CORPORATIONS, STATE AGENCIES, AND THE MANAGEMENT OF STATE CORPORATE INCOME TAX INCENTIVES

By

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ABSTRACT

One of the most popular and controversial economic development strategies in state government is the availability of statutory provisions that allow corporations to reduce their tax obligations when they invest in various business development activities. The popularity of those so-called statutory-tax incentives is based, in part, on widely-held assumptions that greatly limit the expected role of management and organizations in their implementation. The purpose of this study is to examine the influence of management and organization on the implementation of statutory tax incentives. This study is based on models of administrative behavior in classic organization theory and proposes that statutory-tax incentives often do not function according to their rational designs because of corporate and governmental administrator pursuit of various organizational and subunit objectives and their resistance to policy features that require a change in established administrative practices.

This study uses multiple sources to examine whether organizations and management affect the implementation of statutory-tax incentives. The results are primarily based on interviews with eighteen corporate managers and six governmental administrators who manage various elements of statutory-tax incentive programs. The interview results are supplemented, where appropriate, with an analysis of corporate tax return data and various governmental reports and documents.

In contrast to the popular perception of tax incentives, this study finds that

management and organizations matter in the implementation of tax incentives. Tax incentive benefits rarely play a substantive role in corporate cost-benefit analysis prior to investment decisions. Instead, corporate managers claim tax incentives in response to the salience of their corporate tax liability. In addition, corporate managers are as likely to be influenced by the costs of tax incentive programs as the projected benefits.

State administrators affect tax incentives through their influence on program procedures, rules, compliance auditing, and information. Some tax incentive programs are complicated to administer and state managers must cooperate across multiple functional subunits in order to solve problems and improve program design. Their actions, however, are likely to influence the number of corporations that claim tax incentives but are not likely to improve the connection between corporate investment decisions and their consideration of tax incentives.

CHAPTER ONE

INTRODUCTION

Introduction to Statutory-Tax Incentives

Taxation is one of the most coercive and essential powers of government. Models that explain the implementation, administration, and evaluation of tax systems are, therefore, particularly important and interesting. Despite the significance and prevalence of taxation, popular perceptions of tax systems are often inaccurate. Tax systems are too narrowly viewed as coercive mechanisms to finance the direct provision of public services. Though revenue collection is certainly a critical element of taxation, it has become increasingly important to examine what is not taxed in addition to what is. Tax incentives—abatements, credits, and deductions—are frequently used as indirect tools to encourage the private production of public goods. One such use of the tax system—particularly widespread and controversial—attempts to promote economic development through the reduction of corporate tax obligations.

Governments use a variety of tax incentive programs in pursuit of economic development. The most widely-publicized tax incentives are negotiated "deals" between corporations making location decisions and governments that offer tax breaks in order to attract those firms to their jurisdiction. For example, the State of Georgia recently provided $258 million in tax incentives to lure a $1.2 billion KIA automotive plant to West Point, GA; the deal also included an additional $152 million in tax credits from local governments in Georgia (Maynard and Peters 2006). These

types of negotiated tax incentives between governments and individual corporations are certainly spectacular and newsworthy; there are, however, other incentive programs that also provide large reductions in corporate tax obligations, programs that are not negotiated, are not targeted toward specific firms, and receive far less public attention. Tax incentives from state governments often take the form of generalized statutes that provide tax breaks to eligible corporations but leave to individual businesses the decision as to whether to take advantage of the incentives.

For example, the State of Kansas offers a corporate income tax credit for business and job development (K.S.A. 79-32,160a). Businesses that invest in qualified facility improvements and hire new employees, as long as they meet the statutory conditions, are entitled to a reduction in their Kansas corporate income tax liability based on the size of their investment and the number of jobs created. The Kansas Department of Revenue estimates that the Business and Job Development credit reduced corporate income tax revenues by $14.1 million in 2002 (Kansas Department of Revenue, 2004). The Commonwealth of Kentucky provides corporate tax incentives, up to 100 percent of a corporation's state income tax liability, for eligible businesses who create and maintain jobs for Kentucky residents (K.R.S. 141.347; K.R.S. 141.400; K.R.S. 141.403; K.R.S. 141.407; K.R.S. 154.23). The Kentucky incentives reduced state revenues by an estimated $36.9 million in 2006 and are projected to increase to $41.1 million by 2008 (Kentucky Office of State Budget Director, 2006).

Over the past 20 years, statutory-tax incentives for the purpose of promoting

economic development have been widely adopted by state governments. Most states have several statutory-tax incentive programs. Though policy specifics vary by state, the most common incentives are designed to encourage corporations to construct new facilities, purchase additional equipment, hire new employees, and/or invest in research and development. Some incentive policies require corporations to satisfy highly-restrictive eligibility requirements while others are accessible to most businesses operating within the state. The cost of statutory-tax incentives, in terms of reduced tax revenues, varies from several thousand dollars to several million. In any particular year some eligible firms may take advantage of a statutory-tax incentive and others may not.

Assumptions behind the Popularity of Tax Incentives

The popularity of statutory-tax incentives is due, in part, to three widely-held assumptions. First, that policymakers are able to identify specific business-development activities that have a positive effect on their state's economy. Second, that corporations will increase their investment in business-development activities (e.g. hire additional employees or purchase additional equipment) if those activities qualify them to reduce their state tax liability. And third, that once enacted, the administration of statutory-tax incentives is determined by formal rules and procedures; in other words, that statutory-tax incentives manage themselves.

The third assumption is based on a belief that newly enacted statutory-tax

incentive programs need little, to no, additional administrative support because state revenue departments already collect, manage, and audit corporate tax returns.[1] And, that decisions to claim statutory-tax incentives by corporate managers are not considered as program administration. Proponents, thereby, contend that tax incentives are able to increase the production of public goods without increasing the "bureaucracy."

Previous scholarship has focused on the first two popular assumptions of tax incentives and, on the whole, has produced inconclusive evidence to support popular claims that statutory-tax incentives increase employment and/or capital investment (the second assumption) or that incentive policies can positively affect state economic conditions (the first assumption) (for examples see: Bartik 1991; Courant 1994; Greenbaum and Engberg 2000; Peters and Fisher 2002). Relatively little attention, however, has been devoted to assessing the third assumption—that organizations do not influence the implementation of tax incentives. This is a critical gap in our understanding of economic development policies because the first two assumptions depend on an implicit expectation that corporate and governmental organizations do not affect tax incentive outcomes.

The Organization of Corporate Tax Incentives

In contrast to the popular assumptions behind the diffusion of statutory-tax incentives, a century of scholarship suggests that organizations have a significant

effect on human activities (e.g. Taylor 1911; Merton 1936; Selznik 1949; Golembiewski 1964). The purpose of this dissertation is to expand our knowledge of the effect of organizations and management on the implementation of statutory-tax incentives.[2] Do organizations matter, and if so, how do they affect the implementation of statutory-tax incentives? In order to answer this question, it is helpful to understand why the existing literature has not already applied organizational theory to the analysis of tax incentives.

One reason organizational theory has been overlooked is because, upon initial review, tax incentives bear little resemblance to the formal organizations described by early theorists—such as Luther Gulick (1937) and Max Weber (Weber, Mills, and Gerth 1958). Statutory-tax incentives, however, share several important characteristics with classic organizations and are, therefore, better understood as modern versions of formal organizations than as wholly-new institutions. Like Weber's bureaucracy, statutory-tax incentives are established by formal rules that fix the incentive's jurisdiction. For example, statutory-tax incentive rules:

- identify the types of business-development activities that qualify a corporation for a tax reduction,
- outline eligibility requirements, distribute authority to government agencies,
- define the proper procedures for calculating and claiming tax incentives,
- and describe reporting requirements.

Another similar characteristic is that statutory-tax incentives are designed to efficiently achieve goals that are established by individuals outside of the incentives

administration—that is, they are rational. Lastly, tax incentives are implemented by multiple organizational "subunits" that perform specialized functions. *State revenue departments* convert enabling legislation into administrative rules and procedures, audit corporate tax incentive claims, and evaluate program effectiveness. *State departments of economic development* promote the use of tax incentives and may also perform eligibility functions. *Corporations* evaluate the costs and benefits of tax incentives, monitor changes in the enabling legislation and administrative rules, and decide if, when, and how they want to use statutory-tax incentives. *Consultants and accounting firms* frequently assist corporations in identifying and claiming statutory-tax incentives.

Another reason the existing literature overlooks the effect of organizations on statutory-tax incentives is because organizational conditions within the participating corporations and governmental agencies tend to be oversimplified.

Governmental agencies are viewed as value-free policy implementers that enact tax incentive procedures with no concern for how those activities may affect their pursuit of other important organizational goals. However, tax incentives may require government workers in certain subunits to engage in activities that may conflict with the interests of their agency. For example, within departments of revenue, some workers are required to coordinate the reduction of corporate taxpayer liabilities rather than pursue their department's primary purpose of revenue collection. Within departments of economic development, workers may be required to determine that some corporations are not eligible to receive tax incentive benefits

even when that decision harms their department's primary objective of economic development.

Corporations are viewed as unitary actors—where, in actuality, corporations are often highly fragmented and disarticulated. Corporations are composed of multiple subunits (e.g. divisions of development, operations, and accounting) that may be only loosely coordinated and have very different objectives, cultures, and professional norms. Many corporations are also multilayered—organized into local, state, regional, national, and international divisions—and managerial decisions may be based at a regional or national level with little concern for maximizing tax benefits within a given state. How and when statutory-tax incentives are used, therefore, will likely depend on where the decision to claim a statutory-tax incentive occurs—in which subunit and at what organizational level.

A final reason why the economic development literature contains relatively few studies on the effects of organizations and management is because there are significant practical research complications that complicate their study. Confidentiality concerns make corporate-level tax incentive data difficult to obtain (Howard 2002), and corporate officials are reluctant to provide information on their decision process because of concerns that the information may provide an unfair advantage to their competitors.

Theoretical Approach

The complexity of participating governmental agencies and corporations and the apparent similarity between tax incentives and formal organizations suggests that organization theory may provide valuable insights into the implementation of statutory-tax incentives. Recent scholarship has demonstrated the value of applying classic concepts of organizations to contemporary non-bureaucratic governance arrangements (e.g. Suleiman 2003; Hood and Peters 2004). Merton's (1940) theory of bureaucratic personality and organizational dysfunction is particularly useful in this analysis because of its attention to the interaction between formal organizations and the management of their subunits—especially the Mertonian concepts of goal displacement and trained incapacity.

Goal displacement occurs when workers are more concerned with following an organization's rules than in achieving its goals. Goal displacement also occurs when workers pursue the objectives of their subunit (department/division) at the expense of the broader goals of their entire organization. There are several plausible ways that goal displacement may occur in the implementation of tax incentives. Corporate tax managers may decide not to claim a statutory-tax incentive, even though they are eligible and the incentive will result in a net benefit for the corporation, because completing the required procedures are too costly for the tax unit. Goal displacement may also occur when eligibility workers in a state department of economic development are so careful in following the prescribed procedures that a

valuable corporate investment fails to occur.

Trained incapacity occurs when workers become highly efficient at performing specialized tasks and are thereby inflexible and unable to adjust to new purposes or functions. In the implementation of tax incentives, trained incapacity may be demonstrated when revenue department administrators become skilled at applying the rules and procedures of revenue collection and are then unable to use the tax code as an expenditure tool. Within corporations, trained incapacity may occur when tax managers are reluctant to claim a tax incentive because it requires adjusting existing procedures and practices.

Using Merton's concepts of goal displacement and trained incapacity this dissertation seeks to answer the following questions: Do organizations and their managers influence the implementation of statutory-tax incentives? How does the multiple-organizational arrangement of statutory-tax incentive programs affect its implementation? How do organizational features within corporations and government agencies affect the implementation of tax incentives?

Research Method

In order to examine how organizations influence the implementation of statutory-tax incentives this study uses a multi-method approach. Qualitative and quantitative techniques are applied to three data sources which are unique to the study of state tax incentives. The data sources include: (1) interviews with corporate and

government managers, (2) governmental publications and reports on statutory-tax incentives, and (3) confidential corporate tax return data from businesses that filed income tax returns in Kansas from 1998-2004. Governmental sources—interviews and documents—were collected from the State of Kansas. Documents were issued between 1998 and 2007. Each participating corporation conducted a portion of their business between 1998 and 2006.

This research method has four advantages. First, it allows for the analysis of internal organizational dynamics within government and corporate organizations. Corporate organizations are examined through semi-structured interviews with the business managers and executives that make decisions on whether to claim a tax incentive and/or that manage the process of claiming statutory-tax incentives. Corporate managers are usually reluctant to provide detailed information on their business practices due to concerns that the information may unwillingly provide a strategic advantage to their competitors (Howard 2002); the interviews in this study were facilitated by a cooperative relationship with the Kansas Department of Revenue (KDOR) and through the KDOR's assurance of confidentially. As a result, managers from a diverse group of corporations agreed to be interviewed. Government agencies are studied through conducting semi-structured interviews with key staff at the KDOR and the Kansas Department of Commerce (KDOC)—including policy analysts, program managers, and auditors—and by examining publications, documents, and reports produced by those agencies concerning statutory-tax incentives.

The second advantage of this methodology is that, by analyzing governmental reports and corporate tax return data over a six-year period, this study is able to consider organizational and managerial actions over time and in response to changing conditions. Point-in-time evaluations of statutory-tax incentives are not able to observe managerial responses to changes in external and internal constraints and/or opportunities.

Another advantage is that by focusing on statutory-tax incentives in Kansas, we are able to control for fixed effects in the state legal and economic environment. Limiting the study to Kansas may generate generalizability concerns; in order to reduce these concerns, corporate managers were asked to compare statutory-tax incentives programs and their administration in Kansas with statutory-tax incentive programs in other states. For an expanded description of participant characteristics, see chapter four.

The fourth advantage is that, by analyzing confidential corporate income tax returns, this study is able to compare interview responses with general trends in corporate tax incentive use by a larger sample of corporations. The study would have benefited from a similar database of statutory-tax incentive programs in all fifty states. However, though many state governments publish reports on their tax incentive programs and the estimated revenue foregone due to those incentives, such reports have limited value in this study because the quality, frequency, and content of state reports vary significantly from one state to another and within a single state over time (Mikesell 2002)

Implications of this Study

This study seeks to enhance both our theoretical understanding of contemporary organizations and to improve the evaluation, design, and administration of statutory-tax incentive policies.

The study's primary theoretical contribution is testing the ability of classic organization theory to explain contemporary market-based institutions. How do multi-organizational arrangements differ from the hierarchical organizations studied in the 20th century? In what situations do classic organization theories "work" and when do they fail to adequately explain and/or predict administrative behavior? Is a new theory required to explain the organizational dysfunctions of market-based tools such as tax incentives? Organization theory has been underutilized by contemporary scholars seeking to understand non-hierarchical market-based institutions; this study seeks to test and, if necessary, revise classic organizational concepts rather than seek a wholly-new theory.

The second contribution of this study is to enhance our conceptual understanding of statutory-tax incentive policy and thereby improve policy-makers' evaluation, design, and administration of statutory-tax incentives. Improved public policy will not decrease the influence of organizations, but will correctly understand and minimize the dysfunctions of organizations in accomplishing policy objectives.

Lastly, it is not the purpose of this study to determine the effect of organizations on tax incentive policy outcomes. However, this study advances the

pursuit of that question by expanding our understanding of the organizational variables that influence statutory-tax incentives. Future scholarship will be able to utilize those variables to better specify models that seek to predict the outcome of tax incentive policies.

Summary of Subsequent Chapters

This chapter has introduced the practice of statutory-tax incentives and identified important gaps in our understanding of how these policies are implemented. In subsequent chapters I will provide a more comprehensive discussion of tax incentive and organization literature, outline the research methodology, present the finding, and then conclude with a summary of theoretical implications and practical policy suggestions. A brief summary of each subsequent chapter is provided below.

Chapter two presents a review of the existing literature on the use of tax incentives to promote economic development. Much of this literature seeks to evaluate whether various tax incentive programs achieve their intended outcomes. A number of scholars have already summarized the findings of these studies; this chapter focuses on how this literature informs our understanding of organizations and management in the implementation of tax incentives.

The third chapter presents a review of organizational theory and applies that theory to the implementation of statutory-tax incentives. Tax incentives are connected to a broader category of indirect tools of service delivery. A review of the literature

and the conceptual foundations of indirect service provision is presented. This chapter then draws connections between institutional arrangements based on indirect service delivery and classic theories of formal organizations. Merton's concepts of goal displacement and trained incapacity are explored for their applicability in examining contemporary "non-bureaucratic" institutions.

Chapter four reviews the study's research questions, outlines the hypotheses, and describes the research methodology used to test those hypotheses. The sampling and interview processes are described and research analysis techniques are presented.

Chapters five through seven present the findings of the study. Chapter five answers the question: do organizations influence the implementation of tax incentives? Chapter six presents the results of the hypotheses that test for goal displacement in the implementation of statutory-tax incentives and chapter seven presents the results of the hypotheses that test for trained incapacity.

The final chapter summarizes the key findings and then provides a discussion of the theoretical and practical implications of the study. The chapter concludes with a discussion of the study's limitations and outlines prospects for additional research.

Notes

1 To fully examine these three assumptions of statutory-tax incentives, one would also need to explore the political factors behind the development of individual statutory-tax incentive programs—a worthy dissertation in itself. This dissertation

proceeds from the assumption that the statutory-tax incentive policies of interest are intended to affect business development directly. It is entirely possible that tax incentive programs, at times, are created as political gestures to important business constituents and then justified as an economic development tool. Sharp and Elkins (1991) have previously describe the political nature of incentive programs, the intent of this study is to examine the managerial aspects of implementing those programs. I take care, however, to consider political effects in my analysis.

The claim that policy makers view tax incentives as "efficient" programs is commonly held. Howard states that "Tax expenditures are in theory highly automatic. From an administrative perspective, new tax expenditures can be grafted onto the existing income tax system; they rely on existing government bureaucracies (primarily the IRS) and existing procedures for collecting taxes. This feature makes tax expenditures attractive to many policymakers, who believe that aid can be given quickly and without costly government red tape (2002, 413).... Much of the case for tax expenditures hinges on their greater efficiency" (2002, 432). In addition, Surrey and McDaniels (1985, 101) provide multiple examples of federal politicians claiming that tax incentives policies improve administrative efficiency.

2 In this study I use a broad definition of the term "implementation" to refer to the enactment of tax policy by both corporations and governmental agencies. Corporations are considered implementers and not recipients because their actions are intended to achieve a policy goal and they do not receive tax benefits in order to remedy a taxpayer hardship—as occurs in traditional social service benefits either

through direct expenditures or reduced tax obligations.

CHAPTER TWO

CORPORATE TAX INCENTIVES

Introduction

Over the past century, corporate tax incentives have emerged as a central element of governmental efforts to encourage economic development. The prevalence of corporate tax incentives has led to a broad research initiative to answer this important question: do tax incentives stimulate economic development (e.g. Bridges 1965; Schmenner 1982)? The key finding of that literature is summarized by the following terms: “sometimes” and “it depends.”

Given the limited value of those conclusions, the question that should be asked is what factors influence the effectiveness of tax incentive policies. Increasingly, scholars are finding that a number of factors influence the implementation of tax incentives and thereby may affect policy outcomes. The purpose of this chapter is to examine one of those factors—the role of organizations and management.

This chapter proceeds in four sections. The first section defines “tax incentives” and presents a brief background on their use. The second section identifies two prominent normative theories of tax incentives—supply-side theory and market failure—and discusses how each perspective frames the importance of management and organizations in the implementation of incentive policies. Third, the tax incentive literature is reviewed for insights into the role of management and

organizations in the implementation of tax incentives. The chapter concludes with a general discussion on tax administration and a summary of key points.

A Brief Introduction to Tax Incentives

Defining Tax Incentives

Public officials often discuss "tax incentives" as though they represent a single well-defined concept. But "tax incentives" are better understood as a broad term that refers to a diverse group of policy strategies that share a common logic for using the tax system as an indirect mechanism to achieve policy goals.

"Tax incentives" are often defined by listing several of the most common tax incentive strategies (e.g. tax abatements, tax exemptions, and tax credits) and leaving the reader to infer the common traits (e.g. Lynch 1996; McDonald 2006). Others define tax incentives as a subset of a larger concept—tax expenditures (e.g. Howard 2002; Surry & McDaniel 1985; Surrey 1973). The latter approach is preferable because it specifies the common traits of the different strategies.

Tax expenditures are provisions in the tax law that allow a special exclusion, or deduction from a tax base, or that provide a special credit, preferential tax rate, or deferral of tax liability (modified from Mikesell 2007, 663). The term was created to emphasize that tax law is frequently used to indirectly finance public programs and to suggest that such provisions should be allocated, budgeted, and evaluated in the same

way that we authorize, manage, and oversee direct expenditure programs (Surrey 1973). It is not uncommon, however, for scholars to use the term more broadly in reference to any effort that attempts to use the tax code to encourage corporate or individual behavior, without concern for whether the provision actually finance the behavior (Howard 2002; McDaniel 1989).

Tax expenditures have two purposes: to induce taxpayer behavior—tax incentives—and to relieve individual and corporate hardship (Surrey 1973). It is often difficult, however, to distinguish between policies that are intended to relieve hardship and those designed to induce behavior. For example, a tax credit may be used to offset corporate losses due to a natural disaster, such as Hurricane Katrina. The purpose of the tax credit may be to relieve corporate hardship since few managers would intentionally allow their business to be destroyed in order to receive a tax incentive. But the provision also seeks to encourage rebuilding efforts and stimulate economic growth; it can, therefore, also be considered a tax incentive.

It is not critical to determine whether tax expenditures are intended to relieve taxpayer hardship. The key concern in identifying a tax incentive is that a tax provision encourages private behavior in pursuit of public objectives. However, because a tax expenditure may partially achieve both purposes, it is difficult for public managers to accurately evaluate these policies.

In the economic development policy arena, tax incentives seek to encourage corporations to increase their capital investment (including relocation), hiring of new employees, research and development, and other business development activities.

Types of Tax Incentives

Tax incentives include a diverse group of policy strategies. The variety of tax incentive strategies can be a source of confusion. There are three classifications that help provide order to the variation: (1) the number of taxpayers affected, (2) the tax based that is reduced, and (3) the method used to induce taxpayer actions.

Number of Taxpayers Affected

Tax incentives vary in the number of taxpayers they seek to influence. Tax incentives can be used to influence the decisions of a single taxpayer, a small group of taxpayers, or a broad classification of taxpayers. Negotiated tax incentives (or sometimes called individual tax incentives) usually involve large tax breaks and confidential contracts between a small group of taxpayers and the taxing authority. Negotiated tax incentives require significant administrative investment from corporate and government managers in order to develop and enact the contract.

The most common type of tax incentive, however, is a statutory provision that allows all taxpayers to reduce their tax liability if they satisfy legislatively-established eligibility criteria. Taxpayers do not negotiate for statutory-tax incentives because the criteria are clearly established before hand. Individual taxpayers are responsible for claiming statutory-tax incentives. In a given year, some eligible taxpayers will claim statutory-tax incentives, while others will not. Statutory-tax incentives are a more

efficient way to affect a large number of corporations. However, the large number of claimants may also make it more difficult to monitor and evaluate incentive programs.

Tax Base Reduced

Most tax incentive programs attempt to influence behavior by allowing taxpayers to reduce their property, sales, or income tax liabilities. Policy makers decide which tax base to use depending on several factors. The government must have authority (statutory or constitutional) to reduce the tax. Local governments, therefore, most often use property tax incentives to achieve their objectives, and state governments use sales and income tax incentives. Governments may also consider the salience of a tax to the targeted taxpayers before attempting to use that tax as an incentive to induce behavior. Trivial tax liabilities are unlikely to act as a strong motivator. A tax may also be selected for symbolic reasons. Property taxes are sometimes considered the "worst tax" and a government may benefit from offering property tax incentives in order to score political responsiveness points or because the "hated" tax increases the salience of the incentive.

Method Used to Induce Behavior

The most common tax incentive strategies are tax abatements, tax incremental

financing, tax exemptions, and tax credits (McDonald 2006). Tax abatements are partial reductions in tax liabilities for a specified time period—usually associated with the property tax. Tax incremental financing (TIF) is a method of diverting tax proceeds, usually property tax revenue, for a specific time period in order to finance capital improvements. Tax abatements and TIFs are often used to influence small groups of taxpayers and are typically targeted toward specific parcels of real estate.

Tax exemptions exclude designated property or activity from taxation, where the excluded property or activity is normally part of the jurisdiction's tax base. Tax exemptions that are intended to act as an incentive are often difficult to distinguish from exemptions that define the tax base. For example, a property tax exemption on corporate inventory may be an incentive to maintain inventory or it may define taxable business property. The tax law may not identify whether an exemption is intended to act as an incentive or to define the tax base. Tax exemptions, therefore, are difficult for public administrators to evaluate.

Tax credits are provisions that permit taxpayers to reduce their tax burden by engaging in a qualified behavior, such as hiring new employees. Tax credits are often intended to offset a portion of the costs that are incurred from the qualifying behavior. Tax credits can be refundable or nonrefundable. Taxpayers who earn nonrefundable tax credits in excess of their tax liability are usually able to carryover their credits to the following tax year until the credits expire or are exhausted.

Tax credits are the most common method tax incentive method for state governments. Forty-eight states have tax credit programs—only government loans to

private corporations have a higher incidence. By one estimate, 57.9 percent (258 of 445) of all tax incentive programs are tax credits (Peters and Fischer 2002). That figure, however, may significantly underestimate the actual incidence of tax credits. Peters and Fischer's estimation excludes state enterprise zones which provide tax credits to businesses within certain geographical areas. In many states, enterprise zones cover a large portion or all of the state and, therefore, function like state-wide tax credits with varying benefits by geographic area. Kansas, as an example, has two enterprise zones that together cover the entire state. Regardless of how many of the estimated 3000 state enterprise zones can also be counted as tax credits, the prevalence of tax credit programs is clear.

This dissertation examines the most common type of corporate tax incentives: tax credits that are statutory-based and allow for corporate income tax reductions in order to encourage business development.

A Historical Background on the Use of Tax Incentives

State and local governments have attempted to stimulate business development since the early history of the United States. In 1791, the New Jersey legislature incorporated Alexander Hamilton's Society for Establishing Useful Manufacturers as one of the first known examples of a state government taking action to promote economic growth (Eisinger 1988). Though governmental efforts to generate economic development have occurred since the nation's founding, early

efforts were rare. In contrast, contemporary economic development is far more organized and is a common element of government and business relations.

Modern economic development traces to the 1930s when southern states began to use a variety of financial benefits—especially tax incentives—in an attempt to attract wealthy northern manufacturers to the economically depressed southern region (McDonald 2006). By the end of World War II, the southern states' initiative had diffused to the northeast and, by the mid-century, had spread to most of the nation. State officials soon believed that tax incentives were essential in order to remain competitive with other states for corporate investment. States governments, needing to manage and promote their tax incentive policies, became increasingly well organized until nearly every state created a government agency to oversee and promote their economic development programs. By mid-century, the modern era of economic development—organized, aggressive, and wide-spread—was standard practice (Eisinger 1988).

The rise in economic development activity from the 1930s to the 1960s is often referred to as the first wave of economic development and is defined by its use of tax abatements, tax credits, loan packaging, and infrastructure development to attract new firms (Bradshaw and Blakely 1999). First wave practices are sometimes referred to as "smoke stack chasing" because of their focus on recruiting manufacturing firms.

In the early 1980s, state governments expanded their efforts to include the development of existing corporations and support for entrepreneurial ventures—the

second wave of economic development. Popular second wave strategies include small business incubators, research-oriented industrial parks, and expanded government-financed loan programs (Bartik 1991). In the early 1990s, economic development practices, influenced by the strategic management movement and the success of specialized-regional economies such as Silicon Valley, expanded its focus further to promote the development of niche industries and the growth of cluster economies—the third wave of economic development.

Second and third wave efforts, however, did not replace first wave strategies, rather, they increased the number of programs that state departments of economic development and revenue had to coordinate, administer, and evaluate. Despite the additional strategies, tax incentives remain a core economic development strategy and, in terms of forgone revenue, are perhaps the largest and most costly of all economic development programs.

Normative Perspectives on Tax Incentives

Despite the wide-spread use of tax incentives for nearly a century, relatively few scholars have examined the influence of management and organizations on the implementation of tax incentives. It is possible that the oversight is purposeful; that management does not affect the implementation of tax incentives or that its influence is trivial. It is more plausible, however, that the oversight is the result of the dominant theoretical framework—the supply-side tradition—that greatly simplifies the range of

actions that are expected from corporate and governmental managers in the implementation of tax incentives.

As the market failure perspective becomes increasingly prominent, however, and challenges the supply-side tradition, scholars have increasingly recognized that management is an essential element to understanding tax incentive outcomes.[1] This section briefly outlines the supply-side tradition and the market failure approach to tax incentives and identifies their differing perspectives on the role of management in the implementation of tax incentives.

Supply-side Tradition

For most of the 20th century, supply-side theory has been the dominant perspective on the purpose of tax incentives (Eisinger 1988). The basic doctrine of supply-side theory is that free markets are more efficient than the government at allocating and distributing financial resources, and that corporate taxes necessarily shift financial resources from businesses to government, resulting in less business development and wealth creation than is expected in free markets. Supply-side policies, therefore, favor the reduction of corporate tax burdens and assume that those reductions will stimulate business investment and increase economic output.

The prominence of the supply-side tradition is evident in the frequent use of economic output variables (e.g. the number of relocated firms and/or the increase in capital and labor investment) as dependent variables in the evaluation of economic

development policies (see appendix 2.2 of Bartik 1991).

Supply-side policies are frequently criticized for creating unhealthy competition between state and local governments (Rubin and Zorn 1985; Enrich 1996; Peters and Fisher 2004; Brunori 1998; Tannenwald 2001). In the mid-1990s, concern over excessive competition among the states led to a failed effort to encourage congress (Burstein and Rolnick 1996) and the judiciary (Enrich 1996; Enrich 1998) to invoke the Commerce Clause to prohibit interstate tax incentive competition. Others have encouraged a voluntary "cease fire" between states and local governments (Bartik 2005).

The supply-side perspective greatly simplifies the range of expected actions from corporate and public managers. Once tax incentives are enacted, the supply-side logic assumes that its implementation is determined by formal rules and procedures and that the policies, therefore, manage themselves. This assumption is based on an understanding that: because revenue departments already collect, manage, and audit corporate tax returns, little to no additional administrative tasks are required.

Corporate managers are assumed to be passive actors that claim incentives when they increase net profits and forgo incentives when they increase net costs. Corporate managers are only expected to influence the implementation of tax incentives through the accuracy in their cost-benefit analysis. Tax incentive decisions include several costs—the direct costs of the new business investment, opportunity costs from other tax programs that cannot be pursued, and the transaction costs imposed by claiming the incentive and complying with a probable audit. Corporate

benefits include their decreased tax liability and the ability to increase invests and thereby to expand production and increase profits.

Market Failure

Over the past fifteen years, conceptual support for tax incentives has shifted from the supply-side tradition toward viewing tax incentives as a tool to mitigate market failures. Markets failure can occur in several ways. Businesses may insufficiently train their employees due to fears that those employees will leave to work for other employers. Transportation and energy infrastructure may be insufficient or present excessive costs for locating certain business activities within a jurisdiction and thereby prevent business development that would otherwise benefit the entire jurisdiction. Risk-averse companies may under-invest in research and development because of concerns that their competitors will free-ride on their innovations. The housing supply may be insufficient or overpriced in order to attract and retain the necessary labor force. Tax incentives are, therefore, a way to transfer corporate risks and costs to all taxpayers, assuming that the benefits from the resulting economic growth will indirectly improve the circumstances of those taxpayers.

"Unless there is either market failure or dissatisfaction with the income distribution generated by market outcomes," according to Courant "there is no persuasive rationale for government intervention [in business development]" (1994,

863). From a market failure perspective, the purpose of tax incentive programs is not to create jobs or attract business investment; rather, tax incentives are evaluated on how well they improve median household income, lower unemployment, and achieve other economic goods.[2]

In contrast to the supply-side tradition, the market failure perspective assumes that corporate and government managers affect tax incentive programs. Though corporate managers make similar profit-maximizing decisions based on cost-benefit analysis, their decisions are also influenced by risk propensity and information accessibility which may result in corporate managers choosing not to claim a tax incentives when they may have greatly benefited from the tax benefits, and visa versa. For example, a tax manager may incorrectly estimate the amount of time necessary to claim an incentive and thereby decide not to pursue an incentive program that would have greatly benefited their business, or a manager may incorrectly determine that their corporate activity qualifies for a tax incentive and thereby commit the corporation to an expensive documentation process that results does not produce any tax benefits.

The market failure perspective assumes a larger role for public managers than is suggested by the supply-side tradition. Public administrators are expected to accurately identify the sources of market failures within their jurisdiction and then focus their use of incentives to match their unique circumstance (Oden and Mueller 1999; Rubin and Zorn 1985). Empirical evidence, however, suggests that, in most cases, public agencies lack the necessary capacity and expertise to adequately respond

to those expectations.

Administration of Tax Incentives

Though management is rarely the variable of interest in tax incentive research, a review of the tax incentive literature provides several insights into the role of corporate and governmental managers in the implementation of tax incentives.

Insight #1: Tax Incentives Burden Government Agencies with Increased Costs

Tax incentive proponents, particularly those from the supply-side tradition, assume that government agencies are largely unaffected by tax incentive programs. Business growth, however, requires significant additional costs of government agencies in the form of decreased tax revenues and increased service delivery needs (Bartik 2005; Courant 1994). To prevent a net loss from tax incentives, governments are strongly encouraged to engage in rigorous cost-benefit analysis before enacting tax incentive policies (Wiewel, Persky, and Felsenstein 1995). Government agencies that are unable to perform the necessary analysis are at risk of creating programs that they cannot afford.

Insight #2: Tax Incentives Obscure the Accountable Management of Public Financial Resources

Encouraging corporate activity through tax incentives is less transparent than providing corporate benefits through direct expenditures. Corporations are not required to report the size of their tax benefits; and, though many states regularly report on their tax incentive programs, the quality of those reports varies substantially (Mikesell 2002). Because tax incentives are less transparent than direct expenditures (Burman 2003; LeRoy et al. 1997), it is difficult for citizens to hold public administrators and private corporations accountable for their use of public resources.

Insight #3: Governmental Agencies Lack the Necessary Capacity to Administer Tax Incentive Programs

Government agencies often lack the necessary skills and/or capacity to properly implement tax incentive programs. Revenue agencies may need to design and monitor contracts for negotiated tax incentive deals worth millions of dollars with no prior contract management experience. Administrators often lack the necessary skills to hold corporations accountable for promised outcomes (Dalehite, Mikesell, and Zorn 2005; Weber 2002). Improving tax incentive systems by increasing administrative capacity, however, may be difficult to accomplish, especially considering that managing the underlying tax system is already sufficiently difficult

(McDaniel 1989).

Insight #4: Corporations have the Capacity to use Tax Incentives to their Advantage

Corporations, in contrast to governmental agencies, are thought to be sophisticated at managing tax incentive opportunities. The decks, it is argued, are stacked in the favor of corporations—with their access to expert legal and tax advisors—to find ways to claim tax incentives, and thereby minimize their tax liability, without altering their day-to-day business practices (LeRoy et al. 1997; Pomp 1998). State and local governments are "increasingly 'outgunned' in attempting to enforce [the corporate income tax] (Tannenwald 2001, 42). "They lack the legal and accounting talent to keep up with avoidance or evasion strategies of large business" (Mikesell 2007, 64).

Insight #5: Successful Administrators Achieve Political Outcomes—Not Just Economic Growth

Empirical evidence demonstrates that political factors also influence the implementation of economic development programs (Pressman and Wildavsky 1984; Sharp and Elkins 1991). Successful implementation of tax incentive policies, therefore, may require that public administrators are aware of the desired political outcomes, and work with legislators, the governor, and opinion leaders during the

implementation (Dewar 1998).

Conclusion

Tax administration is a difficult task that is further complicated by the wide-spread use of tax incentives to promote economic development. Though little research has directly studied the administration of tax incentives, the economic development literature has identified management as an important factor in the success of tax incentive programs. Scholars are now finding that "economic development, finance, and the *management skills to effectively direct financial tools* that maximize community returns are inseparable if communities are to succeed in efforts to expand and improve" (emphasis added, McDonald 2006, 71).

Previous scholarship has demonstrated that a number of factors influence the effect of public administration on tax incentives—professional capacity, technical expertise, responsiveness to political expectations. However, we still know little about how public managers influence the implementation of tax incentives. The economic development literature has provided less insight into the effect of corporate management on the implementation of tax incentives. Though some research suggests that corporate managers take advantage of tax incentive policies and fail to achieve the policy, no empirical evidence exists to explain whether such behavior exists, and if so, what factors influence corporate decisions.

One of the reasons that the economic development literature has minimized

the role of corporate and public managers is because of simplifying assumptions on the role of management in the implementation of tax incentives. These assumptions are based on the analysis of economic development from economic theory traditions—supply-side economics and market failure. The next chapter reviews the organizational theory literature to better understand how organizations and management may influence the implementation of tax incentives.

Notes

1 Although the market-failure perspective is the most prevalent normative response to the supply-side tradition, a number of alternative perspectives may greatly benefit the empirical study of statutory-tax incentives. This study uses a class organization theory approach to its study, however, developments in behavioral finance (a close cousin to classic administrative theory with roots in Herbert Simon's bounded rationality concept) and institutional theory (also rooted in early organizational research) suggest hypotheses that could greatly expand the self-interested goal-seeking behavior that is expected in the supply-side tradition. For example, behavior finance theorists point out that decisions include managerial calculations of current and future costs and benefits, and that managers typically overly discount future costs and benefits. In contrast, the supply-side tradition has often viewed the decision to claim a tax incentive as based nearly exclusively on current costs and benefits. It could be hypothesized that managers make strategic

decisions on their use of statutory-tax incentives to achieve future benefits or reduce future costs, rather than on current needs. Since the benefits from many statutory-tax incentives can be carried over for multiple terms, there is reason to pursue this line of inquiry further. Also, the institutional literature has demonstrated the importance of various influences in diffusing practices among professional communities. The supply-side tradition implies that decisions to claim a statutory-tax incentive are based on the cost-benefits of the incentive to the financial prosperity of a corporation. From an institutional perspective, decisions to claim tax incentives are also likely to be influenced by isomorphic pressures and concerns of legitimacy by their peers. Such diffusion may occur when a corporate managers seeks to mimic the practices of a successful competitor and adopts their use of tax incentives in that pursuit. Another way this diffusion may occur is through the shared use of accounting firms and the competition among accounting firms to provide new services.

2 Job creation and lower unemployment are listed as separate possible outcomes of tax incentive programs because job growth does not necessarily result in decreased unemployment. For example, if 1,000 jobs are added to a community in a one-year period, but 1,500 new labors move into the jurisdiction and only 250 labors move out, the unemployment rate will actually rise.

CHAPTER THREE

THE ORGANIZATION OF STATUTORY-TAX INCENTIVES

Introduction

State governments have used statutory-tax incentives in pursuit of a wide variety of policy objectives for nearly a century; however, the normative appeal of statutory-tax incentives has significantly increased over the past 25 years in connection with the advancement of supply-side economics and New Public Management (NPM).[1] The central doctrine behind both supply-side economics and NPM is that government bureaucracies are inherently wasteful and unproductive and that public policy is more effectively implemented through market-based institutions (such as tax incentives, contracts, grants, and vouchers) than by traditional government agencies.[2] (In situations where government agencies are still necessary, the NPM doctrine suggests the use of performance-based management to simulate the conditions of market competition.)

A key element of the NPM doctrine is the assumption that market-based institutions allow government officials to lead, or "steer," public policy but use more efficient governance structures (usually private sector firms) to do the "rowing." As a result, policy makers commonly assume that market-based institutions are easy to implement; they need only create the governing rules and regulations, and corporations will then enact the policies in the natural course of maximizing their own self-interest. This view is particularly true of statutory-tax incentives, which are

not expected to significantly increase the administrative responsibilities of existing government agencies or to require the creation of a new agency since state revenue departments already administer the tax system.

Ironically, similar claims of effectiveness, rationality, and efficiency have also been made of the classic organizational structures that NPM strategies are intended to replace (e.g. Taylor 1911; Gulick and Urwick 1937). When statutory-tax incentives are viewed as modern versions of classic organizations, the popular position that statutory-tax incentives are simple to implement and that their organization does not matter is no longer supportable. A broad literature on classic organizations demonstrates that rational rule-bound institutions often fail to achieve their purposive designs due to organizational dysfunctions and unintended effects (e.g. Merton 1936; Simon 1947; Selznik 1949; Golembiewski 1964). Organizational literature, therefore, provides a valuable resource to better understand statutory-tax incentive programs.

The purpose of this chapter is to review the existing organizational theory for insights into the effects of organization and administrative behavior on the implementation of statutory-tax incentives. The next section describes two ways to view the organization of statutory-tax incentives: one that views statutory-tax incentive programs as modern versions of classic organizations, and a second that focuses on the management of statutory-tax incentives within corporate and governmental organizations. I then examine critiques of formal organizations—differentiating between scholarly responses to the scientific management movement and those directed toward Weberian bureaucracy—to identify theoretical perspectives

on formal organizations that may provide insight into statutory-tax incentives. The work of Robert Merton is particularly useful in this analysis because of his attention to the interaction between rules, organizational structure, administrative behavior, and the pursuit of organizational objectives. Merton's concepts and their influence on further theoretical development are highlighted, with attention to those developments that extend his concepts of goal displacement and trained incapacity and are relevant to the organization of statutory-tax incentives.

The Organization of Statutory-Tax Incentives

As discussed in chapter two, much of economic development literature minimizes the expected importance of organization in the implementation of statutory-tax incentives. In that literature and in the popular support of statutory-tax incentives, the common view is that: (1) though multiple organizations are involved in the implementation of statutory-tax incentives, managers in one organization do not affect and are not affected by the actions of managers in other organizations—except in rational ways that are intended and predicted by the enabling policy (e.g. eligibility decisions by government agencies); (2) government agencies are neutral-competent policy implementers and are thereby unobtrusive administrators of statutory-tax incentives; and, (3) corporations are unitary actors, like a single individual, and corporate decisions on the use of statutory-tax incentives reflect the aggregated preferences of the entire firm which is assumed to be increased profits.

However, if organizations and management influence the implementation of statutory-tax incentives the true effect of incentive programs is most likely obscured by the three assumptions. This section, therefore, examines each assumption in an effort to describe the organization of statutory-tax incentives. The discussion proceeds in two parts: first, in response to the first assumption, statutory-tax incentive programs are presented as a type of formal organization that is "co-managed" by multiple organizations (public and private); and second, in response to the second and third assumptions, I briefly describe the organizational structures within government and corporate organizations in order to understand how statutory-tax incentives are managed inside these organizations.

The Co-management of Statutory-Tax Incentives

Tax incentives programs are not commonly thought of as formal organizations.[3] In part because incentive programs bear little resemblance to the classic hierarchical organizations described by early theorists such as Luther Gulick (1937) and Max Weber (Weber, Mills, and Gerth 1958). But, in fact, incentive programs share several important organizing characteristics with classic organizations and are, therefore, better viewed as modern versions of formal organizations than as wholly-new institutions.

Like classic organizations, statutory-tax incentives are designed to efficiently achieve goals that are established outside of the program's administration and are the

basis for its creation—that is, they are rational goal-seeking organizations. State legislatures create statutory-tax incentive programs through statute; departments of economic development and revenue are then mandated to enact the legislation and to pursue program objectives. Corporations are not expected to claim tax incentives with an intent to achieve policy objectives, but like a car salesman who serves the objectives of a dealership by seeking her own self-interest, corporations are expected to advance the interests of statutory-tax incentive policies by using incentives to maximize their own profits.

Like in classic organizations, administrative authority within statutory-tax incentive programs is structured through rules and regulations that fix the jurisdiction of the incentive program. Statutory-tax incentives are rule-bound structures; their rules are used to: (1) identify the types of business-development activities that qualify a corporation for a tax reduction; (2) outline eligibility requirements; (3) distribute authority to government agencies; (4) define the proper procedures for calculating and claiming tax incentives; (5) and describe reporting requirements.

Statutory-tax incentives are implemented by multiple organizations that act as specialized "subunits"—an arrangement similar to the division of labor in classic organizations. *State revenue departments* convert enabling legislation into administrative rules and procedures, audit corporate tax incentive claims, and evaluate program effectiveness. *State departments of economic development* promote the use of tax incentives and may also perform eligibility functions. *Corporations* evaluate the costs and benefits of tax incentives, monitor changes in the enabling

legislation and administrative rules, and decide if, when, and how they want to use statutory-tax incentives. *Consultants and accounting firms* frequently assist corporations in identifying and claiming statutory-tax incentives.

Unlike classic organizations, tax incentives are not managed by hierarchical control. However, participation is not necessary voluntary. State agencies are obligated by the enabling legislation to manage certain elements of statutory-tax incentive programs. Corporations are not obligated to claim a statutory-tax incentive but they are required to complete state income tax returns—nearly every state has a corporate income tax. Corporate managers, therefore, must decide each year whether to claim a statutory-tax incentive and must monitor policy makers to track possible changes in eligibility requirements—many corporations have to go through that process for multiple states.

I refer to the inter-organizational management of statutory-tax incentives, in the absence of hierarchical control but where the various organizations are each responsible for essential elements of its implementation, as co-management.

The Management Statutory-Tax Incentives

The organizational characteristics of government agencies and corporations are similar to those described by Weber (Weber, Mills, and Gerth 1958). Departments of revenue and economic development contain multiple specialized subunits, including: policy analysts, auditors, tax administrators, program support, and

eligibility staff. Subunits must work together in order to achieve organizational objectives. Managing incentive programs, however, may require a subunit to engage in activities that conflict with the general purpose of their agency. For example, the primary purpose of revenue departments is to accurately and efficiently collect tax revenues but tax incentives reduce tax revenues and thereby directly conflict with agency objectives. This provides a reason, therefore, to suspect that government agencies have sufficient motivation and the ability to influence statutory-tax incentives and, therefore, we should question the widely-held assumption that government agencies are neutral-competent policy implementers.

In corporate bureaucracies, power and authority are distributed by formal rules to career employees in order to achieve an explicit rational objective—typically shareholder wealth. The economic development literature infers that corporations are tightly coupled and that their various subunits are easily coordinated toward achieving the objectives of the entire corporation; corporations are, therefore, commonly viewed as unitary actors. This view may simplify policy development and evaluation but, in practice, corporate organizations are often highly fragmented, loosely coordinated, and comprised of a wide variety of objectives, cultures, and professional norms (Mintzberg 1979; Weick 1979).

The management literature of the early 20th century demonstrates that even comparatively simple industrial firms struggled to effectively coordinate disparate specialized subunits (Gulick 1937). Nearly a full century later, most modern corporations are far more complex than the industrial firms analyzed during the

scientific management movement. Modern corporations operate across multiple political jurisdictions (regionally, nationally, and internationally) and managerial decisions concerning statutory-tax incentives may be made at a variety of levels—with little concern for maximizing profits within any single state. Modern corporations, therefore, are significantly challenged in their attempt (if they, if fact, do make such an attempt) to make decisions as a single unitary entity. How and when a corporate manager determines to use a statutory-tax incentive is likely to depend on where that manager sits within the organizational structure.

Evaluating the Formal Organization of Tax Incentives

Recognizing statutory-tax incentive programs as formal organizations greatly expands the theoretical frameworks that are relevant to their explanation. The emergence of formal organizations as a topic of scholarly research is connected with Max Weber's (Weber, Mills, and Gerth 1958) pioneering research on bureaucracy and the corresponding development of the scientific management movement (Taylor 1911; Gulick and Urwick 1938; Fayol 2005). The conceptual elements of Weber's ideal-type bureaucracy and scientific management overlapped significantly and attracted a number of critics who exposed multiple flaws in classic organizations. It is useful, however, to categorize those critics into those that responded primarily to the normative proposals of the scientific management movement—such as Follett, Barnard, Simon, and Waldo—and those that primarily responded to concerns that

Weber's ideal-type bureaucracy as a social phenomenon—including Merton, Selznick, Katz, and Kahn. Both responses are reviewed below with specific attention to how they inform our understanding of statutory-tax incentives.

Response to Scientific Management Movement

Early doubts on the mechanistic logic of scientific management appear in that movements own culminating text, *Papers on the Science of Administration*, where Mary Parker Follett stated that: "If you look at business not theoretically, but as it is, you do not find the board of directors controlling the general manager and the general manager the sales manager and the sales manager the salesman. You see that all the time many are sharing in the control…" (1937, 168). Follett's comments demonstrate her awareness that, contrary to the logic of scientific management, subordinates are not easily controlled through hierarchal authority—a claim that Follett's (2004) had made previously in her famous observation that the giving of administrative orders is more effective when superiors construct their orders with the participation of their subordinates and with an understanding of the settings in which those orders are to be executed.

Chester Barnard (1938) shared Follett's perception on the limitations of hierarchical control. Barnard claimed that superiors do not obtain their authority through the hierarchy, but rather, authority is only gained when subordinates willingly grant it to their superiors. How then do organizations accomplish their

objectives? Barnard suggested that executives create incentives that motivate their subordinates to achieve organizational goals in the course of pursuing their own self-interest.

Follett and Barnard's claims that hierarchy is an insufficient method of administrative control provides support for my earlier assertion that tax incentive programs can be viewed as a type of formal organization even though they lack clear lines of hierarchical authority. The same claim, as shown by Barnard, can also be made of classic organizations.

Barnard's attention to managing subordinates through incentives has an obvious corollary with state attempts to manage business development through tax incentives. It is unclear, however, that statutory-tax incentives are properly designed to accomplish this objective. Some observers have suggested that statutory-tax incentives do not actually influence business development decisions, even though corporations claim millions of dollars in incentive benefits each year. Fortunately, that claim is empirically testable and, as such, is discussed further in chapters four and five.

Follett and Barnard's criticisms of scientific management, however, were minor compared to Herbert Simon's (1947) "attack" on scientific management in his classic text, *Administrative Behavior*. Simon was particularly critical of scientific management on three counts: (1) the scientific management movement overemphasized the need to create efficient administrative *processes*, at the expense of greater study of the decisions behind which process was selected; (2) scientific

management was driven by a quixotic search for generalized principles to identify the one best way to structure organizations and to coordinate specialized functions—Simon referred to these principles as proverbs because they often suggest conflicting courses of action (Simon 1946); and, (3) scientific management practices assume that administrative decision were fully rational. What was needed, Simon argued, was a better understanding of administrative decisions and a recognition that managers have limited-rationality and, therefore, satisfice among acceptable alternatives, rather than maximize their utility.

Simon's work suggests the need to better understand the decisions of governmental and corporate managers in their management of statutory-tax incentives. Many decisions are made in the implementation of statutory-tax incentives. For example, corporate operations managers decide to engage in a business development activity that qualifies them for a tax incentive; corporate tax managers determine whether to claim the tax incentive; government workers decide whether the claim is eligible for a tax reduction; and, government workers decide whether to audit the claim. Each decision is likely made by a different individual in a different organizational subunit. Merton, discussed below, suggests explicit hypotheses as to how organizational factors are likely to influence administrative decisions.

Dwight Waldo's *The Administrative State* (1948) provided a second critical attack on the scientific management movement. Waldo was a political theorist and was less interested in the state-of-the-art in management sciences as with the

implications of the scientific management's emphasis on administrative efficiency as the guiding value of political institutions. His chief concern was that good government be equated with efficient government. In contrast to scientific management's enthusiasm for efficiency, Waldo pointed out that the values of democracy are often costly, slow moving, and thereby inefficient.

Waldo's critique of scientific management suggests a more fundamental questioning of whether tax incentives are the proper method to pursue economic development. To the extent that tax incentives are the preferred tool because of their claim on efficiency, but show little effectiveness at achieving their intended outcomes, Waldo's criticism is most applicable to the very existence of statutory-tax incentives, rather than the need to improve their management.

Response to the Sociology of Formal Organizations

The second category of responses includes scholarship that is primarily concerned with the design and effect of formal, rationally organized social structures as a social phenomenon and less concerned with the application of management science. Weber's ideal-type bureaucracy is the foundation for this response. Weber was interested in understanding how individuals organize to accomplish explicit objectives and in how power and authority is allocated in those organizations. He defined the bureaucratic form as a particularly efficient structure for achieving rational ends. The key elements of Weberian bureaucracy are hierarchical order, the

distribution of authority through impersonal rules, and the division of labor among skilled career workers.

The response to Weber's work, and to the proliferation of rational-legal institutions, has lead to an expansive scholarship on formal organizations. Of that broad literature, Robert Merton's work is especially useful in the analysis of statutory-tax incentives because of his focus on the interaction between organizational objectives, rules, and the actions of workers within organizational subunits—in particular, the concepts of goal displacement and trained incapacity (1940).

According to Merton (1940), goal displacement occurs in two ways: first, when workers are more concerned with following organizational rules than in achieving organizational objectives—rules thereby become the ends unto themselves rather than the means to achieve organizational goals; and second, when workers pursue the objectives of their organizational subunit rather than the broader goals of the entire organization. Because the organization's goals are its very purpose for existing, goal displacement is particularly problematic.

There are several ways goal displacement may arise in the implementation of tax incentives. A corporate tax department may decide not to claim a statutory-tax incentive, even when they are eligible and when the incentive will facilitate corporate profits, because completing the required procedures will harm the tax division's pursuit of its own objectives. Goal displacement may also occur when an eligibility worker in a state department of economic development is so careful in following the prescribed procedures that a valuable corporate investment is not approved even

though it is certain to stimulate economic growth in the state.

Trained incapacity occurs when workers become highly efficient at performing specialized tasks and are thereby inflexible and unable to adjust to new purposes or functions. In the implementation of tax incentives, trained incapacity may be demonstrated when revenue department employees become skilled at the routine application of rules and procedures of revenue collection and then resist the use of the tax code as an expenditure tool. Within corporations, trained incapacity may occur when tax managers are reluctant to claim a tax incentive because it requires adjusting existing procedures and practices.

Merton's work was influential in the development of several areas of study on organizations and organizational behavior. Based on their relevance to the implementation of statutory-tax incentives, two areas of influence are discussed briefly below: bureaucratic rule dysfunction and institutionalism.

Merton demonstrated that rules do not always affect administrative behavior in intended ways and may not therefore achieve the rationality, reliability, efficiency, and predictability outlined by Weber. Goulder (1954) suggests that rules are used to establish a standard of minimal accepted performance; employees are likely to sub-optimize their production to those minimal levels, leading to tensions between superiors and subordinates that result in the proliferation of administrative rules. Gouldner (1952, 414) also describes how goal displacement is an important component of "the red tape frame of reference," where the devotion to rules, procedures, and requirements is perceived as a problem by one or more participants in

an administrative process. The importance of a participant's perception is famously articulated by Kaufman when, in describing red tape, he claimed that "one person's 'red–tape' may be another's treasured procedural safe-guard" (1977, 4). The scholarly development of bureaucratic rules dysfunction continues to be a productive area of scholarship, particularly in the study of red tape in public management (Bozeman 2000; Pandey and Scott 2002). The concepts of rules dysfunction and red tape are important in the study of statutory-tax incentives because incentive programs place significant reliance on rules and procedures and one can expect that managerial perceptions of these procedures will influence the use of tax incentives.

Another theoretical area that Merton influenced was the recognition that organizations consist of a formal rational-legalistic structure (rules, hierarchy, and specialized skills) and an informal institutional dynamic of attitudes, beliefs, and relationships. One cannot truly understand the formal elements of an organization without understanding its informal characteristics as well (Blau and Scott 1962; March and Olsen 1989). Merton describes how workers develop a relationship with their peers and an type of subunit identify. Dimock (1944) contended that personal attachment to the subunit can lead bureaucrats to establish well defined "ruts" and to resist change—a phenomenon sometimes referred to as bureaupathology (Thompson 1961). But the influence of human relationships, customs, and identity do not only slow change; human relationships can lead to the diffusion of organizational practices, as well as stifle innovation (DiMaggio and Powell 1983). The institutional literature would caution against an over emphasis on rules and procedures in

understanding statutory-tax incentives. Managers likely have a relevant history with taxes and with incentive programs that may influence their actions toward its use. And, extant relationships among government and corporate managers should be considered.

A final discussion on Merton is needed to expand on what, so far, has been a focus on administrative behavior in a closed system. Katz and Kahn (1966) are generally credited with expanding our understanding of organizations from closed systems to open systems where external events influence organizational processes and outcomes. Statutory-tax incentives are managed within an open environment with multiple organizations influencing the development, implementation, and development of incentive programs. The inclusion of multiple organizations is necessary because no single organization can accomplish all the required steps. Government agencies need corporations to invest in business development. Corporations often need external accountants and consultants to identify incentive programs, to successful navigate the eligibility process for some incentives, and, in some cases to complete their tax returns. In turn, accounting and consulting firms rely on the information from government officials.

Selzick (1949) described how organizational goals can shift when other organizational units are subsumed within the administrative apparatus in an attempt to minimize exposure to external threats—including lacking sufficient administrative capacity to accomplish organizational tasks. Co-optation may occur in the development and evaluation of statutory-tax incentive programs if an external

organization has been sufficiently integrated into the decision process—even if the external organizations are not able to explicitly influence the decision process. Co-optation may also occur when corporations integrate external consulting and accounting firms into their tax administration—thereby failing to protect a core technology (Thompson 1967).

Conclusion

This chapter examined the popular assumption that organizations do not influence the implementation of statutory-tax incentives. Statutory-tax incentives can be understood as rational formal organizations—such as those defined by the scientific management movement and Weber's ideal-type bureaucracy. A rich literature has developed in response to formal organizations that demonstrates that organization matters. Concepts that were originally developed to examine traditional rational organizations therefore are able to suggest ways that organization is likely to matter in the implementation of statutory-tax incentives. In particular, Merton's concepts of goal displacement and trained incapacity are relevant to the examination of statutory-tax incentives. The next chapter presents hypotheses related to the effect of goal displacement and trained incapacity on the implementation of tax incentives and describes the research methods used to test these hypotheses.

Notes

1 In response to the shift from bureaucratic organizations to market mechanisms and inter-organizational networks, a rich scholarship has immerged. This scholarship is not discussed in depth here but includes discourse on the normative implications (e.g. Barzelay 1992; Suleiman 2003; Olson 2006), managerial response (e.g. Kearney, Feldman, and Scavo 2000; Salamon 2002; Hood and Peters 2004; Moynihan 2005) and theoretical foundations of these new institutional arrangements (e.g. Frederickson 1996; Lynn 1998; Kettl 2002).

2 The theoretical basis of this doctrine and the resulting effect on tax incentive research is discussed in chapter two.

3 Previous scholarship has not considered tax incentives as a type of organization. However, such an approach is not without precedence. Hood and Peters (2004) use Merton's concept of unanticipated consequences, originally developed to explain bureaucratic activity, to analyze the management of NPM strategies such as contracting and privatization. Miller (1991, 136) uses ambiguity theory to explain the interactions in public debt networks and the tendency of those networks to seek institutional arrangements to increase stability—a bureaucratic trait. And, Scott (1995, 35) describes regulatory systems as rational institutions. Statutory-tax incentives are similar to regulation, expect that they provide tax benefits rather than sanctions.

CHAPTER FOUR

RESEARCH QUESTIONS AND METHODS

Introduction

The previous two chapters present a conceptual rationale for the need to examine whether organizations influence the implementation of statutory-tax incentives. Based on that rationale, this study seeks to answer the following questions: Do *corporations* and *governmental agencies* affect the implementation of statutory-tax incentives? And, does the co-management of statutory-tax incentives by *multiple organizations* affect how public and private administrators implement statutory-tax incentives? This chapter presents hypotheses to guide the examination of these questions. This chapter also presents a detailed description of the research methods I have used in order to test those hypotheses.

Of course, if organizations are found to influence the implementation of statutory-tax incentives, then it is especially important to understand who influences incentive policies, how, and to what purpose. In chapter three, I suggested that Merton's (1940) concepts of goal displacement and trained incapacity are particularly useful in that pursuit. This chapter, therefore, presents testable hypotheses to examine whether goal displacement and trained incapacity can accurately describe and predict administrative behavior in the implementation of statutory-tax incentives.

Hypotheses

The first group of hypotheses (H1a – H1c) examines the popular assumption that statutory-tax incentives management themselves and tests an alternative position—that organizations and their managers matter in the implementation of statutory-tax incentives. Of course, if organizations do matter then we should observe that it affects how statutory-tax incentives are used. If, however, organizations do not affect whether statutory-tax incentives achieve their intended purpose of stimulating increased business investment, then, though organizations may influence the program in some way (e.g. such as promoting the replication of the incentive policy in other states or its duplication in the same state but to assist with other investment activities), that influence is of little interest to this study because the popular assumption is largely confirmed. These hypotheses, therefore, test whether organizations, and their managers, influence the implementation of statutory-tax incentives in a manner that mitigates the ability of those programs to stimulate business development. These hypotheses do not stipulate a reason for the influence, only that organizations and their managers do influence statutory-tax incentives—that they matter. The causes of that influence are explored later in H2 – H5.

> H1a: *Corporations* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

H1b: *Governmental organizations* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

H1c: *Multi-organizational structures* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

The remaining hypotheses are based on the assumption that this research will find support for H1a – H1c. The next two sets of hypotheses follow up on H1a and H1b and test for evidence of goal displacement (H2) and trained incapacity (H3) in the implementation of tax incentives within corporations and government agencies.

Goal Displacement within Corporations and Government Agencies

One of the ways that goal displacement occurs is when administrators in organizational subunits put the objectives of their subunit ahead of the goals of the larger organization. If this form of goal displacement occurs in the implementation of statutory-tax incentives, we expect to observe that:

H2a: When organizational subunits are able to benefit from statutory-tax

incentives, administrators within those subunits will seek to increase their organization's use of statutory-tax incentives regardless of the effect of their efforts on the pursuit of general organizational goals.

H2b: When organizational subunits will be harmed by statutory-tax incentives, administrators within those subunits will seek to decrease their organization's use of statutory-tax incentives regardless of the effect of their efforts on the pursuit of general organizational goals.

In addition, goal displacement is more likely to occur when the decisions on when and how to use statutory-tax incentives are located at lower levels within the organizational hierarchy. We should expect, therefore, that when decisions are made by individuals at higher levels in the organizational hierarchy, those decisions will be more likely to benefit the whole organization.

H2c: The higher up in the organizational hierarchy that decisions involving the management of statutory-tax incentives are made the more likely they will be used to achieve general organizational objectives.

Trained Incapacity within Corporations and Government Agencies

Trained incapacity occurs when workers become highly efficient at

performing specialized tasks and are thereby inflexible and unable to adjust to new purposes or functions. One way that trained incapacity is manifest is when workers lack the technical skills necessary to perform new tasks. Another way that trained incapacity is demonstrated is when workers are committed to the subunit's activities and develop a psychologically connection to those tasks that results in their resistance to new processes or responsibilities. H3a is connected with both manifestations of trained incapacity; H3b is primarily associated with the latter form.

> H3a: The more an organizational subunit's established practices differ from those required to administer a statutory-tax incentive program, the more the subunit will resist implementing the program.

> H3b: Administrators that are primarily responsible for the processing of statutory-tax incentive rules and procedures will be less concerned with matching the use of statutory-tax incentives to general organizational objectives.

The next two set of hypotheses tests the effect of the co-management of statutory-tax incentives by multiple organizations on the implementation of incentive programs—again, first testing goal displacement (H4) and then trained incapacity (H5). These hypotheses are based on viewing statutory-tax incentives as modern versions of classic formal organizations, with government agencies and corporations

functioning as organizational subunits. From this perspective, statutory-tax incentives are expected to demonstrate organizational dysfunctions similar to those of classical organizations.

Goal Displacement in the Co-management of Statutory-Tax Incentives

H4a and H4b are similar to H2a and H2b, but substitute organizational subunits with corporations and government agencies, and the rationale for these hypotheses is an extension of the rational for H2a and H2b. The rationale for H4c is that organizations will be more committed to their own objectives than to the objectives of the incentive program and may actually attempt to influence incentive policies to improve their ability to achieve their own objectives while harming those of the statutory-tax incentive.

> H4a: When corporations and government agencies are able to benefit from statutory-tax incentives, administrators within those agencies will seek to increase their organization's use of statutory-tax incentives regardless of the effect of their efforts on the pursuit of policy objectives.

> H4b: When corporations and government agencies will be harmed by statutory-tax incentives, administrators within those agencies will seek to decrease their organization's use of statutory-tax incentives regardless of the

effect of their efforts on the pursuit of policy objectives.

H4c: Administrators will seek to influence statutory-tax incentive policies and procedures to achieve organizational objectives even when such actions will not achieve and may harm the pursuit of economic development policy goals.

Trained Incapacity in the Co-management of Statutory-Tax Incentives

The co-management of statutory-tax incentives should be effected by trained incapacity when organizations with widely-different primary objectives are uncooperative in their implementation of statutory-tax incentives. And, when organizations resist changes to statutory-tax incentive programs.

H5a: The more experienced and routinized the use of statutory-tax incentives within an organization, the more the organization will resist changes to incentive policies.

Before discussing the research methods, it is important to note a few assumptions in these hypotheses. First, organizations are assumed to have a primary objective and, similarly, their subunits are assumed to have a primary objective. For corporations, I assume that objective is the efficient output of products or services in pursuit of firm profits. Though many corporations claim the pursuit of social benefits

as core objectives, I assume those objectives to be, at best, secondary for most corporations. Corporations, therefore, will likely view a state's economic condition as important but not a primary objective in which to expend their limited energy. The primary objective of government agencies is the effective administration of its core function. For departments of revenue, that function is the collection of tax revenues, and for departments of economic development that function is to facilitate the growth and development of the jurisdiction's economy—primarily through encouraging commercial and industrial investment.

The second assumption is that administrators recognize the possible threats and benefits to their organizational and/or subunits objectives that are created by statutory-tax incentives. If organizations do affect the implementation of statutory-tax incentives, therefore, that effect is thought to be intentional.

Finally, the hypotheses make no claim of an expected relationship between how a subunit is managed and how that subunit then affects its organization's interactions with other organizations in the co-management of statutory-tax incentives. It's likely, however, that some corporations only interact with government agencies concerning statutory-tax incentive policies through their tax division. And further, that tax division may only interact with a single subunit within a government agency. In that case, it is misleading to consider the organizations as co-managing an incentive program as it is actually their subunits who are co-managing the incentive programs. And, those subunits may not represent organizational objectives in their interactions (as suggested in H4 and H5) but rather the objectives of their subunit.

Attention to this concern is noted and explored further when presenting the research findings.

Research Method

Qualitative Design

This study uses a deductive qualitative research design that draws on multiple data sources in order to answer the research questions and to test the hypotheses. Four data sources are used: (1) semi-structured interviews with managers and executives from 14 corporations, each of which had taxable income in the State of Kansas from 1998 to 2004—though not necessarily in every year; (2) semi-structured interviews with employees in the Kansas Department of Revenue (KDOR) and the Kansas Department of Commerce (KDOC) whose functional responsibilities include the administration of some aspect of Kansas's four economic development oriented statutory-tax incentive programs; (3) governmental documents and reports concerning statutory-tax incentive programs in Kansas that were published or created from 1998 to 2007; and (4) a dataset of Kansas corporate income tax returns filed between 1998 and 2004 (dataset includes 476 unique corporate tax entities with the largest income tax liabilities in Kansas—comprising approximately 80 percent of the total corporate income tax liability in Kansas according to the KDOR).

These four data sources were selected because they make it possible to

examine administrative behavior within corporations and government agencies. Large-N econometric modeling is not possible because relevant data sources do not exist on the implementation of statutory-tax incentives. One existing source of data on state-level statutory-tax incentives is the tax expenditure budgets and reports produced by many state governments—primarily for the purpose of estimating the amount of revenue they forgo due to tax incentive programs. However, state tax expenditure reports have limited value in this study because they aggregate information on tax incentive use and thereby obscure the administrative behavior within individual corporations. State reports also vary significantly in their quality, frequency, and content (Mikesell 2002). Existing data sources are, therefore, insufficient for answering the research questions.

Howard (2002) suggests that intra-organizational research on tax expenditure programs, such as statutory-tax incentives, has not been conducted because such research requires that the researcher has the unlikely privilege of gaining access to sensitive and confidential data and being permitted to discuss proprietary business development and tax strategies that executives and managers are generally unwilling to expose to outside parties. Also government agencies are usually unable to share confidential tax information, due to federal tax privacy laws, with outside researchers regarding specific actions that affect individual corporations, such as the decision to audit a corporation's use of statutory-tax incentives.

This study is able to overcome those challenges and to examine administrative behavior within corporations and government agencies through a cooperative

relationship with the Kansas Department of Revenue (KDOR). The KDOR provided the researcher access to confidential data and facilitated interviews with corporate and governmental administrators in return for the researcher's willingness to conduct an evaluation of statutory-tax incentive programs in the State of Kansas.

The researcher signed confidentiality agreements with the KDOR holding him to the same requirements for information use as KDOR employees. Several steps were taken to ensure the security of confidential data. For example, tax data and interview transcripts were transmitted between the researcher and KDOR employees in person and not through on-line communication; data files were password protected; and, KDOR officials screened all reports (including this study) to ensure that confidential information was protected and that participating corporations remained anonymous. This research, therefore, complies with the strict level of confidentiality that is required by state and federal law involving the disclosure of corporate income tax data.

Through semi-structured interviews with corporate and governmental managers, this study is able to observe administrative behavior and analyze how organizations influence that behavior. Also, by using multiple data sources, this study is able to "triangulate" evidence of the influence of organizations on statutory-tax incentives from multiple perspectives (Creswell and Miller 2000). Also, by focusing on tax incentive claims within a single state, this research is able to control for the fixed effects influencing corporate decisions—especially the unique economic and legal environment within different states. And, this design builds on a rich

background of empirical scholarship that demonstrates the value of qualitative research at examining complex organizational dynamics in order to generate and test theory (e.g. Selznick 1949; Romzek and Dubnick 1987; Pressman and Wildavsky 1984; Maynard-Moody and Musheno 2003; Moynihan 2005; O'Leary 2006).

Unit of Analysis

The unit of analysis is the administrative behavior of corporate and governmental managers that is associated with the implementation of statutory-tax incentives. In this study, administrative behavior is broadly defined to include the observable actions and decisions of corporate and governmental managers as well as their latent responses to relevant events, such as shifts in their attitudes, values, and expectations. More specifically: administrative behavior is operationalized by managerial decisions, official and unofficial communications, reports, applications, evaluations, responses (explicit or latent) to external events, justifications, and shifts in attitude or expectations.

It should be noted that the selection of administrative behavior as the unit of analysis is based on an assumption that administrative behavior is fundamentally influenced by organization. Though such a claim has been widely accepted in public administration and organizational scholarship (Simon 1947; March and Olsen 1989; Wilson 1989), it is understood that its acceptance is not universal. Simon, however, makes a persuasive case for such a "causal" link when he pointed out that: "a person

does not live for months or years in a particular position in an organization, exposed to some streams of communication, shielded from others, without the most profound effects upon what he knows, believes, attends to, hopes, wishes, emphasizes, fears, and proposes" (1947, 18).

Measurement

Over the past twenty-five years, a broad literature has developed to guide qualitative research efforts in order to maximize measurement validity and minimize researcher bias (e.g. Yin 1984; King, Keohane, Verba 1994; Adcock and Collier 2001; George and Bennett 2005; Rubin and Rubin 2005). This research is greatly influenced by that literature. Of course, some error is expected in any study; I have attempted to maximize measurement validity and reliability; but in situations where bias may exist, I've made an effort to identify it and discuss its expected effects.

Some discussion is necessary on how the key concepts are operationalized and how the "independent" and "dependent" variables are identified. First, goal displacement and trained incapacity are not directly observed; they are demonstrated when we fail to reject H2 – H5. Two variables are observed: administrative behavior (operationalized above in the discussion of the unit of analysis) and organizational characteristics, which includes: objectives, rules, procedures, regulations, communication pathways, responsibilities, and authority.

The causal relationship necessary for hypothesis testing is discovered by

linking observations of administrative behavior and observations of the organizational characteristics that influence that behavior (King, Keohane, Verba 1994). For the hypotheses involving goal displacement, the independent variable is an expected benefit or harm to an organizational or subunit objective and the dependent variable is administrative behavior that seeks to capitalize on the benefit or to mitigate the harm. The independent variable for the trained incapacity hypotheses is an established organizational procedure and the dependent variable is an administrative behavior that attempts to preserve those procedures.

In order to develop the causal relationship, King, Keohane and Verba (1994) contend that the independent variable should not be caused by the dependent variable. This is, of course, not always possible, or desired, in research on dynamic organizational environments. For example, if an organization is heavily dependent on a certain way of operation they may, according to the trained incapacity concept, seek to block or resist any policy proposal to will result in changes to their standard operating procedures; if the group succeeds, they increase procedural stability and deepen their dependence on existing processes. I take caution, therefore, in my analysis to consider the possibility of endogenous relationships and to comment on the expected bias that those relationships may create.

Interviews

Semi-structured interviews were conducted with corporate managers and

government employees from November 2006 through January 2007. Eighteen corporate officials were interviewed from 14 different corporations. Six government employees were interviewed from four different function units within KDOR and KDOC. Interview questions were designed to gather data on the variables of interest. Efforts were taken to examine multiple indicators of administrative behavior and organization in order to strengthen convergent validity.

Each interview was audio recorded. Most interviews were completed in thirty-five to forty-five minutes. The corporate interviews were transcribed. The interviews were analyzed and coded to mark observations that are relevant to the hypotheses. The same coding system and analysis was used for the government documents and reports.

One of the concerns in all participate response research is that participants will provide socially desirable responses and mask their true behavior. Corporate managers may present socially desirable responses that overstate the importance of statutory-tax incentives in their decision processes in order to preserve incentive benefits given the risk that a negative description of statutory-tax incentives may result in a reduction in tax incentive benefits—especially since the corporations know that the research is being conducted in partnership with the Kansas Department of Revenue. The bias created by socially desirable responses by corporate managers, however, would likely increase the probability of rejecting this study's hypotheses; and, therefore, is more likely to lead to an incorrect conclusion that organizations do not matter. Governmental officials may present socially desirable response by giving

responses that would appeal to elected and chief-appointed officials. Elected and appointed officials, however, are not likely to have a single opinion on the value of statutory-tax incentives, and, as such, a socially desirable response by governmental administrators is more difficult to predict.

Interviews with Corporate Managers

Thirty corporations were selected and asked to participate in the study. Contact with the corporations was initiated by an employee of the Kansas Department of Revenue. In order to minimize selection bias, perspective interviewees were selected in a manner that provided variation across multiple demographic categories and in each corporation's prior use of statutory-tax incentives. The selection criteria were also used to control for various alternative explanations for how corporate managements may use statutory-tax incentives (e.g. size of the firm, salience of the Kansas income tax, industrial classification). Selection criteria included: location of firm headquarters (in Kansas and outside of Kansas), industrial classifications, the size of firm, the amount of the firm's business activity that is concentrated in Kansas, frequency they claim statutory-tax incentives, size of statutory-tax incentive claims in dollars, and their variation amongst firms that use each of the four primary economic development-based statutory-tax incentives—the Research and Development Credit, Business Machinery and Equipment Credit, Business and Job Development Credit, and the High-Performance Incentive Program (credit programs are described in

greater detail in Appendix A).

Twenty corporations initially agreed to be interviewed—five withdrew due to scheduling conflicts, concerns of confidentiality, and due to recent changes in management where the current managers had very little experience with the incentive programs. All but one of interviews was conducted over the phone—one interviewee submitted a written response to the interview questions. The interviews transcripts are confidential and are archived with the Kansas Department of Revenue. See Appendix B for the corporate interview questions. The identity of the fourteen participating firms must be kept confidential but some description is necessary to establish external validity:

- Ten of the participating firms are classified as retail or manufacturing (six different classifications are represented in total).
- Eight of the participating firms are headquartered in Kansas though only two conduct a significant portion of their business exclusively in Kansas. Four are internationally recognized, publicly-traded corporations.
- All of the participating firms have more than forty-five employees in their Kansas establishments (one firm employs more than 2000 employees in Kansas)—the median size is 223 employees. The U.S. Census estimates that 80 percent of Kansas firms have more than twenty employees and 61.5 percent have more than 100 employees—the participating firms are representative of those estimates.
- Participating firms claimed more statutory-tax incentive, and more frequently,

than the average. Though over 50 percent of the firms in the Kansas corporate income tax return dataset claim a statutory-tax incentive in any given year. Most of those claims are for the Business Machinery and Equipment credit. All the participating firms claimed that credit, but most also occasionally claimed another credit. The average size of incentive benefits among the interview participants, however, does not significantly differ from the benefits of nonparticipating firms.

- Interview participants included managers and directors of tax departments, a corporate vice-president, a human resources officer, a "senior manager," and a minority owner / company president.

Interviews with Government Administrators

Four employees of the Kansas Department of Revenue and two employees of the Kansas Department of Commerce were interviewed to examine their role in the administration of statutory-tax incentives. All of the government employees have functional responsibility over some element of the four primary statutory-tax incentive programs. Interviews were conducted with policy analysts, program managers, auditors, and eligibility works. The interview findings were augmented with the collection of reports, documents, and studies on the use of statutory-tax incentives in Kansas. These documents were authored by government agencies and outside consultants. See governmental official interview questions in appendix C.

Coding and Analyzing the Interviews and Documents

The following coding system is used to identify and organize the important theoretical concepts in each interview. The number of developed codes are kept to a minimum as to focus on the most relevant and meaningful events (Yin 1981). Administrative behavior is coded by identifying whether an administrator made an explicit action or a latent response and whether that behavior was in response to an organizational level stimulus or at the multi-organizational level. Codes were used to identify the organizations that were involved in the administrative behavior (i.e. Department of Commerce, Department of Revenue, corporate taxpayer, and/or third-party organizations such as accountants and consultants). Administrative behavior is coded for evidence of goal displacement and trained incapacity.

After each interview was coded, the interviews were analyzed to identify the common themes amongst the separate interviews. Though every interview will be considered equally, caution will be used to limit inferences to majority perspectives. Once the common themes are identified, they can be used to test the viability of the proposed hypotheses and to identify the effect of organizations on the implementation of tax incentives. It is expected that the interview data will be most valuable in identifying the effect of corporate organizations and the effect of co-management by multiple-organizations on the implementation of statutory-tax incentives.

Dataset of Kansas Corporate Income Tax Returns

As part of the cooperative arrangement with the Kansas Department of Revenue, this research benefits from a confidential dataset of Kansas corporate income tax returns from 1998 to 2004 to support and refine the qualitative findings. The dataset is used to analyze actual statutory-tax incentive behavior (incentive claims) in Kansas over a seven year period, and permits the researcher to test some of the claims made by interviewees on a broader group of corporations. Four-hundred and seventy-six corporations are represented in the dataset.

The dataset has some limitations. It was constructed by employees of the Kansas Department of Revenue by gathering and recording tax incentive information off of paper copies of Kansas corporate tax returns. The full dataset includes over two-thousand individual records and recording errors are certainly possible; the dataset was therefore carefully reviewed for errors prior to analysis. Prior to 1998, KDOR did not systematically collect tax incentive data, so this study limits the data set to those corporate tax returns that occurred between 1999 and 2004 (the most recent tax year available)—an sample size of 1,492. Because of the expense to gather together the actual tax returns and construct the dataset by hand, KDOR limited the number of firms to only those with the highest tax liabilities—they estimate that the firms in the dataset constitute 80 percent of the corporate tax liability in Kansas. Therefore, generalizations from the findings from this study should not be extended to small business without caution.

Some discussion is also necessary about the possible limited generalizability of this study due to its focus on Kansas. Several points are relevant in defense of limiting the study to a single state. First, the statutory-tax incentive programs are representative of the most popular state-level programs used across the country. Second, Kansas has a diverse economic environment with multiple national corporations headquartered in the competitive Kansas City metropolitan area as well as an economically depressed rural region. The corporate environment in Kansas, therefore, replicates what can be expected through much of the country. Third, by focusing on one state, the study is able to control for a wide variety of legal and economic factors that would challenge a multiple-state analysis. Most importantly the management of statutory-tax incentives by state agencies is constant. Further studies may extend this research by exploring states with different administrative structures and cultures. Finally, each interview participant was questioned to identify differences between Kansas's incentive programs and those in other states. Interviewees commonly asserted that Kansas's incentive programs are more similar to other states than they are different—though specific observations differed on what characteristics they thought were more unique to Kansas.

CHAPTER FIVE

THE EFFECT OF ORGANIZATIONS

The first three hypotheses of this study (H1a – H1c) are used to test whether organizations affect the implementation of statutory-tax incentives. In this chapter, I use a variety of data sources to examine those hypotheses. The results demonstrate that corporate and governmental organizations are influential in the implementation of statutory-tax incentives; however, they are found to influence incentive outcomes in different ways. This chapter proceeds in three sections—each presents the findings to one of the first three hypotheses.

Hypothesis 1a: Corporate Influence

> H1a: *Corporations* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

This study demonstrates that corporate organizations affect statutory-tax incentive outcomes and H1a is, therefore, supported. Three organizational characteristics of corporations are found to influence incentive outcomes: (a) the level of intra-organizational coordination between managers of business development and the managers of taxation; (b) the salience of tax costs on business decisions; and, (c) the proportion of a corporation's business activity that occurs within the jurisdictional boundaries of the government that provided the statutory-tax incentive. Each

characteristic is separately discussed below.

Intra-organizational Coordination

In many corporations, managers who make development and investment decisions do not coordinate their efforts with the personnel who are most likely to know about available statutory-tax incentive. As a result, development decisions are often made without considering statutory-tax incentives. It is logically impossible, in these situations, for a statutory-tax incentive to stimulate new development because the relevant decision-makers do not know that a tax "carrot" is even available.

The failure to coordinate business development with tax expertise is most notable in corporations that rely on third-party accounting firms to manage their taxes. This appears to be most prevalent among smaller regional and local corporations. In the following representative quote, notice the high level of dependence that the corporate tax manager places on his corporation's accounting firm.

> If our accountant thinks there's an additional credit out there, they'll bring us what the credit is and we rely on them for what the credit is and what we're going to need to take the credit…. Tax credits do not affect our decision on business development. At the end of the year we have our human resources create a spreadsheet on employees, which we provide to our accountants…. The credits do not influence the operations; operations do their work and then we claim the credits on the backside. (Accounting Manager of Regional Retail Corporation, 1E)

Some corporate managers claim that they are actively working to better coordinate their tax division and operations personnel. Many of those managers state

that they have lost tax benefits in the past due to coordination failures. In the following representative quote, a tax manager describes how his corporation failed to qualify for a large incentive benefit because development decisions were made without obtaining sufficient information from the tax division, and how, in response, their corporation has attempted to better train the operations personnel on available incentive programs.

> Since [we missed that opportunity to claim a credit], we have worked with our operations people to try and get them educated about the credits that are available to us. In the future, just to have that knowledge upfront to make decisions about expansion, get that information into the budgets…estimated costs. (Tax Manager of National Professional Services Corporation, 1M)

It should be noted, however, that tax manager is not trying to improve the coordination with the operations employees in order to alter investment decision, but rather to make sure the operations staff follow the proper process so that development activity will qualify for an incentive benefit.

Salience of Tax Costs on Business Decisions

Corporate managers are more likely to consider possible benefits from statutory-tax incentives when tax costs are salient components of business decisions. Tax costs are most likely to be salient in two situations: when corporations make abnormally large capital investment and when corporations are in very competitive markets and even a small cost reduction can provide them with a market advantage.

Large Capital Investment.

The salience of tax costs in capital investment decisions depends on a corporation's relative financial risk and the ability of a tax incentive to mitigate a significant portion of that risk. Statutory-tax incentives are particularly important to corporate managers of start-up companies that are making large capital investments and rely on incentives to decrease tax liabilities and to thereby improve cash flow in the early stages of their development. Consider the following representative quotes from a corporate managers who describe how statutory-tax incentives help finance large capital investments.

> So in situations like that where we know that we're going to be ordering a lot of capital equipment, we may wait and see if we can get the credit first. For the most part, we normally just operate the business and the tax is kind of like the tail that does not wag the dog. But on certain big decisions, when we know there's a tax incentive out there, we may let the tax drive our decision a little bit. (Assistant Comptroller from National Professional Services Corporation, 1K)

> The company was concerned about their taxes with all the capital costs that they were incurring so it is definitely analyzed and the question is always asked to the upper management to the value of the Kansas incentives. (Chief Accounting Officer and Vice-President of Kansas-based Manufacturing Corporation, 1B)

Competitive Markets

Corporate managers in highly competitive business environments use statutory-tax incentive in an attempt to achieve even slight advantages over their

competitors. A manufacturing site that is able to reduce the price of their product by a small margin may be able to under price their competition and gain a larger market share. Sometimes the competition is from other worksites within the same corporation, each trying to be awarded a new product-line from corporate headquarters. The following quotes demonstrate the importance of statutory-tax incentives in competitive bidding processes.

> Now, when the team [at headquarters] evaluates all these alternatives, including third-party contractors…. [At] the end of the day it's the low-cost provider who typically wins that. And the [incentive program] is a piece of that formula because, if are going to spend that amount of capital, it triggers the ability for us to qualify for that credit. (Finance and Development Executive of Multinational Manufacturing Corporation, 1I)

> [Tax incentives help] us grow as a business as a whole because being a low-cost provider helps us obtain more work. Because we operate in a competitively bid industry, and so if we can be low cost provider that helps us with our business expansion plans. (Senior Manager of National Construction Corporation, 1H)

Proportion of Business Activity within Governmental Jurisdiction

In most situations, corporate managers view statutory-tax incentive benefits as offsetting their corporation's general tax liability and not the costs of specific investments. For example, managers are more likely to be aware of their total number of annual hires and the incentive benefits associated with all of those hires than to recognize the benefits they received from project-specific hiring within the year. Most often, therefore, corporate managers do not claim incentives to benefit certain projects, they claim statutory-tax incentives after those projects have already been

completed in order to benefit the whole corporation. The following quotes reflect this perspective from a variety of corporate managers.

> I look at it more globally. In the period of time that we are going to purchase that much capital equipment, I pull it all together, what is that cost going to be, what are those returns averaging? And I look at the tax credits on a more global basis, rather than a project-by-project basis. (CFO of Kansas-based Manufacturing Corporation, 1C)

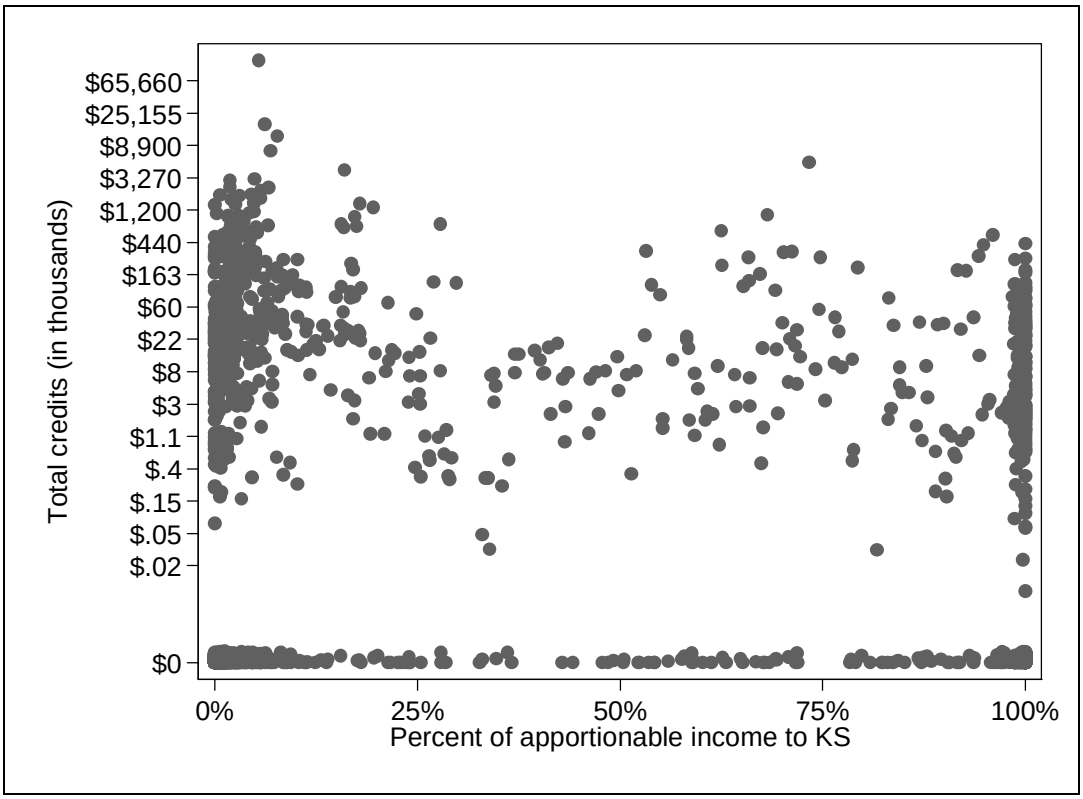
> It would be hard for me to really trace down that a hundred thousand dollars went here specifically. I think it's probably not a perfect Kansas answer, but I think [the Kansas statutory-tax incentives] benefit the company as a whole rather than just the Kansas operation. …I think that the incentives are all designed by a particular state to benefit that state. And they do that, but I think they also benefit the company as a whole, and allow the company to expand. And it might not be dollar for dollar that Kansas benefits from this, but it helps the company to grow and the company becomes more profitable and becomes more taxable in Kansas. So I think that all credits have really helped our ability to expand. (Tax Manager of National Retail Corporation, 1F)

> The parent company has all of the costs to develop products, market them, and sell them. Where do you think most of the income [from the tax incentive benefits] should reside? Obviously with the activities that are adding significant value to the whole value equation. …A manufacturer in Kansas, that's working relatively risk-free, producing product for its parent company that is creating the value that puts our products in front of the consumer and makes them agreeable, and people want to buy them, the income is going to be based more here with our more entrepreneurial activities. (Finance and Development Executive of Multinational Manufacturing Corporation, 1I)

This finding has a significant implication on the likelihood that statutory-tax incentives will be reinvested in the jurisdiction that provided the incentive. Statutory-tax benefits are unlikely to be reinvested within the jurisdiction that granted the incentive if the benefiting corporation only conducts a relatively small portion of their business activities within the jurisdictional boundaries of the government that granted them the tax break. National and multinational corporations are likely to export their Kansas benefits to investments in other states or nations. This finding, therefore,

questions the equity of statutory-tax incentives.

The corporation, of course, may not reinvest the statutory-tax incentives at all; instead, the incentive benefits may be paid out to corporate owners in the form of annual dividends. It seems appropriate to assume that a similar dynamic would occur with owner wealth as with corporate reinvestment. Owners of firms that do the majority of their business within Kansas are relatively more likely to be residents of Kansas and are relatively more likely to reinvest in Kansas-based projects and pay Kansas taxes.



Graph 5.1. The proportion of a corporation's activity in Kansas and the amount of tax incentives claimed. *Source:* Kansas corporate income tax returns from 1999 to 2004, data compiled by the Kansas Department of Revenue. *Note:* 1,492 unique tax returns from 282 corporations. Source data is log transformed but axis labels represent actual dollar values. Data points are "jittered" in order to demonstrate multiple observations at the same data point.

Graph 5.1 demonstrates that a large proportion of Kansas's statutory-tax incentive benefits are received by corporations that conduct a relatively small proportion of their business activity within Kansas. If we assume that only a few of those corporations actually altered their business activities in order to qualify for their incentives, then many corporations (particularly national and international corporations) can be expected to export their tax benefits out of Kansas to benefit other states.

Hypothesis 1b: Government Organization Influence

> H1b: *Governmental organizations* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

This study finds that governmental organizations do not have an independent effect on statutory-tax incentive outcomes. State agencies do influence statutory-incentive programs; but, because they do not actually claim tax incentives and because they must grant incentives to all eligible corporations, their effect on incentive outcomes is primarily indirect and observed through their influence on corporate activity. Hypotheses 1b is, therefore, not supported.

This study examined whether governmental agencies affected incentives by influencing the political support for incentive policies. Interviews with governmental administrators in both the Kansas Department of Revenue (KDOR) and the Kansas

Department of Commerce (KDOC) indicate that administrators within both agencies occasionally engage elected officials regarding statutory-tax incentive policies.

The most frequent types of interactions involve legislative casework on behalf of corporations that have experienced some difficulty in claiming a statutory-tax incentive. Agency officials also interact with elected officials in their attempts to monitor legislative activity for possible changes to tax policy. These actions, however, are largely passive and do not influence incentive outcomes.

Less frequently, state administrators interact with political officials in an attempt to influence the content of statutory-tax incentive policies, but, as yet, those efforts have not affected program outcomes. Over the past four years, for example, KDOR has produced a series of reports that have been critical of statutory-tax incentive programs. Also, in 2007, KDOR and KDOC co-endorsed several legislative recommendations that would have significantly altered existing statutory-tax incentive policies. As yet, however, state agencies have not affected legislative behavior regarding statutory-tax incentives (those reports are discussed in greater detail in chapter six).

There is one recent example where the KDOR was able to influence the Kansas legislature regarding statutory-tax incentives. In 2006, the Kansas legislature approved a statutory provision, recommended by the KDOR, to require additional information from corporations that claim statutory-tax incentives. The additional information is intended to help KDOR administrators to better analyze the marginal increase in corporate business activity that incentives produce (e.g. the number of

additional employees hired “because” of the incentive). I expect that this provision will eventually affect statutory-tax incentive outcomes. Its effect, however, will be observed through its influence on corporate managers’ willingness to tolerate the costs of these procedures in order to claim incentive benefits.

Hypothesis 1c: Multi-organizational Structure Influence

> H1c: *Multi-organizational structures* influence the implementation of statutory-tax incentives through administrative actions that mitigate the ability of the incentive program to stimulate economic development.

This hypothesis is based on the assertion that the multi-organizational arrangement of statutory-tax incentives—which in this study includes KDOR, KDOC, as well as numerous private corporations—affects policy outcomes. This research finds strong support for this hypothesis. This support is observed through the co-management of costs, risk, and accountability by program administrators—corporate and governmental.

Costs

There are several different types of costs that influence how corporations and state agencies manage statutory-tax incentives. Corporations incur transaction and opportunity costs when their managers: (a) search for statutory-incentive programs in which they may qualify, (b) calculate whether the incentive program will benefit their

firm, and (c) complete the process of claiming an incentive—including gathering the necessary information, completing the documentation, and complying with occasional audits.

Costs increase for both corporations and state agencies when incentive policies and procedures are complex. The complexity of a statutory-tax incentive program is a function of the dollar values at stake per taxpayer, the ambiguity within the enabling legislation, and the number of tasks that corporate managers must perform in order to claim the incentive benefit. Consider the importance of compliance costs in the following statements by corporate administrators.

> Right now, we are growing very rapidly, and we are doing a lot of acquisitions. So everyone's time is stretched so thin, whereas no one really has excess capacity. If we did, it may change our cost-benefit analysis. But if it comes down to a question of whether a credit will save us a couple thousand dollars a year or whether this person can be spending their time working on other things, the credits may be good, but we do not have the spare time in the accounting department to deal with it, then it may get passed over. (Assistant Comptroller from National Professional Services Corporation, 1K)

> I know there have been some smaller credits, because of how the job and development credit works you have to look at it by, kind of by location, or business line, and due to the compliance burden, sometimes while they can generate a credit that is small, maybe under $10,000, they will decide not to proceed to try and gather the information to comply, to take the credit. So if it’s fairly small, sometimes the effort is not worth it. (Chief Accounting Officer and Vice-President of Kansas-based Manufacturing Corporation, 1B)

Corporations minimize complexity by hiring consultants to claim the incentives for them or by only claiming statutory-tax incentives that they intend to frequently claim. Some corporations will do both—hire a consultant for the first year or two and then bring the activity in-house once the process is routinized—as demonstrated in the following quote.

> Each of those credits would be evaluated separately in terms of how much work would be required to get a benefit from them. So along those lines, we became aware of a training credit that is up to $50,000 a year and we are going to claim it for 2005 year. We're working with another consultant to claim that but after we get through one year we will do it ourselves. It has ended up being a bit more labor-intensive than I initially expected but for $50,000, we think it's worth pursuing. (Tax Direct of Multinational Food Services and Accommodations Corporation, 1A)

State administrators try to reduce corporate costs by simplifying rules and procedures and by clearly communicating with the business community about what incentive programs are available and how to claim an incentive benefit. State agencies, however, must work within their statutory limits. Many confusing or complex rules, terms, guidelines, and processes are elements of the enabling legislation and create significant costs for state administrators who must frequently respond to situations where the statute and prior case precedent do not indicate a clear course of action. State administrators must, therefore, frequently consult one another to ensure the incentive programs are consistently applied, achieve the legislative intent, and do not violate statutory provisions.

Risk

The decision to claim a statutory-tax incentive creates two types of risk for corporate managers. First, the risk that they will incur significantly higher costs in order to claim the incentive benefit and/or will incorrectly calculate their eligibility for the incentive program and thereby make a large investment and, as a result, will be denied the incentive benefits. This risk is based on a manager's ability to gather

sufficient information about incentive programs in order to be reasonably confident in her cost-benefit analysis. The second type of risk involves the need to release sensitive business information in order to qualify for the incentive. The following quotation from a corporate tax manager demonstrates concern for both types of risks.

> I would say that there are two issues there. One, is it going to require a lot of time on my part and my staff's part to put it together, if so it's going to impede our efforts to obtain those credits and those incentives. Secondly, we want to make sure that it's not information that is sensitive to our company. We wonder how they would use it. We do not want them to use it against us and we certainly do not want to go to any of our competitors. (Tax Direct of Multinational Food Services and Accommodations Corporation, 1A)

Making Decisions Based on Reliable Information.

Corporate managers approach this challenge in two ways. Some managers attempt to stay up-to-date on incentive programs. Typically, these managers are in corporations with in-house accounting expertise, often with specialists in tax incentive policies. These corporations use a combination of communication with state officials, monitoring of state website, and regular consultations with accounting consultants to maintain their knowledge of state policies. For example the following quote demonstrates how a tax manager in a multinational corporation uses a variety of consultants and legal advisors to stay current on changes to state tax-incentive polices.

> We have research services like [a national tax research company] that stay up to date on current changes in tax law. At some point in time, though, you've got a base situation; you know pretty much everything that's out there. Our people have to continually stay up to date with changes, and that's one way.

> We also have various consultants and legal people that are experts in this area and we will contact with changes. For example, the bond counsel for the IRB that we did last year called me up when the Kansas Legislature passed the new law on the property tax and was filling me in on some of the things that were probably going on. Just different ways on keeping up-to-date. (Tax Manager of Multinational Manufacturing Corporation, 1I)

Smaller corporations with little in-house taxation expertise, however, rarely seek to monitor incentive policies. They do not proactively seek out incentives but are likely to only be aware of those programs that are brought to them by their accountants or they learn about new incentive programs when entrepreneurial consultants contact them to "sell" them on an incentive that they may already qualify for. The following quote from a manager in a small Kansas-based corporation demonstrates how some manager rely on third-party firms in order to learn about relevant changes in statutory-tax incentives.

> Even though I am the financial guy, we really rely on our accountants to do the tax issues. Because I am not a tax guy, and that stuff changes so much, they keep us apprised of anything that is coming down the pike. Towards the end of the year, we usually discuss if there is anything that might be available or things that we might do in the middle of the year, but by and large as a company, we do not say. Oh, there is a tax credit and we are going to make a decision to try to get it. (CFO of Kansas-based Manufacturing Corporation, 1L)

Releasing Sensitive Business Information.

Some corporations are concerned how the state will manage the information that they require of corporations when they claim statutory-tax incentives. Companies are concerned that the information may violate the confidentiality of individual

employees (e.g. information on wages and social security numbers) and/or may provide harmful information to their competitors. Corporate concerns on confidential information, however, are mixed with their resistance to the cost of gathering the information.

> Because what the states are asking is typically, the economic development group goes ahead and offers the credit, then the Department of Revenue comes out and their job is to make sure you're appearing to it, and so what they want is a list of all employees are eligible for the credit, meaning new employees, they want their Social Security numbers they want their personal address to find out if they're living in state or outside state, they want to know their wages, the amount of withholding taxes associated with it. Well, we as a company do not feel like we can share that information. (State Income Tax Manager of Multinational Retail Corporation, 1J)

Accountability

State agencies often seek to simplify incentive programs in order to minimize costs. The also seek to maintain the legislative intent of the incentive programs, which often requires them to increase the number and complexity of rules and procedures and to increase their compliance oversight. For example, some corporate managers attempt to claim statutory-tax incentives though their activities do not qualify for the benefits. State administrators must monitor for these types of claims and deny the benefits. Corporate managers may contest the decision. When statutory language is not clear (often it is not) these disputes may need to be resolved by a Court of Tax Appeals, or similar oversight group. In Kansas, KDOR has had to defend several decisions before the Kansas Supreme Court.

State agencies have the paradoxical responsibility to both simplify rules and procedures in order to increase corporate access to statutory-tax incentives and to maintain strict eligibility procedures in order to prevent corporate managers from claiming incentive benefits in ways that do not achieve the policy objectives. If state administrators make the incentive procedures less strict, they lower the compliance costs and risks for corporate managers who will respond by claiming more statutory-tax incentives; and, increasing the complexity of the rules will result in fewer claims.

Both approaches, however, fail to make incentive programs more accountable for achieving their policy purposes. Strict rules will crowd out legitimate claimants who cannot afford to the compliance costs. Another result of strict rules is that it increases the risk for corporate managers and, therefore, managers will likely wait until they are more certain of investment plans before deciding to claim an incentive—decreasing the ability of the incentive to influence the investment decision. Relaxed rules do not fair much better however. Relaxed rules will likely lead to more claimants who are not stimulated to increase their investments by the incentives. Managing the rules, procedures, access to information, and compliance auditing, therefore, is an excellent tool for altering the frequency of claiming statutory-tax incentives but it does not influence the probability that the policies will influence incentive decisions.

Table 5.1. The effect of organizations on the implementation of statutory-tax incentives

Organizational characteristics/conditions	Effects on incentive outcomes		
	Number of incentives claimed	Indirectly influence business investment	Directly influence business investment
Government			
Rules and procedures that make it simple for firms to claim an incentive when they make qualifying business investments	+		-
Rules and procedures require firms to demonstrate an intended action will result in hiring additional employees or increasing capital investment	-		-
Minimal oversight of tax incentive programs	+		-
Well distributed information on what incentive programs are available and how to claim them	+		
Governmental functions are centrally managed	+		
Corporate			
Operations managers are involved in decisions to claim tax incentives			+
A majority of a corporation's business activity occurs within the state		+	
The corporation is experiencing higher than average development costs.			+
The corporation is in a highly competitive market			+
The corporation's business activity is stable	+		-

Note: Plus (+) and minus (-) signs indicate that the condition is found to respectively increase or decrease the likelihood of the given effect on statutory-tax incentive outcomes. Blank cells indicate that the directional effect is not clear.

CHAPTER SIX

EVIDENCE OF GOAL DISPLACEMENT

In this chapter, I explore two sets of hypotheses to test for goal displacement in the implementation of statutory-tax incentives. The first set of hypotheses (H2a-H2c) is used to examine whether goal displacement occurs within state agencies and corporations. I test these hypotheses by analyzing whether corporate and governmental managers pursue the objectives of their organizational subunits at the detriment of organization-wide goals.

The second set of hypotheses (H4a-H4c) is used to examine whether goal displacement occurs in the co-management of statutory-tax incentives. These hypotheses are based on the claim that corporations and state agencies can be viewed as subunits within the formal organizational structure of statutory-tax incentive programs and, therefore, by testing whether corporate and governmental managers work toward the goals of their organizations at the detriment of statutory-tax incentive policy objectives.

This chapter proceeds in two sections. In the first section, I examine the first set of hypotheses involving goal displacement within organizations and present evidence of goal displacement within both corporate and governmental organizations. In the second section, I examine evidence of goal displacement in the co-management of statutory-tax incentive policies. I present evidence of goal displacement by corporate managers and state administrators in their co-management of statutory-tax incentives.

Goal Displacement within Corporations and State Agencies

This section examines three hypotheses that are used to test for goal displacement within state agencies and corporations in their management of statutory-tax incentives. Goal displacement occurs when workers are more concerned with following an organization's rules than in achieving its goals or when workers pursue the objectives of their subunit (department/division) at the expense of the broader goals of their entire organization (Merton 1940).

Organizational subunits of interest in corporations are tax divisions, accounting departments, operational units, location-siting teams, and other functional groups that have interest in tax management and business development. Organizational subunits of interest in state agencies include auditing, policy analysis, program management, and customer relations/appeals subdivisions within the Department of Revenue, and program managers and development specialists in the Department of Commerce.

The corporate managers who were interviewed in this study are employed in a wide variety of corporations—varying in industry-type, stage of development (new firms and stable older firms), and size (in regard to both the number of employees and the geographical territory). The results of this analysis, therefore, are believed to be highly generalizable to corporate activity that can be expected in any state regarding the implementation of statutory-tax incentives.

In comparison, this research's examination of state administrators is less

broadly generalizable. Kansas is a relatively moderate sized state, and I expect, therefore, that the findings involving governmental administration are likely to be most generalizable to moderate and smaller sized states—the majority of American states. This approach is preferable to examining a large state where the results may only be applicable to a few other states. I expect that much larger states may present stronger evidence of goal displacement within their subunits. Subunits within larger states are more likely to be insulated from one another and their middle-managers are thereby less likely to collaborate than administrators within smaller state administrations. These findings, therefore, are more susceptible to type-II error—a more conservative position.

One final item should be reviewed before the findings are presented. In order to identify or reject the presence of goal displacement, one must assume that each organization has a discernable goal or purpose that can be displaced. In this analysis, therefore, I assume the primary goal of corporations is to increase shareholder wealth (to increase profits); the primary goal of the Kansas Department of Revenue (KDOR) is the effective collection of tax revenues; and, the primary goal of the Kansas Department of Commerce (KDOC) is to facilitate the growth and development of the Kansas economy. Managers are assumed to exhibit goal displacement when they displace those organizational goals with a commitment to following rules and procedures and/or the pursuit of subunit objectives.

Do Governmental and Corporate Managers Seek to Achieve their Subunit Objectives Over the Objectives of their Organization?

The first two hypotheses are complementary. They are used to examine whether governmental and corporate managers promote the use of statutory-tax incentives in situations where they expect those programs to benefit their subunits (H2a) and whether they seek to suppress the use of statutory-tax incentives in situations where they expect those programs to harm the interests of their subunits (H2b). And, that managers will act to promote or suppress the use of statutory-tax incentives based on its expected effect on their subunit regardless of how their actions affect the pursuit of organization-wide goals.

Corporate Findings

This study finds strong evidence that corporate managers implement statutory-tax incentives with the intent to achieve organization-wide goals. Tax managers are found to administer incentive programs in ways that benefit their subunits but also assist the pursuit of organization goals. One tax manager, for example, explained how was able to justify adding an additional employee to the tax division based on expected benefits from statutory-tax incentive programs but his purpose for adding the additional employee was to claim more statutory-tax incentives and to save the company money—achieving the central corporate goal of increased profits.

Consider the following quote from a tax manager who explains how statutory-tax incentives are a means to achieve organization-wide benefits.

> What [statutory-tax incentives] do is effectively reduce the overall tax rate, which increases our bottom line, which allows for more investment back into the company, and better profit, and so on and so forth (Tax Manager of National Retail Corporation, 1F).

An argument could be made that tax division managers who promote the use of statutory-tax incentives for tax purposes rather than to stimulate additional investment may be demonstrating goal displacement—since they are using the incentives to benefit their subunit and because corporate profits may be better maximized if those benefits were used to increase investment activity. This second view, however, is not shared by any of the corporate managers that were interviewed for this study. Rather, statutory-tax incentives are consistently viewed as a tool to reduce general tax costs in order to achieve maximum corporate profits. Subunit managers demonstrate that they use incentives to achieve general organizational goals and, therefore, H2a & H2b are rejected for corporate managers.

Governmental Findings

This research finds that state administrators seek to efficiently and effectively manage incentive programs even though they often question whether incentive programs achieve their organization's central goals or serve the interests of Kansas. Administrators are particularly concerned that corporations frequently claim statutory-tax incentives but that they do not change their investment behavior—

forgoing millions of dollars in state revenue for development that would have likely occurred anyway. The following quote from one state administrator demonstrates the belief that statutory-tax incentives are not achieving their intended purpose.

> Corporate managers are really looking into the law and they work…I do not want to say they work the system, but they are working to get the benefits that they can qualify for, and to change something just a little bit so they can get so much more money. It is amazing to me…. So, I'm absolutely questioning the effectiveness of [tax incentive programs]. Are we really getting the bang for our buck and for some of these I do not think that we are. (2O)

Yet this manager and others remain highly committed to effectively managing the rules and procedures of statutory-tax incentives.

This commitment to the rules and procedures of incentive programs, in spite of the perceived harm to organizational goals demonstrates evidence of goal displacement in the implementation of statutory-tax incentives. The exact wording of H2a & H2b, however, is not supported because state administrators do not seek to increase or decrease the use of statutory-tax incentives without concern for the effect of those programs on organizational goals. Rather, they manage the programs as best as possible despite their concerns that the programs may be harmful to their organizational goals.

Does a Governmental or Corporate Manager's Position within their Organizational Hierarchy Affect how they Administer Statutory-tax Incentives?

The third organizational-level hypothesis examines whether managers are more likely to use statutory-tax incentives to achieve organizational goals when they

have a higher position of authority within their organizational hierarchy (H2c).

Corporate Findings

This research demonstrates that hierarchical authority is *associated* with statutory-tax incentives decisions within corporations. Hierarchical authority, however, is not a causal factor in incentive decisions.

Chief executives and central managers are more likely to be involved in statutory-tax incentive decisions when corporations are considering large one-time expenditures—such as a new headquarters, a distribution center, a new manufacturing plant, or a major expansion to existing facilities. Central administrators are much less likely to be involved in decisions to claim statutory-tax incentives for on-going development and routine investment. In both situations, statutory-tax incentives are viewed as benefiting the entire corporation. In the first situation, incentive benefits are used to offset the costs of a large expenditure. In the second situation, incentive benefits are used to decrease the routine costs of ongoing investment and development—for example, routine investment in new computer equipment or fleet vehicles.

The evidence demonstrates, therefore, that hierarchical authority affects the type of business activity in which a manager is likely to consider statutory-tax incentives, but not whether the incentive benefits are used to achieve organizational goals. H2c is, therefore, unsupported for corporations.

Governmental Findings

This research does not find sufficient evidence to support H2c within governmental organizations. Both executive-level managers and their subordinates presented concerns that statutory-tax incentives may not stimulate increased business activity, and therefore may harm the interests of their organization. Both groups also demonstrated a commitment to simplifying and streamlining the incentive process as a means to improve the program and to help their organization.

It should be noted that rejecting H2c for governmental organizations could be due to an insufficient span of hierarchical authority among the interviewed officials and due to the close working relationship between the managers and executives in the KDOR and the KDOC.

Goal Displacement within the Co-management of Incentive Programs

This section examines three hypotheses that are used to examine the effect of goal displacement on the co-management of statutory-tax incentives by governmental and corporate managers.

Do Governmental and Corporate Managers Seek to Achieve Organizational Objectives Over the Objectives of Statutory-tax Incentive Policies?

The first two hypotheses (H4a & H4b) are similar to the first two hypotheses in this chapter involving goal displacement within organizations (H2a & H2b). These hypotheses suggest that governmental and corporate managers will seek to promote the use of statutory-tax incentives or to suppress their use depending on whether they view statutory-tax incentive programs as beneficial (H4a) or harmful (H4b) to the objectives of their organization; and that managers will seek to achieve their organizational goals, even if those actions harm the pursuit of incentive policy objectives.

Corporate Findings

Statutory-tax incentive policies are designed with the assumption that corporations are profit-oriented. Corporate managers are expected to view incentives as a means to stimulate business development beyond what could otherwise be accomplished in order to increase corporate profits—as sort of a budget maximizing view of corporate managers.

Corporate managers do use statutory-tax incentives to increase profits but they rarely stimulate additional investment. Instead corporate managers use incentives in two complementary ways.

First, corporate managers use statutory-tax incentives to minimize development costs. Managers are not likely to alter their plans in order to receive an incentive benefit. Instead, once development plans are established, they seek out any means available to offset their projected costs. Managers state that statutory-tax incentives are increasingly looked at as one of the ways to lower development expenses. In the following quote, a tax manager describes how statutory-tax incentives are used to justify large expenditures and to offset miscellaneous costs of business activity.

> These incentives are used to justify the expenditure and also where the expansion should take place. We compare the options and then make an informed decision considering all of the costs of operating in those locations and the taxes along with all of the other costs associated with that location. (Tax Manager of Multinational Manufacturing Corporation, 1N)

The second way the corporate managers use statutory-tax incentives is to minimize their tax liability. Corporate activity creates taxable income and increases the firm's state income tax liability. Corporate tax managers monitor their income tax liability in the states where they operate and look for opportunities to minimize their tax liabilities. In the following quote, a tax manager from a multinational corporation describes how he pursues statutory-tax incentives once he knows that he has a significant enough tax liability to warrant incurring the costs of claiming the incentive benefits.

> What I do is I look for where I have a stable amount of income, and therefore income tax, before I get involved with some of the credits because I do not do it just once because it costs me more to do it the first time, to understand and develop it; and then, once I've got a steady stream of income tax that I'm trying to cover, then I know it is

> worth pursuing that credit and going after it year after year. (Tax Direct of Multinational Food Services and Accommodations Corporation, 1A)

Because corporate managers are looking to minimize tax costs, state incentive programs that offer significant benefits on paper may not be attractive to firms because the firm does not have a significant tax liability in the state. The following quote, however, demonstrates the importance of considering a corporation's expected tax liability in determining whether incentive programs are likely to entice managerial actions.

> When I think of strictly an income tax credit, if it's in a particular state or jurisdiction where we have a lower tax liability, the credit could be, let's say you've got an investment tax credit, where you get a credit for 10 percent of the capital that you spend and you spend $100 million and you get $10 million in tax credits, but if you're tax credit liability is only $100,000 a year, that credit does not mean a lot to you. (Finance and Development Executive of Multinational Manufacturing Corporation, 1I)

The evidence provides strong support for H4a and H4b. Corporate managers use incentive programs to benefit their corporations and do not achieve policy objectives.

Further econometric analysis should be used to better establish the effect of tax liability on corporate management of statutory-tax incentives. Preliminary logistic regressions indicate that a corporation's tax liability is a highly significant factor in predicting whether a corporation manager will chose to claim a statutory-tax incentive in any given year.

Governmental Findings

The KDOC's core goals are identical to the policy objectives of economic development-based statutory-tax incentives and, unsurprisingly, this study finds that KDOC administrators use incentive programs to further economic development in Kansas.

In contrast, the KDOR's mission is to collect revenue and I expected to find that they would resist implementing statutory-tax incentive policies. Some corporate managers view revenue departments as "adversarial" to statutory-tax incentive programs. In several interviews, corporate managers explain how they discussed development plans with the KDOC and understood that they would qualify for a certain amount of incentive benefits. Managers contended that once the development was completed, the KDOR denied or reduced the expected benefits. A state administrator described this perception as "what commerce giveth, revenue taketh away."

State officials, from both the KDOC and the KDOR, dispute the accuracy of corporate manager's perceptions. Several factors contribute, they claim, to corporate misperceptions. State administrators often find that the projected numbers, time lines, and arrangements that corporate managers presented to the KDOC are substantively different that is actually invested. Also, corporate managers tend to hear what they want to hear when they are being offered benefits from the KDOC without paying attention to important provisions that can affect benefit levels. Finally, state

administrators find that the corporate managers who are first involved in discussing the projected benefits are often different from the managers who implement the project and, as a result, the original information regarding incentive criteria is poorly communicated and development plans often change. The evidence in support of H4a and H4b is inconclusive.

Do Governmental and Corporate Managers Seek to Influence the Development of Statutory-tax Incentive Policy in Order to Achieve their Organizational Objectives and not the Objectives of Statutory-tax Incentive Policies?

Statutory-tax incentive programs have several characteristics of classic formal organizations. One element of this research project is to examine the extent to which formal organizational theory applies to multi-organizational rational institutions such as statutory-tax incentives. One way that statutory-tax incentive programs are found to differ from classic formal organizations is that statutory-tax incentive programs need state agencies and corporations in order to achieve their rational objectives but those same organizations do not need the statutory-tax incentive to achieve their goals. Organizations, therefore, do not have the same type of self-interest in the survival of statutory-tax incentive programs that subunits have in the survival of their organizations.

Revenue departments, in fact, are probably better able to achieve their organizational goals without incentive programs. It may, therefore, be more

dysfunctional (using Merton's term) for a revenue department to seek the objectives of the incentive program than for the department to pursue its own goals at the expense of the program—unless, of course, the incentive program is able to stimulate the creations of additional tax revenue. Revenue departments, however, do not need to sabotage an incentive program in order to pursue their own objectives. Alternatively, they can attempt to influence statutory-tax incentive policy so that incentive programs assist them in their pursuit of their own organizational goals.

The revenue department, of course, is not the only organization that may seek to influence incentive policy. Corporations and departments of economic development also have an interest in incentive policies and may seek to influence programs to better achieve their own organizational goals as well. Such behavior is another example of how goal displacement may influence the implementation of statutory-tax incentives. The last goal-displacement hypothesis (H4c), therefore, examines whether corporate and governmental managers attempt to influence statutory-tax incentive policies so that those policies help them achieve their own organizational goals.

Corporate findings

Only a few of the corporate managers interviewed for this study stated that they have attempt to influence statutory-tax incentive policies. One of the interviewees stated that he occasionally lobbies his elected state officials to maintain

the incentive programs. None of the other corporate managers indicated that they interact directly with elected officials involving statutory-tax incentives or indirectly through business interest groups.

State administrators indicated that the most common interaction between corporate managers and elected officials, to their knowledge, is associated with legislative case work for corporate managers who have enquired about incentives that they may be entitled to or who wish to complain that they have been denied incentive benefits they feel they rightfully deserve. These contacts, however, do not represent attempts to alter statutory-tax incentive policy.

Some corporate managers seek to influence incentive policies through their work with state administrators. One interviewee, quoted below, described how he occasionally has to "educate" state administrators about the importance of tax liabilities in determining whether to claim a statutory-tax incentive.

> You have to do a little education with the Department of Economic Development, and say I know you offer these types of credits, but because of our tax position they are not valuable. They are not going to make an impact. (Finance and Development Executive of Multinational Manufacturing Corporation, 1I)

These findings suggest that corporate managers occasional seek to influence statutory-tax incentives policies in order to better achieve their own organizational goals. Those efforts, however, tend to be unorganized and infrequent.

GovernmentalFindings

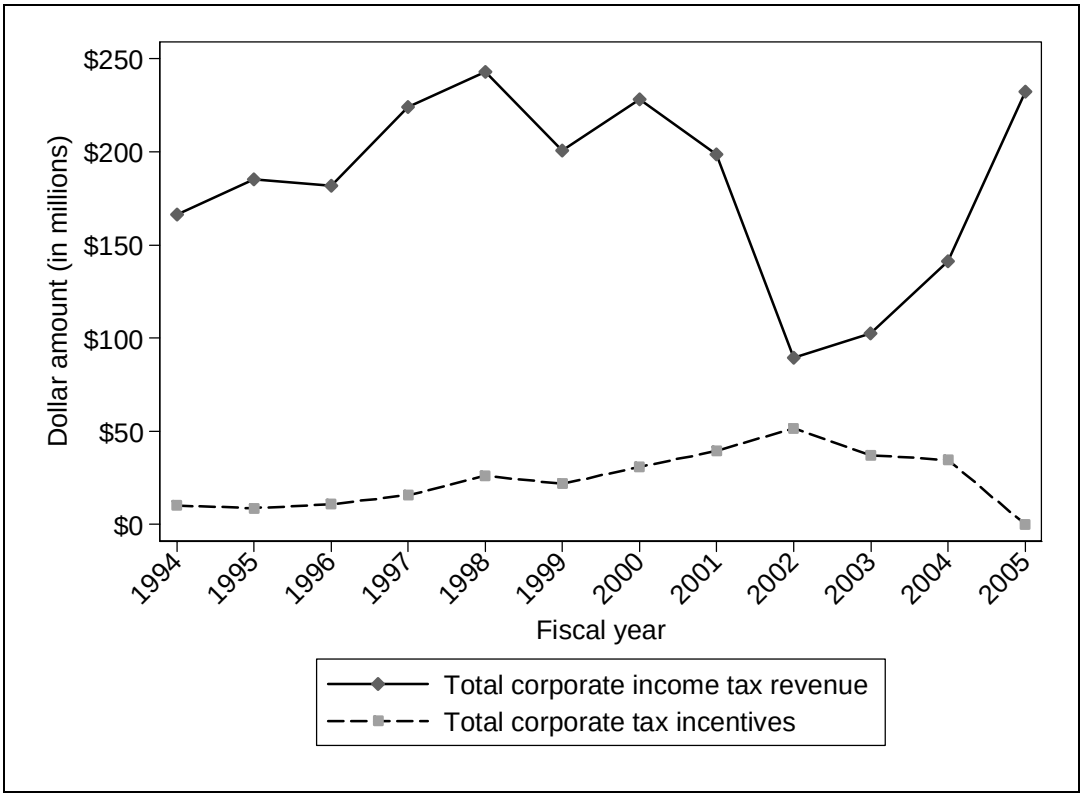
State administrators occasionally work with elected officials to “improve” statutory-tax incentive programs. Administrative efforts to alter statutory-tax incentive policies are primarily related to concerns that statutory language is unnecessarily complex and, therefore, inhibits state and corporate managers from effectively implementing incentive programs.

In an attempt to create usable incentive programs, administrators occasionally work with elected officials to simplify and clarify statutory language and policy regulations. Those changes are usually incremental, but occasionally state administrators endorse large substantive changes to incentive policies. Efforts to change incentive policies are usually intended to improve program performance. For example, the KDOR and the KDOC recently co-endorsed a bill that is intended to combine three incentive programs into a single program in order to simplify incentive procedures and thereby to make the programs more useable by corporate managers.

Though state administrators are primarily concerned with improving the performance of incentive programs, their perceptions of what changes will improve those programs is partly shaped by their organizational goals. For example, KDOC administrators are supportive of the use of refundable and transferable tax incentives. KDOR administrators, on the other hand, are concerned that refundable and transferable incentives will harm state revenues and, therefore, have been less supportive of those policy provisions.

It may appear, at times, that state administrators use their monitoring and evaluation functions in order to influence incentive programs in their favor. The KDOR, for example, has produced several reports over the past four years that have all been critical of existing incentive policies. One can reasonably interpret that this increased evaluation activity, and the critical nature of those reports, as evidence that the KDOR is responding to an apparent threat that statutory-tax incentives pose to state corporate income tax revenues. Graph 6.1 illustrates the economic conditions in which this increased evaluation activity has occurred. In 2002, the state of Kansas had a sharp decline in corporate income tax revenues. Statutory-tax incentive benefits, which had comprised only 5 percent of corporate income tax revenues in 1998, increased to 50 percent in 2002. Though the KDOR had conducted little previous analysis of statutory-tax incentive programs, they began producing annual reports that were critical of incentive programs in 2003.

It is incorrect, however, to attribute the KDOR's increased evaluation efforts solely to the interests of its administrators. Those reports, in fact, were in response to legislative requests for the KDOR to determine Kansas's "return" on their incentive "investments." No doubt the decreased corporate income tax revenues and the increasing incentive benefits greatly contributed to the legislature's interested in evaluating statutory-tax incentives.



Graph 6.1. Income tax revenues and tax incentives in Kansas.
Source: Various reports from the Kansas Department of Revenue, 2002-2006
Note: Constant dollars (2004).

In response to this legislative request, the KDOR initiated several studies on the effects of statutory-tax incentives. The KDOR contracted with researchers from the University of Kansas for two of the reports. Each report has used different data and analytical techniques and each has found that statutory-tax incentives have not stimulated growth in the Kansas economy. The KDOR and KDOC have used these findings to recommend changes to statutory-tax incentive policies, but those changes have been intended to simplify incentive programs in order to create more useable programs for Kansas corporations.

CHAPTER SEVEN

EVIDENCE OF TRAINED INCAPACITY

In this chapter, I examine whether corporate and governmental administrators demonstrate trained incapacity in their implementation of statutory-tax incentives. Trained incapacity occurs when workers are highly efficient at performing routine and specialized tasks and thereby become inflexible and unable to adapt to new circumstances (Merton 1940).

I use three hypotheses to test for trained incapacity. The first two hypotheses are used to test for evidence of trained incapacity *within* corporations and state agencies. To test those hypotheses, I examine whether subunit administrators are overly committed to well-established managerial practices and thereby resist implementing statutory-tax incentives or neglect to implement incentive programs even when those programs might benefit their organizations. The third hypothesis is used to look for trained incapacity in the co-management of statutory-tax incentives. To test that hypothesis, I examine whether state and corporate managers attempt to preserve well-established administrative practices in their implementation of statutory-tax incentives.

This chapter proceeds in two sections. In the first section, I present the findings for the first two hypotheses; in the second section, I present the findings for the third hypothesis. Based on evidence from the management of the Kansas Department of Revenue (KDOR) and the Kansas Department of Commerce (KDOC),

I reject the trained-incapacity hypotheses as they apply to governmental administration. I find, however, sufficient evidence to support the trained-incapacity hypotheses both within corporate subunits and in the co-management of statutory-tax incentives by corporate managers.

Trained Incapacity within Corporations and State Agencies

In this section, I present the findings of the first two trained-incapacity hypotheses. Both hypotheses focus on the administrative behavior of subunit managers within corporate and governmental organizations. The first trained-incapacity hypothesis (H3a) is used to test whether managers resist implementing statutory-tax incentives when those policies necessitate a change in their subunit's administrative routine. The second trained-incapacity hypothesis (H3b) is used to test whether administrative resistance is especially likely in subunits that are process-oriented—operationalized as auditing and eligibility subunits in state agencies and accounting and tax divisions in corporations.

I considered two types of resistance in the analysis of administrative behavior: intentional resistance and resistance due to a subunit's own administrative inertia.

Managers may intentionally resist statutory-tax incentives in several ways. Government administrators, for example, may allocate insufficient resources to properly manage incentive tasks (e.g. insufficient staff support, limited time commitment), limit the visibility of incentive programs to corporate taxpayers, or

increase the procedural complexity for claimants in order to limit the number of participating corporations. Corporate tax managers may exaggerate the costs of claiming statutory-tax incentives or understate the expected benefits to persuade relevant decision-makers that incentives do not provide a sufficient net-benefit; or, tax managers may limit the amount of information they provide to decision-makers in order to minimize managerial awareness of incentive programs.

Managers may also resist statutory-tax incentives due to their own administrative inertia. In corporations, for example, this may occur when investment managers routinely forget to consider possible incentive benefits when making development decisions, or when accounting administrators do not research changes in incentive provisions and thereby fail to claim incentive benefits for which they are eligible. In government agencies, auditors and development specialists may neglect to adapt their practices to changes in incentive policy, thereby increasing the probability that corporation managers will appeal their administrative decisions and that elected officials will increase legislative oversight.

In this study, I do not find evidence of intentional resistance by subunit administrators. I do, however, find evidence of resistance due to administrative inertia within corporate subunits. The findings are presented below—first hypothesis 3a then hypothesis 3b.

Do Subunit Managers Resist Implementing Statutory-tax Incentives when those Incentive Programs Necessitate Changes in their Managerial Routines, even when Incentive Programs are Likely to Serve Organization-wide Interests?

Corporate Findings.

Operations and investment managers demonstrate trained incapacity in their management of statutory-tax incentives (H3a) when they neglect to research possible tax incentives in the process of making investment decisions even though they are expected to evaluate incentive programs as a standard practice in investment decisions.

In the following quote, a manager describes how an operations subunit failed to consider important incentive program criteria before making a large investment and, as a result, the corporation was ineligible to claim significant tax breaks. The manager also describes how, since that time, the tax division has sought to better "educate" the operations subunit so similar mistakes are not repeated.

> Since [we missed that opportunity to claim a credit], we have worked with our operations people to try and get them educated about the credits that are available to us. In the future, just to have that knowledge upfront to make decisions about expansion, get that information into the budgets and the estimated costs. (Tax Manager of National Professional Services Corporation, 1M)

It may take several years for investment managers to change their established practices and to include incentive criteria in their routine information gathering process. This finding suggests that some incentive policies may have a significant lag

time before they regularly affect corporate decisions. In the following quote, a tax manager describes the administrative inertia of investment managers and the effort that is required to move incentive criteria into the "forefront" of their thought process.

> A lot of the history, through the 90s, a lot of that was really hit or miss. Especially at the store level, just, oh, there is something statutory, great, let's take it. And I think it's now becoming a little more in the forefront of people's decision making, and it is asked more and more. It's always been in the thought process, but now it's a little more at the forefront of that thought process. So every real estate manager, when they're looking at sites, asked the question now. And when we do our research now going into a new state, we asked the question. In theory, that's what happened 10 years ago, but it probably did not always get put into practice as well as it does now. (Tax Manager of National Retail Corporation, 1F)

Governmental Findings

This research does not find that governmental subunit administrators resist implementing statutory-tax incentives—either intentionally or due to administrative inertia. Hypothesis 3a, therefore, is not supported for government organizations.

State administrators, of course, do not always like implementing incentive programs. One state administrator explained a common response of state managers in this way: "A lot of people will look at [statutory-tax incentives] with distaste because it is just additional work on their plate that they have to learn how to process and do whatever they have to do with each credit. But I think we pretty much just roll with it." There is no evidence, however, that administrator dissatisfaction with statutory-tax incentives leads to program resistance within governmental subunits.

Are Administrators Who Work in Process-oriented Subunits Less Likely to Match Their Use of Statutory-tax Incentives to General Organizational Goals?

Hypothesis 3b is used to examine whether administrators in process-oriented subunits are more likely to exhibit trained incapacity in their management of statutory-tax incentives. This hypothesis is based on the expectation that process-oriented subunits are more likely to develop highly routinized and inflexible administrative practices than generalist subunits with broader administrative responsibilities. It is expected, therefore, that administrators within process-oriented subunits are more likely to resist incentive provisions that will necessitate changes in their established routines; and, that process-oriented administrators will resist those changes even when adopting the new provisions may serve the interests of their organizational. I test this hypothesis by examining whether managers in process-oriented subunits are more likely to resist changes in their management of statutory-tax incentives. Process-oriented subunits are operationalized as accounting and tax divisions in corporations and auditing and eligibility subunits in state agencies.

Corporate Findings

Prior to conducting the analysis, I expected that managers in accounting and tax subunits would resist implementing statutory-tax incentives because of possible

disruptions that incentive provisions would impose on their subunit. This study, however, finds no correlation between a corporate manager's functional subunit and their resistance to using statutory-tax incentives. Tax managers, as expected, are highly concerned with compliance costs. However, they do not consider high compliance costs a threat to their subunit but as a factor that decreases an organization's overall profits. Tax managers resist changes that negatively affect corporate profitability and do not resist changes, though they often disrupt their subunit, that positively affect their organization. Hypothesis 3b, therefore, is not supported in corporate organizations.

Governmental Findings

In this study, I found that administrators in process-oriented subunits do not demonstrate resistance to changes in statutory-tax incentive programs. The only noticeable difference between administrators in process-oriented subunits and other administrators was a higher level of detailed knowledge about statutory-tax incentive procedures and rules. This finding may be attributed, in part, to the relative stability in Kansas statutory-tax incentive policy over the past decade. Significant changes in incentive policies may stimulate resistant behavior. This finding may also be attributed to the high level of coordination amongst subunit managers in state agencies. Policy analysts, auditors, appeals officers, and program managers frequently discuss, formally and informally, the different incentive programs and

work together to identify ways to improve the management of those programs that benefit all the subunits.

Trained Incapacity and the Co-management of Statutory-Tax Incentives

In the previous section, trained incapacity is considered from a classic Mertonian perspective—affecting administrative behavior within subunits of a Weberian-bureaucracy. In this section, I adapt Merton's concept to test for trained incapacity within a multi-organizational institution. The adaptation is done by viewing government agencies and corporations as functional subunits and the statutory-tax incentive programs as organizations.

Trained incapacity is observed in the co-management of statutory-tax incentives when managers seek to preserve their organizational routines from changes in incentive policies. I test the hypothesis by examining whether (1) corporate administrators seek to preserve incentive-programs that they routinely claim, and if (2) corporate administrators resist claiming new incentives, and if (3) state administrators resist changes to well-established incentive programs. In each organization, I analyze whether the administrative behavior is likely to achieve or inhibit the intended policy outcome and stimulate economic development.

Are Administrators More Likely to Resist Changes in Statutory-tax Incentive Policies When They are More Experienced in the Management of Those Programs?

Corporate Findings

This research finds that corporate managers exhibit trained incapacity in their co-management of statutory-tax incentives (H5a). Managers demonstrate trained incapacity in their reluctance to claim a statutory-tax incentive for the first time; and then, once they are experienced with managing an incentive program, their resistance of changes to incentive policies. To understand this behavior requires further discussion of the importance of costs, risk, and tax liability in the management of statutory-tax incentives.

Corporations often incur significant costs in order to claim a statutory-tax incentive. Relevant costs include both the transaction costs of gathering the necessary documentation and completing the appropriate paperwork in order to claim an incentive and the opportunity costs in dedicating staff time to claiming an incentive when other tasks may return greater benefits. The cost of claiming a statutory-tax incentive depends on two factors: the corporation's experience with an incentive program and the complexity of the program. Costs decrease as managers become more experienced with claiming an incentive and as administrative procedures are put into place to gather the required documentation. Complexity increases transaction costs as managers must invest significant time in order to understand the program and

gather the required documentation; complexity also increases the risk that a manager may incorrectly process an incentive claim and, as a result, be denied a portion, or all, of the anticipated tax benefit.

Managers attempt to reduce costs by only using those incentives that they expect to claim multiple times—thus reducing the costs of future claims. Managers attempt to maximize their benefits by claiming statutory-tax incentives that are most effective at reducing their tax liability. The ideal incentive, therefore, is one that can be claimed for many years, is easy to process, and covers a significant portion of the corporate tax liability. Managers are more willing to incur high costs if they have large tax liabilities. A less favorable way to say it, from a public policy perspective, is that managers are most interested in statutory-tax incentives that remove their tax obligation while requiring the least obstruction to standard business practices.

This finding is based on interviews with corporate managers and analysis of Kansas corporate income tax return data. Results from those data sources are reviewed below.

Managerial attention to compliance costs and the importance of tax liability is demonstrated in the following quotes by a tax manager in multinational corporations. The salience of the tax liability is particularly important in corporations that operate in multiple political jurisdictions because they have the ability to shift investment activity from one state to another where a local corporation that conducts the majority of its business within a single state is not as likely to change the location of their entire business in order to claim incentive benefits in another state. In the first quote,

the manager describes how he looks for high and stable tax liabilities before he takes the time to explore possible incentive programs. In the second quote, the manager describes how large incentive benefits may not be as attractive as a state may think if the corporation does not have the tax liability to realize the benefit. In the third quote, a tax manager describes how he prioritizes his tax incentive efforts depending on the corporation's tax liability within the state and in relation to their federal liability.

> What I do is I look for where I have a stable amount of income, and therefore income tax, before I get involved with some of the credits because I do not do it just once because it costs me more to do it the first time, to understand and develop it; and then, once I've got a steady stream of income tax that I'm trying to cover, then I know it is worth pursuing that credit and going after it year after year. (Tax Direct of Multinational Food Services and Accommodations Corporation, 1A)

> When I think of strictly an income tax credit, if it's in a particular state or jurisdiction where we have a lower tax liability, the credit could be, let's say you've got an investment tax credit, where you get a credit for 10 percent of the capital that you spend and you spend $100 million and you get $10 million in tax credits, but if you're tax credit liability is only $100,000 a year, that credit does not mean a lot to you. So those are the kinds of things that we look at, that make an impact. And I ran into that very scenario in a project I was working on in [a northern state]. And so what you have to do to kind of balanced the sites is do a little education with the Department of Economic Development, and say I know you offer these types of credits, but because of our tax position they are not valuable. They are not going to make an impact. (Finance and Development Executive of Multinational Manufacturing Corporation, 1I)

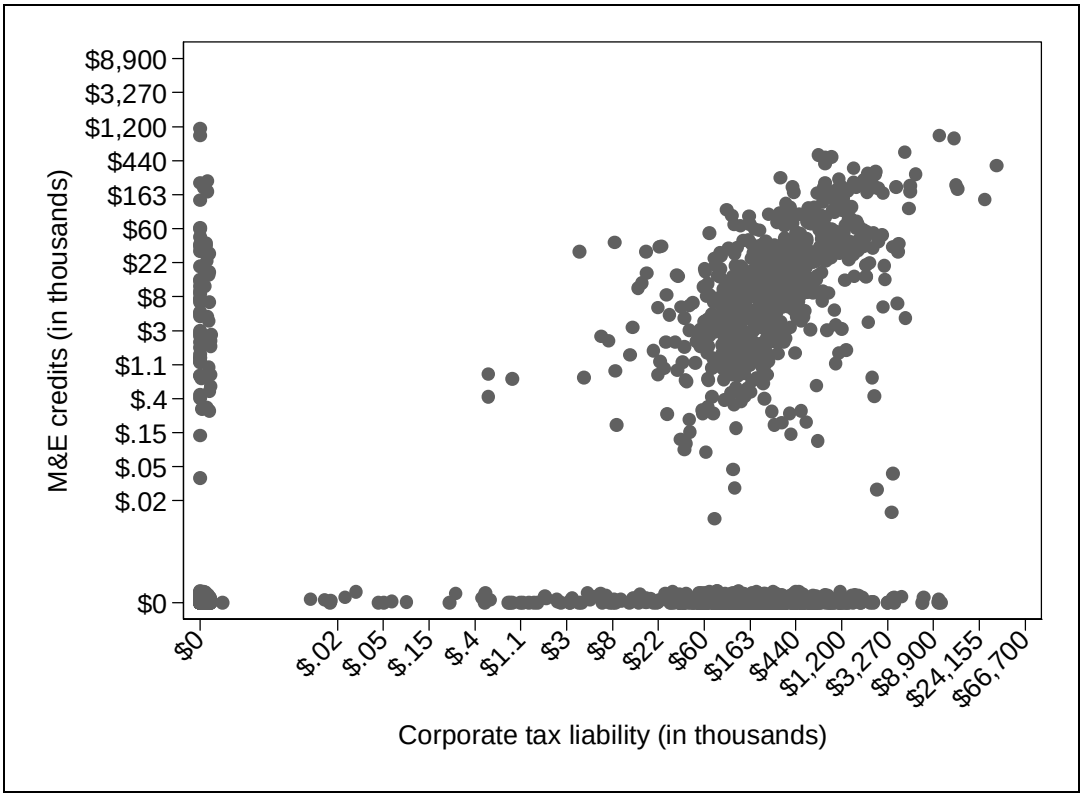
> Our federal credits take high priority, the dollars are much bigger, I mentioned [a western state], the dollars are much bigger. Those are higher priority. There are a few other states, where, just because the nature of our business we have a higher tax liability, so we focus on the credits in those states first. (State Income Tax Manager of Multinational Retail Corporation, 1J)

The importance of tax liability in the decision to claim a statutory-tax

incentive was further explored by analyzing Kansas corporate income tax returns from 1999 to 2004. This analysis allows use to analyze the relationship between tax liability and compliance costs. Compliance costs are examined by comparing the frequency of incentive claims across the four primary economic development statutory tax incentives in Kansas. Graphs 7.1 and 7.2 represent incentive claims for the Business Machinery and Equipment (M&E) credit and the Research and Development (R&D) credits respectively. These two incentives represent programs that are relatively easy to claim—both in terms of requiring a small amount of time to complete the necessary documentation and the policies are relatively unambiguous. Graphs 7.3 and 7.4 illustrate incentive claims for the Business and Job Development (B&J) credit and the High Performance Incentive Program (HPIP) credit. These two programs are much more complex.

The M&E credit is the easiest of the four incentives to claim. The M&E credit allows corporations to reduce their state income tax liability in portion to the amount of personal property tax they paid to Kansas local governments. The necessary property tax numbers are usually very accessible. Corporate managers indicate that it generally takes less than two or three hours to complete the necessary documentation to claim this credit. The M&E credit is different from the other credits because it is refundable—corporations can receive a refund if their M&E credit exceeds their total tax liability. The refundability of the M&E credit is the reason that several corporations claim significant amount of M&E credit though they have no tax liability. Of those corporations with a tax liability though, you'll notice in graph 7.1,

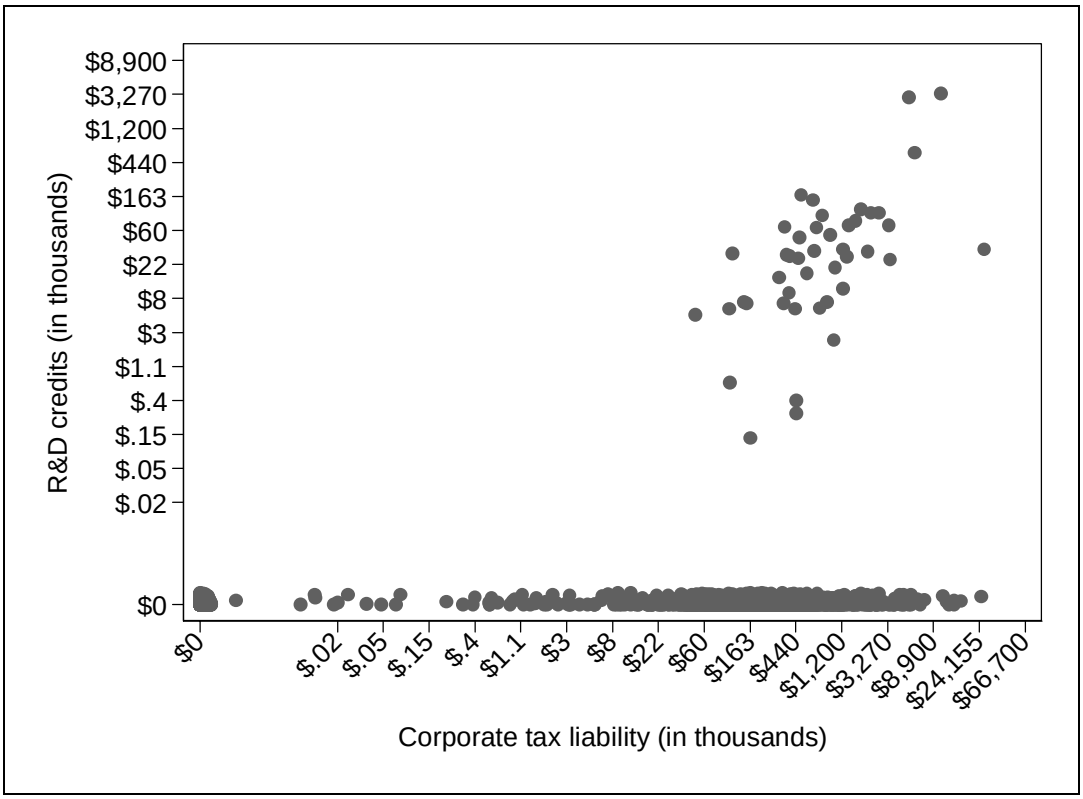
compared to the other graphs, that the M&E credit is frequently claimed, and that there is a weak correlation between incentive claims and tax liability. Because this incentive is easy to claim, corporate managers are willing to claim the incentive even if it does not reduce their full tax liability.



Graph 7.1. Corporate tax liability and the decision to claim the business machinery and equipment credit. *Source:* Kansas corporate income tax returns from 1999 to 2004, data compiled by the Kansas Department of Revenue. *Note:* 1,492 unique tax returns from 282 corporations. Source data is log transformed but axis labels represent actual dollar values. Data points are "jittered" in order to demonstrate multiple observations at the same data point.

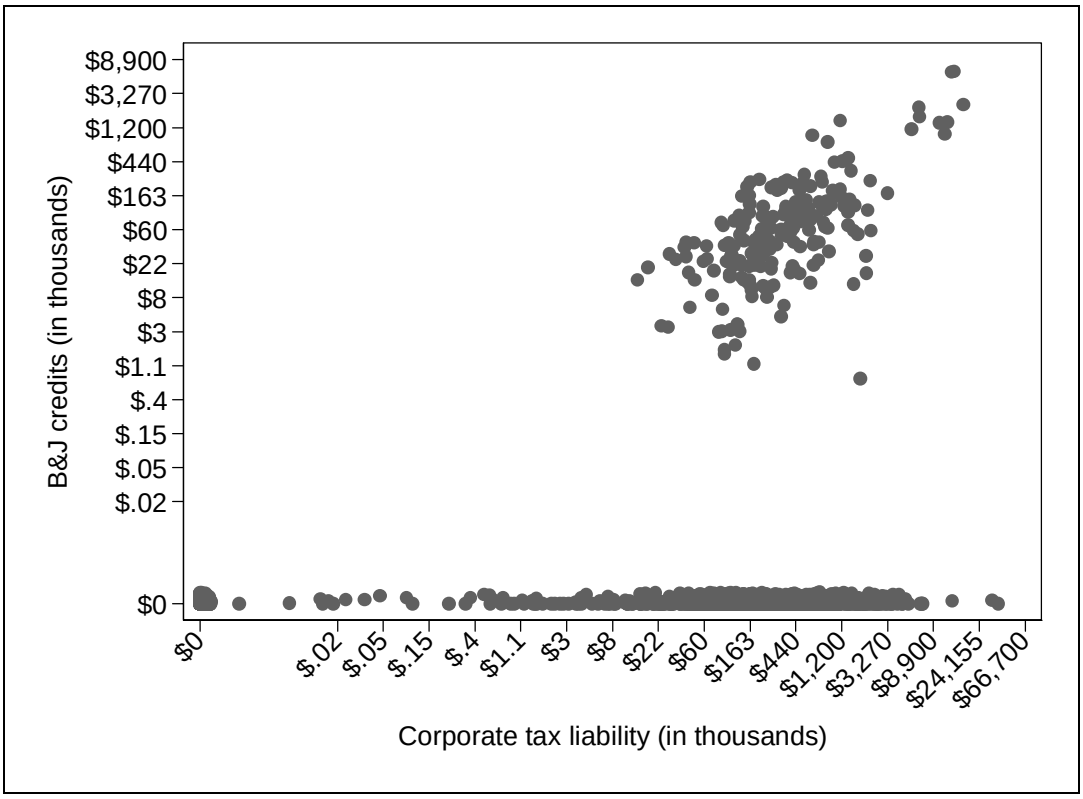
Like the M&E credit, the Research and Development Credit (R&D) has relatively low compliance costs. The R&D credit is linked to the Federal

government's R&D credit. Therefore, corporations that have already undergone the costs of calculating their Federal R&D credit only need to determine how much of that research and development occurred within Kansas in order to claim the Kansas benefit. Like the M&E credit, there is little correlation between a corporation's tax liability and their R&D credit (see Figure 7.2). Because fewer corporations engage in research and development than own personal property, there are relatively few corporations that claim this benefit. The R&D credit is not refundable, so, unlike the M&E credit, there are no incentive benefits that exceed the corporation's tax liability.



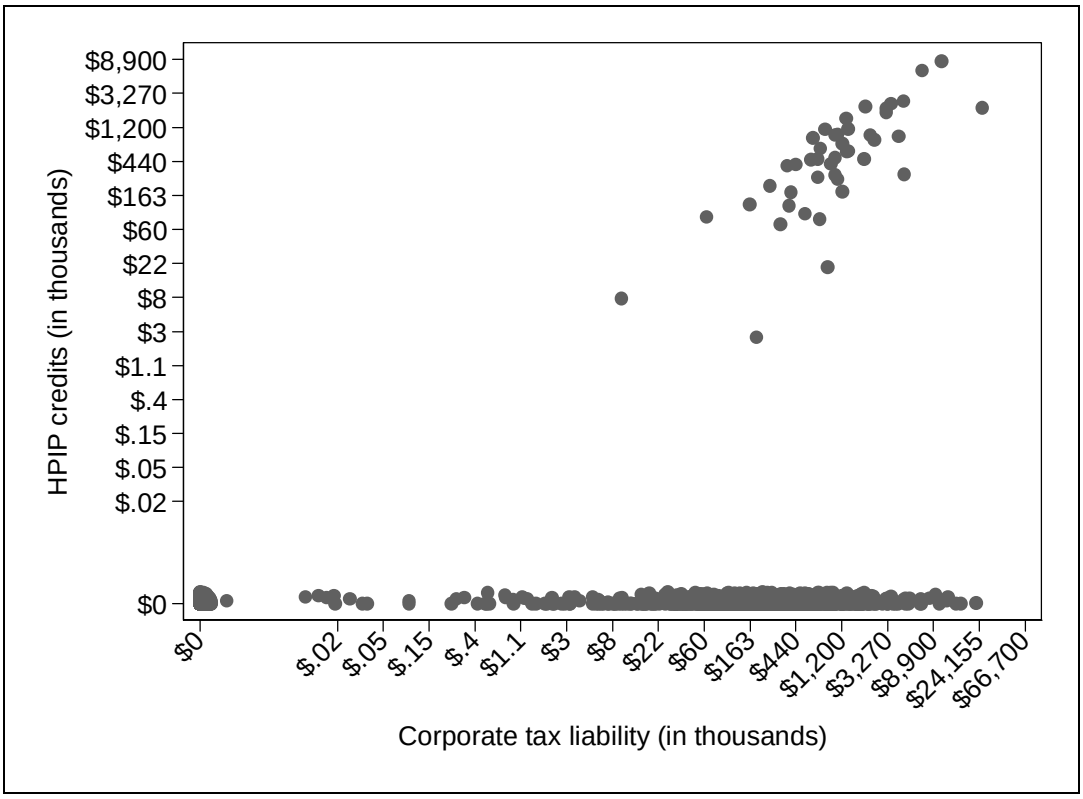
Graph 7.2. Corporate tax liability and the decision to claim research and development credit. *Source:* Kansas corporate income tax returns from 1999 to 2004, data compiled by the Kansas Department of Revenue. *Note:* 1,492 unique tax returns from 282 corporations. Source data is log transformed but axis labels represent actual dollar values. Data points are "jittered" in order to demonstrate multiple observations at the same data point.

The Business and Job Development credit (B&J) and the High Performance Incentive Program credit (HPIP) are significantly more complex than the M&E and R&D credits. State administrators estimate that those two programs occupy nearly ninety percent of the time they spend on incentive programs. The majority of corporate appeals and negative audit actions involve these two programs as well. Figures 7.3 and 7.4 demonstrate how, relative to the first two credits, incentive benefits are more closely correlated with the corporation's tax liability. Corporate managers do not undergo the higher costs of these programs unless those costs lead to a significant reduction in their tax liability. (I identify possible reasons for the number of corporations that cluster on the x-axis in the chapter endnotes).[1]



Graph 7.3. Corporate tax liability and the decision to claim the business and job development credit. *Source:* Kansas corporate income tax returns from 1999 to 2004, data compiled by the

Kansas Department of Revenue. *Note:* 1,492 unique tax returns from 282 corporations. Source data is log transformed but axis labels represent actual dollar values. Data points are "jittered" in order to demonstrate multiple observations at the same data point.



Graph 7.4. Corporate tax liability and the decision to claim the high performance incentive program credit. *Source:* Kansas corporate income tax returns from 1999 to 2004, data compiled by the Kansas Department of Revenue. *Note:* 1,492 unique tax returns from 282 corporations. Source data is log transformed but axis labels represent actual dollar values. Data points are "jittered" in order to demonstrate multiple observations at the same data point.

Once corporations begin to claim a statutory-tax incentive they include the expected annual benefits in their budget projects. The decision to claim an incentive then becomes part of the routine process of filing their corporate tax return. Any change to the incentive program may threaten their expense projects. These corporations, therefore, become invested in the incentive programs and they resist attempts to change the program. Policy analysts may determine that an incentive

program is failing to stimulate economic development and may even be harmful to state interests but the constituents of that program will resist attempts to substantively alter the program. The following quote from a state administrator illustrates this managers experience in trying to alter incentive policies.

> At a certain point for a lot of companies, [the incentive] are not about encouraging behavior, it is just built in their normal course of doing business and their bottom-line transactions. And that is why, when there have been efforts to change the credits, or to change the structure, even though from looking at it from an economic development standpoint you are really getting at the heart and maybe you are even enhancing the credits for making decisions to add a production line and to invest millions of dollars, but you have the folks on the other side who are more in a maintenance mode but are making some investment and adding some people who may want to resist some of this because they see that as a threat to the benefit that they have already built into their transactional activity and are projecting that for the next five years.

Governmental Findings

All four of the statutory-tax incentive programs of interest in this study have been administered in Kansas for at least 13 years and most of the state administrators who were interviewed have work with those programs for over a decade. They are clearly skilled and experienced in managing the statutory-tax incentives. Those administrators, however, are more likely to identify areas where the programs need to be changed than to demonstrate resistance to change.

Several administrators favor dramatic changes to the states incentive program that will greatly increase the complexity of their jobs in the short term. As an example, in early 2007, KDOR and KDOC officials recommended that the legislature

merge three incentive programs into one and greatly simplify the incentive procedures and rules. That proposal would certainly simplify the management responsibilities of state administrators, but the proposal primarily was in response to making the incentives more useable for more corporations.

Other suggested changes would not simplify their administrative responsibilities. One administrator, for example, discussed the possibility of incentives through direct expenditures rather than through tax breaks—a change that would certainly change administrative practices in the KDOC. Another administrator described how current statutory provisions are ill suited for the "new" economy:

> The world is changing and the credits were set in place for a specific type of an economy at that point in time and then things change and our tax incentives do not seem to be changing with the times. Like how we are all going wireless, and with telecommunication and all that, I do not know if our credits are really moving as fast as the global economy or whatever we want to all it. (2O)

State administrators regularly demonstrated a willingness to make significant changes in their management of statutory-tax incentives, despite many years of experience in managing the current programs. State administrators appear to be more focused on achieving benefits for the state of Kansas than in defending the routine operations of their organizations. Hypothesis 5a, therefore, is rejected regarding state administrators' role in the co-management of statutory-tax incentives.

Notes

1 There are several reasons why a corporation may have not claim a statutory-

tax incentive, even when they have a high tax liability. First, the corporation may have high income but has not recently undergone any of the necessary activities to qualify for an incentive program. Second, the corporation may be classified in an industry-type that does not qualify for the incentive and they do not meet any of the necessary exemptions. Third, the corporation may have an unstable tax liability and chose not to undergo the compliance costs to claim the benefits for only a few years. Fourth, the corporation may be receiving another tax incentive and there may be diminishing returns from claiming a second incentive program. Fifth, the corporation's tax liability may be relatively low compared to their liabilities in other states and, therefore, incentive efforts are concentrated in states where the corporation can receive relatively higher net benefits. Six, the corporation may be poorly managed and unaware of statutory-tax benefits in which they qualify. More research is needed to better understand the relationship between tax liability and incentive behavior.

CHAPTER EIGHT

CONCLUSION

One of the most popular and controversial economic development strategies in state government is the availability of statutory provisions that allow corporations to reduce their tax obligations when they expand their operations, hire additional workers, invest in new facilities or equipment, and/or develop new and innovative technologies and procedures. The popularity of these so-called statutory-tax incentives is based, in part, on widely-held assumptions that greatly simplify the expected role of management and organizations in their implementation. Corporations are thought to act as a single unitary actor. Corporate managers are expected to consider tax incentive benefits as part of a rational cost-benefit analysis prior to making investment decisions. Government managers are assumed to be neutral implementers. And, tax incentive programs are expected to impose little to no additional administrative tasks because state agencies already manage business recruitment and administer the tax system. Management, therefore, is not expected to influence tax incentive programs because its role is thought to be clearly limited by financial incentives and institutional rules.

In contrast to the popular perception of tax incentives, this study demonstrates that management and organizations matter in the implementation of tax incentives. Tax incentive benefits rarely play a substantive role in corporate cost-benefit analysis prior to investment decisions. Instead, corporate managers claim tax incentives in response to the salience of their corporate tax liability. In addition, corporate

managers are as likely to be influenced by the costs of tax incentive programs as the projected benefits.

State administrators affect tax incentives through their influence on program procedures, rules, compliance auditing, and information. Some tax incentive programs are complicated to administer and state managers must cooperate across multiple functional subunits in order to solve problems and improve program design. Their actions, however, are likely to influence the number of corporations that claim tax incentives but are not likely to improve the connection between corporate investment decisions and their consideration of tax incentives.

In this final chapter, I review the key findings and examine the implications of those findings on (1) the management of economic development and (2) the co-management of public programs by corporate and governmental organizations. I conclude with a discussion on the prospects for future research.

The Management of Economic Development

Corporate Management

Corporate managers use of statutory-tax incentives is to minimize business costs and thereby increase profits. Corporate managers, however, do not use statutory-tax incentives to reduce the costs of specific development projects (e.g. construction, hiring, or equipment purchase costs), as commonly assumed by policy

makers. There are two other types of costs that influence whether and how managers use statutory-tax incentives—tax costs and compliance costs.

Tax costs influence how corporate managers can be expected to use statutory-tax incentives based on the salience of the corporation's tax liability. For example, how does the corporation's tax liability compare their liabilities in other states? Is a corporation's tax liability expected to be stable, to increase, or to decrease? Corporate managers in firms that conduct business in multiple jurisdictions will look for those states with high, stable tax liabilities and focus their attention on those states where they are able to decrease the largest portion of their total corporate tax liability. Is a corporation's tax liability sufficiently high to disadvantage the corporation in relation to their primary competitors? Corporate managers are found to be more sensitive to tax costs when they are competing with other businesses to be the low cost provider of selected goods and services; tax incentives can help provide corporations with a small price advantage that translates into a large market advantage.

The second type of cost is associated with the administrative effort that is required to claim a tax incentive. Statutory-tax incentives provide corporations with tax benefits but corporate managers expect to incur opportunity and transaction costs in order to comply with program requirements. These compliance costs are especially high the first time a corporate managers seeks to claim an incentive benefit. Administrative costs include: searching out and evaluating potential incentive programs, determining whether the corporation qualifies for an incentive program, collecting the necessary documentation to claim the benefit, monitoring of the

incentive policy for any changes that affect its use, complying with occasional audits, and, potentially, undergoing an appeals process if state officials reduce or deny an incentive claim.

Corporations are not equally capable of managing the costs of tax incentives, nor do they have equal access to sufficient tax expertise in order to successfully complete the various tasks. Large national and multinational corporations usually have specialized in-house experts, they often subscribe to services that alert them on tax incentives policy changes, they have access to professional consulting firms that facilitate the claim process, and they retain their own legal counsel and are able to avoid unfavorable audit finds and to contend them if they occur. Smaller regional corporations rarely benefit from those advantages and, as a result, have less access to statutory-tax incentive benefits. And, arguably, it is the smaller less-developed firms that would most benefit from state assistance.

In order to understand how costs influence the management of statutory-tax incentives it is helpful to consider three decision processes where statutory-tax incentives are managed differently.

First, it is very rare for statutory-tax incentives to be considered during the strategic decision processes. The opportunity costs to consider every possible tax incentive program at this stage of development are too high. Rather, corporate managers make strategic business decisions based on market projections and usually do not consider detailed project costs and benefits until they have already drafted an investment plan—those plans often include well-developed expectations on the size

of facility, number of additional employees, and the necessary machinery. Too frequently, policy makers expect that tax incentives will influence strategic development decisions, but, by the time tax incentives are considered, the projects are generally too far along to be significantly affected in response to tax benefits.

The second decision process involves deliberative location decisions such as the siting of a new manufacturing facility, a corporate headquarters, or a distribution center. In these situations, statutory-tax incentives become one of many costs/benefits that corporate managers may consider when comparing different alternatives. Incentives are more likely to influence the location decision when corporations are confident they will receive the tax benefits with minor administrative costs and they expect to have a salient tax liability within the state.

The third decision process involves maintenance-type investments (e.g. annual purchase of new computers or routine machinery upgrades). Maintenance-type investments often qualify corporations for tax incentives; however, the operations managers who make those investments rarely consider tax incentives in advance of their investment. Instead, corporate accountants (internal or contracted) monitor operations activity and claim the tax incentives that the corporation is entitled at the end of the tax year. Tax managers will invest the time to look for tax incentive programs if their state tax liability is sufficiently high to distract them from other activities.

Governmental Management

This study finds that state administrators are highly committed to the effective and efficient implementation of statutory-tax incentives—even in the Kansas Department of Revenue where tax incentive programs increase administrative workloads and reduce tax revenues. Even when state administrators view tax incentives as “bad” public policy, they still seek to manage them as best as possible.

Though many of the necessary eligibility provisions are determined by legislative statute, state administrators affect the implementation of statutory-tax incentives through their management of incentive programs procedures, rules, compliance auditing, and information. State managers use this influence in an attempt to serve two purposes: first, to make the incentive programs more useable to corporate taxpayers; and second, to ensure that incentives are only claimed for approved purposes. They may seek, for example, to make incentives more “useable” to corporations by simplifying the process, or they may seek to limit “improper” incentive use by tightening the process. The former approach is likely to decrease compliance costs and thereby increase the number of corporations that claim incentives, though it is not likely to change their investment decisions. The later approach is likely to increase the transaction and opportunity costs associated with claiming an incentive.

The more costly the process, the fewer corporations that will, or can, claim the tax incentive. Those corporate managers who are most likely to follow through are

those that will likely realize the largest tax reduction, but the more stringent policy requirements are not likely to change their investment decisions. Stringent incentive policies, unless the rules accurately guide administrative decisions in expected ways, are more likely to limit benefits for smaller firms without altering the decisions of the largest, best resources corporations.

Implications for Economic Development Policy

These findings suggest several implications for the practice and study of statutory-tax incentives and economic development.

First, in the current logic, corporations qualify for tax incentives by performing specific development projects; however, this research finds that corporate managers are not motivated to claim statutory-tax incentives in connection with specific investments but rather in response to organizational tax costs. Policy makers need to shift their orientation from project-based development to incentives that are designed to benefit the whole organization. This may involve identifying ways to provide tax relief to corporations with high tax liabilities that are limiting their ability to reinvest in the state.

A second implication is the need for policy makers to recognize the organizational fragmentation of modern businesses. Corporations often conduct business in multiple states. If a nation or regional corporate headquarters are in State A, for example, the decisions on how to reinvest tax incentive benefits from State F

are likely to be made in State A and are unlikely to result in increased economic development in State F. Policy makers should consider developing incentive benefits to minimize the loss of tax revenues to other states.

These findings also inform the continued attempts to evaluate whether tax breaks stimulate economic growth through econometric modeling. Previous studies have modeled the incentive benefit as an independent variable that affects the dependent variable of business investment activity (e.g. increase number of employees, increased commercial and industrial facility square-footage, increased new business start-ups). This study, however, demonstrates that in most cases the decision to claim a statutory-tax incentive occurs after the qualifying business operation has already occurred. Future modeling would be more correctly specified, therefore, by considering economic output as the independent variable and the tax incentive benefit as the dependent variable.

The Co-management of Public Programs

Another key purpose of this study is to examine the feasibility of applying classic organizational theory to modern non-hierarchical multi-organizational structures. This research pursued that objective by examining whether statutory-tax incentive programs exhibit characteristics of organizational dysfunction—namely goal displacement and trained incapacity (Merton 1940). Multi-organizational structures have obvious differences with classic organizations—in particular, they

lack the same hierarchical controls and dependence of subunits on the whole organization. This study, however, finds that multi-organizational programs demonstrate many of the same dysfunctions as classic organizations. Corporations resist changes that will disrupt their established organizational practices; they also seek to maximize their own organizational objectives without concern for whether there efforts acheive program goals. Governmental organizations seek to effectively and efficiently execute statutory-tax incentive policy, even when they speculate that those programs harm the interests of their organization.

Like a classic organizational hierarchy where managers struggle to align the incentives of individual subunits to achieve organizational objectives, this study demonstrates the difficulty in aligning corporate self-interest to achieve public goals. Statutory-tax incentive programs are certainly susceptible to the typical unintended consequences that often follow the use of incentives to modify behavior. Statutory-tax incentives demonstrate two additional unanticipated consequences in corporate activity.

First, organizational actions depend, in part, on the role of the manager who acts as the link between the organizations and the program. The economic development literature usually views corporations as tightly-coupled institutions where tax decisions and development decisions are closely connected to concerns of corporate profit. Much of the current research on multi-organizational institutions, particularly network theory, also views each participating organization, or “node,” as a unitary actor. This research demonstrates that organizations may respond differently

depending on which subunit within the organization is responsible for the management of the program. Providing incentives through the tax system naturally leads to the incentive programs being managed by tax administrators who are particularly interested in tax liability and less connected to development decisions.

Second, the New Public Management movement includes an increased optimism in the ability of government policy makers to steer the production of public goods through incentives, grants, contracts, and vouchers without manage the programs. This research demonstrates that the devolution of public service production to private corporations favors those private organizations with sufficient administrative capacity to profit from those programs. This observation could be marked as a success by NPM proponents, but high-capacity corporations, arguably, are not expected to benefit as much from incentive programs as others. In order to assess incentive benefits, low-capacity corporations often turn to third party contractors who collect a sizeable share of the incentive benefits without altering policy outcomes.

Further Research

This study illustrates the need for further research in economic development and in the application of organizational and management theories to contemporary multi-organizational arrangements. This concluding section provides a brief discussion on research opportunities in each area of study.

Economic Development Research

First, this research demonstrates the need to better understand the motivations and actions of corporate and governmental managers in the implementation of economic development policies. Policy makers have assumed that tax obligations are connected to business investment; however, are their other types of incentive programs that are more likely to be considered during the strategic business process? How do corporate managers respond to direct cash subsidies for business investment? How might managers respond to the ability to purchase tax credits based on a future commitment to invest within a state? Experimental methods could be used to test these and other conditions to better understand how corporate managers respond to potential incentives. Such experiments should include managers from a wide-range of corporate subunits to better understand how a manager's functional position affects the ability of an incentive provision to motivate behavior.

Second, though Kansas programs are representative of programs in other states, little is known about the variation in statutory-tax incentive policies across the nation. Further research on these programs would benefit from an analysis of all fifty states in order to identify important similarities, categories, and difference in the policy design and organizational structure of these widely used programs. Such an analysis would contribute to the practice and study of economic development and tax policy.

Future research the management of statutory-tax incentives would benefit from cross-sectional survey research. This study greatly enhances such a pursuit by identifying a number of important criteria that may not have been considered without having first interviewed corporate and governmental administrators.

Management of Non-hierarchical Multi-organizational Structures

This research demonstrates the benefit of applying classic organizational theory to contemporary non-hierarchical organizations. Scholars may have tendency to place “old” theories on the shelf and preference “new” theories. Certainly the examination and testing of new theoretical trends is important. We are mistaken, however, if we put aside well developed theories because our current conditions appear to be notably different from previous conditions. Future research on multi-organizational structures will benefit from applying classic organization and management theories to better understand “new” organizational arrangements such as contracting, grants, incentives, and vouchers. Some specific research questions are suggested by this study. For example: What determines whether governmental administrators seek the objectives of their subunit, their organization, or a program when those objectives are not consistent? Why do governmental administrators engage significant effort in programs that they suspect are not working? What role do elected officials play in the co-management of public programs? How do corporate managers exercise voice in the co-management of public programs?

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APPENDIX A

Kansas Economic Development Statutory-tax Incentives
(As summarized on the Lawrence, Kansas Chamber of Commerce Website)

Business and Job Development Credit (Kansas Enterprise Zone program)

The Kansas Enterprise Zone program covers the entire state, unlike similar programs in other states that have limited geographic areas of eligibility. Basic E-Zone incentives are available to eligible businesses throughout the state. All counties, with the exception of Douglas, Johnson, Leavenworth, Sedgwick, Shawnee, and Wyandotte are eligible for approval as designated non-metropolitan regions. Businesses in designated non-metropolitan regions may be eligible for enhanced incentives. Under the Enterprise Zone program, earned credits may be used to offset up to 100 percent of the business' annual state income tax liability, starting in the year the jobs are created and the investment is made. Unused credits may be carried forward indefinitely and applied in subsequent tax years until the credits are exhausted. E-Zone incentives include a sales tax exemption for expenditures made on the materials, equipment, and services purchased when building, expanding, or renovating a business facility. The sales tax exemption is also available for facilities constructed and leased to a qualified firm. The amount of the exemption is dependent on the portion of the building leased and the costs of renovating or developing the facility. Partial exemptions, for leases where only a portion of the building is leased, are also available. Such exemptions may be calculated using a percent-of-total-square-feet-leased method or a cost-per-square-foot method for the leased space. Eligible purchases include the purchase and installation of machinery, equipment, labor, and materials used in the construction, reconstruction, enlarging, or remodeling of a qualified business facility. The exemption includes any telecommunications systems, quality control equipment, or pollution control equipment installed as a part of the aforementioned activities. Any person engaged in the building, remodeling, or enlargement of a facility that will be leased to a business for at least five years may receive the exemption as well. A business must file a Request for Project Exemption Certificate (form PR-70b) with the Department of Revenue before starting the project. Manufacturing and non-manufacturing businesses are eligible for all Enterprise Zone incentives. The sole Enterprise Zone incentive for retail businesses is the sales tax exemption and is only available in communities with a population of less than 2,500 or in unincorporated areas of counties with a population of less than 10,000.

Business Machinery and Equipment Tax Credit

The Kansas Tax Reduction and Reform Act of 1998 provides an annual tax credit against the income tax, privilege tax, and insurance company premiums tax. The credit equals 15 percent of the personal property tax paid on commercial and industrial machinery and equipment. The amount of the credit that exceeds the tax

liability will be refunded for companies paying income tax. The credit will be increased to 20 percent for 2005 and 2006, and to 25 percent beginning in 2007.

High Performance Incentive Program

To be eligible, a firm must either pay above-average wages for their industry, or else 1 1/2 times the statewide average wage exclusive of owner compensation. To determine whether a company pays above-average wages for businesses located within the metropolitan County of Shawnee, the firm's wages will be compared to those of businesses in like industries within that county. Once the wage criterion has been met, the business must either invest an amount equal to two percent of its total payroll on employee training or participate in either the Kansas Industrial Training (KIT) program, the Kansas Industrial Retraining (KIR) program, or the State of Kansas Investment in Lifelong Learning (SKILL) program. Firms must be certified by the Kansas Department of Commerce & Housing before filing for this credit. Participating businesses must be in major standard industrial classification (SIC) categories of 20-51 or 60-89. If a business is in major SIC categories 40-51 or 60-89, more than half of sales must be to Kansas manufacturers and/ or out-of-state commercial or government customers. HPIP also provides that a business establishment may be assigned a standard industrial classification code according to the primary business activity at a single physical location in the state. Specific incentives extended to firms meeting the qualifications include:

- A sales tax exemption on purchases relating to new investment in facility or equipment (without being tied to job creation as with Enterprise Zone sales tax exemption).
- A ten percent investment tax credit against corporate income tax on qualified business facility investment, as defined by KSA 79-32,154, exceeding $50,000. The investment tax credit is a one-time credit with a ten-year carry-over provision, subject to re-qualification, for any unused credits, up to 100 percent of a firm's annual tax liability.
- A workforce training tax credit of up to $50,000 per annum on training expenditures above two percent of total company payroll.
- Priority consideration for other state business assistance programs.
- Eligible purchases covered by the sales tax exemption and capital outlays that qualify for the Investment Tax Credit, are identical to those set forth under the E-Zone program without being tied to a job creation requirement.
- The new credits are available to firms, regardless of their location throughout the state, and participation is voluntary. They do not detract from the state's existing set of incentives or other assistance available to companies under current law. However, a company may not simultaneously claim the investment credit that is tied to new job creation and the ten percent investment credit available to high-performance establishments.

In order to take advantage of HPIP tax credits, the firm must submit a Capital

Investment Project Description form HPIP6k, estimating the scope of anticipated investment. This must be done before the company commits to any investment on which the company expects to claim an HPIP tax credit.

Research and Development Credit

In order to stimulate increased research and development activity by Kansas businesses, the State offers an income tax credit equal to 6.5 percent of a company's investment in research and development above an average expenditure of the previous three-year period. Only 25 percent of the allowable annual credit may be claimed in any one year. Any remaining credit may be carried forward in 25 percent increments until exhausted. Expenditures in research and development activities are defined by Kansas law as separate from other allowable expense deductions identified by federal Internal Revenue code. This tax credit was renewed and made permanent by the 2001 Kansas Legislature.

APPENDIX B

Interview Questions for Corporate Administrators Regarding Economic Development Tax Incentives

Opening Questions

- Kansas has many income tax credits but there are four credits that are the most frequently claimed by corporations. These four credits are what I am interested in discussing today. Your corporation claims (state types of programs claimed), describe how your firm first began to use those tax credits.
- Have you ever considered claiming (state type of programs not claimed)? Describe those circumstances.

Typical Decision

- Describe a typical decision to use a tax credit?
- What are the important criteria? What is the process? Who participates and how?
- Describe the sequence of events between when your firm decides to take a certain action (ex. hire new employees, train employees, purchase equipment) and when your firm decides to claim a tax incentive for that action. Please provide an example.
- Have you ever made business development decisions for the purpose of claiming a credit, in which, absent of the credit, you would have preferred to proceed in a different way?
- How has your use of tax credits changed over time?

These questions are specific to your firm's past use of tax credits. The purpose is to build a case study type description of your corporation's use of tax credits.

- Please describe the actions (ex. trained employees, purchased equipment, building construction) your business took in relation to (identify a claimed tax credit).
- What was the cost of that action?
- Describe the decision process that lead to you claiming the tax credit.
- What portion of your corporate expenses did the tax credit cover?
- What was the effect of the credit?
    - How many jobs were created/retained as a result of the credit?
    - How much payroll was added/retained as a result of the credit?
    - How much additional revenue was generated as a result of the credit?
    - How much additional capital was invested as a result of the credit?
    - In order to facilitate access to tax credits, by how much were wages raised over what they would have otherwise been raised?

Interactions with State Officials

- Describe a typical interaction between your firm and other organizations in regard to your use of corporate tax credits. For example: the Kansas Department of Revenue, the Kansas Department of Commerce, other agencies in the state of Kansas, business associations, or other organizations.
- Who are the best sources of information on the proper use of tax credits?
- Please identify all the types of information you need to obtain from state sources in order to access tax credits, and how you would prefer to access that information (single centralized source, usage examples, etc.).

Alter Business Development

- Describe a situation where Kansas tax credits have greatly facilitated your business development.
- Describe a situation where Kansas tax credits have impeded your business development.

Compliance Costs

- The Kansas legislature has recently altered the tax code to require additional information when claiming tax credits. What do you think of these provisions? How will they affect your claiming of tax credits?
- Compliance with the tax code can be costly for some companies, how do Kansas tax credits influence your tax compliance costs?
- Please distinguish between the costs of tax return preparation, versus preparing applications for tax programs and related costs.
- Has your use of tax credits ever been audited by the state of Kansas?

Comparison with Other Taxes and Tax Incentives

- Are you aware of state-level tax credits in other states? If so, how do they compare with Kansas?
- Where do Kansas tax credits fall in your priority of attention in comparison to federal and local tax credits/abatements? Explain.
- How does the presence of tax credits in Kansas affect your strategies for expanding your national/international business?

Closing Question

From your perspective, what is the purpose of state tax credits and how does your use fit into that purpose?

APPENDIX C

Interview Questions for Government Officials Regarding Economic Development Tax Incentives

The term "tax credit programs" refers to the R&D credit, HPIP credit, M&E credit, and the B&J credit.

Introductory Question

- Can you describe your background? (education, work, time with the department)

General Questions

- Can you describe the history of the current tax credit programs? (How did they come to be, and how have they developed?)
- Who are the different units and individuals that have responsibility for the tax credit programs?
- What is your role?
- Can you please describe a situation that typifies your role in the implementation of tax credit programs? (Is it any different from one credit to another?)

Questions on Managerial Demands/Effort

- What proportion of your time and energy is spent on the various tasks associated with the tax credit programs? (which ones)
  - Are there times when that effort interferes with other responsibilities?
- Has your involvement changed over time? How?

Interactions with Other Agencies, Groups, and Associations

- What other departments or organizations do you interact with in relation to the tax credit programs?
- Can you describe your interactions with those groups?
- Can you describe the relationship between the DOR and the DOC in regard to the management of tax credit programs? (over time)
- Some businesses may have a clear stake in the incentive programs, can you talk about the role of business representatives in the development, evaluation, and management of tax credits?
- What about elected officials? Others?

The Use of Tax Credits

- Can you describe how the tax credit programs fit into the many functions and tasks that your organization is responsible for?
- Can you describe an example of when a tax credit program was successful?
- Can you describe an example of when a tax credit program failed?