AN ANALYSIS OF GEORGIA'S ECONOMIC DEVELOPMENT TAX CREDIT

Introduction

This Policy Brief, presents an analysis of Georgia's economic development tax credit incentives — Georgia's BEST program — established by the Business Expansion Support Act of 1994 and its subsequent amendments. This Policy Brief summarizes the analysis contained in Faulk et. al (2000). BEST consists of a set of corporate income tax credits: (a) a job tax credit; (b) an investment tax credit and an alternative tax credit for large investments; (c) a retraining tax credit; (d) a basic skills tax credit; (e) a child care tax credit; (f) a research and development tax credit; (g) a small business growth companies tax credit; and (h) a ports activity job and investment tax credit.

The values of the Job Tax Credit and Investment Tax Credit are based on which of three tiers the county is assigned to. The assignment to tiers is determined annually using a county ranking based on four factors: (a) unemployment rates averaged for the last three years; (b) per capita income averaged for the last three years; (c) the percentage of residents below the poverty level; and (d) the average weekly manufacturing wage. Each tier contains 53 counties, with counties in Tier 1 being the most economically distressed.

This Policy Brief begins with background material describing Georgia's economic performance and competitiveness. This is followed by a review of approaches to economic development, possible objectives for State economic development policy, and a description of the costs and benefits of tax credits. The report then provides an analysis of BEST together with alternative policy options. A discussion of the requirements of an evaluation system for economic development programs concludes the Policy Brief.

Georgia's Performance and Competitiveness

The need to engage in economic development efforts and the types of programs that should be used are dependent on the economic condition of the State and its economic competitiveness relative to other states. Over the past decade Georgia's economy has performed very well. For the period 1989-1999, total nonfarm employment increased 31.7 percent, exceeding the 16 percent growth rate for the United States as well as the rates for states bordering Georgia. This is true not only for the entire state, but also true when comparisons are made just for counties in metropolitan areas and just for counties in non-metropolitan areas.

However, there are many (61) Georgia counties that grew slower than the national average. In general, these counties tend to lie along the south side of the fall line, essentially a line from Augusta to Columbus. There are 17 counties, again generally located along or south of the fall line, in which employment fell over the past decade.
Competitiveness refers to the relative the conditions firms face in doing business in a given place, and is associated with factors such as the price, quality, and availability of inputs (particularly labor), the adequacy and condition of public infrastructure, access to markets, prevailing taxes and regulations, and certainty and stability of policy. Georgia's strong economic growth certainly implies that Georgia is an attractive location for business. In addition, the Development Report Card, prepared by the Corporation for Enterprise Development (Clones, 1999), assesses each state's potential for future growth. Georgia was given the grade of "C" for development capacity, but none of the states bordering Georgia do better. Low performance in education, crime, teen pregnancy rates, income disparity, and financial resources are mentioned as areas where Georgia compares poorly with other states and are the cause of Georgia's average grade.

Approaches to Economic Development

Economic development policies can be grouped into four broad categories: industrial recruitment, the retention and expansion of existing businesses, entrepreneurial programs, and capacity building. Because industrial recruitment is the oldest type of state economic development policy it is sometimes labeled "first wave." It is also referred to as "supply-side" or pejoratively as "smoke-stack chasing." Industrial recruitment pertains to all activities to attract firms from outside the state, including recruiting efforts, marketing the state, promoting the business climate, and reducing factor costs, including taxes and regulatory burdens. Georgia's industrial recruitment policies include the BEST and REBA (Regional Economic Business Assistance) programs at the state level and the property tax abatements and low interest financing provided by development authorities at the local level. The retention and expansion of existing business is also a type of supply-side policy because the basic idea is to keep the taxes and production costs of existing businesses low.

Entrepreneurial programs, also referred to as "new wave" or "demand-side" policy, emerged in the late 1970s and early 1980s. This category of state economic development policies pertains to activities in which the state risks resources in an effort to help indigenous businesses and entrepreneurs identify and capitalize on new markets and business opportunities. Among Georgia's entrepreneurial programs are the Advanced Technology Development Center (ATDC), the Georgia Center for Advanced Telecommunications Technology (GCATT), and the Georgia Research Alliance (GRA).

The final category of policies, capacity building, is more recent, and is sometimes referred to as the "third wave." Capacity building pertains to activities whose main goal is to build general institutional or individual capacity. Underlying the capacity building approach is the desire to "help people help themselves." Examples include investment in education and job training, industrial modernization initiatives, and encouragement of industry clusters. Although not exclusively capacity building, Georgia's programs that contain this element include the Intellectual Capital Partnership Program (ICAPP), Quick Start, HOPE, and the Yamacraw project.

The relative emphasis of each of these types of efforts has varied over the last several decades. The normative issue that emerges concerns where the emphasis of state economic development policy should lie in the future. The following facts are relevant to this question: (1) each of the three types of policies have their strengths and limitations; (2) each approach complements rather than competes with the others; and (3) no convincing evidence exists which suggests that one approach is superior to the others. Based on these facts, the sensible approach is for the State to have a comprehensive strategy, combining with roughly equal emphasis industrial recruitment, existing business expansion and retention, entrepreneurial programs, and capacity building efforts. Such a diversified portfolio will also allow the State to experiment with novel approaches.

Objectives of State Economic Development Efforts

Economic development efforts can be directed toward achieving a variety of objectives. These objectives should be based on a careful assessment of the state's needs, strengths, and weaknesses. The articulation of objectives must precede program design if economic development efforts are to be successful. Moreover, it is not possible to evaluate these efforts unless objectives are clearly stated at the outset. Possible objectives include:

- **Job creation**: Job creation is the most common objective of economic development programs.
- **Job retention**: Rather than focusing on attracting new jobs, the objective might be to retain existing jobs.
- **Change in industry mix**: The economies of some communities are characterized by cyclical instability as a result of being non-diversified or are particularly vulnerable to external forces. Thus, an objective might be to attract industries that are less affected by the
business cycle or industries whose employment and output tend to move counter-cyclically.

- Reduce intra-state economic welfare disparities: Within the State there are significant differences in economic welfare, measured in terms of employment and earnings, between counties. One possible objective is to reduce these geographic disparities.

- Reduce inter-group economic welfare disparities: In lieu of targeting tax incentives and other development policies to less-developed areas, the objective may be to increase the employment or earnings of disadvantaged groups.

- Attract high-technology companies: In recent years many states have chosen as an objective the development and attraction of high-technology companies.

- Create industry cluster development: Spatial clustering of firms in the same or related industries can result in agglomeration economies that significantly reduce the production costs of affected firms. Thus, an objective would be to develop industry clusters.

- Improve job quality: Focus might be directed at high wage jobs and/or those that provide a good package of non-wage benefits.

- Improve fiscal conditions: Another objective of economic development policy is to generate economic activity that yields tax revenues in excess of public service expenditures.

The Costs and Benefits of Economic Development Tax Credits

The framework for the evaluation of economic development tax credits is to consider the costs and benefits that result from attempts to create more jobs via tax credits. The analysis involves measuring the benefits and costs associated with the creation of an additional job through a tax credit. We first list the costs and benefits, and then provide estimates for some of the benefits. Data are not available that allow estimation of all costs and benefits.

Costs

- Loss of tax revenue: The most significant cost is the loss of tax revenue that results from the tax credits. Because the tax credits are an entitlement, jobs that would have been created even in the absence of the credit are eligible for the tax credit. Thus, the cost per job created depends on the effectiveness of the tax credit program in creating new jobs. For example, if on average only one out of ten new jobs that receives a tax credit can be attributed to the tax credit, then for each job created as a result to the tax credit the State will have had to provide tax credits for ten jobs.

- Loss of competitiveness: Providing tax credits to selected firms raises the possibility of diminished competitiveness for existing similar firms. Because the size of Georgia's tax credit is not large enough to produce a substantial advantage for most firms, this cost is probably not very large.

- Reduction in tax equity: Tax credits reduce tax equity because firms with identical profits pay different taxes if one receives a tax credit and the other does not.

- Compliance and administrative costs: Compliance with and the administration of the tax credits impose costs on both the firm and the government.

Benefits

- Job creation: The value of the benefit of a new job can be obtained by answering the question, how much would the State be willing to pay for one more job, even if the job generates no additional tax revenues? The benefit of creating a job depends on where it is located, what it pays, and who receives it.

- Additional tax revenues: The state receives additional net revenue (i.e., additional tax revenue less additional public expenditures) from each job that is created as a result of the incentive of the tax credit.

- Multiplier effects: A new job will create subsequent increases in employment through a multiplier effect, which in turn results in additional net revenue to the State. The benefits of the jobs and net revenue created in second and subsequent round jobs are equivalent to the benefit from the initial increase in employment.

- Improved business climate: The existence of tax incentives improves the perception of the business climate in the state.

- Synergistic or clustering effects: The tax credit incentives may attract a firm in an industry new to the state and which serves as a magnet for attracting additional firms in the industry.

Participation in BEST

Participation is one measure of effectiveness since if firms are not applying for the tax credits, then it is unlikely that
BEST is having much effect. Participation in BEST programs is low.

- The number of firms taking the Basic Skills Tax Credit has averaged less than 7 per year, with a credit per firm of about $20,000. One firm accounted for 64 percent of the total value of the credits for years 1995-1997.
- Only 7 firms in total took the Child Care Tax Credit over the period 1995-1997.
- An average of 66 firms took the Retraining Tax Credit each year. Most of these firms are large, and about half are repeat users.
- An increasing number of firms (124 in 1997) have taken the Investment Tax Credit. The Alternative Investment Tax Credit provides a much larger tax credit, but has not been in effect long enough to allow a firm to take the credit.

Based on research conducted on other tax incentive programs, we expect that there are many firms that are eligible for these credits but that do not take them. However, for the four tax credit programs discussed above we have no information that allows us to determine how many firms eligible for one of the credits fail to apply. Furthermore, no information exists that allows us to determine how effective the credits are in changing behavior. However, we were able to conduct more extensive analysis of the Job Tax Credit program.

An Analysis of the Job Tax Credit

The focus of the remaining discussion regarding BEST and the focus of our analysis is on the Job Tax Credit, which actually predates BEST.

Participation. In 1999, 201 firms claimed a Job Tax Credit. For the three year period, 1993-1995 we estimate that less than 20 percent of eligible firms applied for the credit. For 1995-1997, we estimate that 32 percent of eligible jobs are taken for a tax credit. There is no trend in the participation rate, and in fact the rate for 1997 is lower than for 1995.

There are several possible reasons why the participation rate is low. First, many firms have a zero corporate tax liability. For example, for 1997, 78 percent of corporations that filed an income tax return had no tax liability. Second, firms may not know about the job tax credit program. Third, the paperwork, fear of an increased possibility of audit, or concern about being seen as taking "corporate welfare" may discourage firms from participating.

Nearly half of the credited jobs over the period 1991-1997 were in Tier 3 (the economically best off counties), even though Tier 3 counties were not eligible for the Job Tax Credit until 1995. Within tiers the bulk of the jobs credited are accounted for by a few counties; approximately 50 percent of the jobs credited in Tiers 1 and 2 have gone to firms in five counties.

Effectiveness. Some percentage of the jobs for which firms take a tax credit would have existed even in the absence of the tax credit. To estimate this percentage we used an econometric model that compares the job creation of firms that did not claim a credit with those that did. Our estimate is that 28.9 percent of jobs credited were actually created as the result of the job tax credit.

Fiscal benefits. One of the potential benefits of the job tax credits is the additional revenue, less additional expenditures, that the state government will receive from the increase in economic activity. To estimate the net revenue effect from an additional job tax credit taken requires the following information:

- The effectiveness of the Job Tax Credit in creating jobs. As noted above, we have estimated that out of 10 jobs for which a credit is taken approximately three can be attributed to the Job Tax Credit.
- The number of jobs created indirectly through the multiplier effect.
- The percentage of new jobs that are taken by current residents of the State. For individuals who move into the State, the State will get additional revenue, but will also have to increase expenditures. Based on our analysis, we adopt two alternative scenarios: first, that all jobs go to new residents, and second, that only 50 percent of new jobs go to new residents.
- The increase in State tax revenues that result from a new job, and in the case of a new resident, the additional State expenditures that are required.

Based on this information we estimated the net fiscal benefit to the State government from a Job Tax Credit. The expected net fiscal benefits, gross of the Job Tax Credit, under alternative scenarios of who takes new jobs are: $108 per year if all of the new jobs go to non-residents, and $1,781 per year if only half of the new jobs go to non-residents.
Problems With the BEST Program and Options for Change

While Georgia's BEST program has laudable features, it also has a number of important problems. We focus particularly on the Job Tax Credit. (There is no intended significance to the order of our list.)

**Problem 1.** The BEST credits have little effective value to many firms. In order for the credits to have value to a firm, the firm must have income tax liability against which the credit can be taken, but most do not. If the credits are not valuable, they cannot be expected to affect job creation or other behavior.

**Possible responses:**
- Permit, as do a number of other states, companies to take the tax credits against state tax liabilities other than the income tax, e.g., the sales tax.
- Make the tax credits fully refundable, as do Indiana, Louisiana, and Ohio.
- Allow firms to take the tax credits by retaining the credit amount from employees' state income tax withholdings, as does South Carolina for its Job Development Tax Credit.
- Allow firms who have no income tax liability to sell their credits to other firms within the State who have income tax liability, as does New Jersey.

**Problem 2.** The Job Tax Credit does not encourage "quality" job creation. All new jobs receive the same credit (reward), regardless of the job's wage rate or fringe benefits.

**Possible responses:**
- Tie the value of the Job Tax Credit to the average manufacturing wage within the Service Delivery Region where the new job is located. For example, credits could be graduated by the percentage that the credited job's wage exceeds the Regional average.
- Add the provision of health care benefits and perhaps other fringe benefits to the eligibility criteria.

**Problem 3.** The Job Tax Credit does not apply to some basic industries (i.e., industries that sell their products out of state) and applies to non-basic industries in Tier 1 counties. Basic industries have large multiplier effects and thus are likely to yield higher net benefits.

**Possible response:**
- Base eligibility on the percentage of the industry's sales that are made out-of-state.

**Problem 4.** The Job Tax Credit discriminates against small businesses by requiring a minimum number of new jobs be created. Even the few new jobs required for eligibility in Tier 1 can be a real hurdle to overcome for small businesses.

**Possible response:**
- The minimum job expansion requirement could be stated as either a minimum number of new jobs or a minimum percentage increase in employment.

**Problem 5.** The list of eligible industries is different between the Job Tax Credit and the Investment Tax Credit.

**Possible response:**
- Make both the Job Tax Credit and the Investment Tax Credit lists of eligible industries the same.

**Problem 6.** BEST is not sufficiently targeted to the neediest counties. Despite the facts that the value of the Job Tax Credit is highest in Tier 1 and the required minimum job expansion is lowest in Tier 1, only 28 percent of the total number of jobs credited have been in this tier.

**Possible responses:**
- Define a new tier consisting of the most economically depressed counties and offer credits with high values.
- Within Tier 1 (or the new tier) increase the nominal value of the credits, e.g., set the credit equal to the $4500 now offered by South Carolina in their Tier 1 equivalent.
- Eliminate, or make the eligibility requirement more stringent, the Job Tax Credit and perhaps one or more of the other BEST credits within all or part of Tier 3.

**Problem 7.** BEST credits are administratively too complicated from the firm's perspective.

**Possible responses:**
- Establish a task force of agency and business representatives to determine how the application process can be made less complex.
- Develop software that firms could access off the Web that would walk firms through the credit application process.
On the tax form, direct firms to the Department of Revenue home page, where credits are described and can be applied for electronically.

**Problem 8.** There are several issues or problems regarding the ranking process and the assignment to tiers:

- The manufacturing wage is measured imprecisely, is subject to annual fluctuations, reflects wages paid to those working in the county regardless of whether the worker is a county resident, and accounts for a very small percentage of all wages.
- The unemployment rate is not necessarily a measure of chronic economic conditions, and seems to fluctuate for reasons other than changes in economic conditions.
- The rankings are not very stable; there is substantial change from year to year. For example, between 1980 and 1999, 46 counties change rank by 20 or more positions.
- The ranking procedure does not account for the magnitude of the difference between counties in any of the factors.
- Although declining employment in the face of national economic prosperity is a sign of fundamental economic difficulties, there are 7 counties that grew by less than a fourth of the statewide growth rate over the past five years that are not in Tier 1.

**Possible responses:**

- Delete the manufacturing wage as a factor.
- Base the overall ranking on the value (not the rank) of each of the three factors, excluding manufacturing wage, relative to the average value across counties.
- Base the ranking on just the poverty rate, or the poverty rate and per capita income.
- Add the percentage change in employment as a factor.
- Add the percentage of the county’s employment in textile and apparel, excluding carpeting. Given the projected decline in employment in this industry, this factor would be a measure of an expected economic problem. Using this factor would allow attention to be focused on these high-risk counties now rather than after the plants have closed.

- Rather than calculating rankings every year, do it every five or ten years.

An alternative approach to the assignment of counties to tiers is to use an absolute standard rather than dividing the number of counties into thirds. Our analysis of this option suggests that it does not work very well.

**Financial Incentive Policies Beyond BEST**

The BEST program is a mildly targeted, entitlement financial incentive program. There are alternatives to BEST that vary in how targeted the incentive are and the extent to which they are an entitlement.

Non-targeted incentives include such policies as eliminating or substantially reducing corporation income taxes, property taxes on business, or sales taxes on business purchases. Eliminating the corporation income tax would make BEST irrelevant as a corporate income tax credit, but it would not provide any incentive to those firms that currently have no income tax liability. Eliminating the corporation income tax or the sales tax on business purchases would be a substantial revenue loss to the State, better than $300 million in the case of the corporate income tax, and an estimated $1.5 billion in the case of the sales tax exemptions.

Targeted incentives include providing incentives to specific industries, firms, or geographic areas. Georgia has adopted incentives aimed at specific industries or industry groupings, for example, the computer chip design industry, tourism, film making, and high tech. Incentives can also be targeted to specific firms, i.e., offering incentives to a firm considering locating in Georgia as part of a “deal” put together to attract that specific firm. Other than REBA, there is not a State-level fund that allows substantial discretion in terms of which firms will be provided an incentive and the amount of the incentive.

**Evaluation Procedures for Economic Development Policy**

Evaluation of economic development policy is a complicated endeavor that requires careful estimation of costs and benefits. While it is not possible to specify in legislation how these estimates would be made, appropriate legislation could address the two main issues surrounding evaluation:
Data are needed. Programs cannot be evaluated or even monitored unless outcomes data are collected and reported on a regular basis. Data are needed for the BEST program and the incentives offered by local communities.

The only BEST credit for which any kind of report is required is the Job Tax Credit. The data in that report are insufficient for evaluation purposes. Information is needed on wages paid, industries affected, and the percentage of jobs that are taken by Georgia residents. Annual reporting requirements should also be established for the other BEST credits.

The State collects no data on the incentives provided to companies by local communities. There are concerns that local incentives (the largest of which are property tax reductions and abatements) are inefficient, inequitable, and perhaps, at least some of the time, illegal. However, none of these concerns has been substantiated because the necessary data are unavailable. Similar concerns caused Minnesota and Tennessee to pass disclosure laws.

Analyses of data are needed. To evaluate state economic development policies, at least two questions should be addressed: (1) What outcomes has the program produced? and (2) What are the economic and fiscal impacts of a particular company's location or expansion within the state?

An assessment of program outputs typically requires sophisticated statistical analyses that estimate the relevant counterfactual (i.e., what reality would be in the absence of the program). An example of this type of analysis is the econometric model we estimated to determine the number of jobs created in the state that could be attributed to the Job Tax Credit. There is an obvious need to estimate the counterfactuals of many other of the state's economic development programs. This should be done on a regular basis.

Presently, Georgia communities must conduct a Local Impact Model (LOCI) analysis to apply for a REBA grant. LOCI has also been used by several communities on their own initiative. Greater use of LOCI should be encouraged, if not required, by Georgia's communities in their negotiations with individual companies, especially in light of the concerns surrounding property tax abatements as mentioned above.

References


ABOUT THE AUTHORS

Dagney Faulk is Assistant Professor of Economics at Indiana University Southeast. Prior to that she was Research Associate in the Fiscal Research Program of the Andrew Young School of Policy Studies at Georgia State University. She has worked at USAID, The World Bank and the U.S. Department of Housing and Urban Development. She has published on topics related to state and local public finance and urban economics. She holds a Ph.D. from Georgia State University.

Keith Ihlanfeldt received his Ph.D. in Economics from Washington University in St. Louis in 1978. He is currently Professor of Economics and Senior Research Associate in the Policy Research Program within the School of Policy Studies at Georgia State University. His research has focused on a wide range of urban problems, including discrimination in the housing and labor markets, urban poverty, neighborhood decline, housing affordability, and economic development incentives. He has published widely and has received grants from numerous organizations, both public and private. Currently he serves on the editorial boards of four urban and regional economics journals.

David L. Sjoquist is Professor of Economics and Director in the Fiscal Research Program of the Andrew Young School of Policy Studies at Georgia State University. He has published widely on topics related to state and local public finance and urban economics. He holds a Ph.D. from the University of Minnesota.
Jeanie Thomas is Senior Research Associate in the Fiscal Research Program of the Andrew Young School of Policy Studies at Georgia State University. Her primary research work has been in economic development (including high technology and rural development) and workforce management and development. She holds an M.A. from Georgia State University.

William J. Smith is a Research Associate in the Fiscal Research Program and a Ph.D. candidate in the Andrew Young School of Policy Studies at Georgia State University. His research interests include education finance, urban economic geography, and urban and regional fiscal policy.

Kathleen Thomas is a Research Associate in the Fiscal Research Program and a Ph.D. candidate in the Andrew Young School of Policy Studies at Georgia State University. Her research interests include education finance, state and local fiscal policy, and public finance. She holds a M.A. from the University of Alabama.

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