

EVALUATION OF TAX INCENTIVES

Analysis of Rural County Sales Tax Program

A Report to the Legislature

Washington State Department of Revenue
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CHAPTER ONE

EXECUTIVE SUMMARY

This report is submitted to the Legislature pursuant to RCW 82.60.070(1) (f). It contains the results of an evaluation of the rural county sales tax deferral for manufacturing and R&D facilities. This program was adopted in 1985 and is codified in chapter 82.60 RCW. This chapter provides a brief synopsis of the result of the study conducted during 2009 by the Department of Revenue.

In the initial eight years of the program, the incentive allowed only a deferral of sales tax for qualified manufacturing or R&D investments in designated economically distressed counties. Starting in 1994, firms that maintained program requirements were excused from the obligation to repay the deferred taxes. Five years later the focus of the program changed from high rates of unemployment to population density; this allowed additional counties to qualify.

Since the change to an outright exemption in 1994, 802 firms have benefited from the tax incentive. The number of approved projects to date total 1,057 and the amount of investment in facilities and equipment for these projects during these 15 years is nearly \$3.2 billion. The amount of retail sales/use tax foregone by the state totals \$208 million, while the impact on local governments is \$45 million.

Thirty-one counties have had qualified projects under the rural county deferral program. Five counties qualify for the incentive but have had no approved projects: Ferry, Garfield, Kitsap, Pacific, and Wahkiakum. Three counties – Clark, Snohomish, and Thurston – do not qualify under the various requirements for being a rural county or having an eligible community empowerment zone.

The statutes require an assessment of and report on these programs, specifically measuring the effects of the programs on the following factors of the state's economy:

- Job creation,
- Jobs created for Washington residents,
- Company growth,
- Diversification of the state's economy,
- Introduction of new products, and
- Movement of firms or the consolidation of firms into the state.

Evidence of job creation by program participants seems positive for those participants used in the analysis. Analysis of trends in employment and job creation was restricted by the limited number of individual firms that had viable data and no disclosure issues. Though limited in the number of firms analyzed, the analysis still represents the core group of firms that the program targets.

Overall, participants had an increase in employment of 4.1 percent, while non-participants in rural counties showed a decline in employment positions of 5.3 percent. Results also indicate that participants have slightly increased their share of U.S. manufacturing employment, while Washington as a whole has maintained its share.

In general, participants also experienced significantly larger increases in gross revenues when compared to non-participants. This trend leads to the conclusion that company growth in the participant group is considerably stronger than the non-participant group.

CHAPTER TWO

OVERVIEW OF TAX INCENTIVE PROGRAM

Over the past two decades, Washington has had a number of tax incentives intended to assist new or existing businesses and to encourage the creation of new jobs in the state. Most of the newer tax incentives target specific industries or geographic regions of the state, have an expiration date scheduled in the law, and have accountability provisions that require participants to report employment and other data.

The sales tax deferral for manufacturing investments in rural counties program was adopted in 1985 and is presently scheduled to expire on July 1, 2010. This program offers a deferral of state and local retail sales tax for construction of qualified manufacturing or research and development facilities and the purchase of related machinery and equipment.

Originally, the participating firms began repaying the deferred sales tax at the end of the third year following completion of the project; the repayment took place over a five-year period. Since 1994 eligible firms have not been required to repay the deferred sales tax if they maintain program requirements, thereby making the deferral an outright exemption. Specifically, to avoid repayment of the deferred sales tax, the firm must file annual surveys, the project must be audited and certified as complete by the Department, the employment requirements for a community empowerment zone (CEZ) must be met for firms in those counties, and the facility must be operated for its intended purpose for at least the succeeding seven years after completion.

The investment must occur in one of 32 “rural” counties or in one of four counties with a designated CEZ. A primary goal of this program is to achieve greater diversification of the state’s economy and create employment opportunities outside of the metropolitan areas or in areas of high unemployment.

Since 1994 when the incentive became an outright tax exemption, 802 firms have used the program. The total investment associated with the rural county deferral/exemption during this period has been approximately \$3.2 billion. The estimated amount of state retail sales tax deferred or forgiven is \$208 million; the local sales tax impact is approximately \$45 million.

According to the surveys filed in 2009 by participating taxpayers, 317 firms have approved projects that are under construction or have completed projects that have been operational for less than seven years. The amount of state and local sales tax deferred for these taxpayers is \$69.1 million. These 317 firms reported total employment of 33,383 jobs in this state.

PROGRAM REQUIREMENTS

Eligible Activity. To qualify for the sales tax deferral/exemption, a firm must be engaged in manufacturing, research and development, production of computer software and computer-related services, operation of commercial testing laboratories, or the conditioning of vegetable seeds. Expenditures for cogeneration may qualify if the power produced is consumed at the same manufacturing facility. Facilities located on leased land may qualify for the program if the lessor passes on the tax benefit to the lessee. Application must be submitted to the Department prior to construction; the application must describe the proposed activity, detail the estimated investment costs, and provide data on current employment of the firm and the anticipated new jobs at the facility.

Eligible Expenditures. The tax deferral/exemption applies to costs associated with planning, installation, and construction of an eligible manufacturing or other qualified facility, including construction or remodeling of new or existing structures and acquisition of machinery and equipment to be used for manufacturing purposes at the site. (Qualified manufacturing machinery has also qualified for sales tax exemption under RCW 82.08.02565 since 1995.) For existing structures, the investment must increase floor space or production capacity of the plant.

Geographic Location. Eligible firms may qualify for the deferral/exemption if the investment takes place in a location that meets one of three criteria:

1. Population Density of County. The law specifies that eligible investments may occur within counties that have an average population density of less than 100 residents per square mile. There are 31 counties that meet this criterion:

Adams	Garfield	Pend Oreille
Asotin	Grant	San Juan
Benton	Grays Harbor	Skagit
Chelan	Jefferson	Skamania
Clallam	Kittitas	Stevens
Columbia	Klickitat	Wahkiakum
Cowlitz	Lewis	Walla Walla
Douglas	Lincoln	Whatcom
Ferry	Mason	Whitman
Franklin	Okanogan	Yakima
	Pacific	

2. Size of County. Another criterion is the land area of the county. If the total square miles within the county boundaries do not exceed 225, investments in the county qualify for the deferral/exemption. This factor allows Island County to qualify for the program.
3. County with a CEZ. There are five qualifying community empowerment zones in Washington. These are specified areas targeted by a city or county for development pursuant to RCW 43.31C.020. At least 51 percent of the households within the zone must have income below 80 percent of the median level for the county, and the unemployment rate

within the zone for the latest 12-month period must exceed the county average by at least 20 percent. The five qualifying CEZs are:

- Duwamish – located in South Seattle, including the Rainier Valley, the SODO area down to Boeing Field, and much of West Seattle.
- White Center - located just south of West Seattle.
- Bremerton – approximately eight blocks in the downtown area along the waterfront adjacent to the Naval Shipyard.
- Tacoma – much of the tidelands adjacent to Commencement Bay and the southern downtown area.
- Spokane – much of the downtown and industrial area to the east.

Note: The city of Yakima also contains an eligible CEZ, but the entire county qualifies for the program as a rural county.

For investment in a CEZ or elsewhere in the same county, the firm must hire at least one person who resides within the CEZ for each \$750,000 of investment that qualifies for the deferral/exemption. Hiring of these employees must occur after the application for the tax incentive has been filed with the Department.

Including CEZs as eligible areas for the deferral/exemption adds four more counties – King, Pierce, Kitsap, and Spokane – to the program.

The combination of the above criteria result in only three counties within Washington that are NOT eligible for the program – Clark, Snohomish, and Thurston counties.

Employment. Originally, there were job creation requirements for any applicant. These have been dropped for investments in rural counties. The one FTE per \$750,000 requirement still remains for facilities in CEZs.

Annual Survey. The original program required an annual report by participants during the tax repayment period to ensure that employment and other requirements were maintained. Starting in 2005, participants have been required to file a survey annually with the Department. The survey asks for information relating to the amount of sales tax deferred; the number of new products or research projects associated with the investment; the number of trademarks, patents, or copyrights developed at the facility; and total employment by the firm, including information on wages paid and benefits provided. Except for the amount of tax benefit received, the information reported on the survey is confidential and may not be disclosed for specific firms. Aggregate data provided by participants are reported to the Legislature annually in a publication entitled, “Descriptive Statistics for Tax Incentive Programs.”

HISTORY OF THE PROGRAM

Following is an outline of the major statutory changes to the tax incentive. Note that a similar tax deferral was in effect from 1972 until 1981; this became a casualty of the economic recession of the early 1980s.

- 1985 Current program enacted by Chapter 232, Laws of 1985, effective July 1, 1985. Allowed deferral of state/local sales tax on construction or improvement of manufacturing or R&D facilities and related equipment. (Note: This was ten years before the complete exemption of manufacturing machinery.) Investment had to take place in a “distressed” county with unemployment at least 20 percent greater than the statewide average. Investment had to create at least one new job for every \$200,000 of investment. Deferral was limited to \$20 million of investment per facility, and a cap of \$20 million in deferred tax applied to all applications. Tax was deferred for three years following completion of the project, and repayment then occurred over five years. The initial program was limited to a six-year period and was scheduled to expire on July 1, 1991.
- 1986 Sales tax on construction labor for eligible facilities need not be repaid. Biennial cap of \$20 million in deferred tax for all projects and limitation on eligible investment to \$20 million for each participant are removed. Amount of investment eligible for deferral for each new job increased from \$200,000 to \$300,000. Extension of program to leased facilities.
- 1987 Confidentiality requirement removed; all information on applications for the program may be publicly disclosed.
- 1988 Expiration date extended three years to July 1, 1994. One-year extension of the program to metropolitan statistical areas (MSAs) extends the tax deferral to portions of Benton and Franklin counties.
- 1993 Program extended to neighborhood reinvestment areas designated by the Department of Community, Trade and Economic Development. Expiration date extended four years to July 1, 1998.
- 1994 Requirement to repay deferred taxes eliminated if program requirements are met for seven years after project is certified as complete. Amount of investment eligible for deferral for each new job increased from \$300,000 to \$750,000. Program extended to (1) counties adjacent to a distressed county; (2) CEZs; (3) areas designated by the Governor for reasons of natural disasters, military base closures, and large reductions in employment; or (4) timber impact areas (five towns in Whatcom and Snohomish counties). Investment in cogeneration projects included. Expiration date extended six years to July 1, 2004.
- 1995 Eliminated the job creation requirement in distressed counties, leaving only the employment criterion for CEZs. Eliminated the requirement that expansion of

existing facility must increase the value by at least 25 percent. Expansion of deferral/exemption to entire county containing a CEZ. Definitional changes in relation to the new sales tax exemption for manufacturing machinery. Repayment of previously deferred taxes on equipment used by timber industry is waived.

- 1996 Deferral/exemption broadened to counties with median household income less than 75 percent of state average (includes Asotin and Whitman counties).
- 1999 Rural county designation based on population density replaces the previous distressed area criteria. Annual reporting by participants during the deferral repayment period is repealed. Definition of manufacturing amended to exclude mere processing of agricultural products (sorting, washing, packing, etc.).
- 2000 Qualified employment position for CEZ is defined; FTEs must be full time and position must be filled by end of second year following completion.
- 2004 Program extended to counties with fewer than 225 square miles (Island County). Qualified employment position is defined in terms of minimum number of hours worked. Expiration date extended six years to July 1, 2010. Accountability provisions adopted: surveys required of participants by the end of March each year and annual reports required by the Department by September 1. In addition, this evaluation of the program was mandated with a due date of December 1, 2009.
- 2006 Manufacturing re-defined to include conditioning of vegetable seeds; conditioning includes drying, cleaning, sorting, and related processing activities to prepare the seeds for sale.

CHAPTER THREE

PROGRAM PARTICIPATION

Distressed and Rural Deferral Participation

The distressed and rural deferral program has been amended several times since its adoption in 1985. This study looks at applications beginning in 1994 when the requirement to repay deferred taxes was eliminated if program requirements were met, thereby making the tax incentive an outright exemption.

From 1994 through 2008, the Department received applications for 1,496 distressed area and rural county deferral projects. More than one application may be approved for a project when a lessor applies for structure costs and one or more lessees apply for leasehold improvements. Project counts listed here exclude the lessor when a lessee also applies for the deferral. The chart below shows the number of projects along with the actual number of applications received.

Table 3.1
Status of Distressed or Rural Deferral Applications: 1994 – 2008

Status of Application	Applications	Projects
Approved	1,128	1,057
Approved - Cancelled	68	68
Withdrawn	180	180
Denied	189	189
Pending - Needs Review	2	2
Total	1,567	1,496

Approved Projects

The Department approved applications for 1,057 distressed area and rural county sales and use tax deferral projects between 1994 and 2008. Project costs for these applications total \$3.2 billion. State and local sales and use taxes deferred for these projects are estimated to be \$253.2 million.

Cancelled or Withdrawn Projects

Another 248 investment projects were cancelled or withdrawn. The main reasons for an application to be cancelled or withdrawn were:

- More than one application was submitted for the same structure costs.
- The applicant purchased machinery and equipment that qualified for the machinery and equipment exemption, so there was no sales tax to defer.
- The applicant never started the project because of a financial decision, so the certificate was never used.

Denied Projects

The Department has had to deny 189 applications. Multiple attempts were made to verify information before an application was denied. The most frequent reasons for an application to be denied were (1) the taxpayer began construction or acquired machinery and equipment prior to the application date, or (2) the taxpayer did not provide sufficient information to determine whether or not they were performing qualified manufacturing.

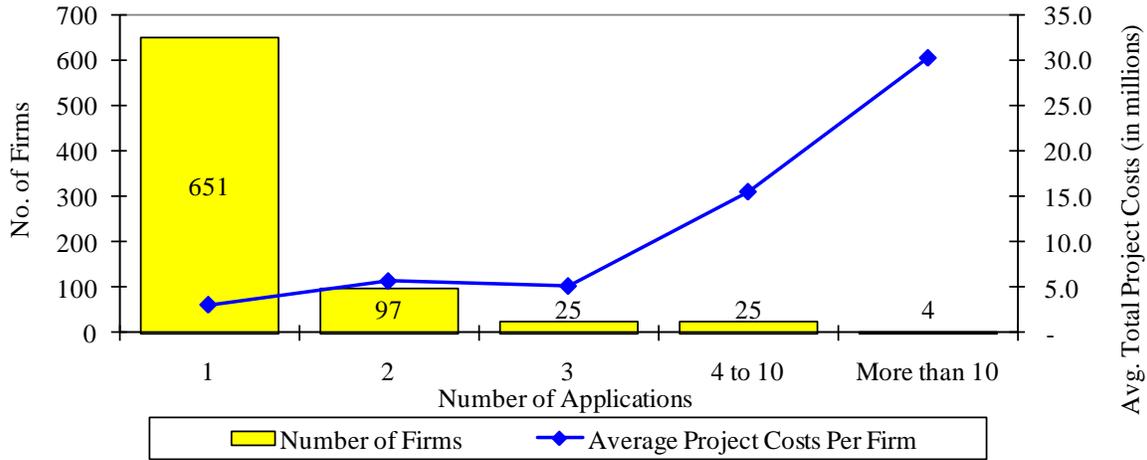
Sales and Use Tax Deferral by Firm

It should be noted that the 1,057 approved distressed area and rural county sales and use tax deferral projects are distributed among 802 firms. While over 80 percent of the firms have only one approved project, many other firms have several projects in the program.

Approved Applications per Firm

The 651 firms with only one approved project account for 62.6 percent of the total project costs, with average total project costs of \$3 million per firm. At the other end of the spectrum, there are four firms that each has more than ten approved projects. Those four firms have average total project costs of \$30.2 million per firm.

**Chart 3-A
Approved Applications Per Firm**

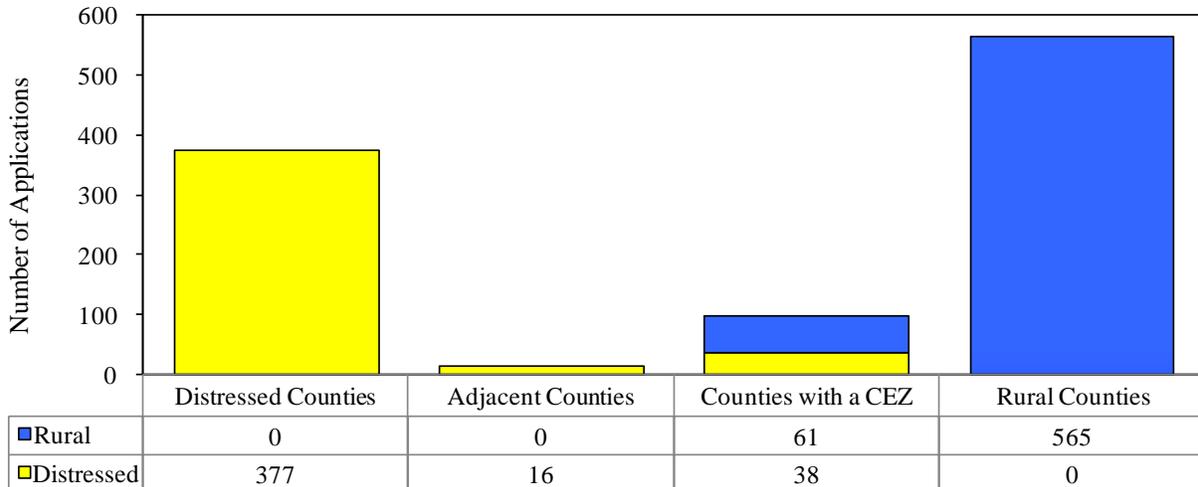


Sales and Use Tax Deferral by Type of Qualified Area

Under the distressed area deferral program for the initial four years, a qualified firm locating in a distressed county was granted a deferral. A firm could also locate in a county adjacent to a distressed county, in a CEZ, or a county containing a CEZ. However, additional employment requirements had to be met, limiting the number of applicants in these areas. During this period of the program, 87.5 percent of all distressed area deferral projects reviewed were located in a distressed county.

Beginning in August 1999, the deferral program was changed to allow firms to locate in a rural county, a CEZ, or a county containing a CEZ. Again, there were additional employment requirements for firms locating in a CEZ or a county containing a CEZ.

**Chart 3-B
Approved Distressed Area and Rural Deferral Projects**



Chapter Three – PROGRAM PARTICIPATION

Distressed counties were counties with a three-year average unemployment rate equal to or greater than 120 percent of the statewide unemployment rate.

A rural county is defined as: (1) a county with a population density of less than 100 persons per square mile or (2) a county smaller than 225 square miles as determined by the Office of Financial Management. The list of eligible areas is revised annually (effective July 1 through June 30).

More counties qualify as rural counties than as distressed. To illustrate this, the two maps below highlight counties designated as distressed and counties designated as rural.

Distressed Counties



Rural Counties



Project Costs

The project costs align very closely with the number of approved projects by type of qualified area. Since 1994, 85.7 percent of the project costs under the distressed area deferral program were in distressed counties, and 93.7 percent of the project costs under the rural program have been in rural counties, with the remainder in a CEZ or adjacent county.

Table 3.2
Approved Project costs of Distressed Area and Rural Deferral Projects

Type of Program	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
Distressed	\$779,442,302	\$38,700,365	\$91,467,784		\$909,610,451
Rural			\$142,354,924	\$2,131,339,607	\$2,273,694,531
Total	\$779,442,302	\$38,700,365	\$233,822,708	\$2,131,339,607	\$3,183,304,981

Chapter Three – PROGRAM PARTICIPATION

Table 3.3
Count of Projects (Excluding Certain Lessors)

	Year	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
↑ Distressed ↓	1994	58	2	9		69
	1995	72	6	6		84
	1996	53	2	9		64
	1997	73	3	7		83
	1998	77	3	4		84
	1999	44	0	3		47
↑ Rural County ↓	1999			3	20	23
	2000			2	61	63
	2001			2	41	43
	2002			9	55	64
	2003			5	51	56
	2004			3	71	74
	2005			11	70	81
	2006			12	77	89
	2007			8	56	64
	2008			6	63	69
Totals		377	16	99	565	1,057

Table 3.4
Estimated Project Costs

	Year	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
↑ Distressed ↓	1994	\$136,665,665	\$440,506	\$9,217,786		\$146,323,957
	1995	135,185,325	20,104,380	4,669,659		159,959,364
	1996	138,486,071	6,455,097	37,695,719		182,636,887
	1997	130,240,428	10,085,823	10,152,912		150,479,163
	1998	194,790,187	1,614,559	21,113,183		217,517,929
	1999	44,074,626	0	8,618,525		52,693,151
↑ Rural County ↓	1999			6,991,473	37,331,487	44,322,960
	2000			1,305,609	176,214,771	177,520,380
	2001			3,109,789	41,016,961	44,126,750
	2002			4,314,581	71,132,413	75,446,994
	2003			28,239,544	61,196,087	89,435,631
	2004			2,664,669	313,780,418	316,445,087
	2005			39,361,550	168,155,990	207,517,540
	2006			34,688,355	392,949,610	427,637,965
	2007			14,278,779	366,062,479	380,341,258
	2008			7,400,575	503,499,391	510,899,966
Totals	\$779,442,302	\$38,700,365	\$233,822,708	\$2,131,339,607	\$3,183,304,981	

Chapter Three – PROGRAM PARTICIPATION

Table 3.5
Estimated State and Local Sales Tax Deferred or Exempted

	Year	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
↑ Distressed	1994	\$9,925,429	\$73,002	\$757,693		\$10,756,124
	1995	10,329,752	1,504,359	370,030		12,204,141
	1996	10,550,561	519,436	3,121,014		14,191,011
	1997	10,197,045	766,522	832,446		11,796,013
	1998	14,963,630	128,209	1,837,927		16,929,766
	1999	3,424,532	0	735,555		4,160,087
↓ Rural County	1999			605,405	2,946,222	3,551,627
	2000			110,411	13,897,885	14,008,296
	2001			258,801	3,263,760	3,522,561
	2002			366,781	4,701,503	5,068,284
	2003			2,400,199	4,710,644	7,110,843
	2004			227,010	27,649,367	27,876,377
	2005			3,427,306	13,384,171	16,811,477
	2006			3,005,442	31,100,639	34,106,081
	2007			1,234,962	29,347,916	30,582,878
	2008			621,237	39,863,580	40,484,817
Totals	\$59,390,949	\$2,991,528	\$19,912,219	\$170,865,688	\$253,160,384	

Table 3.6
Estimated STATE Sales Tax Deferred or Exempted

	Year	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
	1994	\$8,418,577	\$63,268	\$609,819		\$9,091,664
	1995	8,816,065	1,222,189	303,393		10,341,647
	1996	8,972,467	419,582	2,494,759		11,886,808
	1997	8,474,961	655,578	639,143		9,769,681
	1998	12,617,050	108,187	1,422,205		14,147,442
	1999	2,849,073	0	560,203		3,409,276
	1999			479,460	2,429,822	2,909,282
	2000			85,437	11,842,676	11,928,113
	2001			203,455	2,668,987	2,872,442
	2002			280,448	3,924,145	4,204,593
	2003			1,905,898	3,887,782	5,793,680
	2004			173,447	22,759,178	22,932,626
	2005			2,594,000	10,859,575	13,453,574
	2006			2,254,742	25,383,337	27,638,079
	2007			928,695	23,703,952	24,632,648
	2008			481,746	32,727,579	33,209,325
Total	\$50,148,192	\$2,468,804	\$15,416,851	\$140,187,035	\$208,220,882	

Table 3.7
Estimated LOCAL Sales Tax Deferred or Exempted

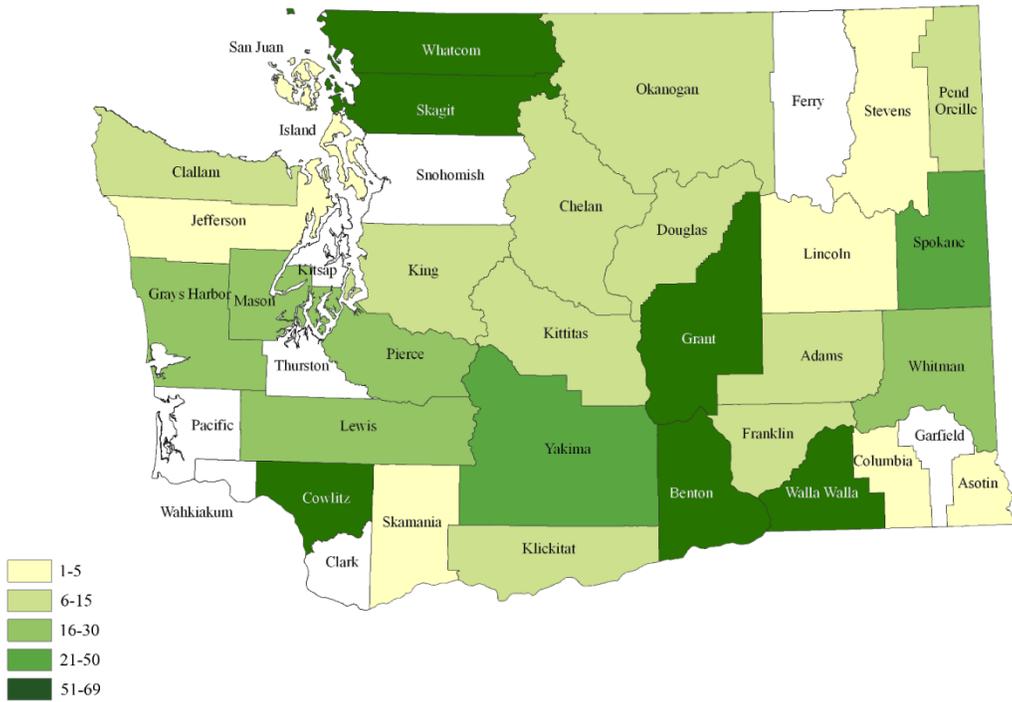
Year	Distressed Counties	Adjacent Counties	Counties with a CEZ	Rural Counties	Total
1994	\$1,506,852	\$9,734	\$147,874		\$1,664,460
1995	1,513,687	282,170	66,637		1,862,494
1996	1,578,093	99,854	626,254		2,304,202
1997	1,722,084	110,944	193,303		2,026,332
1998	2,346,580	20,022	415,722		2,782,324
1999	575,459	0	175,352		750,811
1999			125,945	516,400	642,345
2000			24,974	2,055,209	2,080,183
2001			55,346	594,773	650,119
2002			86,333	777,358	863,691
2003			494,301	822,862	1,317,163
2004			53,563	4,890,189	4,943,751
2005			833,306	2,524,596	3,357,903
2006			750,700	5,717,302	6,468,002
2007			306,267	5,643,964	5,950,231
2008			139,491	7,136,001	7,275,492
Total	\$9,242,757	\$522,724	\$4,495,368	\$30,678,653	\$44,939,502

Geographic Location of Participants Using the Rural County Deferral

Projects have been located in 31 counties throughout the state of Washington under the rural county deferral program. Only five qualified counties do not have a project to date: Ferry, Garfield, Kitsap, Pacific, and Wahkiakum. (Clark, Snohomish, and Thurston counties are not eligible for the program, since they do not meet the definition of rural and they lack a qualifying CEZ.) Below the two maps show the approved applications and project costs by county.

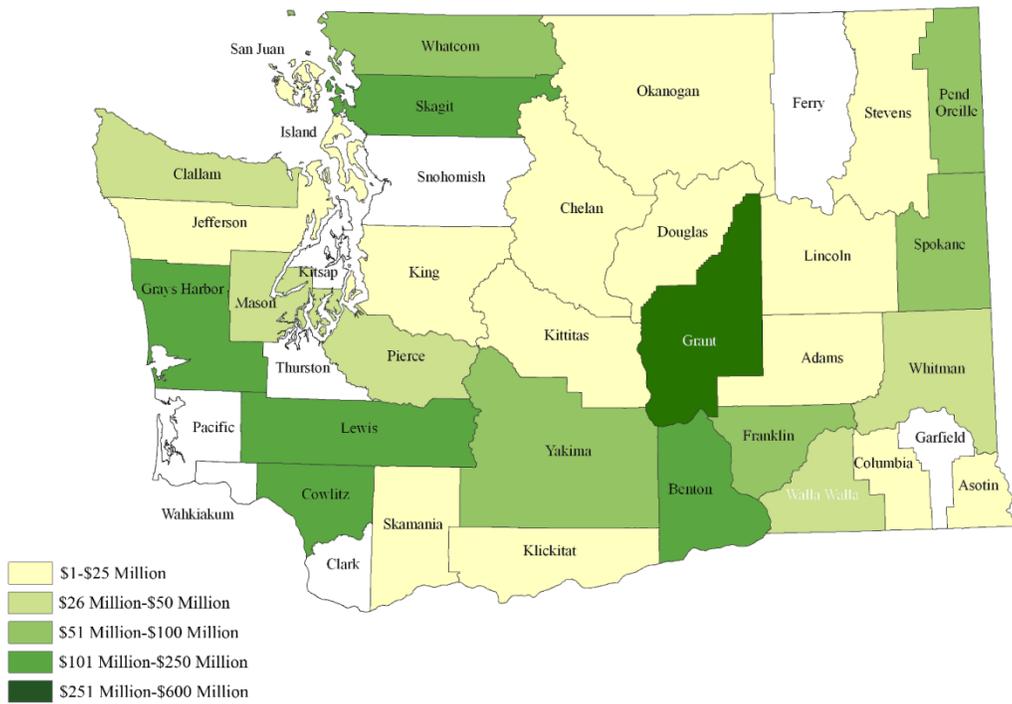
Rural County Deferral

Approved Applications By County (1999 - 2008)



Rural County Deferral

Project Costs By County (1999 - 2008)



Completed Projects

Through calendar year 2008, 1,057 projects have been approved and 1,026 have been completed. The Department conducts audits of deferred sales and use taxes once projects are operationally complete. Audits have been completed on 970 of the projects amounting to \$151.5 million in deferred taxes, almost 60 percent of all deferrals.

Table 3.8 shows amounts of deferred sales and use taxes audited or remaining to be audited. Most of the audits have been conducted on projects with application dates in the earlier years of the incentive program. Recipients are required to notify the Department when projects are operationally complete. It should be noted that there are often several years between project application and completion.

Table 3.8
Audited and Unaudited Deferred State and Local Sales and Use Taxes

Application	Audited Amount	Unaudited	Total	Audited Percent
1994	\$10,698,404	\$57,720	\$10,756,124	99.5%
1995	12,185,343	18,798	12,204,141	99.8%
1996	14,191,011	0	14,191,011	100.0%
1997	11,778,853	17,160	11,796,013	99.9%
1998	15,061,972	1,867,794	16,929,766	89.0%
1999	5,048,414	2,663,300	7,711,714	65.5%
2000	12,733,110	1,275,186	14,008,296	90.9%
2001	3,367,097	155,464	3,522,561	95.6%
2002	3,969,650	1,098,634	5,068,284	78.3%
2003	7,036,518	74,325	7,110,843	99.0%
2004	23,898,222	3,978,155	27,876,377	85.7%
2005	13,956,665	2,854,812	16,811,477	83.0%
2006	10,924,662	23,181,419	34,106,081	32.0%
2007	5,569,423	25,013,455	30,582,878	18.2%
2008	1,120,579	39,364,238	40,484,817	2.8%
Total	\$151,539,923	\$101,620,461	\$253,160,384	59.9%

CHAPTER FOUR

EVALUATION OF THE TAX INCENTIVE

Under the statutory mandate for this study in RCW 82.60.070(1) (f) and declaration statement in RCW 82.60.010; several areas of interest were identified for analysis by the Legislature. This chapter attempts to identify trends in data provided by participants in these programs or information available from other sources to give insights into these questions.

Areas of Analysis

- Job creation,
- Jobs created for residents of eligible areas,
- Company growth,
- Introduction of new products,
- Diversification of the state's economy,
- Growth in research and development investment, and
- The movement of firms or consolidation of firms' operations into the state.

Job creation

Analysis:

Employment patterns for participants in the rural deferral program were compared to non-participants in manufacturing industries in the same geographic areas and with U.S. manufacturing employment trends. Since this program's focus is on discrete manufacturing projects rather than continuous activity, one of the types of analysis performed was an analysis of five-year employment changes around a project's completion date compared with other non-participating firms for the same period. This comparison includes firms with projects completed between 1994 and 2000. Participants and non-participants were grouped by firm size with small firms having 50 employees or less in the project completion year, medium firms having 50 to 250 employees, and large firms with over 250 employees.

Results:

The results of this analysis indicate that participating firms fared better when compared to non-participant firms with an average increase in employment of 4.1 percent, with small and medium size firms driving the positive results. Table 4.1 shows the average yearly percent change for a five-year period around the completion of a project for participants and the same years of analysis for non-participants.

Table 4.1
Average Yearly Percent Change in Employment: Participants vs. Non-Participants

Participants: Complete Year	Total Employment: Base year for all firms*	Total Employment: Four years after base year for all firms	All Firms: Average Yearly Percent Change
1994	149	197	8.0%
1995	1,699	1,935	3.5%
1996	1,334	1,603	5.0%
1997	2,354	2,569	2.3%
1998	2,541	4,037	14.7%
1999	5,835	6,088	1.1%
2000	3,131	2,501	-5.0%
2001	2,908	2,620	-2.5%
2002	253	458	20.2%
2003	770	1,603	27.0%
2004	741	849	3.6%
2005	1,006	1,988	24.4%
Total	22,721	26,446	4.1%

* Base year has employment one year prior to a project complete year;
i.e. the base year for a project completed in 1994 is employment from 1993.

Non-Participants:	Total Employment: Base year for all firms*	Total Employment: Four years after base year for all firms	All Firms: Average Yearly Percent Change
1994	49,242	42,716	-3.3%
1995	51,139	40,686	-5.1%
1996	51,616	40,314	-5.5%
1997	50,870	40,319	-5.2%
1998	50,790	37,919	-6.3%
1999	49,486	33,881	-7.9%
2000	48,514	34,868	-7.0%
2001	47,850	35,437	-6.5%
2002	45,323	36,987	-4.6%
2003	43,998	36,534	-4.2%
2004	43,264	37,472	-3.3%
2005	44,649	37,235	-4.2%
Total	576,742	454,368	-5.3%

* The non-participants analysis was done using the same method as the participants;
i.e. the base year for the 1994 group is 1993.

Methodology:

While these results represent the core of the intended beneficiaries for this program, there were significant reductions in the number of projects analyzed for various reasons. The following describes the methodology and reasons for the reduction in the number of firms and projects analyzed for the area of job creation, specifically in the yearly analysis.

There were 1,057 approved projects that were completed after 1994. However, analysis was limited to 376 projects for the following reasons:

- 115 projects located in a CEZ or county adjacent to a rural county were removed. The analysis for this study focused only on the rural and distressed counties.
- 266 projects completed after 2004 were removed because employment data required for the analysis was not available. Five years of employment data needed includes:
 - the year prior to completion of the project,
 - the year the project was complete, and
 - three years after the project was complete to allow firms to reach full employment levels in the facility.
- 247 projects were removed because of the firm’s NAICS code. The program is for manufacturing activity. Some firms with industry codes outside of manufacturing are eligible because a portion of their activity is eligible. To avoid inaccurate comparisons only firms in manufacturing, agriculture (presumed food processors), and wholesale NAICS codes were selected for analysis.
- 53 projects with employment in an urban county were removed. In general, employers report employment by location, so firm employment trends can be analyzed using employment reported specifically in rural counties to the Employment Security Department. However, revenues are not reported to the Department of Revenue by location, only by firm. To allocate revenues by location would have required a subjective analysis; therefore firms with employment in an urban county were dropped so only true “rural” activity would be analyzed.

The analysis of trends by firm size was restricted by the limited number of individual firms with 250 employees or more. The larger firm size analysis became difficult due to disclosure issues, the lack of completed projects for all ten years of the analysis, and because many of the firms had urban area employment which required that they be dropped from the analysis.

Though large participant firms had an average decline in employment, -0.76 percent, for the years analyzed, they were less severe than non-participants who had a -6.1 percent average yearly decline from 1997 to 2001. Tables 4.2 and 4.3 show employment trends comparing participants and non-participants by firm size.

Table 4.2
Employment Trends of Large Firms: Participants vs. Non-Participants
Base Years 1997 to 2001*

	Large Firms: More than 250 employees in base year
Participants: From 1997 to 2001	
Base Year Total Employment	11,571
Total Employment: Fourth year after base year	11,218
Average Yearly Percent Change	-0.76%
Non-Participants: From 1997 to 2001	
Base Year Total Employment	96,458
Total Employment: Fourth year after base year	72,903
Average Yearly Percent Change	-6.1%

*Data was only available from 1997 through 2001 for analysis.

Table 4.3
Employment Trends of Small and Medium Firms: Participants vs. Non-Participants
Base Years 1994 to 2004

	Small Firms: Less than 50 employees in base year	Medium Firms: 50 - 250 employees in base year	Total: Small and Medium Firms
Participants: From 1994 to 2004			
Total Employment: All base years	1,873	9,276	11,150
Total Employment: Fourth year after base year	3,973	11,255	15,228
Average Yearly Percent Change	28.0%	5.3%	9.1%
Non-Participants: From 1994 to 2004			
Total Employment: All base years	166,936	171,168	338,104
Total Employment: Fourth year after base year	138,070	128,976	267,046
Average Yearly Percent Change	-4.3%	-6.2%	-6.2%

Comparing rural deferral participants against the national manufacturing employment trends indicates that the program participants are maintaining their relative employment share. Table 4.4 illustrates the share of national manufacturing represented by all program participants from 1994 to 2004 with a project established in a rural or distressed county.

Table 4.4
Employment Trends: All Participants Compared to the U.S.

Year	Participants	U.S.	Percent of U.S.
1994	28,925	17,020,000	0.17%
1995	31,106	17,241,000	0.18%
1996	32,483	17,237,000	0.19%
1997	33,696	17,419,000	0.19%
1998	34,902	17,560,000	0.20%
1999	35,237	17,322,000	0.20%
2000	37,426	17,263,000	0.22%
2001	37,653	16,441,000	0.23%
2002	35,823	15,259,000	0.23%
2003	35,392	14,510,000	0.24%
2004	34,988	14,315,000	0.24%
2005	33,881	14,226,000	0.24%
2006	35,755	14,155,000	0.25%
2007	37,877	13,879,000	0.27%
2008	35,355	13,431,000	0.26%

Jobs created for residents of eligible areas

Based on survey responses, the vast majority of program participants hire their employees from Washington residents. While the share of resident new hires varies each year, the trend appears to be increasing. Table 4.5 shows the number of firms that responded to the survey question about new hires and the percent of new hires that were from Washington.

Table 4.5
Rural Deferral Participants: Percent of Employees from Washington

Tax Year	Firm Count	Average
		Percent: WA
2004	16	80.5%
2005	34	68.0%
2006	59	80.2%
2007	141	89.4%
2008	120	87.0%

It appears that participant firms generally pay comparable wages, while providing better benefits than non-participant firms. The exception is in the software industry in which non-rural program participants provide medical benefits to a higher portion of employees. Washington rural participant firms also appear to pay better than the average wage in the U.S. in similar industries. See Tables 4.6 through 4.9.

Rural deferral program participants complete annual survey reports covering employee benefits such as medical coverage or retirement programs. The Employment Security Department also does surveys of employer-provided benefits, although their survey coverage is different. The Department combined the data for both of these surveys to allow comparison between program participants and non-participants. The following tables, 4.6 and 4.7, provide comparisons of employee medical benefits and retirement benefits for program participants and non-participants. From these tables it can be seen that, for years in which data can be compared, program participants provide medical benefits to a higher percent of employees for some industries (32, 33, and 54) than non-participants in similar industries do. For retirement benefits, participants in all industries provide better benefits than for non-participants for all NAICS in nearly every year shown.

Table 4.6
Medical Coverage: Participants vs. Non-Participants

Participants	2004*	2005	2006	2007*	2008
Manufacturing (32)	91.8%	89.9%	85.6%	76.6%	82.0%
Manufacturing (33)	81.3%	76.5%	85.0%	83.1%	88.1%
Information (51)	67.2%	62.9%	67.0%	64.2%	58.1%
Scientific Services (54)	90.3%	97.8%	90.8%	74.0%	90.1%
Waste Management (56)	9.7%	20.5%	35.0%	55.6%	47.4%
Non-Participants					
Manufacturing (32)	NA	82.1%	83.7%	NA	79.5%
Manufacturing (33)	NA	81.1%	83.9%	NA	81.5%
Information (51)	NA	75.5%	78.8%	NA	82.5%
Scientific Services (54)	NA	80.5%	82.3%	NA	79.5%
Waste Management (56)	NA	52.5%	56.8%	NA	39.1%

*The Employment Security Department's annual Employee Benefit Survey did not include data in years 2004 and 2007.

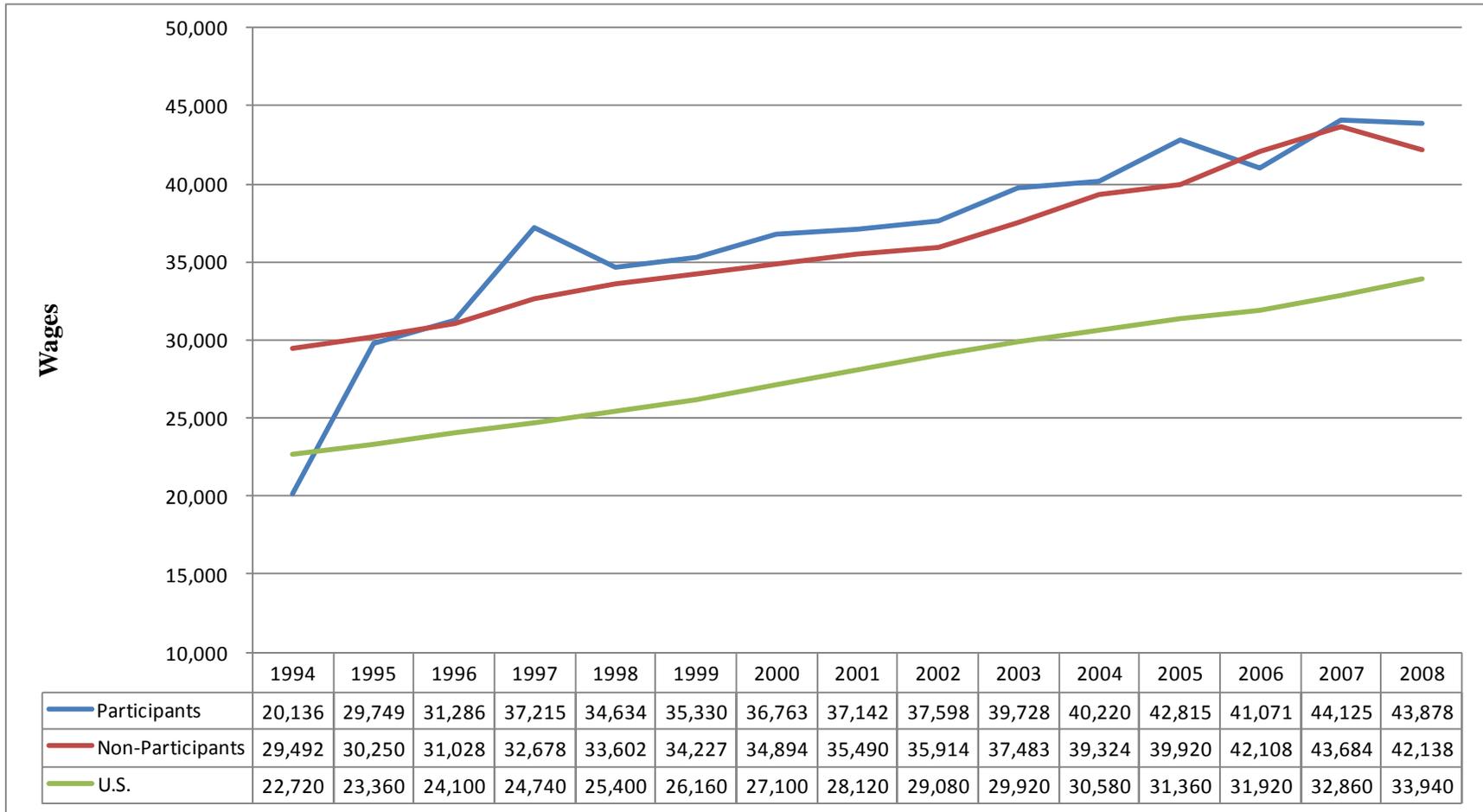
Table 4.7
Retirement Plans: Participants vs. Non-Participants

Participants	2004*	2005	2006	2007*	2008
Manufacturing (32)	79.5%	82.7%	69.1%	89.2%	77.8%
Manufacturing (33)	50.1%	53.5%	59.4%	62.5%	62.1%
Information (51)	68.8%	72.2%	73.9%	75.7%	58.6%
Scientific Services (54)	62.3%	73.9%	53.6%	64.3%	75.8%
Waste Management (56)	5.4%	15.4%	55.0%	61.1%	47.4%
Non-Participants					
Manufacturing (32)	NA	59.2%	52.6%	NA	52.1%
Manufacturing (33)	NA	49.7%	51.4%	NA	51.9%
Information (51)	NA	46.1%	49.7%	NA	53.0%
Scientific Services (54)	NA	63.3%	55.6%	NA	60.5%
Waste Management (56)	NA	30.7%	35.4%	NA	22.6%

*The Employment Security Department's annual Employee Benefit Survey did not include data in years 2004 and 2007.

The following chart shows the average manufacturing wages of participants, non-participants, and the average U.S. wage. It can be seen that by 1996, program participants had comparable wages to non-participants and since 1996; participants have had slightly higher wages in manufacturing. Both participants in the program and non-participants have much higher wages in manufacturing jobs compared to the rest of the nation.

Chart 4-A
Average Manufacturing Wages: Participants, Non-Participants and U.S.



Company growth

Growth in revenues for participant and non-participant firms was analyzed in a way similar to employment. Tables 4.8 and 4.9 show the gross in any given base year compared to the gross four years after the base year for participants and non-participants by firm size.

Analysis shows that small and medium size participant firms had significantly greater revenue increases than non-participant firms of the same size for the 1994-2004 period. These results are consistent with the employment analysis that shows small and medium size firms growing.

Table 4.8
Gross Revenue Trends: Participants vs. Non-Participants - Base Years 1994 to 2004

	Small Firms: Less than 50 employees in base year	Medium Firms: 50 - 250 employees in base year	Total: Small and Medium Firms
Participants			
Base Year Total Gross	315,766,851	1,140,167,822	1,455,934,673
Total Gross: Fourth year after base year	730,812,585	1,741,020,743	2,471,833,328
Average Yearly Percent Change	32.86%	13.17%	17.44%
Non-Participants			
Base Year Total Gross	42,969,278,864	32,478,706,135	75,447,984,999
Total Gross: Fourth year after base year	40,762,003,301	34,688,918,616	75,450,921,917
Average Yearly Percent Change	-1.28%	1.70%	0.001%

Large firms did not compare favorably with non-participant firms of the same size for the same time period that was analyzed (1997-2001). Large firm results were hampered by limitations in the number of projects that could be analyzed due to disclosure issues and the lack of completed projects for all ten years of the analysis.

Table 4.9
Gross Revenue Trends: Participants vs. Non-Participants - Base Years 1997 to 2001

	Large Firms: More than 250 employees in base year
Participants	
Base Year Total Gross	2,649,298,575
Total Gross: Fourth year after base year	2,415,070,324
Average Yearly Percent Change	-2.21%
Non-Participants	
Base Year Total Gross	18,404,130,206
Total Gross: Fourth year after base year	19,619,635,233
Average Yearly Percent Change	1.65%

Table 4.10 illustrates the change in gross revenues for any given base year and the four years following, for participants and non-participants. Once again, the trend towards company growth seems to be more positive in the participant group versus non-participants but, in general, both saw growth in gross revenues during the period analyzed.

Table 4.10
Average Yearly Percent Change in Gross: Participants vs. Non-Participants

Participants: Complete Year	Total Gross: Base year for all firms *	Total Gross: Four years after base year for all firms	All Firms: Average Yearly Percent Change
1994 **	26,694,572	50,008,435	21.8%
1995	306,884,919	624,390,615	25.9%
1996	348,689,820	469,136,964	8.6%
1997	821,241,761	816,111,965	-0.2%
1998	540,397,202	546,240,590	0.3%
1999	727,319,226	839,873,559	3.9%
2000	846,075,799	862,159,481	0.5%
2001	121,567,689	213,916,563	19.0%
2002 **	17,620,503	96,762,445	112.3%
2003	39,362,106	200,101,710	102.1%
2004 **	57,966,032	86,502,097	12.3%
2005	186,037,423	204,817,241	2.5%
Total	4,039,857,052	5,010,021,665	6.0%

* Base year equals gross one year prior to a project complete year, i.e. base year 1994 has gross from 1993

** Large Firms are not included: No project completion in base year.

Non-Participants			
1994	5,594,710,693	8,317,194,722	12.17%
1995	8,022,420,901	6,888,786,330	-3.53%
1996	9,539,961,154	7,000,394,427	-6.66%
1997	7,884,958,598	8,901,686,542	3.22%
1998	8,424,154,216	7,679,288,366	-2.21%
1999	8,933,363,054	9,015,610,510	0.23%
2000	9,896,645,052	8,678,944,886	-3.08%
2001	11,788,137,560	9,423,417,147	-5.02%
2002	10,231,389,889	10,504,267,163	0.67%
2003	9,417,936,067	12,213,362,307	7.42%
2004	10,779,883,438	15,939,997,238	11.97%
2005	12,428,314,398	17,011,645,602	9.22%
Total	112,941,875,020	121,574,595,240	1.91%

Introduction of new products

Since only 9 percent of program participants responded to the survey questions covering new products and services, there are few definitive conclusions from the data. For those firms that did respond there appeared to be growth in new products, particularly for those that were involved in high technology categories. Table 4.11 shows the number of respondents for each year of the survey along with the actual responses given in the survey.

Table 4.11
Number of New Products, Services Process and Projects and
Count of Respondents

Survey Responses	2004	2005	2006	2007	2008
5 High Technology categories	273	824	772	1,707	1,389
Other categories	119	851	878	357	412
Total	392	1,675	1,650	2,064	1,801
Count of Firms Responding to Question	2004	2005	2006	2007	2008
5 High Technology categories	13	14	13	13	9
Other categories	12	16	12	9	8
Total	25	30	25	22	17
Total Rural Survey Respondents	260	242	263	308	316
Percent of total survey respondents that answered new product question	10%	12%	10%	7%	5%

Diversification of the state’s economy

Analysis:

Patent information is helpful for evaluating trends in innovation. The United States (U.S.) Patent and Trademark Office keeps statistics on patents granted in about 450 classification codes by state and by owner. The classifications define a general area of knowledge, which is similar to an industry code.

One method of measuring trends in diversity for a state is to measure the number of patent classifications over time. These trends indicate potential economic diversification due to inventions.

Methodology:

Patent information was used to evaluate potential diversification compared to the early 1990s. Firms that averaged at least one patent per year were included in the analysis.

Washington was compared to the United States and the selected competitive states of California, Missouri, Nevada, North Carolina, Oregon and Texas. Population ratios were used to make the patent information comparable for evaluation. The ratio works as follows:

- Washington must have one patent in a class to count the class.
- Selected States must have 13.5 patents in a class to count the class.
- The U.S. must have 50 patents in a class to count the class.

Results:

Washington has fewer classification codes with granted patents than the U.S. and the selected competitive states. However, Washington has not lost ground since 1990. Both the U.S. and the selected competitive states have fewer classification codes with granted patents than in 1990.

**Chart 4-B
Number of Classifications with Granted Patents: U.S, Selected States, and Washington**

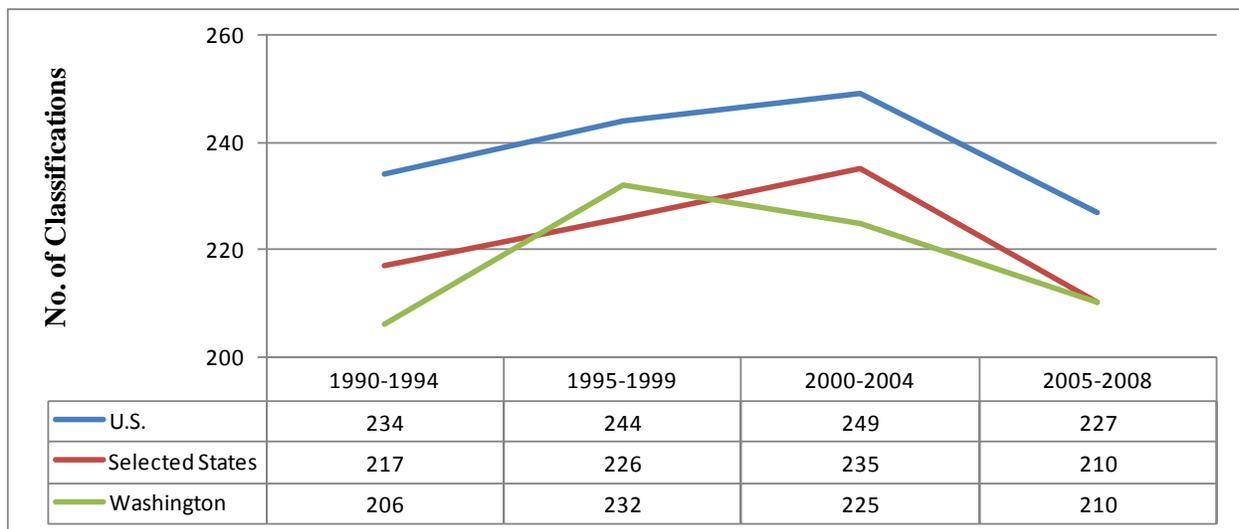


Table 4.12 expands on the data provided in Chart 4-B on the previous page. The left section of the table shows the number of classifications with granted patents for the U.S., selected states, and Washington as shown in Chart 4-B. However, it also includes information on Washington non-participants, and Washington rural deferral participants.

Analysis indicates that participants in the rural deferral program are maintaining their level of diversity over time. Participants had patents in 13 classifications in the 1990-1994 time period, and 14 in the 2005-2008 time period.

The middle section of the table compares Washington as a percent of the U.S. and selected states. For example, during the time period of 1990-1994 Washington had patents in 206 classifications and the U.S. had 234, which equates to Washington having 88 percent of the number of classifications as the U.S. This percent was calculated by dividing 206 by 234.

The right section of the table compares participants as a percent of the U.S., selected states and non-participants. Analysis indicates that participant classifications as a percent of the U.S. has increased over time. The same can be seen with the selected states. Participants had 3.5 percent the number of classifications as selected states in the time period of 1995-1999, and have increased to 6.7 percent in the time period of 2005-2008.

**Table 4.12
Patent Class Diversification**

Time Period	Number of Classifications with Granted Patents					WA Classifications as a Percent		Participant Classifications as a Percent		
	U.S.	Selected States	WA Total	WA Non-Participants	Rural Deferral Only	WA / U.S.	WA / Selected States	Rural Deferral / US	Rural Deferral / Selected States	Rural Deferral / Non-Participants
1990-1994	234	217	206	139	13	88%	95%	5.6%	6.0%	9.4%
1995-1999	244	226	232	146	8	95%	103%	3.3%	3.5%	5.5%
2000-2004	249	235	225	156	15	90%	96%	6.0%	6.4%	9.6%
2005-2008	227	210	210	160	14	93%	100%	6.2%	6.7%	8.8%

U.S. - Those classes with 50 or more patents averaged per year for the time period specified

Selected States - Those classes with 13.5 or more patents averaged per year for the time period specified

Washington - Those classes with 1 or more patents averaged per year for the time period specified

Number of patents per class determined by ratio of 50:13.5:1 estimated 2008 population for each group selected

US = 304,060,000

Selected States = 82,607,000

Washington = 6,550,000

Growth in research and development investment

Firms that participate in the rural deferral program solely are not required to report research spending information in their annual survey, so trends cannot be analyzed from that source. Some of the participants do participate in the high technology research and development credit program, so their information is included in results for that study.

Firms that are expanding their operations are asked in the survey about the types of employment that they are adding. During 2004 to 2008, firms responded that about 11 percent of employees were for research functions on average, but that percentage varied over the period.

The movement of firms or consolidation of firms' operations into the state

Based on survey responses by participants in the 2004 to 2008 period, favorable growth trends are evident, as many firms indicated they moved operations into the state or expanded within the state. Few firms reported moving operations out of state. In addition, survey responses that related to expansions indicate that about 70 percent of new hiring was for manufacturing positions. Table 4.13 shows the number of participants answering the question about movement and the results from those respondents.

Table 4.13
Participant Trends in Movement and Employment Positions by Function

Number of respondents to the following questions:	2004	2005	2006	2007	2008	
Moved activities into Washington	2	8	16	15	10	
Expanded existing operations in Washington	12	21	46	135	105	
Created a new activity in Washington	2	11	12	22	17	
Moved activities out of Washington	0	2	5	7	0	
Employment Positions by Function	2004	2005	2006	2007	2008	Avg.
Research	1%	15%	12%	15%	4%	11%
Manufacturing	87%	78%	77%	72%	61%	70%
Distribution	6%	6%	8%	10%	30%	16%
Administrative	6%	6%	8%	10%	30%	16%

For the rural deferral program, those respondents that indicated they moved activities in, expanded, or created new activities, stated that about 70 percent of their new positions were in manufacturing, 16 percent in distribution, and about 11 percent were in research activities. From these survey trends, it appears that a smaller share of new hiring is in manufacturing activities over this five-year period. Though participants seem to be maintaining their relative share of manufacturing compared to the U.S., in general manufacturing employment in Washington has been slowly declining.

Chart 4-C shows Washington manufacturing employment as a percent of U.S. manufacturing employment, while Chart 4-D shows participant manufacturing employment as a percent of U.S. manufacturing employment. Participants in the rural deferral program seem to be increasing their share of manufacturing employment, helping Washington maintain its national share.

Chart 4-C
Washington's Manufacturing Employment Share of U.S. Manufacturing

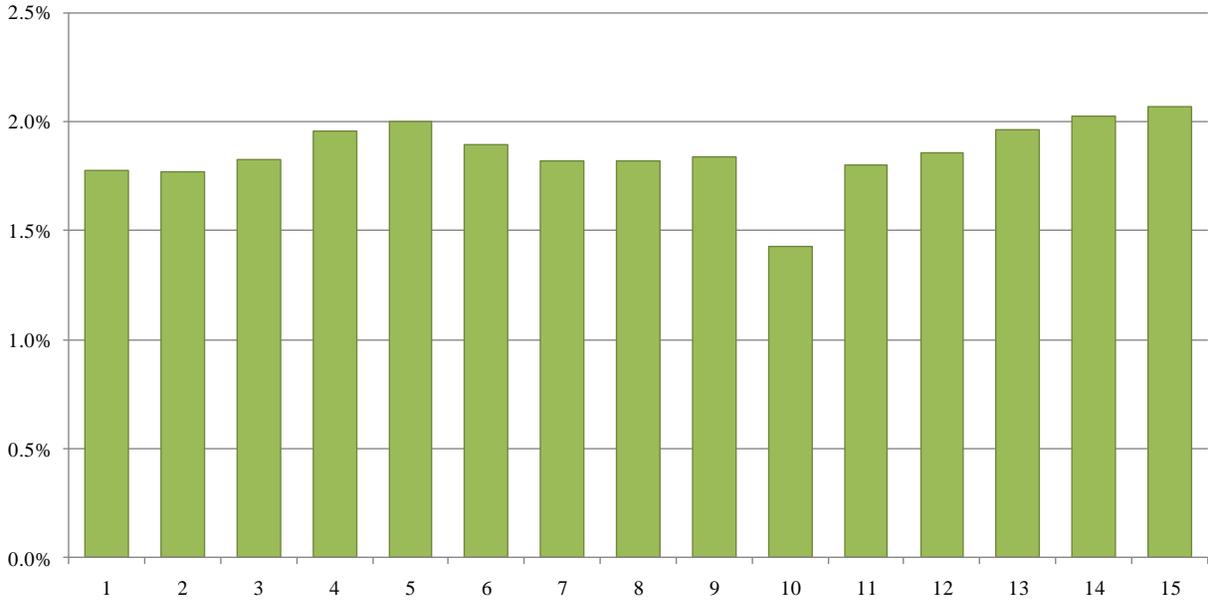


Chart 4-D
Participants' Employment Share of U.S. Manufacturing

