Tax Expenditure Review Working Group

DECD Response to Questions – 10/8/21

Senator Libby, Representative Terry and members of the Tax Expenditure Review working group, my name is Phoenix McLaughlin, and I am the Tax Incentive Policy Manager for the Department of Economic and Community Development. I am also joined on this call by Charlotte Mace, Director of the Office of Business Development. I am here today to respond to the working group’s request for feedback on three questions regarding the tax expenditure review process.

The first is what about the process is working well. On this question, it goes without saying that OPEGA produces incredibly thorough reports. Few government offices do as good a job at taking such a detailed look at a program while making it understandable to the public. Many of these programs are complex, and sometimes the full picture of how they are operationalized is only clear to the handful of staff who administer them. Diving into the statutory requirements as well as the day-to-day practical implementation of a program is not easy work, but OPEGA does it well.

OPEGA’s thorough research has led to tangible improvements in the function of tax expenditure programs in the past. For example, their 2017 report on the Pine Tree Development Zone program, which I now manage, led to the Legislature updating statute to require that a business first demonstrate they have hired the required employee before they are able to access certain benefits. Their eye for potential program pitfalls can be valuable for protecting public funds.

The rigor of OPEGA’s reviews ensures a level of transparency that is a benefit in and of itself. The Legislature and the broader public are regularly provided with an in-depth look at some of the ways taxpayer funds are spent (or revenue is foregone). Whether a program is found to be without major issue or in need of reform, people can know that there is an additional layer of protection for this type of use of State money.

In the course of doing such expansive research for the Legislature, OPEGA staff has always been good to work with—courteous and professional, despite the workload and tight timelines that this group has discussed. This was the first point that came up when I was talking with other DECD staff about what we wanted to share with this working group. OPEGA staff are clearly dedicated and doing a great service for the State.

The next question is what challenges the expenditure review structure creates. A major substantive issue is the prescription that each tax expenditure receives its own review. This means that many programs that often work in tandem have to be split up and looked at separately, with reviews coming years apart. The expectation for business support programs is often that OPEGA should establish what investment and economic activity can be attributed directly to the specific program. This is a very difficult task in the best of circumstances, but it is near impossible when looking at one program in isolation. As stated in previous testimonies, when adding employees or investing in new areas, businesses often partake in multiple State programs, including tax benefits, grants, and in-kind assistance. There is no rigorous way to separate out the effect of only one of the programs they use in those circumstances.

The other problem this approach creates is that it induces a narrowly focused policy process. As tax expenditures are reviewed one-by-one, the underlying policies are likewise updated one-by-one. A more holistic approach to reforming policy is de-emphasized. There is less opportunity to look at the broader picture of a policy category like small business assistance, for example, which may lead to more impactful changes. There is still that opportunity in other forums, namely the policy committees, but the policy analysis and accountability perspective of OPEGA is not applied in the same way. Instead, programs receive narrower, although still valuable updates to issues like data collection and benefit timelines.

That brings us to the final question, ideas for change and improvement. One option for economic development tax expenditures would be to shift some of the work to a third-party review that DECD is required to obtain. As discussed at the last meeting, statute requires that DECD hire a third party to review our economic development programs. The Department’s first attempt to issue that RFP only returned proposals that exceeded the budget allowed in statute for this review. However, we are hopeful that we can adjust the scope of work to bring proposals in within the budget cap. That review would produce a progress report in 2023 and a full report in 2025, both looking at the full breadth of “state economic development investments”. We are working on updating the RFP and hope to have it reissued soon.

The third-party review could allow for a more effective division of labor. Already required and funded by statute, this review could dive into the weeds of the state’s economic development programs, including those that are tax expenditures. The oversight and taxation committees, along with OPEGA, could reorient the tax expenditure review schedules and scopes of work with the independent review in mind, ideally freeing up some of the time burden on legislative committee members and staff. Economic development tax expenditures would then have a dedicated review process through the third-party review without requiring OPEGA to sort through the data of each program on a constant cycle.

DECD is happy to continue discussions with the working group and OPEGA to identify an effective and sustainable way to review the state’s tax expenditures. I am happy to answer any questions you have at this time. Thank you very much.