

Wooing Companies to Move: Are Business Incentives Worth the Cost?

Economic development incentives aimed at attracting companies to a region have been a defining feature of many regional economic growth strategies. Are they worth it?

The high-profile negotiations for Amazon's second headquarters in 2018 serve as a prominent example of policy interest and substantial resources related to these incentives.

In 2015, state and local business incentives in the United States totaled nearly \$45 billion, and most of these incentives were in the form

of job creation tax credits.¹ As of 2019, some estimates place the total annual value of incentives closer to \$90 billion.² Yet business incentives largely do not produce strong positive gains on firm-level and broader economic outcomes – and they can impede local entrepreneurship and redirect public funds from other activities.

Using incentives to attract existing businesses from other locations to a region

A large firm in one sector can mean new jobs in the local economy, leading to increased demand for local goods and services through a ripple effect that is not limited by sector. This refers to the ripple effects that can be caused by one new job. As workers spend more locally, there is more demand for local businesses,³ greater tax revenues, and more jobs.

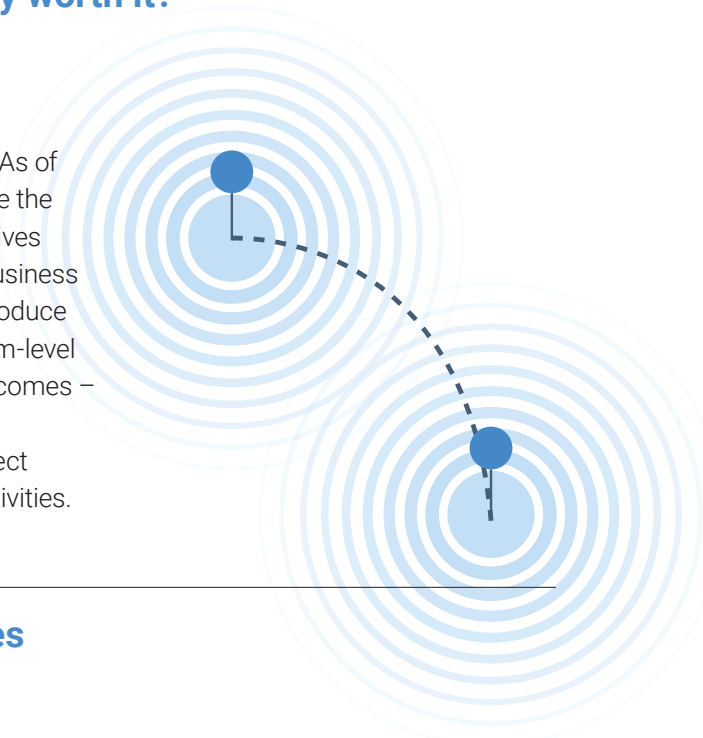
A business can serve as an anchor for other business activity,

encouraging the growth of industry that can further expand the local economy.

Incentives are often intended to attract existing businesses to a region. The relocation of an existing business can be seen as a way to bring jobs to the area and stimulate the regional economy.

Incentives may also be used to signal a "pro-business" environment⁴ to business owners and investors.

In 1993, for example, the state of Alabama spent \$168,000 per job to attract a Mercedes-Benz plant. The governor explained that the expenditure would help the "state break through old stereotypes and announce to the corporate world that Alabama is open for business."⁵ Policymakers may be motivated to woo large businesses to the region by the media buzz that often accompanies these incentives.



Using incentives to attract existing businesses from other locations to a region, cont.

They can also be concerned that not engaging in incentives programs could damage a place's brand recognition and marketability, diminishing its potential to attract businesses in the future.⁴

Some common incentives to bring existing businesses to a region can include tax vehicles, services, and grants:¹

- Job Creation Tax Credits (JCTCs) can be tied to the creation of new jobs or payroll.
- Property Tax Abatements can lower property taxes below normal rates.
- Investment Tax Credits (ITCs) can offset the business tax liability if new capital investments are made.
- R&D Tax Credits can offset the business tax liability if the firm invests in qualified research and development activities.
- Services like customized job training support can be used for workforce training and upskilling programs.

Did you know?

Surveys find that even when a state does not succeed in attracting a large firm, offering tax incentives could result in as much as a 5 percentage point increase in the incumbent governor's vote total in an election.⁶



Cost of business incentives

The typical state or local government incentive package represents about 2% to 3% of the incensed firm's wages, averaged over the life of the investment. If a company's payroll is \$10,000,000, for example, a typical incentive valuation would be between \$200,000 and \$300,000. Some states, however, provide three

times as much,⁷ and the cost-per-job created depends heavily on the type of incentive offered. In a study of manufacturing-intensive communities, tax incentives had an annual cost of about \$16,000 per job created, while customized job training incentives had an average annual cost of about \$3,000 per job.⁸

The budget implications of incentives can vary depending on the type and longevity of the program, the way in which it is funded, and whether business attraction results in higher demand for government services like transportation and public safety.³

Are the benefits of incentives worth the cost?

The benefits of an incentives package typically depend on the number and quality of new jobs created. Some industries, such as high-tech manufacturing, tend to produce a large number of new jobs, both directly and indirectly. Other,

more-capital intensive industries, like data centers or chemical plants, tend to yield fewer jobs.⁹

Research indicates, however, that higher state spending on incentives packages rarely correlates with increased job quality or higher wages.

Further, the direct budget costs have been found to outweigh the fiscal benefits of incentives significantly.⁷ It is important to note that incentives packages seem to have little influence on the location decisions of large firms. In fact, firms

Are the benefits of incentives worth the cost?, cont.

targeted for incentives can catalyze competitive, race-to-the-bottom bidding processes to secure more favorable terms. Often, they have already decided on the location¹⁰ – this means that incentives can be more costly than beneficial. For example, property tax incentives can deplete the tax base without providing economic development gains.¹⁷

In addition, using incentives to lure businesses to a region can cause “border wars” in cities that spread over two or more states. In the greater Kansas City metropolitan area, for example, competition across the Kansas-Missouri state line led to jobs being shuffled around and the states competing

against each other with incentives deals. Over a period of a decade, about 10,000 jobs moved between three counties in the two states (Johnson and Wyandotte counties in Kansas, and Jackson county in Missouri), with an incentive price tag of about \$330 million.¹¹ In 2019, the governors of Kansas and Missouri agreed to end the use of tax incentives to woo businesses that would not result in *new* regional jobs across the state line.



Do incentives to attract existing businesses to a region mean sacrificing support for local entrepreneurs?

Most new jobs are created by entrepreneurs – and they overwhelmingly tend to start businesses where they live.¹² Home-grown jobs, created by businesses already in a state, account for almost 80% of new job creation. **There is little evidence that entrepreneurs move in order to start businesses.**

Generous incentives packages, however, negatively impact these entrepreneurs and small businesses. First, state incentives programs have been found to neglect small, regional, and entrepreneurial businesses.^{7, 13} Businesses with more than 100 employees account for 2%, on average, of a state’s employers, but they receive between 80% and 90% of incentive dollars.¹⁴

Moreover, these incentives, like any other type of public spending, reflect the opportunity cost of *something else not receiving those funds*, such as public services like education or workforce development that are critical to long-term economic growth and the success of entrepreneurs.⁷ New, home-grown businesses rely on local resources, including infrastructure, workers, educational institutions, and public

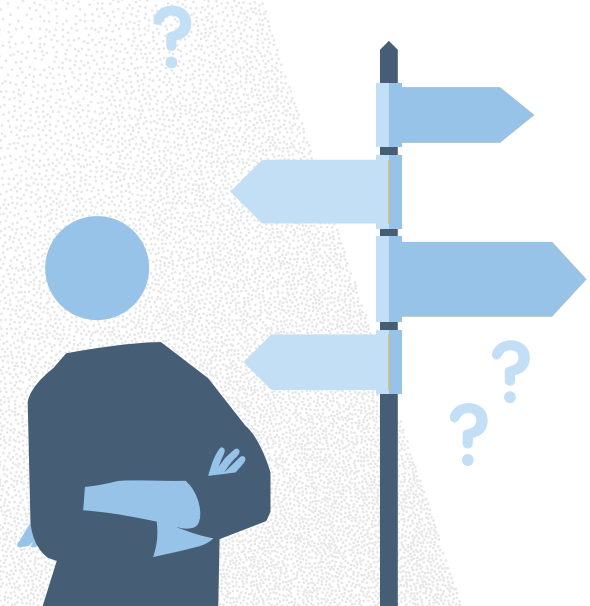
Do incentives to attract existing businesses to a region mean sacrificing support for local entrepreneurs?, cont.

services. More investment in supportive conditions for local businesses – such as spending on education, transportation, broadband, and R&D – benefits the entire community and can boost opportunities for these entrepreneurs to emerge, grow, and create new jobs.

This is important because **incentives have been found to have little relationship with wages, income, and**

unemployment¹⁵ or even to have a negative effect on the ability of a firm to create jobs.¹⁶

Property taxes incentives, in particular, are found to have no significant impact on firm profitability because property taxes actually account for a small share of total costs for most firms. For example, property taxes are less than 1% of manufacturing firm costs in the United States.¹⁷



Implications for policymakers

→ **Policymakers should conduct a thorough analysis of costs and benefits before considering an incentive package to attract a large business to the region.**

A full cost-benefit analysis can give policymakers a better sense of expected returns for every dollar spent on incentives, which can be used to negotiate more reasonable deals.

- This can help policymakers understand if offering business incentives is worth the cost and the reallocation of public funds from other areas. Analysis can also evaluate if incentives simply will not be efficient or if they could be improved. This is especially important given that most incentives are not clear in

structure or targeting.¹

- Post-deal analyses are also helpful to determine whether promised gains were realized.¹⁴

→ **Policymakers should consider the opportunity costs of using incentives to woo existing businesses to their regions.**

Since cities and states must balance budgets, business incentives can be paid for by either increasing taxes or cutting spending – or a combination of the two. These cuts frequently occur in K-12 spending, which has been shown to reduce future wages, particularly for low-income groups.⁷ This is especially important because incentives are more likely in poor, economically disadvantaged communities.¹⁸

→ **Policymakers should consider the expected effects of bringing an existing business to a region on local businesses.**

Business incentives that are used to attract successful larger businesses to a region could displace local businesses. Existing businesses can have existing cash flow and market advantages over local businesses, and receive benefits from the incentives. If the incented firm is a substitute for the goods and services of local businesses, it can have a negative impact on the economic fortunes of residents.⁶

Implications for policymakers, cont.

→ Policymakers should ask whether incentives to relocate businesses actually maximize a job creation goal.

Firms in some industries create more jobs than firms in others, like in high-tech manufacturing.⁵ However, most jobs are created by new businesses. And, since entrepreneurs tend to start businesses where they are, there could be even higher job gains from new home-grown businesses started locally than from new-to-

the-area businesses started elsewhere. Policymakers should weigh the use of incentives to attract and relocate large firms from other regions against other policies that support the regional economy.

→ Policymakers in regions with the potential for – or already engaged in – incentives border wars can instead concentrate on new gains for the region.

Using incentives in cities and regions that sit at the intersection of two jurisdictions can create intense

race-to-the-bottom scenarios. If policymakers still deem it worthwhile to use incentives to attract businesses to their regions, they can design them with broader regional economic gains in mind, like generating net new jobs to the region rather than moving the same jobs across borders.

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