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Memo

To: Maine Tax Expenditure Review Working Group

From: Shane Benz, The Pew Charitable Trusts

Date: October 13, 2021

Subject: Strengthening evaluation processes

Thank you for the opportunity to present to your working group. This memo reviews the best practices and state examples discussed during last week's presentation. We are happy to remain a resource to the working group as it continues its work. Please feel free to reach out with any additional questions or comments.

National landscape of tax incentive reviews

When we began this work over 9 years ago, only a small number of states required incentive evaluations. Today, over 30 states regularly review these programs.

Who conducts?

States approach their evaluation processes in a wide variety of ways. This includes who conducts evaluations. Like Maine, many states charge legislative audit or program evaluation offices to complete incentive reviews, including Colorado, Nebraska, Virginia, and others.

Some utilize executive branch agencies, such as departments of revenue, including Iowa and Rhode Island. Oklahoma takes a different approach, utilizing contractors to analyze incentives. Finally, some states also benefit from partnerships with academic institutions: both Virginia and Mississippi rely in-part on universities for information on how incentives impact their respective states.

What is reviewed?

The scope of evaluations also varies depending on the lawmakers' needs and interests, the capacity of the staff completing the reviews, and the composition of a state's incentive portfolio.

Some states, such as Virginia and Oklahoma, evaluate all economic development incentives (including credits, deductions, abatements, grants etc.). Others examine all tax expenditures. Colorado's evaluation process goes beyond economic development incentives to review the state's broader universe of credits and exemptions, including those that benefit individuals.

At a minimum, Pew recommends that states evaluate their economic development tax incentives, as done in Indiana or Rhode Island. Evaluation processes work best when they are designed to meet the needs and priorities of the legislature while ensuring those tasked with reviewing incentives have the bandwidth and resources to get the job done.

Maine: What works well

Since establishing its current evaluation process in 2015, Pew has considered Maine to be a leader in incentive evaluations because the process follows many of our recommended practices.

For instance, Maine's evaluation scope includes all major economic development tax incentives, plus other tax expenditures, which provides policymakers with valuable information about the state's entire portfolio of tax incentive programs. Additionally, requiring an experienced and non-partisan office like OPEGA to conduct the evaluations provides certainty that the information is high quality and objective.

And when OPEGA publishes its findings, policymakers take notice, thanks in large part to the hearings held by the Government Oversight and Tax committees. Our research has found that policy improvements are more likely when states create a formal procedure to review the results of tax incentive evaluations.

Strategies to further strengthen process

Does the scope of the evaluation process reflect legislative priorities and evaluator capacity?

The range of incentives a state chooses to evaluate depends heavily on several factors. This includes a state's needs, staff capacity, time, financial resources to conduct the reviews, the state's portfolio of incentives and tax expenditures, and the level of detail requested for each program.

Generally, the greater the number of programs subject to review and the greater the level of detail required, the more resources needed. Some states, as Maine has done, have tried to balance workload issues by setting different evaluation standards based on things like program cost.

Washington's Joint Legislative Audit and Review Committee re-organized their incentive review schedule into multiple tiers after the number of incentives ballooned from 200 to 700 over time. Some receive a full review, while "alternates" are reviewed that year only if staff have the time. Other incentives are not subject to review if nothing has changed since their first evaluation. The state also reduced the amount of "full reviews" from approximately 25 to between 8-15 per year, giving analysts breathing room to focus on a more manageable workload of incentives.

Some states decided to add staff capacity to offices because they felt strongly that a comprehensive review scope was a worthy investment. Since 2018, Colorado's Office of the State Auditor has been responsible for evaluating all the state's tax expenditures and has reviewed approximately 162 of them. To accommodate such a high volume of work, the legislature increased the Auditor's budget to hire additional staff for the office responsible for tax expenditure reviews.

In general, we estimate that it takes between 1 to 2.5 full-time employees to regularly evaluate tax incentives, but staffing depends on the number of programs being evaluated, other responsibilities that staff members have, and the frequency and level of detail in the evaluations.

Is the process sufficiently linked with policymaking?

Having a strong connection to policymaking is a core component of effective evaluation processes as it provides the greatest opportunity for lawmakers to put their findings to use. Like Maine, many states that regularly evaluate incentives have designated a legislative committee to discuss the results of evaluations, receive input from stakeholders, and consider whether policy changes are needed.

Some states, like Kansas and Virginia, use existing committee structures that legislative audit offices already report to, as is done in Maine. In Oklahoma, contracted evaluators present their findings to an evaluation commission made up of private citizens appointed by the governor, legislative leaders, and NGOs while executive branch officials serve as nonvoting members. The commission holds multiple hearings a year and sends recommendations to the governor and legislature based on evaluation findings. This process has yielded several policy changes.

The process may look different for some states, but the takeaway is clear: states should consider what works well for them to ensure this information has the best chance to inform policymaker decisions.

Does the review schedule yield maximum benefit to the state?

To efficiently allocate the finite time that states can dedicate to evaluations, many set rotating review schedules. This helps evaluators manage their workloads and provides predictable cycles so that lawmakers can reasonably plan time to consider their findings.

States that focus on economic development incentives typically use shorter review cycles (between three to six years), while those that include other types of tax expenditures have been more likely to use longer cycles (seven to ten years). The goal is to balance the need for reasonably current information, while giving the authors of the reports enough time to go into more depth than if every incentive were evaluated yearly.

In Maryland, lawmakers noted that their schedule did not give enough time to review their findings. Working with evaluation staff to adjust the delivery and hearing schedules so that it works well for everyone is one option states can consider to ensure that time is dedicated to digesting this information. Other strategies could include avoiding review of larger programs back-to-back, aligning reviews with sunset dates, or exempting programs from subsequent review cycles if the program hasn't changed.

Can evaluators securely access relevant data?

Finally, states and cities have found creative ways of improving data accessibility to make it easier for evaluators to use high quality data in their analyses while maintaining appropriate confidentiality and non-disclosure protections.

For example, analysts in the District of Columbia's Office of the Chief Financial Officer noted that some relevant information needed for reviews was only available on paper forms and companies had not always filled them out completely. In part to address this problem, in 2017 the city began requiring that the forms be submitted online. The district's evaluators are also working with tax officials to add additional fields to capture more data to assist with future evaluations.

Another example is a 2013 Michigan executive directive that required all state departments and agencies to work toward improving data-sharing procedures. It also created the Michigan Information Management Governance Board. The board's steering committee reviewed confidentiality laws to verify what information agencies can share with each other. The efforts were part of a larger goal to improve analysis and reporting capabilities and to make state operations more efficient.