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## Can START-UP NY jumpstart the Upstate economy?[1]

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### What is the Issue?

In May 2013, Governor Andrew M. Cuomo launched the "START-UP NY" policy in order to jumpstart the Upstate New York economy. START-UP NY (**S**UNY **T**ax-free **A**reas to **R**evitalize and **T**ransform **UP**state **NY**) transforms State University of New York (SUNY) and private college campuses into tax-free areas in order to attract and retain high-tech businesses and startups, venture capital, and investments with the goal of promoting entrepreneurialism and job creation in the Upstate region[2]. This brief examines some of the basic provisions of the program, discusses how START-UP NY differs from the past Empire Zone program, and offers suggestions for improvement.

### What is START-UP NY?

Originally called "Tax-Free NY," "START-UP NY" is a policy intended to stimulate economic growth in Upstate New York, a region challenged by population change, economic sluggishness, and municipal fiscal stress. Businesses that locate within approved tax-free areas[3] in SUNY or private college campuses (60 out of 64 SUNY campuses are located in the Upstate region - see Figure 1) are eligible for exemptions from corporate income tax, sales tax and property taxes for a decade while their employees are exempt from State personal income taxes[4]. Governor Cuomo has positioned this program to counter New York's image as the "tax capital" of the nation, to attract new businesses to the State[5], and to help the State retain businesses and skilled graduates.

START-UP NY was designed to capitalize on the new knowledge economy through university-business partnerships by allowing businesses to benefit from academic resources such as technology, research, and access to a skilled workforce. Universities are required to present a campus plan for the tax-free area showing how proposed businesses would further the university's academic mission without affecting existing or future academic programs, and how potential businesses would make positive community and economic contributions. The plan must be shared with campus groups, local municipalities and economic development entities for public comment prior to submission.

In order to participate in START-UP NY, businesses are required to be a new business in the State or an expanding business that would create net new jobs. Applicant businesses must not compete with other businesses outside the tax-free area in the same community, nor displace any other jobs within the State, and provide the number of projected net new jobs including plans to recruit employees from the local workforce.

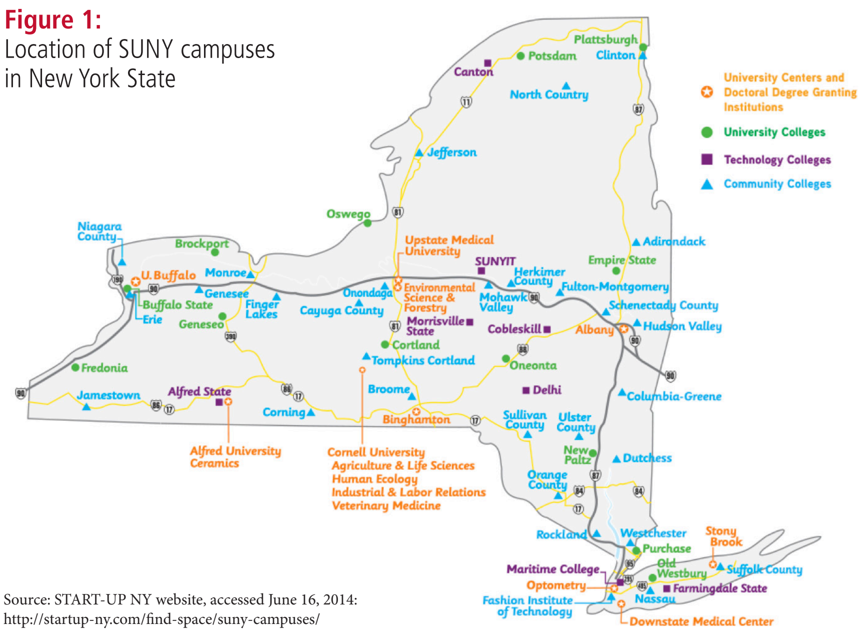
To date, more than 130 tax-free areas have been approved at 26 campuses across the State[6]. On June 4, 2014, Governor Cuomo announced the first 12 businesses approved to participate in the START-UP NY program—businesses projected to invest $50 million and create nearly 400 jobs in tax-free areas at the University at Buffalo, Rochester Institute of Technology, SUNY Downstate Medical Center in Brooklyn, and Cornell University[7].

While the policy does not include any direct costs to the State or municipalities (except for marketing costs), there is a potential loss from forecasted future revenue growth. The Governor's Budget Office estimated that the program would cost the State $323 million through 2017[8]. It is conceivable that some firms could take undue advantage of the program's tax-free feature, a similar problem that faced the failed Empire Zone program, but the State has attempted to plug some of these loopholes.

### Plugging Empire Zone's loopholes

The Empire Zone program (EZ) was an economic development program designed to revitalize distressed areas of the State by retaining and attracting business through public subsidies such as business, personal income, property, insurance and sales tax credits[9]. However, the State incurred significant losses as some of these refunds were greater than the respective firms' original investment costs, and nearly two-thirds of participating firms failed to meet employment and investment targets. In contrast, START-UP NY is a tax exemption program, there are no refunds, but there

**Figure 1:**
Location of SUNY campuses in New York State




Source: START-UP NY website, accessed June 16, 2014: http://startup-ny.com/find-space/suny-campuses/

is a loss through foregone revenues. Under START-UP NY, the State is empowered to recover proportionate tax benefits, suspend the business or terminate it from the program if fraudulent practices such as "shirtchanging" (where companies close down and reopen under a different name to claim tax benefits - observed under the EZ program) occur, or if employment targets are not met.

EZ policy also suffered from political gerrymandering of legislative districts to draw up zone boundaries instead of focusing on revitalizing distressed areas. START-UP NY instead shifts the planning process from local governments to university leadership, and restricts the tax-free areas to university properties and their surroundings. It explicitly prohibits retail, law firms, real estate brokers, medical practices, restaurants, utilities and power plants from participating in the program. It targets high-tech businesses or new companies incubated from university research.

## START-UP NY's tax exemptions – Handy or handout?

START-UP NY aims to attract high-tech businesses to Upstate regions through tax exemptions and the benefits of partnering with research universities. However, firms do not make location decisions on the basis of taxes alone, nor do low taxes translate into increases in employment or economic growth (see note 4). Critical to the location decision is the availability of skilled labor, low energy and transportation costs, a high quality of life, good governance, quality public infrastructure, and the presence of an industry cluster to access suppliers and other interconnected firms. Tax exemptions may partially influence out-of-state firms with existing research ties to the partnering university, but early stage startups generally have fewer employees and generate little revenue, hence, tax exemptions do little to support their growth or help them commercialize technology[10].

The *Task Force on Diversifying the New York State Economy through Industry-Higher Education Partnerships* states that the State needs to develop an effective innovation ecosystem that unites universities, industries and capital to achieve economic development by concentrating investment in fields where NYS could be a world leader—healthcare and life sciences, energy, nanotech, agriculture and food industries—achievable by sustaining a regional cluster of interdependent but complementary firms to reduce risks for all participants[11]. Being embedded in a regional economic ecosystem could help prevent relocation of startups incubated in the Upstate region upon maturation or when the tax-free incentives cease. START-UP NY's provisions do not focus on fostering existing regional economic clusters; the anti-competitive provision is detrimental to the formation of a cluster beyond the zone. Although several campus plans acknowledge the role of regional clusters by including local employment, and sourcing from local vendors as criteria for selecting businesses[12], the policy specifies no metrics to measure the regional economic and community impacts of participating businesses.

Technology-based startups require different kinds and amounts of funding at the various critical stages of scaling up - prototyping, pilot production, demonstration and testing, early manufacturing and full scale commercialization. However, START-UP NY assumes that funding requirements for all university-based startups and firms can be fulfilled through tax exemptions irrespective of their size, field, or stage of growth. Although there are other efforts in NYS to incubate startups, such as the Business Incubator and Innovation Hot Spot Program (launched in 2013-14), and the Innovate NY Fund to provide early seed stage funding, the amount of funding for these programs is currently limited. To increase access to much-needed capital, the State could match federal grants like the Small Business Innovation Research (SBIR) grants, which provide pre-venture capital funding during the early, high risk stages of product development for joint university-business applications.

## Recommendations

Based on this analysis, the following recommendations are offered:

- In consultation with local governments and regional economic development councils, START-UP NY should design and prescribe clear metrics based on desired economic and community impact to help universities choose participating businesses, with due consideration towards building and fostering regional economic clusters, including a reconsideration of the anti-competitive provisions of the policy.
- In the absence of conclusive evidence, START-UP NY's tax exemptions may not be the most effective tool to achieve the goals of higher employment or economic growth[13]. Instead, the State should study the appropriate funding mechanism to help maturation of high-tech startups, and allocate this funding on the basis of their potential economic and community impact.

## Conclusion

START-UP NY shows promise in contributing to bottom-up regional economic development through collaborations between universities and businesses. Although START-UP NY has remedied some of the Empire Zone program's shortcomings, its tax exemption provisions should be reassessed to more effectively meet the goals of employment growth and economic development. Tax exemptions increase pressure on already constrained tax bases of fiscally distressed Upstate cities, diverting public funds away from investments in social welfare such as schools, healthcare, cultural and social services, and infrastructural improvements. These public investments are necessary to attract and retain a skilled workforce as well as businesses. It is recommended that the current version of START-UP NY be revised to reflect these economic, social and fiscal realities with a more clearly articulated set of provisions.

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2 START-UP NY Regulations. Retrieved from: http://www.empire.state.ny.us/BusinessPrograms/Data/StartUpNY/StartUpNY2013FinalRegulations.pdf

3 For a complete list of eligible areas, see http://startup.ny.gov/find-space/eligible-spaces/

4 For a full list of tax exemptions, see Section 434 of the START-UP NY statute available at http://www.empire.state.ny.us/BusinessPrograms/Data/StartUpNY/StartUpNYStatute.pdf

5 High taxes are not correlated with poor economic growth. Minnesota and California—ranked 46th and 47th respectively on the ALEC-Laffer State Economic Index (which ranks states highly if they have low taxes) had higher employment growth rates compared to states with higher ranks. For details, see: Hiltzik, M. (6 May, 2014). "Surprise! 'Pro-business' policies hurt state economic growth." The LA Times. Retrieved from: http://www.latimes.com/business/hiltzik/la-fi-mh-surprise-probusiness-20140506-column.html

6 For a full list of tax-free areas by school and region, see http://startup.ny.gov/properties/

7 New York Governor's Press Office. (4 June, 2014). "Governor Cuomo Announces First Wave of Businesses to Expand or Locate in New York State Under Start-Up NY." Retrieved from: https://www.governor.ny.gov/press/06042014-first-wave-businesses-start-up-ny

8 New York State Division of the Budget. (2014). FY 2014 Financial Plan: First Quarterly Update. Retrieved from: http://www.budget.ny.gov/pubs/archive/fy1314archive/enacted1314/FY2014FirstQuarterlyUpdate.pdf

9 Citizens Budget Commission. (2008). "It's Time to End New York's Empire Zone Program." New York & Albany, NY. Retrieved from: www.cbcny.org/sites/default/files/report_ez_12012009.pdf.

10 A 2009 study shows that more than 50% of small businesses (under which we can categorize early stage startups) filing federal income tax returns in 2004 had gross receipts of less than $25,000, and almost 88% of all small business tax returns filed in 2004 had receipts no more than $250,000. See: Quantria Strategies LLC. (April 2009). "Effective Federal Income Tax Rates Faced by Small Businesses in the United States." Small Business Administration, Office of Advocacy. Retrieved from: http://www.sba.gov/sites/default/files/rs343.pdf

11 A MIT Report finds that location in such a regional cluster with access to high risk capital is crucial for the success of early stage startups. Locke, R. M. and Wellhausen, R. (2013). "A Preview of the MIT Production in the Innovation Economy Report." Cambridge, MA: MIT Press. Retrieved from: http://web.mit.edu/press/images/documents/pie-report.pdf

12 For example, see Cornell University START-UP NY campus plan available at: http://startup.ny.gov/wp-content/uploads/2014/04/Cornell-University-START-UP-NY-Campus-Plan.pdf.

13 A recent report by Gov. Cuomo's NYS Tax Reform and Fairness Commission confirms this finding. See: Rubin, M. M. and Boyd, D. J. (November 2013). "New York State Business Tax Credits: Analysis and Evaluation." Retrieved from: http://www.capitalnewyork.com/sites/default/files/131115__Incentive_Study_Final_0.pdf

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