The Role of Business Taxes, Incentives, and Other State Policies in Economic Development

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Testimony to Legislative Finance Committee, New Mexico Legislature
September 27, 2023

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Based in part on June 2022 Bartik report and policy brief on how states can best help distressed places.
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What is goal of state economic development policy? What are appropriate programs to achieve that goal?

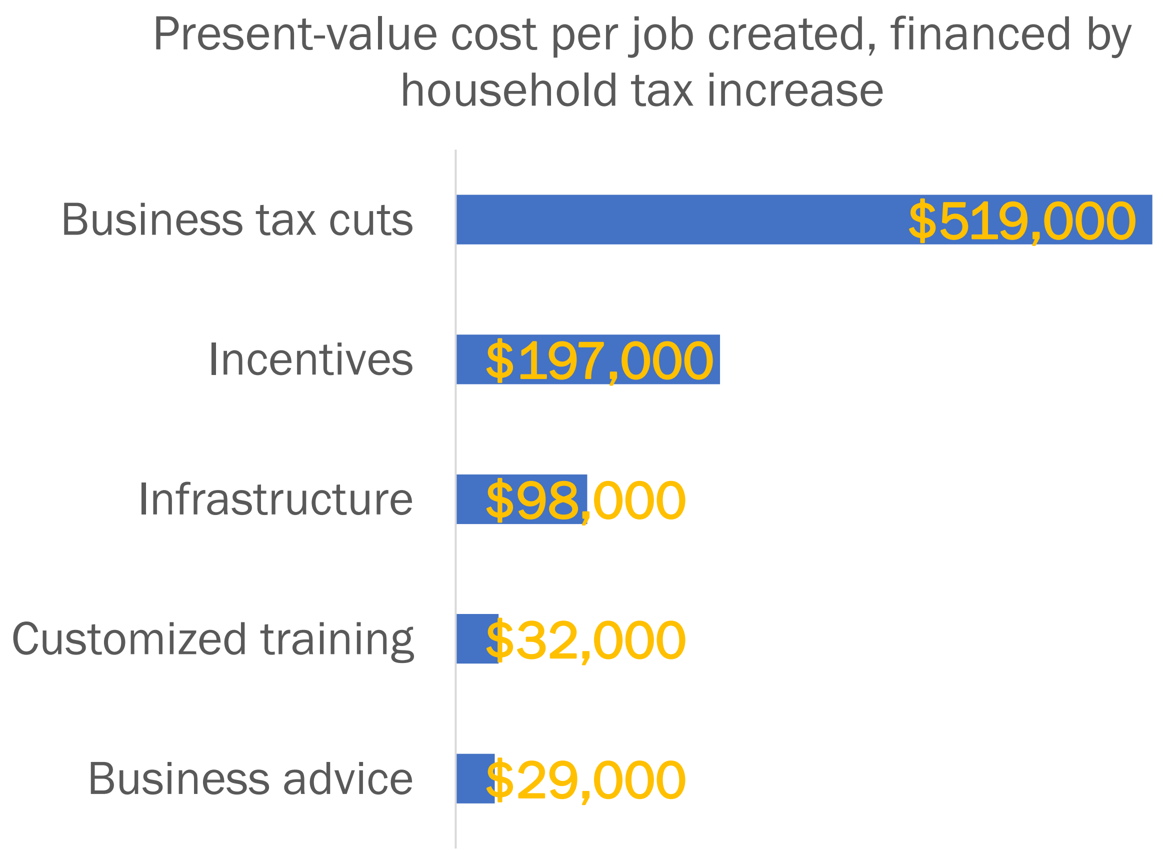
- Appropriate goal of economic development policy is “economic development benefits”: increases in per capita earnings of original state residents. Increases in job growth do not always and automatically translate into per-capita earnings increases.

- If focus is per capita earnings increases, the policies to achieve that goal are broader than handing out cash to businesses via incentives.

- Beyond incentives, job creation may be affected by overall business taxes, customized business services to individual businesses (customized job training; business advice programs such as SBDCs), and infrastructure (access roads, industrial parks).

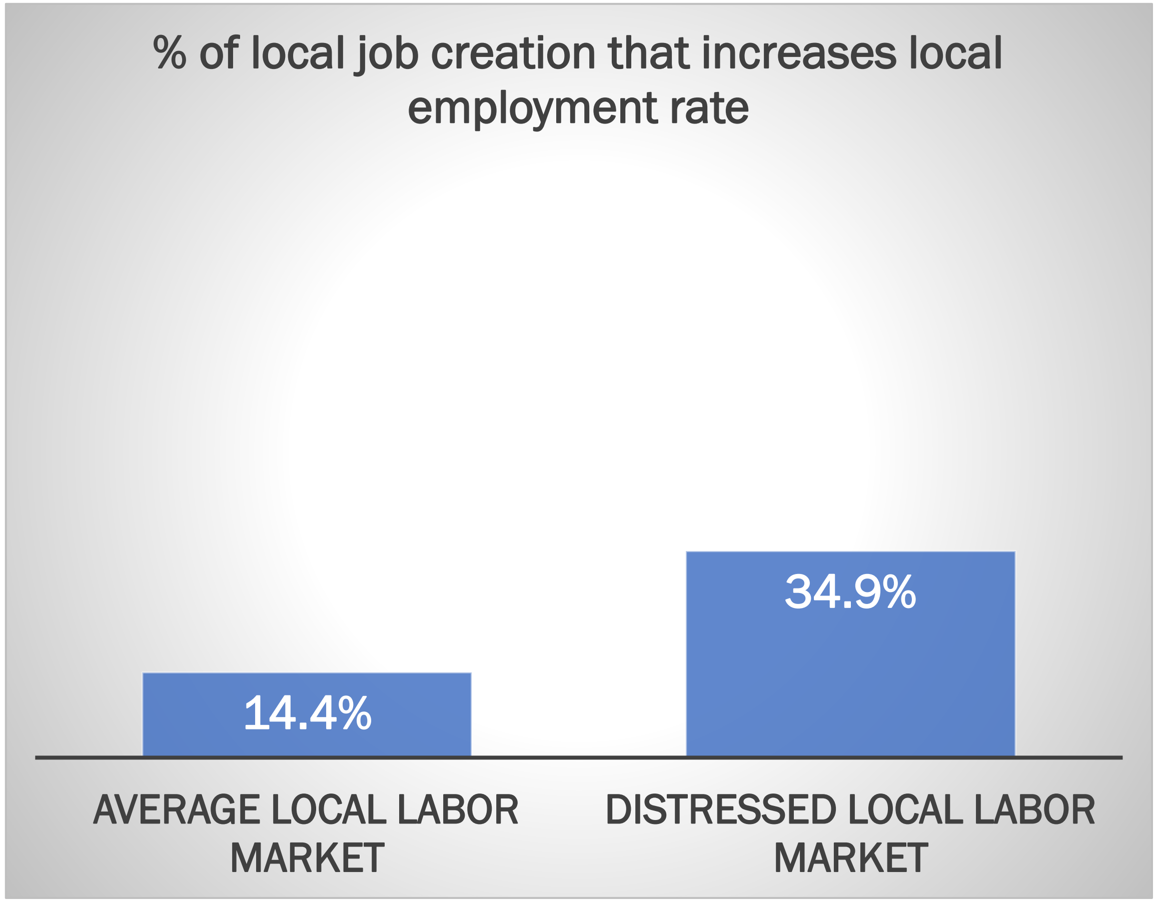
- State per-capita earnings also affected by programs that help state residents better access jobs or access better jobs: child care; education from pre-K to higher ed; job training.

Cost per job of job creation programs: Highest for business tax cuts, lowest for customized services



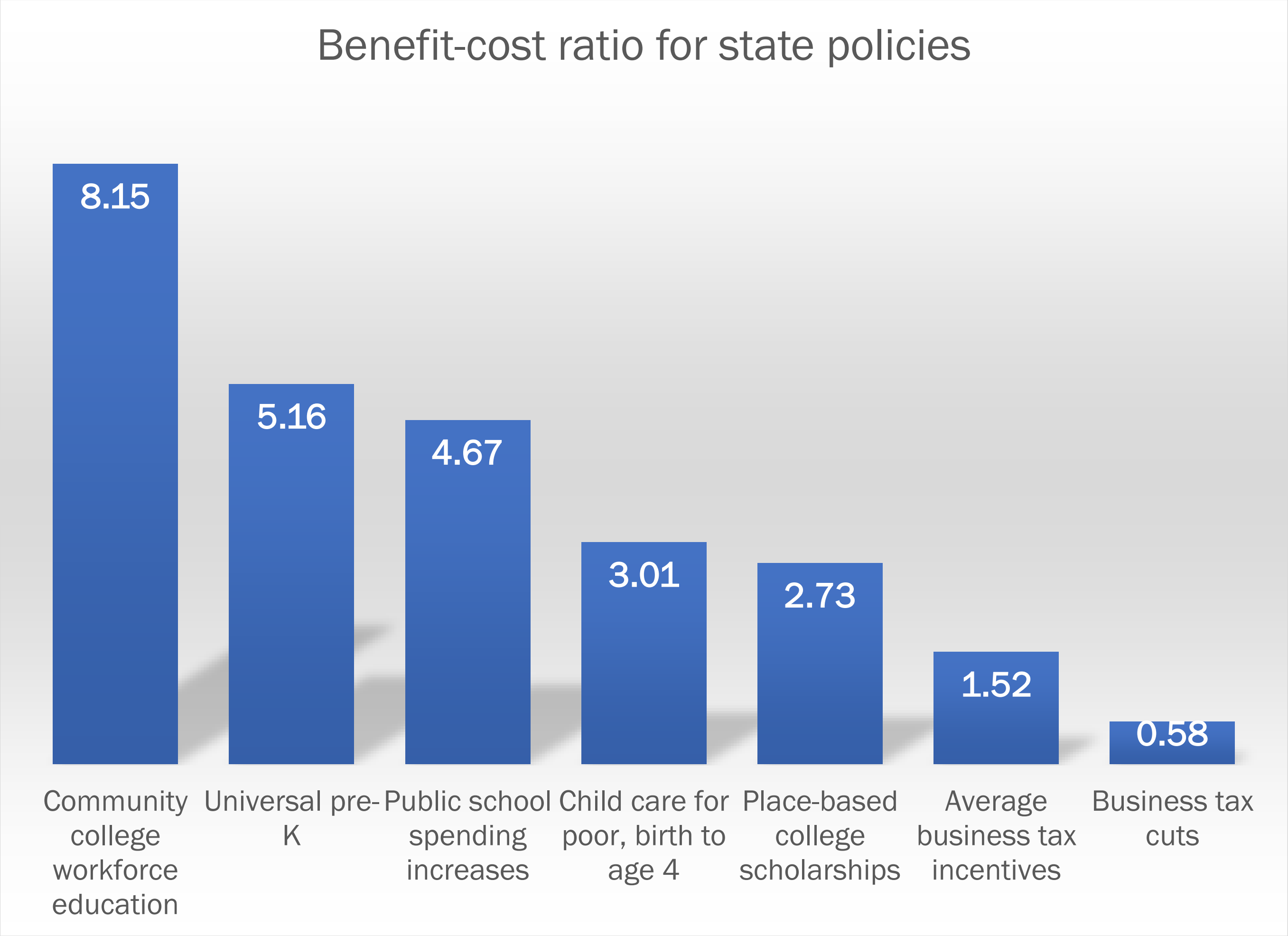
Business tax cuts have high cost because not targeted. Incentives do better because targeted on export-based businesses making investment decisions. Infrastructure and customized services can provide services with value much greater than costs.

Local job creation: Most jobs do not end up increasing local employment rates, but instead go to in-migrants



Remainder of jobs (85.6% average area, 65.1% distressed area) go to in-migrants. Jobs immediately go to: (1) employed residents; (2) unemployed residents; (3) in-migrants. But category (1) yields job vacancy, filled in same 3 ways. Job vacancy chain terminates when all jobs ultimately are reflected in employment for local unemployed or in-migrants. More jobs go to unemployed if (1) area more distressed, or (2) local institutions more effective in getting unemployed into hiring queue. Specific figures here come from Bartik (2023).

Benefit-cost ratio of many “labor supply” programs is greater than for incentives or business tax cuts.



Business tax cuts do create jobs, but earnings effects are insufficient to offset negative effects of higher household taxes. Effects of “labor supply” programs (increase labor force participation, or increase “quality/skills” of residents’ labor supply) are adjusted down because some residents leave, although on average about 70% of Americans spend most of career in the state of their childhood. In addition, higher skills of SOME residents have SPILLOVER BENEFITS for other residents. For example, my wages may be higher if my co-workers have more skills, as this enables my employer to be more productive.

Policy Recommendation #1: Incentives should NOT be funded by inadequately funding infrastructure, customized business services, or labor supply/skills programs.

- Why: these programs have higher benefit-cost ratios in achieving "economic development benefit" of higher earnings per capita.

- Caveat 1: This assumes infrastructure, customized business services and skills programs are all run at high quality level, e.g., "bridge to nowhere" creates few if any jobs.

- Caveat 2: There are potential diminishing returns to scale in these service programs, e.g., at some point customized training has gone to most firms, etc.

Policy Recommendation #2: Business tax incentives should be subject to an enforceable budget cap.

- Why: To ensure these incentives do not displace programs with higher ratios of economic development benefits to costs.
- Budget cap facilitated by making incentives more upfront, say only run for 5 years. More upfront avoids political temptation of passing costs on to successors. More upfront is probably more cost-effective. But if more upfront, need to have enforced clawbacks.
- Virginia model: Job creation credit of one-time payment of slightly over $20,000 per job, but only paid once job is maintained for 4 years.
- California Competes: Allocate fixed incentive budget 3x/year, firms in 1st round propose incentive, state ranks proposals by incentive/(sum of 5-year added payroll + investment), and proposals go to 2nd round if below cutoff so 2nd round proposals = twice budget for that allocation cycle. 2nd round then selects from this group of proposals.

Policy Recommendation #3: Target economic development dollars more to distressed places

- Why: Economic/social benefits greater in distressed places. For example, job creation benefits are twice as high.

- Targeting is politically and practically difficult. Example: NC had job creation credit higher in rural areas than in more prosperous counties, but fewer $ per capita went to these rural areas, due to lower rate of job creation there.

- My 2022 report outlined proposal for states to provide economic development block grants: grant is allocated based on jobs needed for place to reach full employment. All places get something, but distressed places get more per capita. Block grant can be used for incentives or services.

- Key advantage: such block grants can be flexibly used to address regional needs.

Policy Recommendation #4: Link economic development programs more with workforce development programs

- Why: Who gets the jobs matters; the benefit-cost ratio from job creation programs is higher if more jobs go to local residents who are non-employed. Workforce development programs can influence who gets the jobs.
- Example: Customized job training programs can help get more disadvantaged local residents into the hiring queue.
- Another example: if job creation coordinated with greater childcare provision, more state residents will benefit from job creation.

Conclusion

- Main point: Our economic development GOALS should be more focused; our economic development MEANS to achieve those goals should be more varied.
- Our focus should be on job growth that leads to more state residents getting good jobs, rather than focusing on job growth, regardless of who gets the jobs.
- But getting more state residents into good jobs is better accomplished by diverse programs that go beyond incentives to include customized business services, and labor supply programs to increase access of state residents to good jobs.