Economic Development Incentives Keep Flowing, Despite Uncertain Benefits

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In October 2017, Amazon ignited a frenzy among economic developers. When the company announced plans to open a second North American headquarters and staff it with 50,000 high-paying jobs, more than 200 cities, counties, and states made formal bids.

Many jurisdictions promised publicly financed incentives—packages of tax breaks, free land, grants, and other subsidies such as job training programs—totaling more than a billion dollars each. At least one state pledged public incentives that would exceed the $5 billion Amazon plans to invest in its new base. On November 13, Amazon announced it would split its second headquarters between two locations: New York City and Crystal City, Virginia, in suburban Washington, DC.

Amazon's "HQ2" sweepstakes turned a spotlight on taxpayer-financed inducements that state and local governments have increasingly offered to lure payrolls and spillover economic benefits. Although the array of inducements complicates tallying their total cost, estimates from sources including the *New York Times* and the W.E. Upjohn Institute for Employment Research range from about $45 billion to $90 billion a year.

The value of incentives roughly tripled between 1990 and 2015, according to Timothy Bartik, an economist at the Upjohn Institute. Though the annual growth in inducements has been gradual since 2000, "recent [individual] incentives have been shockingly large," Bartik wrote in a March 2018 research paper. Southern states have been eager participants (see the infographic).

Recent Economic Development Subsidies in the Southeast

States spend billions to attract firms despite unclear benefits

	SUBSIDIES GRANTED	SUBSIDIES' VALUE	BIGGEST RECIPIENT
Louisiana	8,910 (since '95)	$22.6B	Cheniere Energy, $3.3B
Alabama	4,207 (since '93)	$4.4B	ThyssenKrupp, $1.1B
Tennessee	9,264 (since '95)	$4.29B	Volkswagen, $818M
Mississippi	1,474 (since '00)	$4.17B	Nissan, $1.3B
Florida	3,714 (since '95)	$3.9B	Scripps Research Institute, $545M
Georgia	929 (since '95)	$1.6B	Kia Motors, $410M

Source: Good Jobs First and Together Louisiana

Note: Dollar amounts are not adjusted for inflation.

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Incentives are a basic tool

Economic development incentives are a fundamental tool for many states, cities, and counties. Yet, according to an extensive body of research, their payoff is unclear.

In some cases, the "winners" in incentive-fueled competitions for major corporate relocations or expansions end up losing. Governments may forgo so much revenue via tax breaks that they can't support the high-quality public goods—schools, parks, infrastructure—that these firms often demand. Still, some research shows that subsidies can work in some cases. Incentives frequently generate short-run benefits in job creation, Bartik has found. Very large manufacturing plants sometimes spur greater productivity among surrounding companies, generating various local benefits, according to a frequently cited 2010 paper by economists Michael Greenstone, Richard Hornbeck, and Enrico Moretti.

ThyssenKrupp got the biggest economic development incentive package in Alabama. The company sold the plant three years after it opened. Image courtesy of Wikimedia Commons

Incentive packages frequently receive credit for helping transform southern states whose manufacturing sectors were crippled by the decline of textile and apparel production, particularly South Carolina. While he does not issue blanket praise for publicly funded economic development incentives, University of South Carolina economist Douglas Woodward has written that the initial, one-time state and local inducements of $60 million (about $110 million in today's dollars) to the German automaker BMW essentially were paid back within the first five years of its plant opening in Greer in 1994.

BMW's first U.S. plant near Spartanburg, South Carolina, helped transform the state into a hub of automotive and auto parts manufacturing. The plant represents an example of an incentive deal experts say worked. Image courtesy of BMW Group Plant Spartanburg

The argument for incentives holds that their costs to the government or residents can be outweighed by positive spillovers such as higher wages, new establishments, increased employment, better public services, and perhaps lower tax rates, as Carlianne Patrick, a Georgia State University economist, put it in a 2016 research paper.

Ideally, properly designed inducements don't lure just a single firm. Rather, they help to create a cluster of companies in an industry that creates high-paying jobs and high value–added products, Woodward pointed out. That's what he finds BMW has done in South Carolina's Upstate region, whose economy suffered from the decline of textile and apparel manufacturing beginning in the mid-1970s.

Despite individual successes, however, the debate over publicly financed economic development incentives remains unsettled. As Patrick wrote: "After decades of research, there is no clear consensus on the effects of economic development incentives competition."

Research split but generally skeptical

Though researchers don't share a uniform perspective on incentives, they tend to be skeptical that providing tax incentives is sound public policy, noted Joseph Parilla, a fellow in the metropolitan policy program at the Brookings Institution, a think tank in Washington, DC. Parilla wrote that researchers generally question whether tax incentives:

- are truly important to companies, as state, local, and property taxes are usually a small cost compared to labor.
- help create jobs—and, if they do, if they focus job creation on particular populations and communities.
- can be carried out in a way that makes fiscal sense for local governments.

Ample research supports the skepticism. For instance, typical incentives, according to a July 2018 study by Bartik, "probably tip somewhere between 2 percent and 25 percent of incented firms toward making a decision favoring the location providing the incentive."

Another complication for large-scale economic development incentives is the changing nature of economic development and job creation (see the sidebar). Further, the number of major corporate relocations and expansions has declined by 50 percent over roughly the past decade, according to Parilla and Sifan Liu of Brookings. Thus, as the supply of such deals shrinks, the average incentive price tag rises.

The Nature of Work Is Changing. Economic Developers Must Keep Up –

States and municipalities invest billions in economic development incentives each year. Yet untangling the effects of these inducements on location decisions, local economies, and government finances remains challenging.

Making matters still more complicated, history may be of limited use. Most research on the implications of economic development subsidies is based on events in the 1980s and '90s, Georgia State University economist Carlianne Patrick said in an interview. After all, measuring the long-term effects becomes possible only 20 to 30 years later.

However, what worked then might not work now. The problem is that the nature of companies shopping for locations and the structure of the jobs they bring have fundamentally changed since the advent of generous incentive packages.

Traditionally, the bulk of incentives went to manufacturers. Consequently, most of the information that researchers and officials have gleaned about economic development subsidies relates to manufacturing companies, Patrick said.

But many 21st-century economic development prizes are service- or technology-focused firms, rather than heavy manufacturers. During a recent conference at the Federal Reserve Bank of Atlanta, economist David Dorn, coauthor of a widely noted research paper on "superstar firms," said the most productive and profitable American companies today include few manufacturers.

Instead, superstar firms are concentrated in fields such as technology and services related to health care. These big, prosperous companies are most likely to expand and scout for new business locations, thus attracting the attention of state and local economic development officials.

These firms affect their surrounding communities differently than manufacturers do. For instance, unlike manufacturers, information technology and services companies may not spawn extensive networks of suppliers. On the other hand, research by Enrico Moretti of the University of California, Berkeley and Per Thulin of the Royal Institute of Technology in Stockholm suggests that high-tech companies employing well-educated workers generate more external jobs in surrounding communities than do companies in other industries, including manufacturing.

Meanwhile, as the industry mix changes, so does the workforce. Manufacturers in the past mainly hired middle-skilled workers for full-time positions with benefits. Firms today demand different talents, concentrated at the high and low ends of the skills spectrum by some measures, Patrick said.

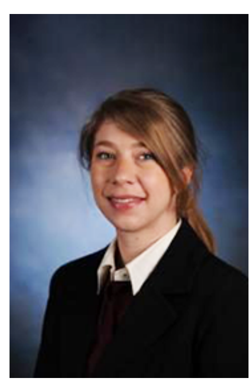
What's more, a community that wins a big employer now will likely land comparatively fewer full-time jobs with benefits than it would have even 10 years ago. Larger firms today use more independent contractors, contracting firms, and temporary help agencies for a wider range of jobs that previously were handled in-house, according to Dorn of the University of Zurich.

Deals surrounding economic development incentives often include pledges to create certain numbers of jobs. Yet today's economic development contracts generally do not account for the changing nature of companies and employer-employee relationships, Patrick noted, a situation she said needs to change.

At the same time, considerable research suggests that most jobs are homegrown and not produced by corporations far from home, the typical targets of big incentives. The Atlanta Fed's Gazelle Project and work by University of Maryland economist John Haltiwanger and others have found that a small fraction of fast-growing young companies contribute disproportionately to job creation in the United States.

Some economists also contend that even if incentives pay off locally, they make little sense from a national perspective. A competition pitting states against each other becomes a zero-sum game, at best—one place wins, another loses, and national welfare is unchanged regardless of where a business decides to locate, according to Arthur Rolnick, former research chief at the Minneapolis Fed and now senior fellow at the University of Minnesota's Humphrey School of Public Affairs.

Without clear information, evaluating incentives is difficult



No clear consensus about the effectiveness of incentives exists, in part because such deals are riddled with unknowns, making evaluation challenging. For one, it's usually difficult to know whether a firm would have chosen a particular location without incentives. Also, it's tough to determine the long-term benefit of spending money that might have gone to incentives targeting some other public service such as schools, broadband services, or lower taxes.

In general, straightforward, apples-to-apples comparisons when it comes to dissecting the effects of public economic development incentives simply don't exist, Patrick said. The incentives that different states or localities offer vary greatly, from property tax breaks to free land to low-interest loans and more. Adding yet another layer of complexity: low-income and affluent communities tend to offer, broadly speaking, the most incentives.

Therefore, untangling how much difference incentives make in location decisions—and quantifying the subsequent economic impact—is difficult, because local economies don't start from an equal footing. Even after incentive deals have been in place for a time, "it's not super clear who the winners and losers are.… But certainly the winners are a little easier to identify," Patrick said.

Carlianne Patrick. Image courtesy of Georgia State University

If nobody knows if they work, why are incentives so popular?

Why do incentives remain so prevalent when their effects are so unclear? This is one question whose answers are fairly simple, researchers conclude. Foremost, for elected officials, being able to discuss "creating jobs" has a tried-and-true appeal to voters. If short-term gains mean later closing public libraries or cutting parks budgets, odds are future elected officials will have to grapple with such choices.

"They can buy their way into the ribbon-cutting photos knowing that, if they grossly overbid, they won't be around when the bills come due," former Indiana governor and now Purdue University president Mitch Daniels recently wrote in the *Washington Post*.

In fairness, most communities lack the financial and research muscle to thoroughly analyze the costs and benefits of potential incentive packages before they offer them, said Patrick, a former economic development practitioner. Nor do many states and localities conduct extensive analysis of how companies perform after they've set up shop in their new community, so there is a limited body of knowledge on those results.

So for governments keeping a close eye on budgets, weighing the pros and cons and knowing when to stop bidding is complicated. To cite one con: a successful bid for a new employer often attracts many newcomers, who often get most of the new jobs, according to research. And more residents require more public services—transportation, schools, water, sewer, police and fire protection—and thus more public spending.

To be sure, communities can succeed with well-crafted incentives. Some communities, for example, design packages aimed at developing "industry clusters" of highly productive companies, with clear employment and investment targets and "claw back" provisions to recoup incentive money if the new employers don't meet the targets. Some researchers urge public officials to focus less on incentives and rather finance fundamental economic development initiatives such as early childhood education, workforce development, and infrastructure.

The Brookings researchers noted progress toward "a more responsible and rigorous incentives approach" across many cities. Citizen opinion may be helping. Patrick said provisions that protect the public purse are spreading, mainly because the public is demanding them.

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