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## **DC'S HIGH-TECH TAX INCENTIVES ARE NOT WORKING Proposal to Expand Tax Breaks for High-Technology Businesses Has Little Merit**

By Dang Du and Ed Lazere

The New E-conomy Act Transformation of 2007 would expand a set of tax benefits adopted in 2000 that were intended to encourage high-technology businesses to locate in the District. The 2000 law established numerous tax incentives, including five-year abatements of property tax increases for all qualified high technology companies that move to the District, as well as a five-year 100-percent franchise tax exemption for businesses in designated "high technology zones." The new E-conomy Act, introduced late in 2007, would extend both of those tax benefits to 10 years — including to businesses currently benefiting from the five-year provisions — at a cost of roughly \$4 million per year in lost revenue.

Tax incentive programs like the E-conomy Act should be assessed to determine whether they meet their intended objectives in a cost-effective manner. The original E-Conomy Act, however, was not evaluated before the expansions were proposed. A review of trends in high-tech employment in the District since 2000 suggests that the tax incentives have not been effective and that the proposed expansion is not warranted.

- As discussed below, employment in high-tech occupations in DC has grown more slowly since 2000 than high-tech employment in the suburbs — and slower than overall employment in DC.
- Moreover, the main beneficiaries of the expanded tax benefits in the new legislation would be businesses that already have located in the District. Also, the new bill would provide expanded tax benefits to businesses that already have located in the District, which does not make sense if the goal of the E-conomy Act of encouraging firms to locate to the District.

### **E-conomy Act of 2000 Has Not Helped Boost High-Tech Employment in the District**

The Bureau of Labor Statistics identifies 36 occupations that can be considered high-technology. A review of the employment in these occupations in the District of Columbia suggests that the E-Conomy Act has not increased high-technology employment in the District.

- **Growth in DC's high- tech sector has been slower than overall job growth in the District.** From 2000 to 2006, high-tech employment grew 4.9 percent, which was less than the District's overall job growth of 5.9 percent.
- **Growth in high-tech employment in the District has been slower than in the DC suburbs.** DC's high-tech employment growth of 4.9% from 2000 to 2006 was less than high-tech growth employment growth in the DC metro area during the same period — 5.7 percent. This means that the District's share of the area's high-tech sector has shrunk since 2000.

These findings suggest that the E-Conomy Act has not been effective at boosting high-tech employment in the District.

### **Expansion of High-tech Tax Benefits under the New E-Conomy Act Is Not Warranted**

The New E-Conomy Act of 2007 would extend tax benefits under the original act from five years to 10 years, including businesses already in the District. In other words it would provide an additional five years of tax reductions to businesses that already located in DC under the initial Act.

The lack of evidence of any impact of the original E-conomy Act argues against keeping these tax incentives — and suggests that the tax incentives should not be expanded. There is no evidence that expanding the E-Conomy Act tax incentives from five years to 10 years would have any more success attracting and retaining businesses than the current five-year breaks. Without this evidence, expanding the tax incentives cannot be justified.

Moreover, the new legislation would provide expanded tax benefits to businesses that already have located in the District. According to the DC Chief Financial Officer, these are the main beneficiaries of the extended tax breaks. Yet there is no evidence to suggest that these businesses will not remain here unless they get these additional tax benefits, which means that extending tax breaks to existing companies is not an efficient use of DC tax incentives.

### **Greater Scrutiny of All DC Tax Incentives Is Needed**

Tax incentives like those in the E-Conomy Act are considered tax “expenditures” — government programs operated through provisions of the tax code. Tax expenditures are equivalent to on-budget programs in that they are designed to meet specific public purposes, in this case economic development. The goals of tax expenditure programs often could be met through an equivalent on-budget program. The goals of the E-conomy Act could be met, for example, through a program to provide grants to help high-technology businesses locate in the city.

Like on-budget program, tax expenditures also have a cost, because they reduce revenue collections. As noted, the new E-Conomy Act would reduce revenues by roughly \$4 million

per year. Those are revenues that could be devoted to other uses — including other forms of business assistance, to other public services, or to other tax reductions.

For both of these reasons, tax expenditure programs merit the same level of scrutiny as on-budget programs: How much do they cost? Do they meet their intended goals? Do they do so in a cost-efficient way? This is especially important because research relating on local economic development strategies suggests that tax incentives generally do not play a large role in businesses' decisions to locate in a specific area. Rather, the cost and quality of labor, the quantity and quality of public services, the proximity to business markets, and the access to raw materials and supplies “tend to be more important than taxes in business location decisions.”<sup>1</sup>

The lack of effectiveness of the E-Conomy Act and the efforts to expand these tax incentives without any analysis of their impact highlights the need for the District to systematically assess the effectiveness of all tax incentive programs. DC tax expenditures that are found to be ineffective should be modified or eliminated so that the resources devoted to them can be used more productively.

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<sup>1</sup> Robert G. Lynch, “Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,” Economic Policy Institute, 2004, [http://www.epinet.org/books/rethinking\\_growth\\_full.pdf](http://www.epinet.org/books/rethinking_growth_full.pdf).