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OKLAHOMA'S QUALITY JOBS PROGRAM: A LOOK AT ONE OF THE LARGEST BUSINESS SUBSIDIES IN THE STATE

by **MARK LASH**

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According to a New York Times report published in December 2012, state and local governments provide over \$80 billion each year to a variety of businesses through tax exemptions, tax credits, incentives, and other programs.¹ That same report showed Oklahoma provides over \$2 billion each year to businesses for economic development.²

Perhaps the most popular and well-known subsidy in Oklahoma is the Quality Jobs Program. This program was created in 1993, with the first companies enrolling in the fall of that year. Through the end of fiscal year 2014, the Quality Jobs Program has paid out over \$955 million to private businesses for job creation in the state. Quality Jobs payments have increased for the past four years, going from \$56 million in fiscal year 2010 to \$82.3 million in fiscal year 2014.³

Who can receive Quality Jobs payments has expanded significantly since the program was created. It was originally focused on manufacturing jobs, but many other business sectors have been added over the years. Oil and gas companies were made eligible to receive Quality Jobs payments in 2005, and in fiscal year 2013 they received over 53% of incentive payments compared to 28% for manufacturing companies. The size of companies approved for the program range from relatively small to those with thousands of employees and hundreds of millions of dollars in annual revenues.

Spending by the program has no cap, and it is not subject to the normal state budget process. The program's authorization also does not include a sunset provision to require reauthorization by the state legislature. Funding needed for incentive payments is simply "taken off the top" of estimated revenues for the budget year.

The program is required to be revenue neutral. However, the Department of Commerce's methodology for determining revenue neutrality has been questioned by at least two Oklahoma economists and includes some obvious flaws. If the Quality Jobs program continues without changes, we can expect that costs will continue to rise as they have over the past 20 years.

This issue brief provides the background of the Quality Jobs Program, describes key elements of the program, and makes recommendations on how to best achieve its stated purpose of job growth while also maximizing the use of limited state revenues.



Overview

The Quality Jobs Program (QJP) was created to provide incentives for businesses to expand or locate within Oklahoma. A detailed description and guidelines for the program can be found on the Commerce Department website.⁴

If accepted into the program, a company can qualify for a cash rebate of up to 5 percent of new taxable payroll over a 10-year period. Some exceptions allow a larger percentage for cash rebates and longer-term contracts for specific industries and circumstances.

To qualify for this program a company must:⁵

- Be a qualifying basic industry as defined by the QJP. Initially the principal industry code for participation was manufacturing, but eligible industries have expanded over the years to include Transportation of Freight or Cargo, Grocery Wholesale Distributing, Oil & Gas Extraction, Adjustment and Collection Services, Professional Organizations, and others.⁶
- Add a minimum of \$2.5 million in annual new taxable payroll in Oklahoma within the first three years of their participation in the program. If this condition is not met, the company is removed from the program and cannot participate again for at least one year. There are exceptions to this payroll threshold that are detailed in the Quality Jobs Program Guidelines.
- Offer health insurance to all employees who are counted as new jobs. The employee cannot be required to pay more than 50 percent of the premium cost.
- Pay new employees at a level that is at least equal to the average county wage where the company is located. However, the maximum wage level that can be required is \$30,754, even if the average county wage is higher than that amount (effective June 2003). Applicants located in “opportunity zones” designated by the Department of Commerce are exempt from the requirement.

Legislative Changes

The QJP has undergone many legislative changes since its inception, with a list of those changes shown in Appendix A.⁷ Some of the more significant changes include:

- Oklahoma residents must hold jobs eligible for the program and employees must work at least 30 hours per week and be offered health benefits (2006).
- A company that incurred an ownership change could apply for the program with a baseline employment level of zero, even if it employs existing workers. The company must demonstrate that the jobs are likely to be lost to the state due to new ownership (2006).
- The program was expanded to include professional sports teams and allow them to participate for 15 years instead of the standard 10 years. This legislation was passed in anticipation of the Seattle SuperSonics basketball team relocating to Oklahoma City (2008).
- Many new industry codes were added to allow a more diverse set of companies to participate in the program (Multiple Years).

- A “clawback provision” was imposed if a participant does not maintain operations in the state for a full three years from the start date of joining the program. If they do not maintain operations, they must repay 100 percent of the benefit received (2013).
- Participants failing to reach the required payroll threshold within the three-year ramp up period may not reapply for at least 12 months after dismissal from the program (2013).
- The state may establish a public trust for the purpose of making incentive payments that assist a purchase of property by the United States Armed Forces. This provision was made to assist Tinker Air Force Base in the purchase of a 175-acre railway yard (2014).

Company Participation

According to the QJP Triennial Report dated January 2014, 713 companies have enrolled in this program since its inception.⁸

During the most recent three-year period (FY 2011-2013) there were 123 new enrollments in the program. The chart below shows the number of companies actively participating in the program during that period.

The Commerce Department would not provide incentive payment totals associated with the above breakdown by sector. They also would not provide a list of companies that were associated with each sector.

The biggest recipients of Quality Jobs payments are large energy companies. In FY 2013 the top ten active companies (6 percent) received 54 percent of incentive payments.

Sector/Industry	FY 2011	FY 2012	FY 2013
Energy	12	19	23
Manufacturing	85	103	92
Distribution & Transportation	8	10	11
Information & Professional Services	28	29	27
Corporate & Back Office	23	25	22
Total	156	186	175

Source: Oklahoma Tax Commission

Ten Largest Quality Jobs Payment Recipients, FY 2013			
Chesapeake Energy	\$8,268,951	ConocoPhillips	\$3,250,975
Sandridge Energy	\$6,147,396	Dell Computers	\$3,238,774
Spirit Aerosystems	\$4,871,726	Holly Refining & Marketing	\$3,173,779
Boeing	\$3,589,428	Phillips 66	\$3,055,624
Professional Basketball Club*	\$3,575,201	Devon Energy	\$3,021,064

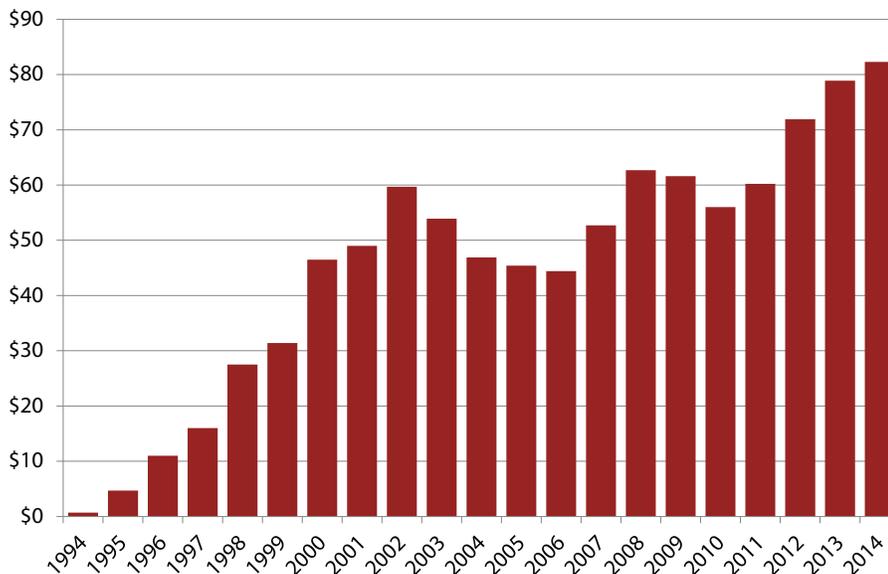
Source: Oklahoma Tax Commission

*This group owns the Oklahoma City Thunder and Tulsa 66ers
(<http://www.nba.com/thunder/ownership.html>)

Program Funding

Funding for the Quality Jobs Program is taken directly from revenues generated by the personal income tax. The annual spending for this program is not subject to the state's budget appropriation process, and there is no limit on how much can be spent each year. The spending level is determined by the number of new qualified jobs created by companies enrolled in the program.

Quality Jobs Program Payments (in \$ millions)



Source: Oklahoma Department of Commerce Triennial Reports and Oklahoma Tax Commission Reports

With the continued growth of this program, costs in FY 2013 are two and a half times what they were in FY 1999. On the other hand, revenues from individual income tax are only one and a half times more over the same time period. State tax revenue is not keeping pace with the growth of this program.

The chart shows the cost history of the program since its creation in fiscal year 1994.

Program Participation

At its inception, the QJP was focused primarily on companies in the manufacturing sector. Over time, it has expanded to include many other industry sectors in Oklahoma.

The range of companies participating in the program spans the spectrum in type and size. For example, Aegis Food Testing Laboratories started business in South Dakota in 2008 and opened a second laboratory in Oklahoma City in 2010. They have a small staff and received incentive payments of \$13,843 in FY 2013.

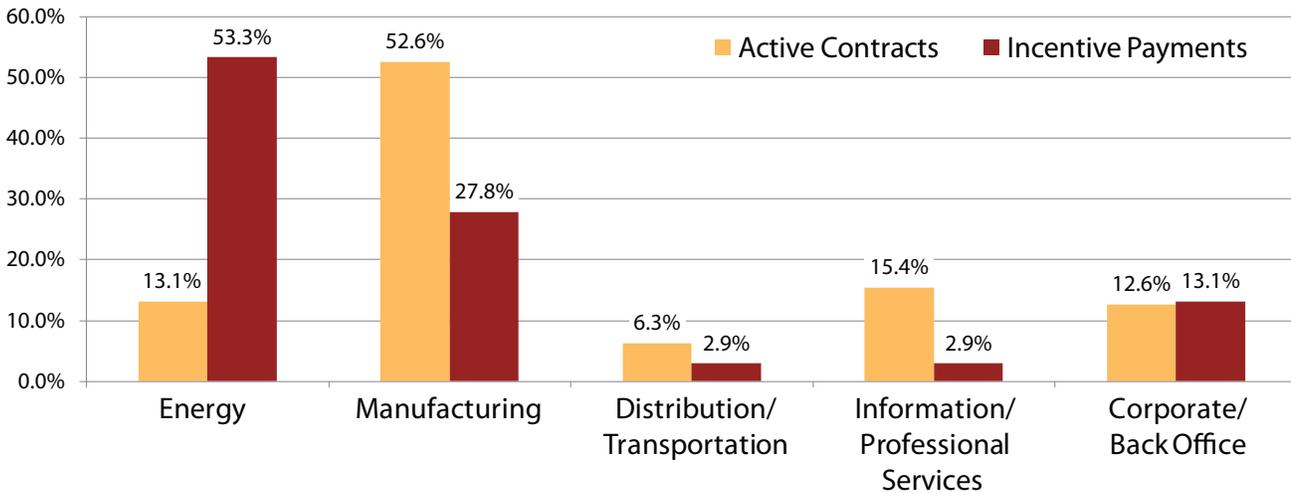
On the other end of the spectrum is Chesapeake Energy, which received incentive payments of \$8,268,951 in FY 2013, the most paid to any company that year. According to their 2012 annual report, Chesapeake had revenues of \$12.3 billion and nearly 12,000 employees. They were the largest recipient of Quality Jobs payments in the same year that the company eliminated 600 jobs in Oklahoma City.⁹

A breakdown by industry of FY 2013 active contracts reflects a distribution of Manufacturing (92/53% of total), Information & Professional Services (27/15%), Energy (23/13%), Corporate & Back Office (22/13%), and Distribution & Transportation (11/6%).

Data shows that the inclusion of energy companies has had a significant impact on the overall cost of the program. In FY 2005 the first contract was entered into with a company categorized under the NAICS code for Oil & Gas Extraction. When this category was first added to the QJP, jobs eligible for incentive payments were limited to those in the corporate headquarters or directly related to administrative, financial, engineering, surveying, geological, or geophysical services. Employment relating to drilling or field services was not considered a new direct job for the purpose of incentive payments at that time.

Between FY 2007 and FY 2103 there were an additional 26 contracts awarded under this newly eligible category.¹⁰ In 2012, companies categorized under the NAICS code for Drilling of Oil and Gas Wells were added to the list of eligible participants in the program. The jobs eligible for incentive payments in this area excluded field workers.

Quality Jobs Program Incentive Payments and Active Contracts, FY 2013

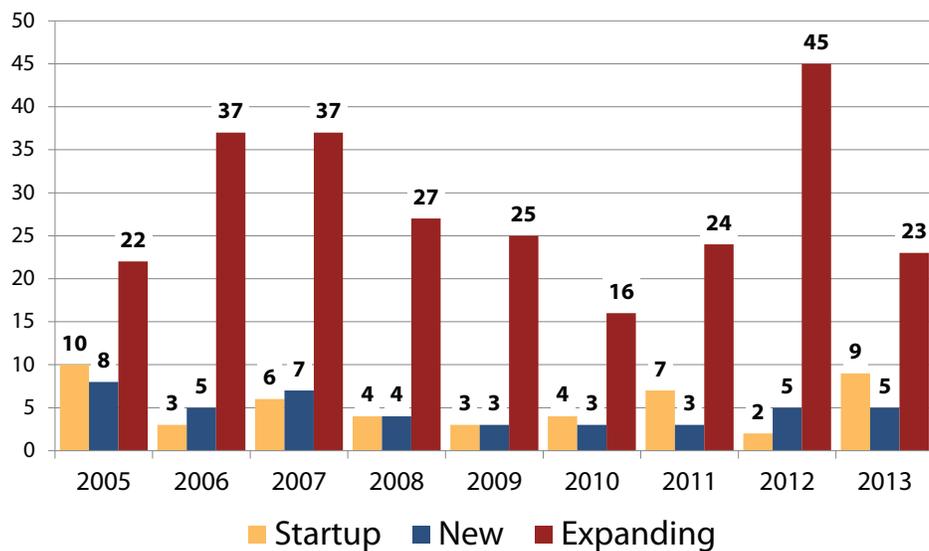


The addition of the oil and gas sector has tipped the overall payments away from manufacturing companies. The charts show the percent breakdown by sector of the active contracts and incentive payments for FY 2013.¹¹

Although energy companies made up only 13 percent of active contracts, they received 53 percent of incentive payments.¹²

The Triennial Reports show the number of new contracts awarded each fiscal year with a breakdown by startup, new and expanding. New companies are new to Oklahoma, but existed elsewhere before locating here. Startups are brand new companies and expanding are those that are already established in Oklahoma.¹³

New Quality Jobs Contract Awards, 2005-2013



From 2005 to 2013, nearly three-fourths (73.8 percent) of new Quality Jobs contracts went to expanding companies that already existed in Oklahoma. Of the remaining contracts, 13.8 percent went to startups and 12.4 percent went to existing companies that were new to Oklahoma. It is clear that most Quality Jobs contracts are not being used to entice companies outside the state to relocate here or to assist brand new companies, but are instead going to already existing Oklahoma businesses.

Source: Oklahoma Department of Commerce Triennial Reports

Program Evaluation & Economic Impact

While there are examples of successes and failures among individual companies, it is necessary to look at the program as a whole to determine the level of success for the QJP.

There has been much discussion about whether programs of this type have a positive economic impact on communities greater than the costs involved. Oklahoma law requires that incentives provided under the Oklahoma Quality Jobs Program “not exceed the estimated net direct state benefits that will accrue to the state as a result of the establishment locating in the State of Oklahoma” (Oklahoma Laws §68-3602 (2)(b)).

To ensure this requirement is met, the Commerce Department performs an economic analysis showing the net benefit of this program. For fiscal years 2011-2013, they showed costs of incentive payments of \$210.8 million and increased revenue to the state of \$231.8 million, which reflects a net benefit of \$21.0 million.

The Commerce Department reports on a regular basis the number of new jobs created and factors that information into its economic analysis to determine the benefits and costs of this program. Companies that are active participants in the program are creating new jobs, which is certainly a measure of success. Unfortunately, the Department indicated that due to lack of resources they are unable to track overall jobs that have been created as well as those jobs that have been lost due to layoffs, bankruptcy, etc. This type of information is critical in performing the analysis needed to determine program performance and to identify areas of improvement.

To evaluate the program fairly, we also need to know if jobs would have been created even without incentives. The Commerce Department performed a survey of program participants covering the first 5 and 1/2 years of the program that gives some insight into that question. The companies surveyed said that just 50 percent of the jobs they added were a result of receiving incentives. However, the formula that the Department of Commerce uses to determine that the program is revenue neutral assumes that every job being subsidized would not have been created without Quality Jobs payments.

“ I have no doubt that the [Quality Jobs] program creates a net budgetary loss if its objective is to generate new, or even better, jobs.”

-Dr. Kent Olson, Professor of Economics Emeritus at Oklahoma State University

To better evaluate the Commerce Department’s findings, I provided a copy of their analysis to three different economists and asked whether they thought the methodology used was reasonable. Their responses provided quite a diverse range of opinions.

Dr. Kent Olson, a Professor of Economics Emeritus at Oklahoma State University, argued that only 50 percent of the jobs should be used in the economic analysis, due to the survey indicating that only half of the jobs were created because of the incentive program. In addition, he stated that even the 50 percent of jobs may not be truly “new” jobs unless they “are jobs provided to in-migrants or to individuals who would have been otherwise unemployed.” If they were jobs provided to workers who were already employed in Oklahoma, “then the benefits are equal to the taxes generated only from the increase in wages that these workers receive.” His bottom line was “that the real benefits to Oklahoma are less than those claimed.”

Another economist who provided feedback was Dr. Mickey Hepner, the Dean of the College of Business at the University of Central Oklahoma. Hepner argued that even assuming 50 percent of the jobs incentivized under this program would not have been created otherwise is too much, since Quality Jobs pays just 5 percent of payroll cost.

“By definition, if the immigration rate is accurate and the jobs are basic, a Quality Jobs incentive never costs more than what it brings in.”

-Daniel Gorin, former Chief Economist of the Oklahoma Department of Commerce

He said, “Economic research over the last few decades generally finds that in the long-run, a 5 percent reduction of labor costs typically results in a 5 percent increase in the quantity of labor demanded.” Under this assumption, if a company planned to add 100 new jobs to meet demand for their products and services and they received a 5 percent incentive payment on those jobs, then they would add 5 new jobs that would be paid for by the incentive payments received. Therefore “the program itself only added 5 new jobs.”

Daniel Gorin, the former Chief Economist of the Oklahoma Department of Commerce, provided a different take. Gorin was at the Department of Commerce when this program was implemented and for about the first six years of its operation. He argued that the economic multiplier of jobs created under this program is enough to make up for the cost of paying for jobs that would have been created anyway. He said, “If the incentive is inducement for half of the new direct jobs and there is an economic multiplier of 2.0 (a reasonably low estimate), then the total job growth in the state induced by the incentive is equal to the number of jobs in the program (the half that were induced times two).”

Gorin also argued that all jobs added under this program add to economic growth, as long as they are “basic jobs”, which means they do not displace other economic activity. Even if a job is filled by an Oklahoman that had been employed elsewhere, the job being vacated by him or her would then be filled by someone else, on down the line until eventually a job is created for an in-migrant or unemployed worker. Gorin said, “By definition, if the immigration rate is accurate and the jobs are basic, a Quality Jobs incentive never costs more than what it brings in. And, if it still induces more than 40 to 50 percent of the jobs from enrolled projects (something about which I have no knowledge), it could still have payments that come from previously unanticipated tax revenues.”

Gorin did have some concern that the in-migration rate used in the analysis was too low, but overall he seemed comfortable with the Department’s methodology.

This debate over how to account for jobs that would be created without the incentive is crucial to the analysis of whether or not the Quality Jobs Program pays for itself. Under the methodology

“CHANGE IN CONTROL EVENTS”: HOW OKLAHOMA MAKES QUALITY JOBS PAYMENTS TO COMPANIES THAT AREN’T CREATING NEW JOBS

The “Change in Control Event” provision, which was added to the Quality Jobs program in 2006, comes into play when a company transfers more than 50 percent of its ownership or assets. The company can then make a case to the Department of Commerce that they have offers and incentives to relocate their business outside of Oklahoma. In one example, \$2.3 million was paid to glass manufacturer Zeledyne beginning July 2008 as an incentive to maintain existing jobs. Nevertheless, the company shut down in 2011, laying off more than 400 employees.

The Department of Commerce has used this provision to approve Quality Jobs payments for a variety of reasons. In the case of a Holly Refining & Marketing refinery, \$12.1 million has been paid to make up for the cost of complying with EPA pollution regulations. Oklahoma is subsidizing this refinery for a maximum benefit over a ten-year period of \$25.2 million.¹⁴

currently used by the Department of Commerce, there is a net benefit to the state of \$21 million for the three year period. If we assume just 50 percent of the jobs would not have been created otherwise, and we do not apply a multiplier to the additional state revenue from those jobs, then the Quality Jobs Program would be a net loss to the state of \$94.9 million. Finally, if we only count 5 percent of the jobs for which incentives were paid, then the net loss to the state would be \$199.2 million.

Given this range of opinions it is not at all certain that this program is meeting its statutory requirement to be revenue neutral.

Recommendations

The strength of the Quality Jobs program is that it provides incentives for job creation. Properly targeted, this can be very helpful to certain companies while also making the best use of limited state revenues.

- **Review/Revise Eligibility Criteria** — The evaluation of applicant companies should consider factors such as whether the company is a local startup, moving from out of state, or well established in the state. Industry sector, as well as the size and current profitability of the company, should also be considered as measures of whether incentive payments are a meaningful consideration in the company's bottom line;
- **Review/Revise Factors for Incentive Payment Percentage** — Surveys early in the program showed that around half of new jobs would have been created without incentives being provided. This needs to be taken into account, along with other factors, when determining the payroll percentage paid for each qualified new job;
- **Review/Revise Economic Analysis** — Given the statutory requirement that this program be revenue neutral, a public review of the methodology used by the Commerce Department to determine costs and benefits to the state is needed;
- **Cap Program Expenditures** — Annual expenditures should be capped within a reasonable limit, whether as a dollar amount or a percentage of income tax revenues. With core state agencies already facing budget shortfalls, expenditures on the Quality Jobs Program should not be allowed to increase without limit;
- **Improve Program Management and Oversight** — The state needs additional staff to effectively manage a program of this size. By assessing a fee percentage against each contract, it could ensure that the Commerce Department and Oklahoma Tax Commission would have the necessary resources to effectively oversee, evaluate and manage this program;
- **Review Special Provisions** — Preferred treatment for sports teams, companies claiming they've received offers to relocate out of state, etc. need to be reevaluated to determine if they are appropriate for this program;
- **Revise Open Records Act** — The release of most information relating to this program is currently not required under the Open Records Act. Revisions are needed that would allow the release of more information which would provide a better understanding of the program and greater transparency.

The rapid growth of Quality Jobs Payments during a time when most Oklahoma public services have seen flat funding or budget cuts should be cause for concern. At the least, lawmakers should create better oversight for the program, to ensure that the millions in taxpayer dollars going to private businesses are creating a benefit for the whole state.

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A current list of industry codes that qualify for the QJP can be found in the appendix of the Oklahoma Business Incentives and Tax Guide for Fiscal Year 2014: http://okcommerce.gov/assets/files/incentives/Oklahoma_Business_Incentives_and_Tax_Guide.pdf
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APPENDIX A LEGISLATIVE CHANGES TO QUALITY JOBS PROGRAM

2005 Legislative Changes

- Regarding basic industries, the FAA center in Oklahoma City was added as an eligible entity for participation. Flight training was added as a qualifying activity.
- Automatic 5% net benefit areas were redefined. (Certain counties automatically receive a 5% net benefit rate based on economic statistics such as lower percentile wages or loss of population). The opportunity to receive up to a 6% net benefit rate was added, for those companies in the program and expanding, which pay 150% more than its current wages.
- New legislation establishes a 24-month timeline for a company to enter into the program after the application date.

2006 Legislative Changes

- Oklahoma residents must hold jobs eligible for the program. The requirement for a standard “workweek” was changed from 25 hours to 30 hours per week. Employees must work at least 30 hours per week and be offered health benefits to be included for program benefits.
- A company that incurred an ownership change, noted as a “change in control” could apply for the program with a baseline of zero, even if it had existing jobs. This company also has to demonstrate its “at risk” status, meaning that the jobs are likely to be lost to the state due to the new ownership.
- A company that is located in a county where a Negative Economic Event occurred (closing of a company resulting in the loss of a large number of jobs) may qualify for the program without regard to an average wage threshold.
- A company that was already in the program, but suffered an Extraordinary Adverse Business Circumstance such as a physical or financial disaster would be allowed to withdraw from the program, repay any benefits received and reapply in the future without regard to timeframe.
- Added industry activities were Web Portal companies and Dairy Cattle, Egg, and Milk production industries.

2007 Legislative Changes

- The residency requirement for a qualifying job was clarified so that the job (its activities and functions) must be located within the state even if the person holding that job lives in another state.
- Language was clarified that a company wishing to withdraw from the program due to an Extraordinary Adverse Business Circumstance must first make application and go before the Incentive Approval Committee to receive such permission.

2008 Legislative Changes

- Expanded the program to include professional sports teams and allow them to participate in the program for 15 years instead of the standard 10-year participation.
- The participant must file its initial claim for benefits for the jobs that were created in the first full quarter following the Project Start Date (formerly could be any quarter up to 3 years later).
- Additional qualifying NAICS codes were added to the definition of “basic industry”: 51830, Web Search Portals; 488190, Support Activities for Air Transport.
- The NAICS code for Research & Development was amended by the Federal Government, now listed as 541711 and 541712.
- Language specifically excluded the use of the Program if the participant also participated in the Quality Investment Act.

2009 Legislative Changes

- Use of the Investment Tax Credit concurrently with the use of the Program became allowable, provided the qualifying investment exceeded \$40 million dollars (effective January 1, 2010).
- Addition of Program elements that allow Federal Prime Contractors to bring work to Oklahoma and receive incentive payments on the direct labor of both the Prime and any Oklahoma subcontractors.
- The NAICS code for Wind Power Equipment Maintenance activities was added to the list of basic industries, listed as 811310 (effective November 1 2000)

2010 Legislative Changes

- Program elements related to the qualification of Federal Prime Contractor was enhanced to be more congruent with other Program language.
- Additional qualifying NAICS code were added as “basic industries”: Alternative Energy Structure Construction (237130), Solar Reflective Coating Application (238160), Solar Heating Equipment Installation (238220), Support Activities for Rail Transportation (4882), an Support Activities for Water Transportation (4883).

2011 Legislative Changes

- PrimeWin program changes to the qualifying NAICS codes; also remedy for establishing priority when both Prime ad subcontractor are interested in participation.

2012 Legislative Changes

- Removal of 16 NAICS codes that had not been used in the program since inception.
- Addition of Drilling of Oil & Gas Wells (excluding field job) as a qualifying activity.
- Program payments to companies to be made by EFT only.

2013 Legislative Changes

- Added 5 NAIC codes to coincide with the Eco System strategy at the Department of Commerce.
- Higher Net Benefit Rate (up to 6%) can be earned if a participant creates at least 10% of their new payroll with qualified military veterans.
- Clawback imposed, if a participant does not maintain operations here in the state for a full 3 years from start date they must repay 100% of benefit received.
- Participants failing to reach the required payroll threshold within the 3-year ramp up period may not reapply for at least 12 months from dismissal.

2014 Legislative Changes

- Allowed the state to establish proxy organizations to be used when incentive payments must be deposited in a public trust, rather than being paid directly an organization. This reform was made so that the program could be used to subsidize a land purchase by Tinker Air Force Base.