January 14, 2022 Testimony by Timothy J. Bartik for New York State Senate, Joint Hearing of Committees on: Finance; Commerce, Economic Development, and Small Business; Investigations and Government Operations

"REFORMING BUSINESS INCENTIVES"

My comments on business incentives will make two points:

(1) Typical cash incentives have a high cost per job truly created.
(2) Reforms to incentives can significantly increase their ratio of benefits to costs.

(1) Why incentives are costly per job created

Based on research on incentives, the average incentive package in the United States – which is around $50,000 per job – probably tips the location or expansion decision for less than 25% of incented projects. That is, only 25% of the incented jobs would not have been created in the state "but for" the incentives. Therefore, the cost per job actually created for incentives is at least $200,000 per induced job ($50,000 divided by 0.25).

Even though it is sometimes claimed that incentives pay for themselves through increased state and local tax revenue, this is seldom true. First, at least 75% of the time, incentives are all costs and no benefits. Second, induced jobs will attract in-migrants, and state and local governments will need to increase spending to keep the quality of public services constant – hiring teachers and police and fire, and expanding infrastructure.

(2) Reforms to increase the benefit-cost ratio of incentives

State policymakers can increase the benefits of incentives, relative to the costs, via four reforms:

(1) Cap the per job amount of incentives. Doubling the tax break per job does not double the probability of inducing the jobs, so costs per induced job go up with higher magnitude incentives.
(2) Make incentives more upfront. The business executives making business location and expansion decisions heavily discount the future, so the tax break provided in year 10 of the project has little effect.
(3) Before providing cash incentives, state policymakers should make sure that they provide adequate non-cash incentives, by which I mean public services to business that enhance the quality of business inputs. Such services include: customized job training; business advice programs such as manufacturing extension services and small business development services; and land development programs such as research parks, business incubators, and brownfield redevelopment. These targeted business services have a cost per job created that is less than one-fifth of the cost per job created of "cash incentives" such as business tax incentives and cash grants.
(4) Target distressed places, by which I mean places with lower prime-age employment rates (the "prime-age employment rate" is the employment to population ratio for workers

between the ages of 25 to 54). In distressed places, compared to booming places, the proportion of created jobs that go to local residents will be three times higher. As a result, creating jobs in distressed places will increase earnings per capita by more, whereas creating jobs in booming places mostly just increases in-migration, which requires increased public spending.

Are there useful models of such incentive reforms? Yes. In the United States, Virginia illustrates the potential power of a strategy that emphasizes providing incentives that are both limited in size and upfront, while providing good business services. Virginia attracted Amazon HQ2 with an incentive package of $22,000 per job, far less than the U.S. average, and less than one-third of what was offered to Amazon by Maryland. In addition, this cash is to be allocated up-front, but the actual payment to Amazon only occurs with a 4-year delay to make sure the jobs are maintained. This is a reasonable way to make incentives more cost-effective by front-loading them, while avoiding paying out incentives for jobs that quickly disappear.

In addition, Virginia combined these cash incentives with specific public services of use to Amazon. These services include upgrades to the public transportation and highways near the site, and locating a new campus of Virginia Tech near the site.

Another good model of incentive reforms are the incentive rules of the European Union (EU). The EU limits cash incentives to about $10,000 per job in booming areas such as Paris and Berlin, but cash incentives can be $50,000 per job in distressed places such as Bulgaria. Non-cash incentives such as training are not so constrained.

Summary and conclusion

In sum, state policymakers need to recognize that tax breaks and other cash incentives often have high costs per job actually created, and make the most sense in more distressed places. They should target economic development programs at those distressed places, and in so doing make sure they first target the key inputs to business profitability, which are land, labor, and business advice, not cash. And cash incentives should be kept within bounds and provided upfront, when this cash assistance is most impactful. Useful models of sensible incentive design are provided by both the European Union and the state of Virginia, which have done well economically while keeping cash incentives limited.

Biography: Timothy J. Bartik is a senior economist at the Upjohn Institute for Employment Research, a non-profit and non-partisan research organization in Kalamazoo, Michigan, where he has worked since 1989. His research focuses on state and local economic development policies. Bartik's most recent book is *Making Sense of Incentives: Taming Business Incentives to Promote Prosperity* (2019), available for free download at https://research.upjohn.org/up_press/258/ . He received his B.A. from Yale University, and his Ph.D. from the University of Wisconsin-Madison.