Risky Business: New Jersey Must Hold Corporations More Accountable in Subsidy Deals

Tougher Standard in Economic Benefits Test is an Essential Taxpayer Protection

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As New Jersey continues to award record-setting tax subsidies to businesses in a failed attempt to grow the state’s economy, it has drastically lowered the standards corporations must meet to qualify for a tax break. Nowhere is this more evident than in the state’s special treatment for the city of Camden, where the bar for determining whether a subsidy will result in “net benefits” to the economy has been set so low that New Jersey is now approving deals with major financial risks to taxpayers.

This bar – called the “net benefits test” – estimates how much New Jersey taxpayers stand to benefit from any proposed subsidy deal, compared to the amount of tax revenue the state would lose through future credits to a company. If the company “passes” this test, the deal can be approved. But that alone doesn’t mean it’s a good deal for taxpayers.

While the state touts a net economic benefit of $308 million from nine deals it has approved in Camden in the past 17 months under the Grow New Jersey program, the reality is that New Jersey is at risk of losing $97 million on the deals because of loose language in the law governing Camden subsidies.¹

[Table: Lopsided Net Benefits Test for Camden Tax Breaks Puts State at Risk]

New Jersey’s Own Estimates Warn of Potential Loss from 9 Camden Deals Combined

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<th>Benefit to Taxpayers</th>
<th>Loss to Taxpayers</th>
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<td>$308M Net Benefit</td>
<td>$97M Net Loss</td>
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Over 35 Years

Over 15 Years

Source: NJPP analysis of NJ EDA Net Benefits Tests

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To mitigate this risk, New Jersey policymakers need to revise the law governing the state’s tax subsidies so that the calculation of taxpayer benefits is matched to the number of years a corporation is required to provide the jobs and the investment it promises. Currently, taxpayer benefits are estimated for up to 35 years, while corporations only have to uphold their end of the bargain for, at most, 15 years.

This simple reform would quickly and easily reduce the recklessness of the state’s business tax subsidy boom – although it would not change the fact that these types of tax breaks are ineffective and unproven ways to grow the state’s economy.²

**Camden Becomes Focus Under Subsidy Revisions**

Since legislation overhauling New Jersey’s business tax subsidies went into effect³ – written to heavily favor projects in Camden in particular – nine new tax breaks for jobs and capital investment were approved in the city. The amount awarded totals $631 million, including blockbuster nine-figure deals for Holtec International ($260 million), Subaru ($118 million) and Lockheed Martin ($107 million).

These Camden-specific subsidies have come at a great cost to taxpayers – $300,000 per job, or $896,000 when considering only jobs that are new to the state. As a comparison, in 2014 the cost per job for all business tax subsidies approved across the state – including these Camden deals – was $79,000, which was already a record level and far higher than the cost of $18,000 per job just five years earlier, in 2009.
Compared to subsidy deals elsewhere in the state, the Camden tax breaks are notably more focused on keeping existing – labeled as “at-risk” – jobs in New Jersey or shifting jobs around the region rather than creating new job opportunities. Sixty-seven percent of the jobs tied to Camden tax breaks are considered “retained” jobs rather than “new” ones – a far higher share than the 44 percent overall since January 2010, and the 25 percent in the 2000s.

And even these discouraging numbers undercount the lack of new regional investment being generated by these deals. Only 71 of the 2,102 jobs – 3 percent – are being brought to New Jersey from outside our region. The rest of the so-called “new” jobs are either existing and currently-filled jobs being brought to Camden from Philadelphia (as is the case with the 250 jobs in the 76ers deal), or new jobs that companies already in New Jersey say they will create in coming years. While some of these “new” jobs may indeed have only been created in New Jersey as a direct result of the tax subsidy, many would likely have been created anyway in the regular course of business growth.

**Net Benefit or Net Loss?**

Taken together, the state estimates that the $631 million of tax breaks in these nine deals could produce a total of $988 million in economic benefits – through increased income, sales and property tax collections, as well as economic ripple effects that the promised jobs and investment would theoretically bring to the state. But the economic benefits could actually be as low as $534 million – $97 million less than the amount of the overall tax subsidy – if the companies did
nothing more than fulfill all their contractual requirements, according to the state’s own calculations.

Here’s why:

When a corporation applies for a tax subsidy from New Jersey, the state Economic Development Authority (EDA) takes a variety of inputs – like the number of proposed jobs, their promised wages and other factors – and runs them through a formula designed to estimate the economic benefits to the state. This is the aforementioned “net benefits test.”

Before 2013 legislation overhauling New Jersey’s subsidies, in order to be approved for a tax break, a Grow New Jersey project would need to deliver a benefit to the state of at least 110 percent – in other words, 10 percent more than the dollar value of the subsidy – over the same period (usually 15 years) that the company was committed to keeping the jobs in-state. If the corporation didn’t meet those promised obligations, it would receive less of a tax break, or none at all.

But now, a project in Camden need only deliver a 100 percent benefit – in other words, break even – over 35 years. And the corporation is obligated to deliver the proposed jobs and economic activity for, at most, only 15 years. After that, it can move, slash its workforce, cut pay across the board, or threaten to move in order to receive yet another tax break – and the state would have no recourse to claw back any of the tax credits that had already been claimed.

And Camden isn’t the only area where a corporation could receive an incredibly lopsided benefit. In the four other cities the state considers to be most distressed – Atlantic City, Passaic, Paterson and Trenton⁴ – a project’s benefits must equal 110 percent of the tax break but are estimated over 30 years, which still creates a significant imbalance between taxpayer and corporate interests.

To date, the number and size of deals in Camden has far outpaced those in these other cities, which together have seen just four projects approved for $70 million in subsidies. This is in part due to the singularly preferential treatment Camden projects receive under the revised programs. But it also is likely due to Camden’s unique location (a port city right across the river from

35 Years is Far Too Long a Horizon

In 1979, the Philadelphia 76ers – led by “Dr. J” Julius Erving – began a basketball season that would lead the team to the NBA finals, where it would ultimately lose to a Los Angeles Lakers team featuring standout rookie Magic Johnson.

Like the eight other companies that have received Grow New Jersey tax subsidies to locate in Camden, the 76ers was a very different business back then. In fact, one third of the companies receiving these tax breaks didn’t even exist in 1979. Those that did exist quite obviously were doing business differently, long before the commercial internet, widespread cell and smart phone usage and other technological advancements that have dramatically and fundamentally changed the business world.

Given how much has changed in the past 35 years, it is a mystery why New Jersey believes it can accurately predict what these nine businesses will be doing in the next 35 years. And it’s irresponsible to pledge taxpayer dollars to corporations based on the state’s estimates of those companies’ behavior up to and in 2049, particularly when the most uncertain timeframe in question – from 2030 on – is a time in which the companies are no longer accountable to the state for its actions.
Philadelphia), other policy changes undertaken first (the merger of the county and city police forces) and the fact that the city has a very vocal, powerful and connected player working on its behalf (George Norcross).

A Closer Look: Holtec Promises Thousands of Jobs But is Accountable for Only a Few Hundred

The largest deal for Camden so far is the $260 million award to Holtec International, which makes parts and systems for the energy industry, to build a manufacturing and engineering complex along the Delaware River. In announcing the deal, Holtec said it would employ at least 3,000 at the facility within five years of opening. While supporters of New Jersey’s subsidy offerings have widely touted this promise of thousands of jobs, the company’s deal with the state requires that it have only 395 jobs at the facility to qualify for the full benefit of the tax break.

It’s clear that Holtec’s obligation is as minimal as possible under the requirements of the Grow New Jersey program. Over a 35-year time span, in fact, the state’s own net benefits test projected the deal would only generate a slim $155,000 net economic benefit to the state. So even if Holtec stayed in Camden with the obligated levels of employment for 34 years, the taxpayers would lose – a loss that gets larger and larger when estimated over 30, 20 or 15 years.

When pressed about this mismatch and the inherent risk it creates, the Economic Development Authority has rightly cited the legislature for writing the law that way, but has also justified it based on the large scale of the project. “You don’t invest $250 million into a plant and then leave in 10 years,” EDA president and COO Tim Lizura said earlier this year. “If business is viable, they will still be using that plant in 30, 40 years.”
Lizura’s comment fails to take into account that the company actually isn’t investing $250 million, since its capital investment costs will be covered entirely by New Jersey’s tax break in just 10 years. More to the point, while Holtec’s new facility is indeed a massive undertaking, and it seems unlikely they would just abandon it after 15 years, it is not beyond the realm of possibility. Think back 35 years to 1980 and how sensible a major investment in a Kodak film factory or a Yugo car dealership would have seemed. The state of New Jersey should not be in the position of using taxpayer dollars to take a gamble on whether a business will be “viable” in 35 years.

If the net benefits test was reformed to be fairer to taxpayers, Holtec would be on the hook for all 3,000 jobs it has promised. Taxpayers wouldn’t just be relying on a hope and a prayer that they’ll deliver. If the EDA’s estimates were revised to have Holtec creating 3,000 permanent jobs, instead of 395, the projection would be for a $32 million net benefit to the state over 15 years, or a 112 percent total return on the $260 million investment of taxpayer money.

**The Net Benefits Test Has Other Major Flaws**

While fixing the net benefits test is an important and commonsense step to prevent New Jersey from making bad deals that put almost all the risk on taxpayers, the test itself has many other major flaws.

While the test is a laudable attempt to gauge the impact of subsidies and provides reasonable approximations of some direct and indirect economic activity they are anticipated to produce, it ignores a number of important factors and simply cannot account for certain variables.

*It can’t predict what would happen if no subsidy were awarded*

Applications for Grow New Jersey subsidies require that corporations demonstrate that the tax break is a “material factor” to the company’s decision. However, there is no way to determine the accuracy of these statements. Given the evidence that tax breaks and rates are rarely the drivers of location decisions, there is certainly reason for strong skepticism. For instance, New Jersey’s Office of Legislative Services (OLS) has noted that “it is not possible to know the decision that a business would have made [if a subsidy were not offered].”

Yet despite the inability to accurately predict the economic impact of zero subsidy, the test goes ahead and predicts it anyway, by assuming that the lack of a subsidy equals no economic activity within the borders of New Jersey.

*It fails to see the economic forest for one single tree*

The net benefits test focuses on the economic behavior of just one company – a tree in a dense forest made up of hundreds of thousands of companies in New Jersey alone. In other words, even
if a company leaves the state due to the lack of subsidy, all economic activity related to that company, its employees and its property does not disappear.

“When a company leaves the state and leaves behind 100 unemployed persons and vacant property, the state will not experience a permanent reduction in revenue equal to all of the collections associated with that business,” OLS explains. “Eventually another use will be developed for the property and the unemployed state residents will eventually find new jobs or start new businesses of their own.”

In other words, it is not a zero-sum game: while economic activity certainly decreases with the loss of a large employer or if a proposed project falls through, it is not a 100-percent loss.

*It fails to account for how a subsidy shifts taxes to other businesses*

When taxes are decreased for a lucky few businesses but not for the overwhelming majority of them, it creates an uneven economic playing field. Existing businesses that haven’t received a subsidy are put at a disadvantage, since they aren’t getting the same tax breaks as their competitors and may also lose business to them. OLS notes that this “could impact the competitive marketplace in ways that cannot be easily predicted and calculated.”

**Net Benefits Fix One Piece of Subsidy Reform Agenda**

In addition to the proposed fixes to the law governing the net benefits test, there are three other key proposals that would greatly improve accountability while reining in some of the excesses of New Jersey’s recent subsidy surge.

*Place caps on spending*

Prior to 2013 legislation overhauling the state’s subsidy offerings, all of New Jersey’s subsidy programs had some sort of spending cap. Returning these caps would be a great victory for accountability and would increase the legislature’s key role in monitoring the subsidies. Caps prevent subsidy programs from growing beyond a predetermined size without gaining the re-approval of lawmakers – a real threat in a state like New Jersey, where the legislature writes the law governing the programs but then hands it off to an executive agency to award and manage the grants.

A cap would also force the state to be more selective in approving subsidy applications by making the process more competitive. As it stands now, if a company meets the minimum requirements, the state has no compelling reason to reject the application, since there is no limit on the amount it can award.

In addition to a broad cap, New Jersey should consider tighter caps on the amount that can be awarded per company and, particularly, per job. Regardless of what one thinks about the efficacy of tax subsidies for economic development, all can agree that per-job subsidies that enter six-
figure territory – like $658,000 per job for Holtec, $328,000 per job for the 76ers and $196,000 per job for Subaru – are unnecessarily extravagant and unlikely to ever recapture the value of the state’s investment.

Require more information on the results of past tax breaks

New Jersey has improved the information it provides to the public about state subsidies over the past few years, including producing annual reports on tax breaks and other tax expenditures – so called since they are akin to other state spending. Still, a huge hole remains.

The state needs to honor its obligation to create a Unified Economic Development Budget, which is designed to provide more detailed information from most corporations receiving state subsidies, including how many jobs have been created, how much they pay, whether those jobs are full- or part-time, and whether they include health coverage. The state Treasury Department has never produced this report, despite being required to do so by legislation enacted in 2007. A bill currently on the governor’s desk, if signed and enforced, could force Treasury’s hand by altering the language in the law.9

Alternatively, the Economic Development Authority could take the lead and produce an annual report that includes the key information called for in the Unified Economic Development Budget. This may reduce some of the bureaucratic, coordination and confidentiality issues that have reportedly prevented the Treasury from producing this report to date.

Rein in the subsidies going to existing jobs

The practice of rewarding companies that threaten to leave New Jersey is short-sighted, as is awarding millions of dollars to companies simply to relocate from one town to another. As we see in Camden, hundreds of millions of dollars in tax breaks are being approved for very few jobs that are truly new to the region’s economy. Policymakers should develop more stringent standards that would limit subsidies for jobs supposedly at risk of being moved to another state.

Luckily, lawmakers have already taken one step forward in 2013’s overhaul legislation, which made subsidies for “retained” jobs only half as large as subsidies for jobs that are new to the state. They also required companies only keeping jobs in New Jersey to meet greater overall job-numbers requirements. For example, tech startups and manufacturing firms moving here from Connecticut must bring only 10 new jobs to qualify for a subsidy, while the same types of companies already in New Jersey would have to keep 25 existing jobs to be eligible for the same award.

New Jersey should build on that progress by placing a cap on the share of subsidy dollars – 25 percent could be a starting point – that can go to existing jobs. Ideally, this cap would reflect the minimal economic growth created by retaining jobs, as well as the obvious fact that not all threats to leave the state are real.
Endnotes

1 This analysis uses only projects approved under the revamped Grow New Jersey assistance program, which is focused on jobs and capital investment, not the Economic Redevelopment and Growth program, which is focused on redevelopment. All NJPP calculations use Economic Development Authority documents and economic estimates as source material.


3 The “New Jersey Economic Opportunity Act of 2013,” enacted in September 2013, overhauled the state’s subsidy programs. For more, see the pamphlet law (http://www.njleg.state.nj.us/2012/Bills/PL13/161_1.PDF) and New Jersey Policy Perspective, New Jersey’s Subsidy Overhaul: One Step Forward, Five Steps Back, August 2013 (http://www.njpp.org/reports/new-jerseys-subsidy-overhaul-one-step-forward-five-steps-back)


