax incentive zone programs in that its wide geographic boundaries are superior to the narrow focus of other programs. However as the program's incentives tend to benefit certain types of businesses, the GO Zone also suffers from many of the same weaknesses as earlier geographic tax zones. To be effective, any revision to tax incentive programs in New Orleans should be consistent and non-discriminatory. Specifically, the programs should:

Institute real regulatory reform. The Renewal Community attempts to reduce onerous regulations on eligible businesses in the zone, but it is unclear the extent to which this has been done on more than a case-by-case basis. Economic develop-

FIGURE 1—TAX CREDITS

STATE INCENTIVE PROGRAMS

ENTERPRISE ZONE PROGRAM

Franchise Tax Credit
Provides a credit of $2,500 ($5,000 if aerospace or auto manufacturing) per employee hired within the EZ.

Sales Tax Rebate
Abates sales/use tax on plant and equipment purchased and used exclusively within the EZ.

Refundable Investment Tax Credit
A credit equal to 1.5% of the capitalized investment (for Federal Income Tax purposes) minus plant and assets exempt under sales/use tax.

Commercial Revitalization Cost Deduction.
Allows businesses looking for land to deduct clean up costs for hazardous substances.

Welfare to Work Credit
Up to $3,500 for the first year and $5,000 for the second year of each new hire of someone on long-term family assistance.

FEDERAL INCENTIVE PROGRAMS

RENEWAL COMMUNITY

New Markets Tax Credit
Investors in qualified projects can obtain a tax credit of 5–6 % of the amount invested for each of the years the investment is held, for up to seven years.

Work Opportunity Tax Credit
Up to $2,400 for employees hired from groups that have high unemployment rates.

Low-Income Housing Credit
Ten-year credit for owners of newly constructed or renovated rental housing who set aside a number of units for low-income residents.

Increased Section 179 Expensing
Allows businesses to take an additional deduction of up to $35,000 on equipment purchases.

Zero Percent Capital Gains Rate
Any business that holds an asset for at least five years does not have to pay taxes on profit gained from the asset's sale.

Qualified Zone Academy Bonds
State or local governments can issue no interest bonds to finance certain public school programs.

Wage Credit
$1,500 or 15% of an employee's salary up to $10,000 per employee who lives and works in the renewal community.

GULF OPPORTUNITY ZONE

New Markets Tax Credit
GO Zone Act expanded the New Market Tax Credit program by $700 million for additional credits between 2005–2007.

Work Opportunity Tax Credit
KETRA (Katrina Emergency Tax Relief Act) allows "Hurricane Katrina employees" to count towards Work Opportunity Tax Credits.

Low-Income Housing Credit
Applies new rules for eligibility and increases the cap for each individual eligible for low-income housing credits from $1.80 per resident to $18.00 per resident.

Increased Section 179 Expensing
Increases the normal $108,000 maximum amount that a taxpayer may elect to deduct under Section 179 by $100,000 for 2006–2007.

Increased Tax Credit For Rehabilitation Expenditures
Increases historic rehabilitation expenditures tax credit from 20% to 26% provided the rehabilitation on such buildings are incurred between August 28, 2005 and January 1, 2009.

Cleanup, Remediation, and Timber Reforestation Tax Abatement
Taxpayers in a trade or business may claim a 50% deduction for costs paid or incurred in the GO Zone on or after August 28, 2005 and before January 1, 2008 if those costs were incurred to clean up and remove debris from real property or to demolish structures.

GO Zone Bonus Depreciation
Allows an additional depreciation deduction equal to 50% of the depreciable basis of qualified Gulf Zone property for the first year the property is placed in service, so long as the property is placed in service after August 28, 2005.

OTHER STATE ADMINISTERED CREDITS

Historic Tax Abatement Credit (Historic District)
Historic properties may freeze assessed value in order to make improvements on the property. Pre-improvement assessment taxes can then be used for up to five years.

State Historic Tax Credit
Tax credits up to $5 million available for historic properties for renovations or improvements.

ment programs should provide all businesses with regulatory relief, equally and impartially throughout the entire city. Doing so would be an important step in creating a vibrant entrepreneurial climate.

Not condition credits on employee residence. Employers should be free to hire employees with the right mix of skills. The GO Zone and the RC both condition wage credits on whether the employee lives in the zone. This may force firms to make less than adequate hiring choices. The RC tries to serve two goals—economic (stimulating business) and social (lowering unemployment in distressed areas)—and these goals may work against one another. Allowing businesses to make unconstrained hiring choices is more likely to produce sustainable economic development that improves the condition of the entire city and creates opportunities for all residents.

CONCLUSION

The best tax environment for business is one that is broad and neutral, both geographically and conceptually. Though the GO Zone represents a significant improvement, it did not go far enough—especially given the scale of damage caused by Hurricanes Katrina and Rita. A better approach to economic development is to create an environment conducive to stable and sustainable growth that offers a level playing field for individuals and firms seeking to rebuild after a disaster. This means lowering taxes and regulations across the board and not conditioning credits on individual firms' hiring decisions, asset composition, or business operations.

ENDNOTES

1. The concept of enterprise zones was first implemented in the United Kingdom in 1978. See Peter Hall, "Green Fields and Gray Area" (Address to the Royal Town Planning Institute Annual Conference, Chester, UK, June 15, 1977).
2. There have been three rounds of EZ/EC designations. Currently there are 40 empowerment zones and 66 enterprise communities; most are set to expire in 2009.
3. An RC must agree to reduce or suspend at least four of the following: a) licensing requirements for occupations that do not ordinarily require a professional degree; b) zoning restrictions on home-based businesses that do not create a public nuisance; c) permit requirements for street vendors who do not create a public nuisance; d) zoning or other restrictions that impede the formation of schools or childcare centers; and e) franchise or other restrictions on competition for businesses providing public services, including taxicabs, jitneys, cable television, or trash hauling.
4. New Orleans LA Renewal Community, *Renewal Community Annual Report*, report prepared for Office of Community Planning and Development, Department of Housing and Urban Development, (2005). http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/tour/la/neworleans/ (last visited February 4, 2008).
5. Alan H. Peters and Peter S. Fisher, *State Enterprise Zone Programs: Have They Worked?* (Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research, 2002), 100.
6. Government Accountability Office, *Empowerment Zone and Enterprise Community Program: Improvements Occurred in Communities, but the Effect of the Program is Unclear.* GAO-06-727 (Washington, DC: GAO, 2006), 25. GAO found that the IRS collects some data on EZ businesses' use of tax credits for employing EZ residents, but the data cannot be separated to show how much was claimed in individual EZs. Also, taxpayers are not required to report the expensing deduction for depreciable property as a separate line item on their returns.

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