

APPENDIX

What Should States Do about Incentives?

Prepared testimony of Timothy J. Bartik (Senior Economist, Upjohn Institute for Employment Research) before New Jersey State Senate Select Committee on Economic Growth Strategies, September 5, 2019

Mr. Chairman and members of the Select Committee, thank you for the opportunity to share some research findings on how New Jersey might reform its incentives.

My name is Tim Bartik. I am a senior economist at the Upjohn Institute for Employment Research, a non-profit and non-partisan research organization in Kalamazoo, Michigan. Based on my over 30 years of research on state economic development policies, what should states such as New Jersey be doing to reform incentives?

First, we need to recognize that the “but for” of incentives – the percentage of incented jobs that would not have existed in the state “but for” the state providing these incentives – is less than one-quarter of the incented jobs. At least three-fourths of the time, the incentives are all costs with no job creation. And unless the state has staff who can read the minds of firms requesting incentives, it is close to impossible to only provide incentives to firms in cases in which it will tip the location or expansion decision.

Second, incentives rarely if ever pay for themselves. Probably at least 90% of any increase in tax revenue due to inducing job creation are offset by increased public service costs, as new jobs will attract population who will require more spending on infrastructure, education, police and fire services, and other public services.

The main benefit for New Jersey from the jobs created by incentives comes not from fiscal benefits, but rather from increasing the employment to population ratio for New Jersey residents – that is, from providing jobs to New Jersey residents who otherwise would be non-employed.

Therefore, reforms can increase incentives’ benefits by designing incentives so that more jobs go to non-employed New Jersey residents. This can be done in two ways:

- (1) Target incentives at areas with higher non-employment rates, where new jobs are more likely to go to the local non-employed rather than to in-migrants.
- (2) Tie incentives to sticks or carrots that encourage local hiring of the non-employed. A “stick” is tying incentives to so-called “first-source” hiring agreements, under which the incented firms agrees to consider, for hiring for entry-level jobs, job candidates referred via the local workforce development system. A carrot is making customized job training part of the incentive package, where part of the firm’s assistance comes through local community colleges helping train and screen workers who meet the firm’s hiring needs.

With incentives, more is not always better. New Jersey has about twice the national average incentive level (around \$66 thousand per incented job versus a national average of around \$33 thousand). But these twice as costly incentives do not tip twice as many incented firms, so there are some diminishing returns to being above average in incentives.

Long-term incentives, which New Jersey emphasizes, are less cost-effective than up-front incentives. U.S. corporations heavily discount the future, so a given dollar amount of incentives provided 10 years from now has less effect than the same dollars provided today. Providing incentives upfront can create 40% more jobs at the same costs to the state government. Of course, providing incentives upfront creates the problem of what to do if the incited jobs go away. To deal with this, states should tie upfront incentives to clawbacks that recover incentives if the jobs do not adequately persist.

We should also recognize that there are economic development policies other than incentives that, if well-designed, can produce more jobs per dollar than is true of incentives. These other policies include:

- A wide variety of skills development policies, such as customized job training programs.
- Programs that provide various services to help smaller businesses, such as manufacturing extension programs, small business development centers, and business incubators.
- Infrastructure programs, including highways, transit, business parks, and brownfield redevelopment.

These other economic development programs can have job-creation effects per dollar that are 5 to 10 times that of providing tax incentives and other cash incentives.

In seeking to reform incentives, New Jersey policymakers can look to ideas from other states.

Consider Virginia's bid for Amazon. Virginia provided incentives of less than one-third of New Jersey's level, equivalent in present value to less than \$20 thousand per job. Virginia provides more incentives upfront than New Jersey, but only incentivizes the same job for one year, rather than multiple years as is true in New Jersey.

Furthermore, Virginia's incentive offer had an implicit clawback in that although Amazon will immediately earn an incentive due to creating jobs, the actual payment is delayed four years, and is the lesser of the immediate jobs created versus the average jobs created over those four years. If jobs are reduced, so is the incentive payment.

Finally, Virginia accompanied its cash incentives with major investments in infrastructure and job skills, including a new high-tech college campus in Northern Virginia, and improvements in transportation access in Northern Virginia. These skill investments will encourage Amazon to do more local hiring of Virginia residents, rather than bringing in employees from out-of-state.

Another interesting state example is Oregon. Oregon makes clawbacks easier by providing incentives as forgivable loans, which do not have to be repaid if the incited jobs are maintained. The state also gives priority to providing incentives to firms that agree to maximize Oregon benefits in any of various ways, including entering into First Source Hiring Agreements to target the local non-employed for open jobs, and committing to youth internships and promoting from within.

North Carolina provides an example of consistent and clear targeting of incentives on distressed areas. North Carolina annually divides its 100 counties into tiers based on statistical indicators of

economic distress. The more distressed counties get higher levels of incentives, and the expected local government contribution to incentive packages is reduced.

In summary, New Jersey policymakers should consider the following incentive reforms:

- New Jersey's twice-average incentive levels should be cut by at least half in dollar amount per job.
- New Jersey should make its incentives less long-term, and more upfront, with clawbacks.
- Maximum incentives should only be available in distressed local labor markets, with distress identified using objective economic criteria.
- Incentives should be tied to first-source hiring agreements and customized job training, to encourage local hiring of New Jersey residents who are not employed.
- Complement incentives with investments in skills training, small business services, infrastructure, and land development.

Reforms to New Jersey's incentives need not mean a lesser commitment to creating jobs for New Jersey residents. With reforms, New Jersey's economic development policies can be less costly to the state budget yet result in more job opportunities for New Jersey's residents.

Note: For more on state and local economic development policy, see many of my prior papers on this topic. For two recent policy briefs of 4-pages each, backed by more extensive full reports that cite the research behind the policy briefs' arguments, see: *Should We Target Jobs at Distressed Places, and If So, How?* 2019 Upjohn Institute Policy Brief by Timothy J. Bartik; *Improving Economic Development Incentives*, 2018 Upjohn Institute Policy Brief by Timothy J. Bartik.

What Should States Do about Incentives?

Tim Bartik
Senior Economist
W.E. Upjohn Institute for Employment Research
bartik@upjohn.org

September 5, 2019

Testimony before Senate Select Committee on Economic Growth Strategies, New Jersey Senate
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in this testimony are those of the author, and may not reflect the views of the Upjohn Institute.

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Model State Incentive Reforms

- "But-for" for incentives < 25%. Hard to target firms to boost.
- Incentives' fiscal benefits low due to public service costs.
- Encourage hiring of local non-employed by: (1) targeting distressed areas; (2) tying incentives to "first source" hiring agreements or customized training.
- Avoid excessive incentives: Avg national incentives \$33K/job, New Jersey at \$66K, but not twice as effective.
- Avoid long-term incentives (NJ heavily uses): Upfront incentives 40% more effective, as firms heavily discount. Use clawbacks.

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Other Policies Can Create More Jobs per \$ than Incentives

- Customized job training 10 times as effective as incentives; other skills development can also be effective.
- Manufacturing extension programs 10 times as effective as incentives; other small business development programs also cost-effective.
- Infrastructure programs (highways, transit, industrial or research parks, brownfield redevelopment) can be 5 times as effective.

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Virginia Amazon example

- Virginia attracted Amazon with tax incentives of \$10K to \$20K per job, depending on how calculated.
- Virginia awards one-time incentives per job created, but payment not made until 4 years later, & is calculated as job credit times LOWER of (initial jobs, 4-year average jobs).
- For 38K Amazon jobs, Virginia combined up to \$750M in tax incentives with around \$1.3B in investments, including new NoVA campus for Va Tech, expanded computer skills in K-12 & post-sec across states, & transit/highway improvements.

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Oregon discretionary incentives

- Discretionary incentives awarded as forgivable loans, to allow easier clawbacks if jobs not maintained.
- Give priority to business projects that provide "public benefits"
- Example of public benefits: "First Source Hiring Agreement" to ensure unemployed/underemployed/hard-to-employ are priority targets for open jobs.
- Other example: local youth internship programs.
- Other example: company career ladders that encourage internal promotions
- Other example: adoption of plan to increase firm's local purchases.

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North Carolina tiers

- North Carolina annually divides its 100 counties into 3 tiers: 40 most distressed, 40 in middle, 20 least distressed.
- Distress criteria vary over time. Currently include: average unemployment rate, median household income, % growth in population, and property tax base per capita.
- More distressed tiers get higher incentives, and local government contribution is less.

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Summary

- New Jersey should cut average per job amount of its incentives by at least one-half or more.
- Incentives should be awarded up-front, with clawbacks that can be enforced (forgivable loans, delayed payment)
- Maximum incentive only available in distressed areas, based on objective economic criteria.
- Tie incentives to local hiring, particularly of non-employed.
- Use savings from lower incentives to invest in skills training, small business services, infrastructure, & land development.

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2005 Market Street, Suite 2800 · 215.575.9050 Phone
Philadelphia, PA 19103-7077

901 E Street NW · 202.552.2000 Phone
Washington, DC 20004
www.pewtrusts.org

**Testimony of Josh Goodman
Senior Officer, State Fiscal Health
The Pew Charitable Trusts**

**Senate Select Committee on Economic Growth Strategies
September 5, 2019**

Chairman Smith and members of the committee, thank you very much for the invitation to testify today. My name is Josh Goodman and I'm a senior officer with the Pew Charitable Trusts. Pew is a public charity that provides research and technical assistance to state policymakers across a range of policy issues. For the last seven years, we have conducted nonpartisan research and analysis on how states can improve the effectiveness of their tax incentives and other economic development programs.

Based on that research, I'm going to talk about three important strategies states around the country are using to get better results. First, states can ensure that incentives are well-designed to maximize their economic effectiveness. Second, states can design incentives with fiscal protections to make sure the programs do not cost more than expected or intended. And third, states can establish regular, independent evaluations of incentives and other economic development programs.

I'll start with economic effectiveness. Designing incentives is complicated work. However, lawmakers around the country are benefitting from a growing body of research that shows what works in economic development. This research points to some straightforward, intuitive steps to help states achieve their economic development goals.

For instance, one insight of the research is that the timing of incentives matters. Businesses generally heavily discount money that they're promised far in the future. One study showed that if you offer corporate executives a dollar ten years from now, they value it at only 32 cents today. As a result, if states offer incentives on shorter time horizons, they can potentially spend less on incentives while having the same impact.

Minnesota's Job Creation Fund is a good example of a program that follows this principle. Once the state's economic development agency approves an application, the business is required to ramp up its activities quickly. Companies must make "reasonable progress" on the projects in six months, reach capital investment thresholds within a year, and hit their job creation goals within two years. Then, businesses can earn incentives for up to five years in the Minneapolis-St. Paul metro area and up to seven years elsewhere in the state, shorter than many similar programs across the country.

Another finding from the research literature is that states should target their incentives to businesses that will grow the state's economy, such as those that sell their goods nationally and internationally. If policymakers are trying to encourage statewide economic growth, they should

avoid providing incentives to businesses that primarily serve a local market such as hotels and restaurants. These businesses compete for customers with other local businesses, so helping one business expand will generally result in job losses elsewhere in the local economy.

Next, I'll move on to fiscal protections. Across the country, states have faced two related challenges when it comes to the budget impact of incentives. In some cases, states have experienced sudden one-year spikes in the cost of incentives. In others, the long-term costs of incentives have grown beyond states' expectations and have begun to crowd out other priorities. Either way, lawmakers can be forced to make difficult choices between raising taxes and cutting spending in other areas to make up the difference.

These challenges are not inevitable, however. Our research points to several strategies that allow states to invest in incentives with confidence that they won't cost more than expected or intended. One effective approach is to set annual cost limits, or caps, on incentive programs. Caps allow lawmakers to determine how much money is available for incentives, in the same way they can adjust spending levels in other policy areas such as education or transportation as part of the annual budget process.

States around the country have capped many incentive programs, including New York's Excelsior Jobs Program and New Jersey's recently relaunched film tax credit. However, lawmakers also often raise reasonable questions about caps. They wonder whether the state will miss out on economic development opportunities if it reaches the cap before the year is over. They also wonder whether caps will contribute to business uncertainty because companies will be unsure whether incentives will be available.

The good news is that some states have designed flexible caps that help alleviate those concerns. For example, in Nebraska earlier this year, the legislature voted to place an innovative cap on the state's largest incentive. Under the amendment, the program would be capped at \$125 million a year. But if the program reached the cap for the year, the legislature's Executive Board would have the option of voting to exceed it. This approach offers a way for lawmakers to remain firmly in control of spending on incentives, with the flexibility to pursue extraordinary economic opportunities.

Minnesota's Job Creation Fund shows how states can cap incentives without causing business uncertainty. Under the program, when the state enters into an agreement with a company, it places the dollars to pay the incentives in a state account—guaranteeing that the money will be there when the company fulfills its commitments.

Caps aren't the only strategy to make the costs of incentives more predictable. States have also worked to gather better data on potential costs, so budget writers aren't caught off guard. For example, Iowa's Department of Revenue forecasts the costs of each tax credit five years into the future, with the numbers updated three times a year. These projections are incorporated into official state revenue forecasts. A system like Iowa's depends on effective sharing of data across agencies. It also helps if businesses are earning and using incentives on predictable schedules, so that it's easier to know when state revenue will be impacted.

Third and finally, states should evaluate the effectiveness of their economic development programs. With incentives, the details matter. Subtle decisions—such as how benefits are structured or how states determine which companies are eligible—can make the difference between programs that achieve their goals and ones that prove to be costly disappointments. Evaluations can help you get the details right. They offer evidence of what's working and what isn't and how incentives can be improved.

Around thirty states have approved legislation requiring regular evaluation of tax incentives. In virtually every case, these bills have won strong bipartisan support. They have also brought together supporters and skeptics of incentives alike who agree on the need for better information.

This information helps lawmakers improve policy. For instance, Maine's legislature relied on an evaluation in 2018 to fix a flaw in a program that allowed state businesses to receive incentives merely for promising to create jobs. A tax credit for rehabilitating historic buildings in Maryland received strong marks in an evaluation, so lawmakers decided in 2016 to continue the program beyond its scheduled expiration date. And, in Pennsylvania, lawmakers adopted changes to incentives within months of the state's first evaluations being published under a 2017 law.

To achieve similar results, states should consider the key details for an evaluation process, including who is best positioned to assess the programs, which incentives to include, and over what time period evaluations should occur. For example, many states have adopted multiyear review schedules, an approach that helps lawmakers focus more closely on a subset of incentives each year. To ensure the studies are rigorous, they have tasked economists, auditors, and fiscal experts inside or outside of government with studying the programs.

Let me just conclude by saying that, with the expiration of major New Jersey tax incentives, you have an opportunity to make sure these programs are serving the needs of your businesses, budget, and workers. Our research points to ways to ensure that the next generation of New Jersey economic development programs is effective, accountable, and fiscally sound.

Thank you for the opportunity to discuss our research and I'm happy to answer any questions.

Testimony Submitted to New Jersey Senate Select Committee on Economic Growth Strategies

Joseph Parilla | Fellow
Brookings Metropolitan Policy Program
September 5, 2019

Chairman Smith and members of the committee,

Thank you for the invitation to testify today and for the flexibility to do so remotely. My name is Joseph Parilla and I am a fellow at the Brookings Institution's Metropolitan Policy Program. Brookings helps inform mayors, governors, and other local and state institutions that are on the front lines of the nation's central challenge: ensuring that more people and communities share in the benefits of economic growth.

In this testimony, I'll make three brief points.

First, economic development incentives should be reserved for businesses whose behaviors and investments are consistent with the public good.

Currently, incentives transactions reward a somewhat limited set of what can be considered beneficial business behaviors, typically job creation or job retention. But to ensure that incentives policies are promoting the public interest, some communities such as Austin, Indianapolis, and Portland are adopting a broader set of criteria to ensure that incentives are deployed in line with, in this case, local economic objectives.ⁱ

In addition to the creation of jobs with livable wages and benefits, these incentives scorecards reward other "opportunity-rich" business behaviors, such as whether the company exports or is in an export industry, whether it is likely to drive technological innovation, or whether it will commit to opportunity-enhancing activities such as hosting job fairs, partnering with local schools, reserving internship slots for disadvantaged youth, and supporting the creation of other businesses through participation in local innovation incubators.

This scorecard approach creates a decision-making rubric that helps states simultaneously master the global scale and technological complexity of the advanced economy and address the entrenched biases that prevent all workers and communities from meeting their productive potential.

Second, economic development incentives should be targeted toward the core drivers of business investment decisions—principally, the development of a skilled workforce.

Workforce quality is paramount to core economic development interests such as business attraction, retention, and expansion. For instance, 95% of executives rate the availability of skilled labor as "very important" or "important" to their investment location decision.ⁱⁱ

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Evolving economic development incentives to focus more on job training is a logical step for state governments, for four reasons:

- From a growth perspective, well-designed job-training tax credits and/or skill grants address talent shortages, which are a binding constraint to opening and expansion for many firms.
- From a shared prosperity perspective, using public subsidies for investments in education and workforce development is more likely to distribute the benefits of incentives to workers that need training, in addition to employers.
- From a fiscal perspective, Tim Bartik has already shared that customized job-training incentives achieve greater returns at lower costs than traditional incentives such as job-creation tax credits or abatements.ⁱⁱⁱ
- From an efficiency perspective, pushing training resources into the domain of employers—rather than simply subsidizing higher education or workforce training in general—also ensures that the training is more relevant, as in-firm/on-the-job training tends to outperform classroom-based training because it more closely resembles the activities eventually done in the workplace.^{iv}

Of course, most states do have either a job-training tax credit, a customized training incentive, or both. But this segment represents a small share of overall incentive spending. Tim Bartik's research has shown that only 2% of the \$50 billion in annual local and state economic development incentives goes to job training. Given the importance of talent to business decisions, this seems misaligned.

Third, tax incentives will not always be the right tool for states and businesses to advance economic development objectives.

This hearing is about economic development incentives, but given the remit of this Committee I'd be remiss to not point out that incentives are not always the best way to bolster the twin interests of business growth and community prosperity.

For instance, staying in the remit of talent development, companies may care less about an incentive and more about flexible, quality partnerships with job-training providers. Yet, in many states, the job-training space is extremely fragmented and unclear. States have a unique capability to not only offer training relief directly to businesses, but to support the regional intermediaries that alleviate this miscoordination by connecting middle schools, high schools, community colleges, higher education institutions, and in-demand skills providers with businesses in key growth sectors. States such as Maryland, Massachusetts, Rhode Island, Tennessee, and New York have pursued such grant programs to support regional industry training partnerships such as these.

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This is but one example. The broader point is that state economic development must evolve from a “transactions game”—one whose governing metrics are overwhelmingly about deals won and measured by incentives deployed—to a “conditions game,” where government is designing and deploying policies that change the broader economic conditions of a state’s economy. Even this is hard to do from state capitals, so oftentimes these state-level strategies can be most effective when they are providing resources that enable the public, private, and civic sectors to collaborate locally so that both businesses and residents can prosper.

Thank you for the opportunity to participate in this hearing, and I’m happy to answer any questions.

ⁱ Joseph Parilla and Sifan Liu, “Examining the Local Value of Economic Development Incentives” (Washington: Brookings Institution, 2018).

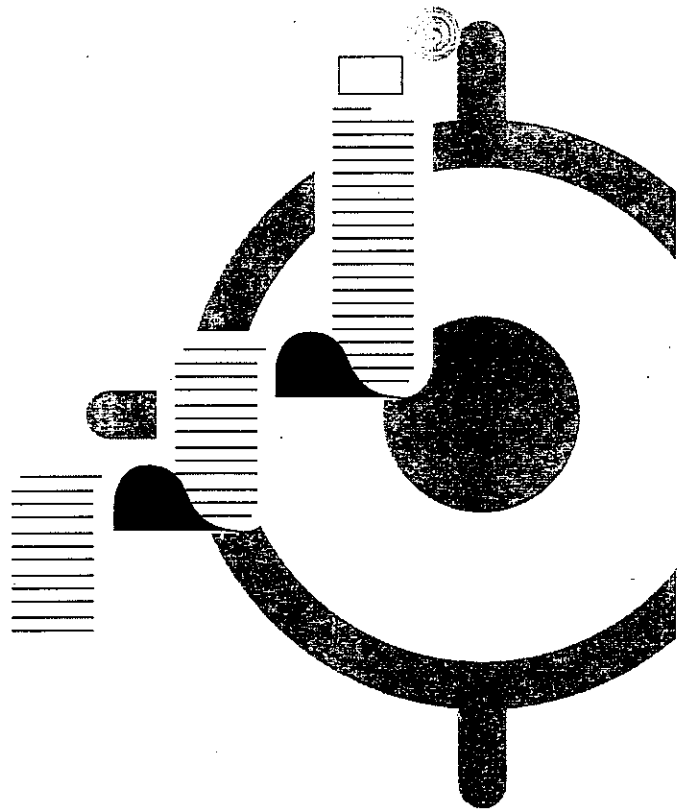
ⁱⁱ Matthew Tarleton and Evan Robertson, “Quality of Place and Its Role in Corporate Location Decisions,” *Site Selection Magazine*, 2014.

ⁱⁱⁱ Timothy Bartik, “A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States” (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2017).

^{iv} What Works Centre for Local Economic Growth, “Employment Training Financial Incentives Toolkit” (2017).

EXAMINING THE LOCAL VALUE OF ECONOMIC DEVELOPMENT INCENTIVES

Evidence from four U.S. cities



JOSEPH PARILLA

SIFAN LIU

March 2018

B Metropolitan Policy Program
at BROOKINGS

Summary

Every year local and state governments in the United States expend tens of billions of dollars on economic development incentives. Under intense pressure to deliver economic opportunity, policymakers utilize incentives to encourage private sector firms to create jobs, invest in communities, and strengthen local industries. Drawing on a detailed literature review and a unique analysis of economic development transactions in four U.S. cities (Cincinnati, Indianapolis, Salt Lake County, and San Diego), this report advances a framework for inclusive economic development to help leaders analyze and evolve their incentive policies. Its key findings include:

1. **Economic development incentives remain a core aspect of local and state economic development policy.** This report defines economic development incentives as direct financial benefits that incentivize a firm's opening, expansion, or retention. What distinguishes incentives from broader economic development efforts is that governments selectively provide these incentives to individual businesses, arguing that their investment or expansion would not occur but for the incentive. Estimates suggest that these policies contribute to significant public expenditures, ranging between \$45 and \$90 billion per year depending on the definition and estimation method.
2. **Incentives have come under renewed scrutiny from both academic researchers and the public.** The competition between cities to land Amazon's second corporate headquarters—along with the controversial billion-dollar incentives packages being offered—has thrust local and state economic development approaches into the public spotlight. Pressure to limit incentives for big

corporate relocations has drawn on academic evidence that remains skeptical about the effectiveness of incentives, arguing that incentives do not influence business decisions to nearly the extent policymakers claim nor are they properly targeted to businesses and industries that can offer the greatest economic and social benefit.

3. **Cities should target incentives based on core principles of inclusive economic development.** A review of local and state economic development incentives provided to firms in four U.S. cities finds that transactions align with several principles of inclusive economic development but fall short on others. Cities, regions, and states must master the global scale and technological complexity of the advanced economy and address the entrenched and exclusionary biases that prevent all workers and communities from meeting their productive potential. We distill this dynamic into four principles toward which cities and states can align incentives. Drawing on unique transaction-level information with businesses in Cincinnati, Indianapolis, Salt Lake, and San Diego, we conducted a "census of incentives" to determine whether local and state incentive policies are aligned with these four principles:
 - **Grow from within** by prioritizing firms in advanced industries that drive local comparative advantage, innovation, productivity, and wage gains. Across all four cities, local and state economic development incentives disproportionately go to firms in advanced industries. On average, advanced industries account for about 20 percent of economic output but receive about one-third of all incentives.

- **Boost trade** by facilitating export growth and trade with other markets in the United States and abroad in ways that deepen regional industry specializations and bring in new income and investment. Across all four cities, local and state economic development incentives disproportionately go to firms in exporting industries. The export intensity of industries that receive economic development incentives—that is, the share of local output accounted for by goods and services exports—across the four cities is more than twice as high (25 percent) as the economy as a whole (11 percent).
- **Invest in people and skills** by incorporating workers' skill development as a priority for economic development and employers so that improving human capacities results in meaningful work and wages. Partly because of their tradability and technological sophistication, incentivized industries in these four cities pay 25 percent higher wages than the overall economy. Yet, we identified concerns related to racial inclusion. Black and Hispanic workers remain underrepresented in industries that receive economic development incentives, and a low share of incentives go to firms for job training purposes.
- **Connect place** by catalyzing economic place-making, and work at multiple geographic levels to connect local communities to regional jobs, housing, and opportunity. Within this principle, many cities focus incentives on addressing blight and distress in communities of concentrated poverty. Cincinnati and Salt Lake clearly display this focus, but

it is less apparent in Indianapolis and San Diego. The average poverty rate of a neighborhood in which a business or redevelopment receives incentives is nearly 30 percent in Cincinnati and 18 percent in Salt Lake, compared to jurisdiction-wide poverty rates of 18 percent and 12 percent, respectively.

4. **Economic development leaders should ensure incentives policies align with broader economic objectives, embrace public transparency and rigorous evaluation, and only target firms that advance broad-based opportunity.** While not a full analysis of economic impact, our findings offer some implications for economic development incentives policy and practice. First, policymakers should ensure incentives reflect local and regional economic objectives. This census of incentives provides one guide for how cities can situate their incentives practices within four principles of inclusive economic development. Second, localities must commit to making incentives information publicly transparent, and then rigorously evaluate their impact on firm outcomes to determine what works. Finally, clearer criteria and more effective targeting should reserve incentives only for those firms that will advance broad-based opportunity, either by incentivizing opportunity-rich firms and industries, incentivizing firms to provide workers more opportunity, or by addressing place-based disparities in opportunity.

Fortunately, we observe progress toward a more responsible and rigorous incentives approach in many U.S. cities, signaling a nascent but necessary progression in the practice of economic development. We hope this report can help provide insights and tools to local leaders as they undertake that important and needed evolution.

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I. Introduction

In October 2017, Amazon, the world's fourth largest company, received 238 proposals from North American cities aiming to become the site of its second corporate headquarters (or HQ2). In a uniquely public request for proposals, Amazon asked applicants to highlight their local strengths: the talents of their workforce, quality of their infrastructure, strength of their schools, and livability of their communities.

Amazon also requested each jurisdiction list their tax incentive programs that would defray the cost of their proposed \$5 billion investment. Critics looked askance at a company valued at close to three-quarters of a trillion dollars requesting public subsidy, but many cities and states responded with significant packages. Corporate relocations and expansions such as the one proposed by Amazon have declined by 50 percent over the past decade, and as the supply of deals has dwindled, the average incentive price tag has increased. The packages for Amazon reflect this upward trend. New Jersey offered \$7 billion. Maryland offered \$5 billion. Philadelphia offered \$3 billion. Illinois's tax credit package could total up to \$1.3 billion.²

The incredible volume of city bids, and the historic size of the incentive packages, reflects not only the scale of the Amazon investment, but the intense pressure that economic development officials in U.S. cities and states are under to deliver economic opportunity in the face of widening socioeconomic disparities. Since 1980, the bottom 50 percent of earners—half of U.S. workers—have experienced zero before-tax income growth.³ In 2016, only 11 of the largest 100 U.S. metropolitan areas experienced gains in metrics of growth, prosperity, and inclusion.⁴

Mayors, governors, and other local and state institutions remain on the frontlines of the nation's central challenge: ensuring that more people and communities share in the benefits of economic growth. Two disruptions are forcing the local and state economic development field to reevaluate its tactics: 1) the declining viability of an economic development approach predominantly reliant on a declining pool of business attractions, and 2) the acknowledgment that, in the face of both structural opportunity gaps and rapid technological change, no amount of overall growth seems to be enough to deliver widespread prosperity.⁵

These tectonic shifts require a set of economic development principles that recognize cities must master the global scale and technological complexity of the advanced economy and address the entrenched and exclusionary biases that prevent all workers and communities from meeting their productive potential. In "Remaking Economic Development," Amy Liu of the Brookings Metropolitan Policy Program distilled this dynamic into four principles:

1. **Grow from within** by prioritizing firms in advanced industries that drive local comparative advantage, innovation, productivity, and wage gains
2. **Boost trade** by facilitating export growth and trade with other markets in the United States and abroad in ways that deepen regional industry specializations and bring in new income and investment
3. **Invest in people and skills** by incorporating skills development of workers as a priority for economic development and employers so that improving human capacities results in meaningful work and income gains

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4. **Connect place** by catalyzing economic place-making and work at multiple geographic levels to connect local communities to regional jobs, housing, and opportunity

This report examines how one critical economic development tool—incentives—aligns with these principles. Incentives attract the most attention when tied to megadeals like Amazon, but they are also a significant part of the day-to-day economy-shaping conducted by local and state governments. And while the public's support of these programs totals tens of billions of dollars per year, surprisingly little research exists examining how incentive transactions, particularly those conducted by local governments, align with modern economic realities.

This analysis advances our understanding of what kinds of firms, industries, and neighborhoods receive economic development incentives, as previous research suggests the way governments target incentives significantly determines their

broader public benefit. To do so, we conducted a census of incentives in four central cities, drawing on five years of transactions between local and state governments and firms in Cincinnati, Indianapolis, Salt Lake County, and San Diego. While these data cover a small sample and do not allow for a full cost-benefit evaluation of economic and social impact, they do fill an important gap in prior research: a rare transaction-level snapshot into how local and state governments target incentives in four urban economies.

The report begins by briefly defining what incentives are, how they work, and why they matter, including a review of the most relevant literature. It then analyzes incentive spending in the case study cities to see how it aligns with four key principles of 21st century economic development. Finally, the report concludes with implications for economic development incentives policy and practice that can support local growth and opportunity.

II. Background

What are economic development incentives, why and how do cities and states provide them, and do they work? This section briefly reviews those three questions in turn.

WHAT ARE ECONOMIC DEVELOPMENT INCENTIVES?

In this report, we define economic development incentives as direct financial benefits provided to firms to incentivize their opening, expansion, or retention. What distinguishes incentives from broader economic development efforts is that

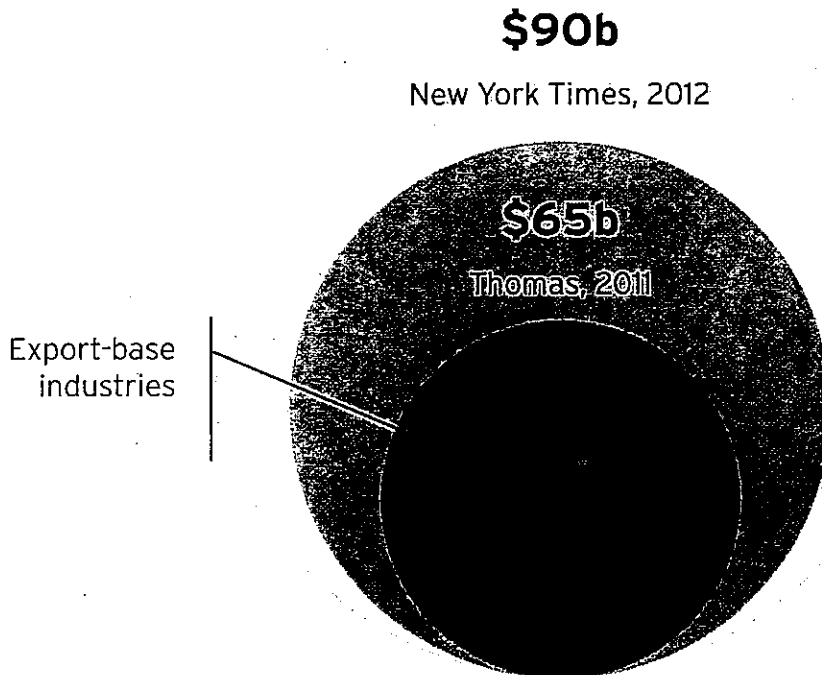
governments selectively provide these incentives to individual businesses.

Since firms have been mobile, local and state governments have been incentivizing businesses to locate within their jurisdictions. Richard McGahey traces the origins of incentives back to the depths of the Great Depression. In 1936, Durant, a small town in Mississippi, developed a new type of industrial revenue bond to induce Real Silk Hosiery Mills, and its 4,000 knitting-machine operators, to relocate from Indianapolis.⁶ The Durant strategy soon expanded to the rest of

FIGURE 1

Local and state economic development incentives are a big business

Estimated total amount of local and state incentives (billions, in 2015 US dollars)



Source: Louise Story, Tiff Fehr, and Derek Watkins, "Explore Government Subsidies," The New York Times, December 1, 2012. K. Thomas, Investment Incentives and the Global Competition for Capital (Springer, 2010). Timothy Bartik, "A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States" (Kalamazoo: W.E. Upjohn Institute for Employment Research, 2017)

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the industrializing American South as a means to spur new demand for labor, particularly in manufacturing. Northern communities and states eventually responded with their own incentive packages. As demand for firms went global during the 1970s and 1980s, the economic development incentive regime spread nationwide.

Today, economic development incentives represent a fundamental component of local and state economic policy. In 2012, the New York Times estimated that U.S. cities, counties, and states issued roughly \$80 billion in incentives per year, or about \$90 billion 2015 dollars.⁷ The Upjohn Institute for Employment and Research found that total local and state incentives provided to firms in “export-base” industries had an annual cost of \$45 billion in 2015, or about 30 percent of the average local and state business tax collections. This represents a *tripling* of incentive spending on these industries since 1990, up from 9 percent of local and state business taxes.⁸ Finally, Kenneth Thomas estimated that in 2011 incentive spending amounted to \$65 billion in 2015 dollars. The significant differences between these estimates reflect the lack of comparable, timely, and relevant information about local and state economic development incentive spending.

No matter the estimate, the local and state spending dwarfs other forms of economic development funding. The Economic Development Administration’s latest budget request was \$258 million.⁹ Our colleagues Elizabeth Kneebone and Alan Berube estimated that federal spending focused on neighborhood revitalization totals about \$14 billion per year.¹⁰

WHY AND HOW DO CITIES AND STATES GIVE OUT ECONOMIC DEVELOPMENT INCENTIVES?

The numbers reveal that economic development is big business in American cities and states. Why?

The first rationale is economic. Talk to an

economic developer who wants to incentivize a company to locate in a particular neighborhood, city, or state and you may hear the “but for” test: “*But for* this incentive, company X would not be making this investment.”

Under this rubric, cities and states deploy a firm-specific financial incentive to nudge firm behavior in a manner in which it would not otherwise occur in order to improve a given location’s labor market, tax base, physical footprint, or industrial advantage. Should the “but for” condition hold and the economic benefits of the investment outweigh the costs of the incentives, the deal raises the collective well-being of the jurisdiction since investment and job creation has occurred where it would have otherwise not, with the incentive making the difference.

Cities and states often use incentives to attract or retain firms in a specific sector, industry, or technology to develop or sustain competitive advantage. Many Southern U.S. states have deployed this approach in attracting major automotive or aerospace manufacturers and their suppliers, but it also extends to cities and states seeking to gain a foothold in advanced industries like life sciences or information technology. Governments undertake these strategies with the hope that if the incentive landed a major employer in a high-growth export industry, it could deliver notable spillover benefits to other businesses and workers that support those industries.¹¹

Other times the purpose of economic development incentives—particularly at the local level—is to spur physical revitalization of distressed neighborhoods. This approach is particularly popular in slower growth markets with struggling economies and lots of empty land or vacant city-owned property. From a city’s perspective, those are underutilized assets, and incentivizing a developer or firm to fill that vacancy is a win-win: The firm gets a tax benefit to spur market activity in a community in which there is little, and the city expands its tax base because it is now receiving revenue from a dormant asset.

Finally, some incentives aim to correct market failures such as the private sector's underinvestment in job training or research and development (R&D). Instruments such as job training tax credits, workforce development grants, or R&D tax credits nudge companies to make investments that enhance the public good.

The second rationale for incentives is political. Like in any job, elected officials and political appointees are judged by their performance: Are the streets clean? Are communities safe? How many jobs have been created? Do residents *feel* like their living standards are rising? As an increasing share of Americans express declining confidence in their economic circumstances, local and state policymakers have come under intense pressure to deliver growth that lifts up a broad swath of their residents.

Enter economic development policy. As a field, economic development tends to measure its impact based on private sector investments and the resulting job creation. Those metrics are subject to macroeconomic fluctuations, industry and technological trends, and the broader competitive assets of a regional economy (e.g. workforce, infrastructure, universities, etc.). Some of those factors are outside any city's direct control while others require local investments over many political cycles. Constituents, however, hold local officials to account for economic changes in their communities, regardless of what is driving those changes.

The political pressure to deliver near-term economic results is quite real and occurs through a couple of different channels. The first channel is the "Amazon effect." As was just seen with that company's HQ2 competition, a footloose corporation dangles a major investment in front of many cities. Political officials then find themselves in a classic prisoner's dilemma. They know that they would all be better off simply competing on their natural advantages, not by offering incentives. But because many cities will use incentives, all feel they must. In a recent New York Times op-ed, former Delaware Governor

Jack Markell highlighted how he begrudgingly accepted this dynamic because he thought it was necessary to deliver economic opportunities for his constituents.¹²

Site selection consultants are oftentimes the intermediaries between firms and local and state governments in these types of transactions and are a fundamental component of the modern economic development system. Firms hire site selectors when they are contemplating a new expansion or relocation. Selectors compile the firm's workforce, land, energy, and real estate requirements and then provide those to local and state economic development offices. Governments may have no direct interaction with the investor they are courting until the very end of the deal. Companies and site selectors have disproportionate advantage in these interactions. It is nearly impossible for cities and states to determine whether firms actually need the incentive, but they are competing in a non-transparent market with other jurisdictions for the jobs and tax revenue corporate relocations provide. And, ultimately, should the commissions of site selectors be tied more to the size of the incentive packages than the goodness of fit between the location's business environment and the company's needs, it could lead to an even more perverse overprovision of incentives.

There is a second political incentive for incentives. Local job creation and development are great, but local job creation and development that policymakers can claim direct responsibility for is even greater. If officials are measured based on the economic impact of the policy tools at their disposal, they may be motivated to overextend the use of those tools. Recall that the "but for" test depends on local officials being stingy about how they deploy incentives so as not to publicly subsidize a firm that would have made the same decision without the incentive. Yet, if that policymaker's performance is based on the number of deals they incentivized, then perversely it may be in their interest to give *more* incentives, not fewer. Evidence suggests that this is often the case.¹³

ARE ECONOMIC DEVELOPMENT INCENTIVES GOOD PUBLIC POLICY?

Significant spending on incentives has invariably led to questions about their efficacy. Hundreds of academic studies and dozens of books have documented the rationale and impact of economic development incentives, and whether they further job creation, income growth, and general economic welfare.¹⁴

When taking a national perspective, few economists conclude that the city and state incentives competition is an effective use of taxpayer money, as total U.S. welfare remains unchanged regardless of where a business decides to locate. To avoid this inefficiency, the European Union (EU) has utilized "state aid control" as a means to prevent EU member states from outbidding each other for firms.¹⁵ However, despite agreement that bidding wars between communities is suboptimal, U.S. federal intervention appears unlikely.

How, then, can cities and states orient their economic development tools toward enhancing local welfare? To this question, the unsatisfying answer comes from Sammis White: "all (economic development) tools work some of the time, none of the tools work all of the time, and a few tools can be said to work only under special circumstances."¹⁶ In other words, it depends—on the incentive type, on the place, and on the capacity of the incentive provider. Economists, even with improved data and estimation techniques, have yet to reach consensus on what works.¹⁷

That lack of unanimity noted, we would generally characterize the academic literature as skeptical about the impact of economic development incentives:

- Skeptical that tax incentives really matter that much to companies; state, local, and property taxes are a relatively small cost compared to labor and recent evaluations suggest that a minority of companies actually make decisions based on incentives¹⁸

- Skeptical that tax incentives actually lead to job creation, or if it does that that job creation can be targeted to specific populations or communities that need it most¹⁹
- And skeptical that, even if incentives do deliver all these goals (and sometimes they do), that it can be done in a way that makes fiscal sense

In a comprehensive review of the incentives literature, Alan Peters and Peter Fisher conclude that local and state policymakers need to lower their expectations for what benefits economic incentives can deliver while focusing their attention and resources on strengthening public goods related to infrastructure, education, and quality of life.²⁰

Other economists have shown that tax rates, and therefore incentives that lower those rates, do influence firm location decisions.²¹ In one of the most comprehensive studies of economic development incentives to date, Timothy Bartik finds that firm-level incentives *can* affect business location decisions but that in many cases do not deliver a good public return on investment, often because they are not strategically targeted. Three reasons stand out. First, Bartik argues, governments overprovide incentives to firms that do not need them to locate in a given jurisdiction. In other words, incentives in practice do not always follow the "but for" test. Moreover, some firms are more valuable to local economies than others, but incentives struggle to target firms that can offer the greatest local spillover benefits, such as those that pay high wages, conduct research and development, and export their products and services outside the local economy. These activities generate multiplier effects that ripple throughout the rest of the economy. Second, governments do not strategically reserve incentives for firms that are investing in societally valuable activities that the private sector underprovides, such as research and development or skills training. Finally, Bartik argues that incentives will have the greatest social benefit if the hiring they induce goes to previously unemployed workers in the local

economy, yet it is unclear whether economic development departments can effectively target these objectives.²²

The political economy that drives these dynamics is complicated. Bartik concludes that one reason state governments may not sufficiently target incentives is that "political culture and past practices seem to dictate incentives more than economic and fiscal conditions."²³ In many instances, the political rationale certainly overwhelms the market rationale. Yet, there is a second, more nuanced, challenge related to effective targeting: information. Governments may have the best intentions but, like all public officials, operate with limited resources and imperfect information. Local governments simply may not have the time, information, and expertise to target public resources to their greatest economic and social impact, relying more on intuition and experience.

Additionally, the time horizon of these investments does not correspond with the time

horizon of most local elected officials, who demand more and better jobs in the near-term, and require significant discretionary resources up-front that many municipalities simply do not have. Incentives remain a popular tool because they align with realities of the political cycle, can draw on deferred tax revenues as opposed to discretionary funding, and position a city with the necessary ammo in an arms race that, while flawed, is a modern reality.

In short, incentives will likely remain a substantial policy tool for local and state economic developers in the near-term, and even the most intense incentive critics acknowledge that they can be societally beneficial if properly targeted, transparently deployed, and rigorously evaluated. However, if better *targeting* is an important component of better incentives policy, then it is important to understand the characteristics of the firms that actually receive incentives. What is needed is a more granular analysis of incentive transactions, firm by firm, industry by industry, and neighborhood by neighborhood.

III. Data and methods

This section summarizes the data and methods that undergird this report, which occurred in four basic stages:

1. City selection
2. Incentives data collection
3. Industry and neighborhood data collection
4. Linking incentives data to industry/neighborhood data

CITY SELECTION

Prior economic development incentives research has rarely analyzed transaction-level information across multiple jurisdictions. To do so, Brookings collected information on local and state incentives provided to businesses located within the geographic boundaries of four U.S. jurisdictions: the city of Cincinnati, city of Indianapolis (coterminous with Marion County), Salt Lake County, and the city of San Diego.

As part of its city selection process, Brookings asked leaders in over a dozen U.S. cities to participate in the study, seeking geographic and economic diversity. Ultimately, only four cities were willing to share data on economic development incentive transactions over at least five years. Thus, they do not represent a random sample. As such, the results from this study are not statistically representative of all U.S. cities.

INCENTIVES DATA

This study focuses on a five-year window between 2012 and 2016. We define economic development incentives as discretionary financial benefits provided to firms incentivize economic activity. Under this definition, incentives include cash grants (e.g. job training grants), tax abatements and credits, and special forms of financing (e.g. tax increment financing, industrial revenue

bonds, etc.). It would not include loans or general technical assistance provided to companies by economic development departments or other local and state government actors. It also would not include tax credits that are available to all companies. Table 2 lists the main incentive programs from each city and state.

Data collection required multiple sources. The economic development departments at the city of Cincinnati, city of San Diego, Indy Chamber, and Salt Lake County provided local incentives. Brookings complemented this list with information from Good Jobs First's Subsidy Tracker 2, which collects data from 836 state and local jurisdictions.

In addition to data from Good Jobs First, staff at the city of San Diego and Salt Lake County shared incentives provided to firms in those jurisdictions by their respective state governments. The Indiana Economic Development Corporation publicly lists incentives. Brookings downloaded incentives provided to companies located in the city of Indianapolis from that tool. Similarly, the Ohio Development Services Agency provides data on firms that receive state tax incentives, from which Brookings collected information for firms located in the city of Cincinnati.

Together, the database aims to understand incentives provided by local and state entities to companies within these four municipalities, but the analysis does not extend to the metro area-level. We did not collect data on federal programs nor did we exhaustively collect data on all activities that subsidize firm-level behavior within these cities, including information from organizations that incentivize housing development and non-government entities that support entrepreneurship, business competitiveness, or cluster development.

Our focus is on publicly provided incentives for which we can obtain enough information about the firm to match it to an industry and geographic location.

INDUSTRY AND NEIGHBORHOOD DATA

We are interested in how well incentives align with the principles of "high-road economic development," which seeks to direct economic development toward quality jobs that benefit the greater community. These principles acknowledge that industries vary in the wages they pay, the people they employ, and their contributions to key economic outcomes. Thus, we investigate what types of industries receive economic development incentives using county-level data on wages and demographic characteristics provided by Economic Modeling Specialists Inc. (EMSI).²⁴

This study further looks at whether industries that receive economic incentives have unique specializations in R&D, STEM workers, and trade. Brookings identified 50 industries out of the 287 four-digit NAICS industries as advanced industries by the share of their STEM-oriented workforce and their R&D spending per worker.²⁵ Export data comes from Brookings Export Monitor database, which estimates county-level U.S. exports by production location.²⁶ Brookings' method also estimates both goods and services exports for 91 detailed goods and 40 services industries.

An additional principle of high-road economic development involves connecting people and communities to opportunities. As such, we explore the characteristics of communities in which incentivized firms are physically located using data from the U.S. Census Bureau's American Community Survey (ACS), specifically 2015 5-year estimates.

LINKING FIRMS TO INDUSTRIES AND NEIGHBORHOOD

The data collected from local and state government sources contains varying levels of information. In nearly every case, the data includes the firm or physical development name, along with the incentive type and amount. In some instances, the data includes individual addresses and industry categorizations.

But for most of the records, we needed to link the firm to an industry code and site address. Linking this information required multiple steps. To attain consistent industry and geographic analysis, we first tried to merge the firm-level incentives with company data from Dunn & Bradstreet (D&B) Hoover's, an online platform backed by the world's largest commercial database, which provided site location addresses and industry classifications (6-digit NAICS codes). If there were multiple establishment addresses and/or NAICS codes, and we had no additional information about the incentive to select from that group, we distributed the incentive evenly across the available records. For records that could not be matched with the D&B Hoover's information, we manually matched the records to an address and industry code when possible using Google Maps searches and information from aggregators like Manta.com.

To link each firm to a neighborhood, we geocoded site addresses using Google Maps Geocoding API and Census Geocoder. This technique allowed us to assign each firm to a Census Tract, geographic units that approximate neighborhoods. We then merged ACS data on neighborhood characteristics to each firm-neighborhood pairing.

For a complete list of incentive programs and categorization, see Appendix A.

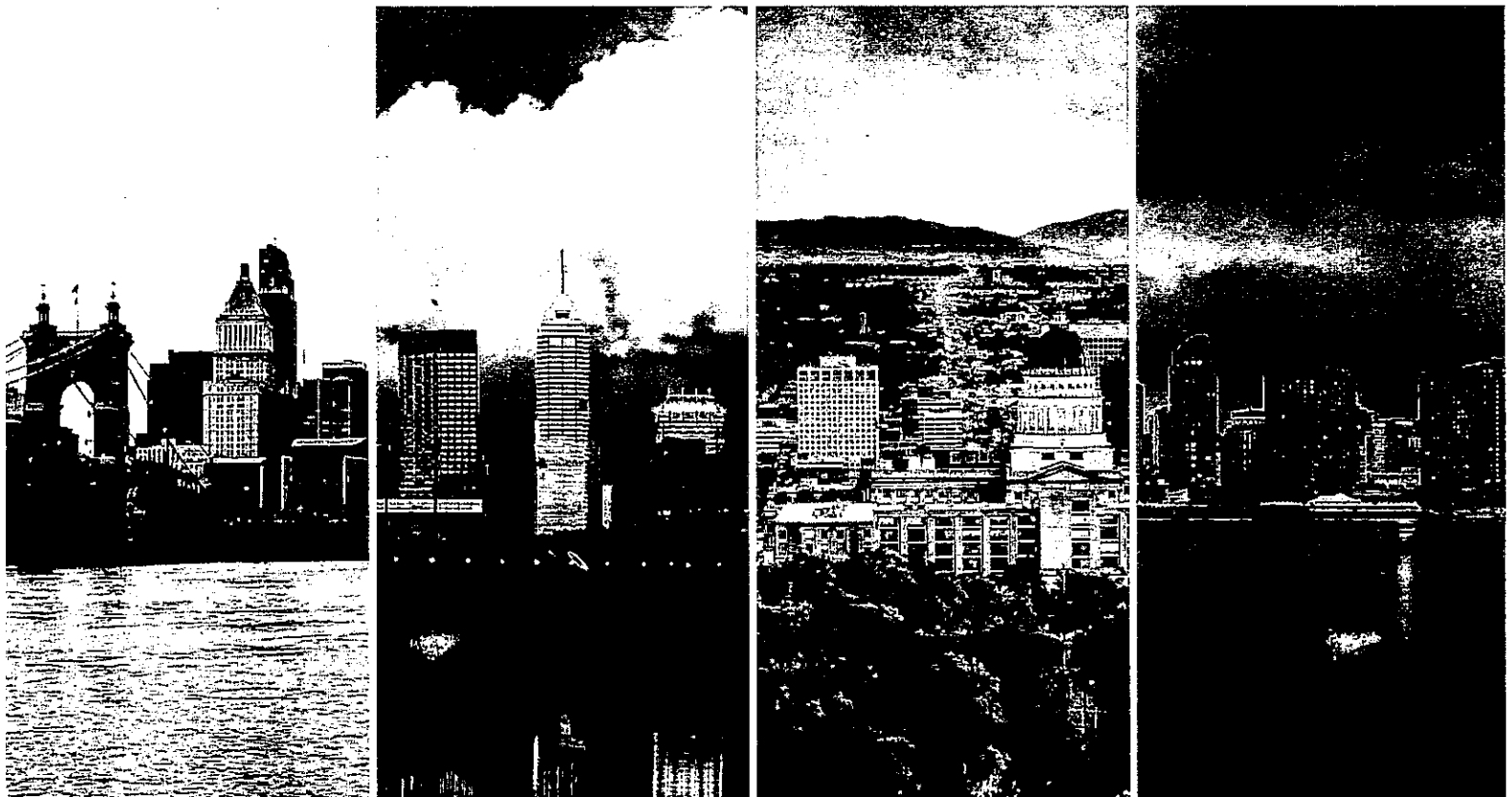
IV. Overview of economic development incentives in four U.S. cities

Before delving into how the incentives provided in four cities align with core principles of successful economic development, it helps to understand the economic conditions and basic characteristics of incentive spending in these four markets.

The four cities share several characteristics. All four anchor mid-sized metropolitan areas, which range in population size from 1.1 million inhabitants in the Salt Lake region to 3.3 million in San Diego. All four regional economies are expanding, adding to their employment and output bases between 2011 and 2016. Similarly, GDP per capita—a common metric of living standards—increased in all four metro regions during that same period, suggesting that each economy on average is

becoming more prosperous. Growth has also translated into increases in median earnings in all four regions.

The four cities differ in their economic trajectories on other metrics, however. Labor productivity has increased moderately in San Diego but leveled in Indianapolis and declined in Cincinnati and Salt Lake. Relative poverty rates also vary across the four metropolitan areas. The diverse industrial histories of these four cities is also a notable factor. In Cincinnati and Indianapolis, manufacturing's historic primacy, and subsequent decline, means that those cities tend to have more industrial land that must be repurposed to new forms of economic activity. This physical footprint differs



from Salt Lake and San Diego, which did not tend to house much industrial activity in their urban cores.

These economic conditions help contextualize the local and state incentive tools deployed in each market. Table 2 outlines the lead local agency and its goal, along with key local and state incentive tools. Tracking data from these programs, we estimate approximately \$1.8 billion in total local and state incentives were provided between 2012 and 2016 within the jurisdictional boundaries of the city of Cincinnati, city of Indianapolis (coterminous with Marion County), Salt Lake County, and the city of San Diego.²⁸

However, this overall number masks a significant range between cities. Local and state government provided approximately \$711 million in economic development in Cincinnati, followed by Indianapolis (\$605 million), Salt Lake (\$424 million), and San Diego (\$50 million).

Across the four cities, local governments provided 44 percent of economic development incentives

while states dispensed the remaining 56 percent, but there is also considerable variation in the local-state split across the four sample cities. In San Diego, for instance, the local government distributes a negligible amount of traditional local economic development incentives. Therefore, 96 percent of economic development incentives received by San Diego-based firms come from the state. By contrast, 67 percent of the incentives provided to Salt Lake-based companies come from local economic development entities.

This breakdown matters because there are notable distinctions between the goals of local versus state economic development departments. Local economic development is often concerned with several goals: creating jobs, expanding the tax base, and rejuvenating downtowns and distressed communities. Incentivizing private sector real estate development, therefore, is a much more important for cities than states. States, meanwhile, are more likely to focus incentives on job creation and maintaining competitiveness in key industries.

TABLE 1

The four cities lie within metro economies with varied inclusive growth outcomes²⁷
Metropolitan area, % change from 2011 - 2016

		Cincinnati	Indianapolis	Salt Lake	San Diego
Growth	Gross Metropolitan Product	9.7%	9.0%	15.6%	14.2%
	Jobs	12.3%	8.9%	17.2%	13.4%
	Entrepreneurship	5.5%	19.3%	26.0%	4.6%
Prosperity	Productivity	-2.3%	0.1%	-1.4%	0.7%
	Average Wage	4.0%	4.5%	6.4%	3.5%
	Standard of Living	4.6%	6.9%	7.9%	8.1%
Inclusion	Median Earnings	9.1%	9.2%	7.0%	8.9%
	Relative Poverty Rate	2.2%	-0.4%	-5.7%	3.0%
	Employment -to-Population Ratio	7.4%	5.6%	3.9%	7.6%

Source: Metro Monitor, 2018, Brookings

Note: Entrepreneurship: The total number of full- and part-time jobs at young, private-sector firms less than five years old. Relative poverty rate: The share of people earning less than half of the local median wage (among people at least 16 years old).

27x

The variance between the four cities is notable. In Salt Lake, the largest source of locally provided incentives came from tax increment financing (TIF) programs. Tax increment financing is a public financing tool that many cities use to incentivize private development in designated communities. By providing an area with a TIF

designation, cities can take the tax dollars generated by new development and redirect them away from their traditional uses back into the project area, either to fund community amenities such as infrastructure or to ease the tax burden of the companies that originally invested in those communities.

TABLE 2

Key incentives tools at local and state level

	Cincinnati	Indianapolis	Salt Lake	San Diego
Agency	Cincinnati Department of Community & Economic Development	Develop Indy	Salt Lake County Economic Development Department	City of San Diego's Economic Development Department
Goal	To cultivate commercial development in all of Cincinnati's 52 neighborhoods; serving the needs of residents and businesses through job creation, implementation of public infrastructure projects, urban redevelopment initiatives and revitalization of the city's 34 neighborhood business districts.	Ensuring the Indianapolis region is a place where business can grow and enjoy the accessibility of a small city with the amenities of a large metro.	To attract, retain, and grow businesses in Salt Lake County and to position and promote the region as a strong competitor in the global economy in order to ensure health, prosperity, and exceptional opportunities for all county residents.	Goal 1: Strategically invest in the growth and development of businesses, neighborhoods and residents; Goal 2: Cultivate a globally competitive, sustainable and resilient local economy; Goal 3: Provide high quality public service.
Local	Tax Increment Financing (TIF); Job Creation Tax Credit LEED CRA Abatement	Property Tax Abatement; Tax Increment Financing (TIF)	Tax Increment Financing (TIF)	Business Cooperation Program; Storefront Improvement Program; San Diego Regional Revolving Loan Fund
State	Job Creation Tax Credit; Ohio Historic Preservation Tax Credit	EDGE Tax Credit; Skill Enhancement Fund	EDTIF Tax Credit	Tax Credit; Employment Training Panel Reimbursement

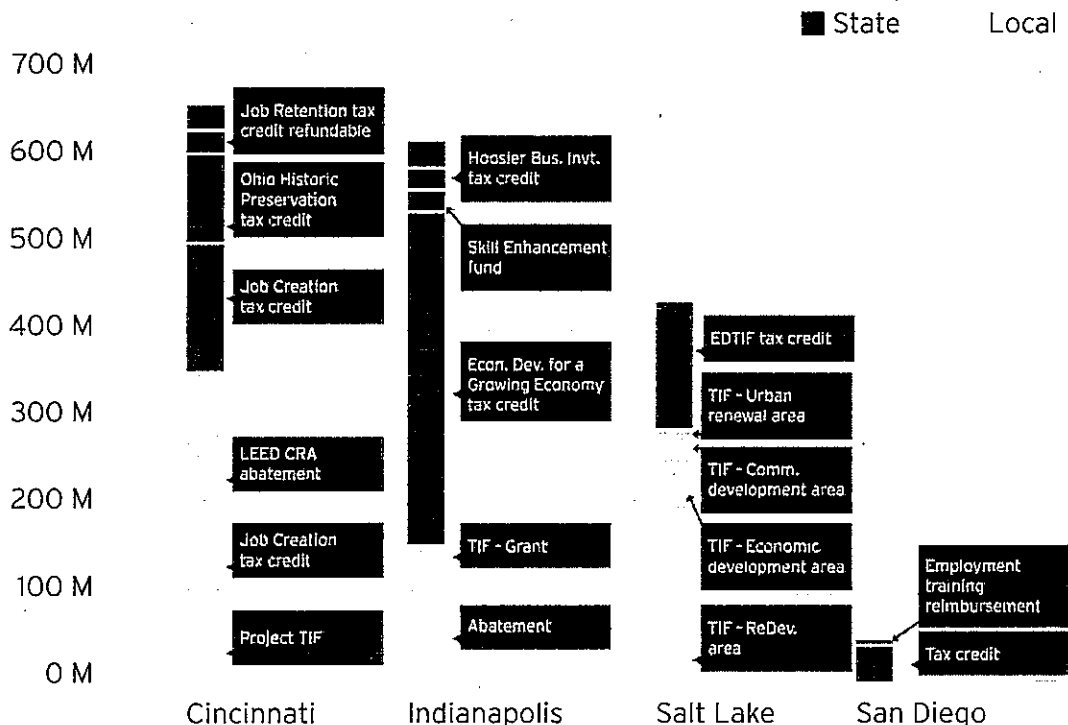
Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

28x

FIGURE 2

Incentive amounts vary significantly across the four cities

2012 - 2016



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

In Salt Lake, the TIF program has designated 119 micro geographies as redevelopment areas, each managed by a redevelopment agency (RDA). Importantly, the county tracks incentive spending based on the total tax increment provided back to RDAs but cannot match these funds to individual companies. Therefore, it is likely that some of the tax increment tracked in this analysis is not going directly to private sector companies. But because of the way the data is collected, it is not possible to separate whether the final use of the increment is for public and private ends.

The second most common local incentive tool across the four cities are property tax abatements. Abatements reduce a firm’s property taxes below normal rates for a defined time span. Abatements

may be provided for key local employers to incentivize a site location decision or to a real estate developer to invest in a particular property or community. This is the most popular tool in Cincinnati and Indianapolis. Indianapolis provides abatements to firms to create new jobs, expand the tax base, and diversify the economy. Cincinnati also offers property tax abatements to companies and developers building or renovating a residential, commercial, industrial, or mixed-use facility when the new or renovated facilities will result in job creation.

Notably, San Diego offers essentially no traditional local economic development incentives. It does not operate a TIF program and sparingly provides firm-specific abatements. Rather, most of San

29x

Diego's economic development efforts involve technical assistance to companies that are trying to navigate permitting or site location decisions. The other three cities provide these types of supports as well, but these technical assistance resources are not included in this analysis.

If city-level economic development is often focused on stimulating physical development and community revitalization, state incentives overwhelmingly focus on overall job creation and building and sustaining key industries. For all four cities, the most popular state-provided incentive is tax credits for new jobs created or payroll invested. States use job creation tax credits to incentivize corporate relocations, expansions,

or retentions. Decisions about when to provide job creation tax credits are often determined by whether the firm is in a key tradable industry for the state and whether it passes a certain wage threshold.

States are also more likely than localities to provide incentives for activities that further a firm's productivity such as research and development, job training, or exporting. Indiana, for instance, operates the 21 Fund, which offers investments in advanced manufacturing and life sciences companies, and the Skills Enhancement Fund, which assists businesses to support training and skills upgrades.

V. How do incentives align with four principles of inclusive economic development?

Cities and states have several tools at their disposal to help firms spur growth and create opportunity. Cities contain a dense mix of the assets that businesses need to thrive: workforce skills, the innovation created in universities and research institutes, the land and infrastructure that enables commerce, and the public policies that shape firm behavior. One could think of an economic development deal being an exchange in which cities offer firms access to these assets in exchange for the jobs and tax revenue they create.

In this transaction, the fundamental drivers of growth—innovation, skills, and infrastructure—are more important to companies than economic development incentives. Incentives, therefore, should not be viewed as a strategy unto themselves, but rather act *in service of* the key principles of broader economic development. In this section, we analyze these four cities' economic development incentives against four principles of high-road economic development adopted from Amy Liu's paper "Remaking Economic Development":

1. **Grow from within** by prioritizing firms in advanced industries that drive local comparative advantage, innovation, productivity, and wage gains
2. **Boost trade** by facilitating export growth and trade with other markets in the United States

and abroad in ways that deepen regional industry specializations and bring in new income and investment

3. **Invest in people and skills** by incorporating skills development of workers as a priority for economic development and employers so that improving human capacities results in meaningful work and income gains
4. **Connect place** by catalyzing economic place-making and work at multiple geographic levels to connect local communities to regional jobs, housing, and opportunity

GROW FROM WITHIN

The first principle—growing from within—draws on a few key tenets of regional economics.

First, local economies are anchored by a core set of industrial specializations, found particularly in a set of 50 advanced industries across manufacturing, services, and energy that meet two conditions: 1) they disproportionately conduct research and development (R&D) and 2) they disproportionately employ workers in science, technology, engineering, and mathematics (STEM) occupations. Because of their unique reliance on and deployment of technology, jobs in advanced industries are highly productive and offer average wages that are twice as high as employment in the economy as a whole.²⁹

Second, advanced industries are important for local economies because they create notable spillovers. Every new advanced industries job in the United States creates 0.8 additional jobs locally, due to the long supply chains these industries attract and the higher spending by advanced industries workers that support activities in locally serving industries³⁰.

Third, advanced industries power innovation, productivity, and wage growth by drawing primarily from *within*, meaning growth tends to occur organically from the existing innovation and workforce assets a region already has rather than a myopic focus on firm attraction. Advanced industry clusters can rarely be built through attraction alone but targeting incentives to

advanced industries likely offers a greater return on the public's investment than incentives to other industries.

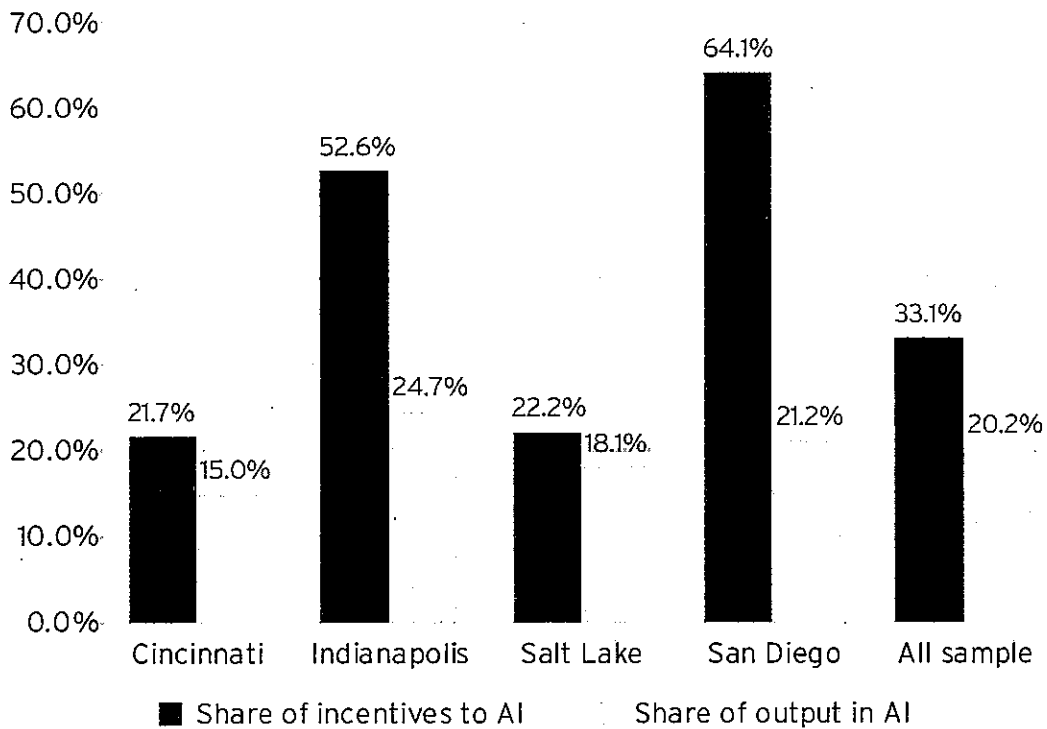
All four cities in our analysis disproportionately target their local and state economic development incentives to firms in advanced industries. Across the four cities, advanced industries account for about 20 percent of economic output but receive about one-third of all incentive spending. In San Diego and Indianapolis, 53 and 64 percent of incentives go to firms in advanced industries, respectively.

State incentive programs target advanced industry companies more frequently than local efforts. About 44 percent of the incentives by

FIGURE 3

All four cities disproportionately incentivize advanced industries

2012 - 2016



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

32x

the governments of California, Indiana, Ohio, and Utah go to advanced industry companies as compared to only 20 percent of incentives provided by local governments. About two-thirds of Utah's EDTIF tax credits targeted advanced industries, including firms operating in renewable energy (SolarCity) and advanced manufacturing (BioFire Diagnostics). Similarly, about one-third of Ohio's Job Creation Tax Credit (JCTC) targeted advanced industry companies, ranging from information technology (CDK Global) to biotechnology (Medpace).

BOOST TRADE

Economic theory also justifies a focus on firms and industries that export outside of a local economy. Firms selling outside of a region inject

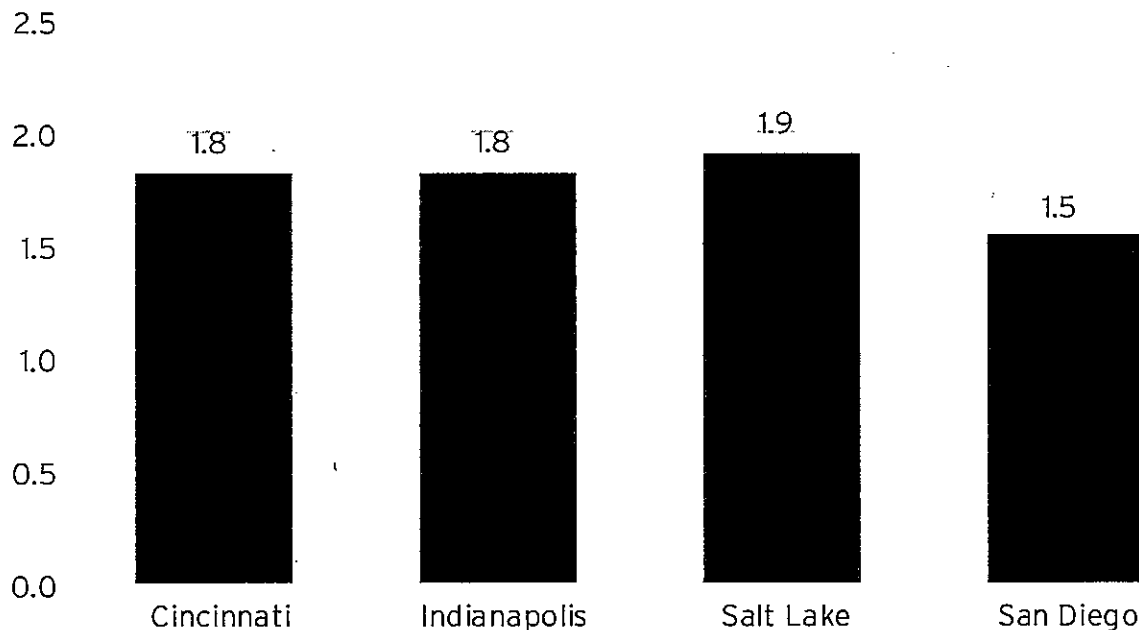
external wealth that, when spent locally, creates a multiplier effect in the local economy, spurring new jobs, growth, and further tax revenue.³¹ Participating in trade also makes metro areas more productive and innovative. Firms that generate revenue from outside their home market must provide goods and services faster, better, and cheaper than global competitors. This process tends to boost productivity and wages.³²

Ideally, to determine whether economic development incentives tend to target firms in export industries, we would collect data on whether the incentivized business exports. But since we lack that information, we segmented those industries that have received incentives and analyzed the extent to which those industries support trade.

FIGURE 4

Incentives are most effective if they boost trade

Average location quotient weighted by incentive amounts for incentivized industries



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

We explore this dynamic in two different ways: industrial location quotients and industrial export intensity. Location quotients measure the ratio of an industry's share of local employment divided by the industry's share of national employment. Location quotients greater than one indicate a city has a relative employment concentration in that industry. In all four cities, those industries that have at least one firm receiving at least one incentive-incentivized industries—have a location quotient greater than one, ranging from 1.9 in Salt Lake to 1.6 in San Diego.³³

Similarly, the export intensity of the incentivized industries—that is the share of local output accounted for by goods and services exports—across the four cities is more than twice as

high (25 percent) as the economy as a whole (11 percent).³⁴ For instance, exports account for about 12 percent of San Diego's economy overall but 29 percent of the incentivized industries' output. Similar advantages hold for Indianapolis and Salt Lake. Cincinnati's incentivized industries are more export-intensive (13 percent) than its economy as a whole (10 percent), but only by a few percentage points due that city's disproportionate emphasis on real estate development.

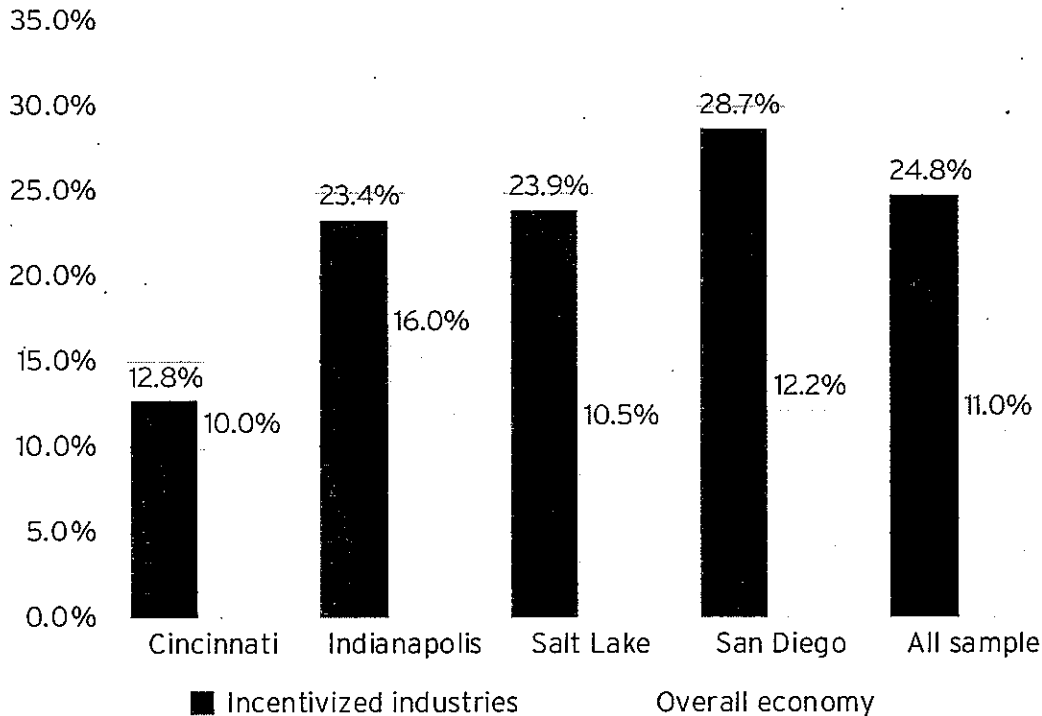
INVEST IN PEOPLE AND SKILLS

The third principle—invest in people and skills—draws on deep evidence that links the skills and capabilities of a region's workforce to the productivity of its economy and the well-being

FIGURE 5

Incentivized industries are more export intensive

Export intensity, export value as a share of economic output



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

34x

of its population.³⁵ It also reflects that a key goal of providing economic development incentives is to create jobs that provide workers with middle-class incomes and living standards.

How well do incentivized industries pay in these four cities? The average earnings in the incentivized industries, weighted by the industry incentive amount, are about \$87,000 per year, 25 percent higher than the \$69,000 in average earnings provided by the overall economy. The wage gap between incentivized industries and the overall economy ranges from 15 percent in Cincinnati to 65 percent in Salt Lake. These observed wage advantages relate directly to the incentivized industries' disproportionate focus on trade and innovation—parts of the economy that

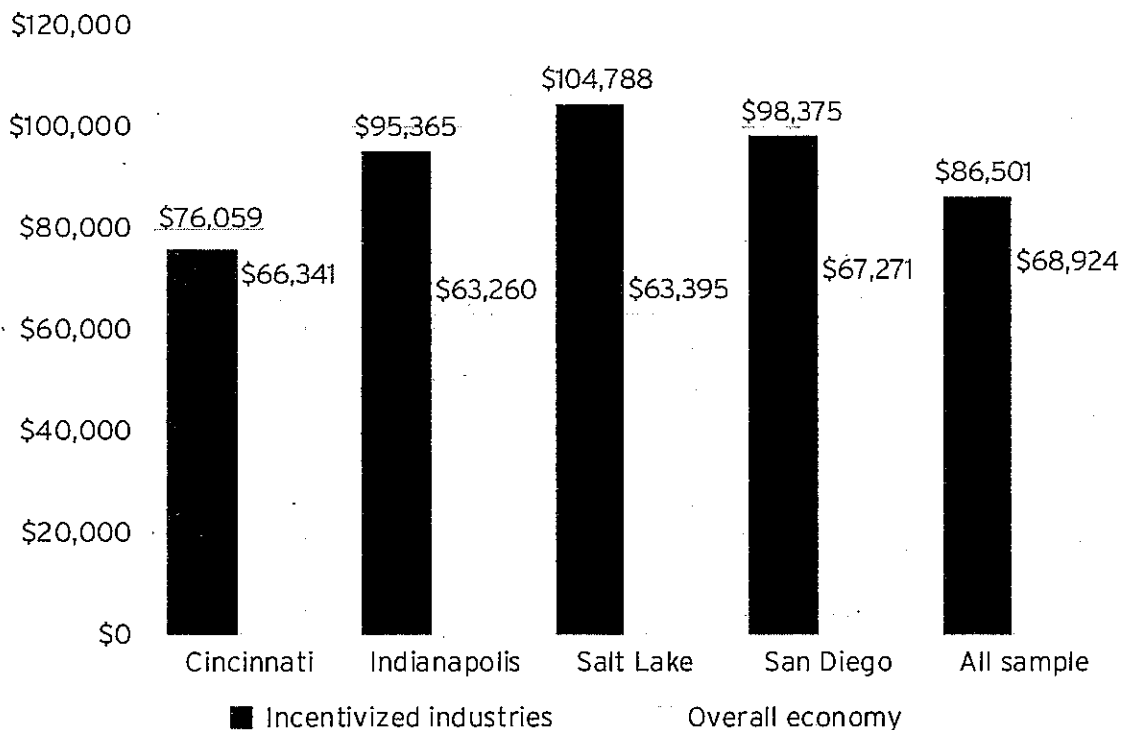
offer higher wages.

Beyond offering high wages, Bartik argues that incentives will be most effective if they lead to hiring of underemployed or unemployed workers.³⁶ Using incentives to lower unemployment improves labor market efficiency and helps lift individuals into economic self-sufficiency, a process that can limit the detrimental human and fiscal costs associated with poverty and economic distress. While our analysis cannot determine whether incentives induced companies to hire previously unemployed workers, we can examine the degree to which incentivized industries employ workers from underemployed groups. Previous research has shown that employment rates among black and Hispanic Americans, for instance, lag those

FIGURE 6

Incentivized industries pay workers higher wages

Average annual earnings per worker, 2016



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

35x

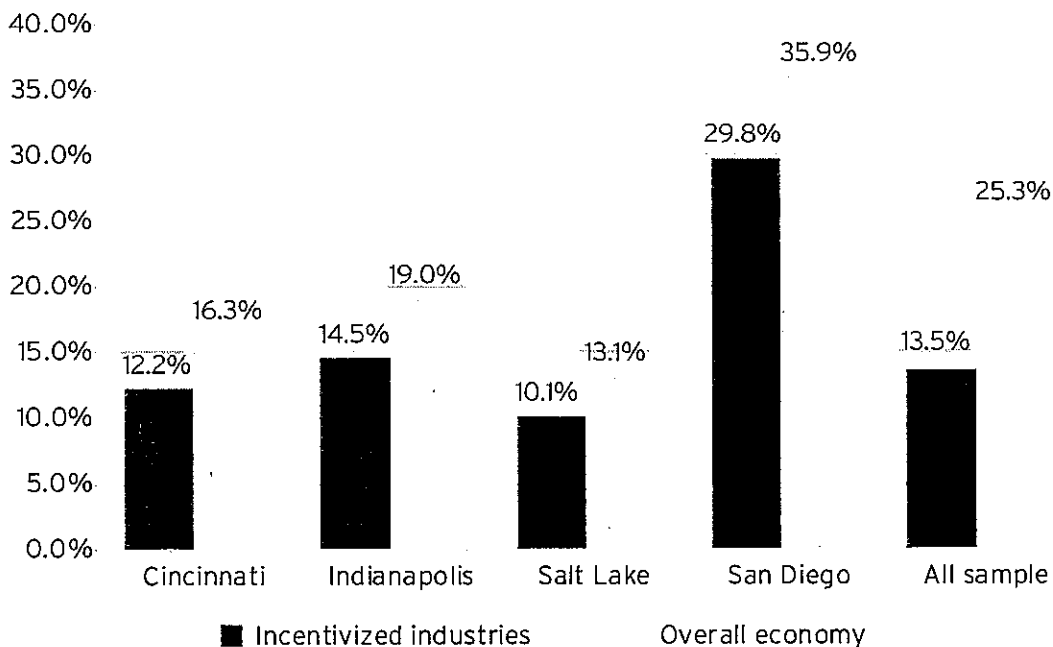
of whites and Asians.³⁷ These patterns hold for these four cities and has led in some instances to intentional policies to spur employment and business opportunities for minority residents through hiring and contracts requirements.

Notwithstanding these well-intended policies, black and Hispanic workers remain underrepresented in industries that receive economic development incentives. Across the four cities, black and Hispanic workers make up about one-quarter of the overall workforce, but only 14 percent of the workforce in the incentivized industries. Local and state incentives in this analysis do target firms and industries that offer relatively good employment opportunities but are not particularly racially inclusive.

A final component of the principle of investing in people and skills involves the role of employers in job training and skill development. A modern labor market reality is that employers continue to demand workers who have levels of skills and training beyond high school. Today, nearly two-thirds of U.S. jobs require at least some post-secondary education or credentials.³⁸ As the skills requirements of existing occupations increase, employers continue to report hiring difficulties. According the Manpower Group, the share of U.S. employers reporting worker shortages in the last year increased from 32 percent to 45 percent, the largest increase of any large nation surveyed.³⁹ Yet, these hiring challenges coincide with a decline in work-based training over the past several decades, from an average of 2.5 weeks per year in 1979 to 11 hours per year two

FIGURE 7

Black and Hispanic workers are underrepresented in incentivized industries
 Share of black and Hispanic workers employed in incentivized industries/ overall economy



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

3lex

decades later.⁴⁰ In 2011, Accenture found that only 21 percent of employees surveyed had received employer-provided training in the past five years.⁴¹

Against this backdrop of declining employer investment in training and the simultaneous increase in demand for skills, the low share of incentives in this analysis that directly incentivize firms to conduct job training and skill development is notable. Only 7 percent of incentives went to job training in San Diego, the *highest* share in the analysis, followed by Indianapolis at 4.4 percent, and Cincinnati at 1.1 percent. To our knowledge, Salt Lake did not have any incentive programs related to job training. This is not to say that job-training programs are not underway in these communities; they just operate outside of firm-specific economic development incentive programs. That noted, the prominence of incentives within the economic development

toolkit and the urgency of employer skills needs suggests a mismatch that economic development departments should examine closely.

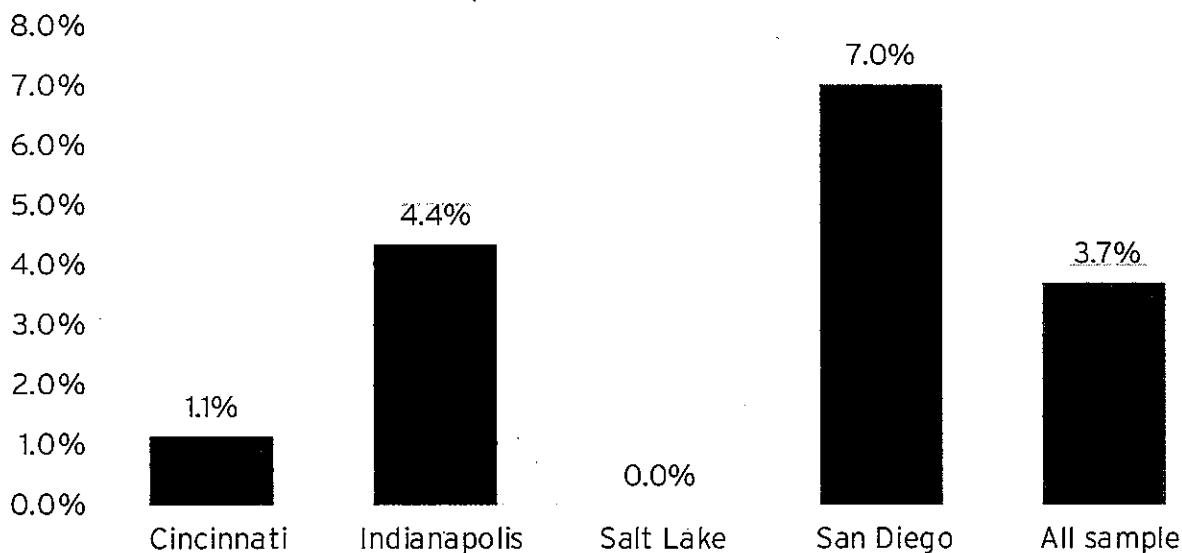
CONNECT PLACE

The final principle is to connect place, specifically neighborhoods that struggle to benefit from broader local and regional growth. Even affluent cities and regions have significant disparities by race and neighborhood. Taking a place-conscious approach to economic development acknowledges that an opportunity structure determined by where one lives does not arise due to market forces or consumer preferences alone, but rather government policies related to zoning, housing development, transportation, and education that diminished the market attractiveness of certain communities, oftentimes communities of color, relative to others.⁴²

FIGURE 8

Job training is not a significant share of incentives

Share of incentives targeting job training



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

37x

The challenges related to neighborhood disinvestment, blight, and concentrated poverty are front and center in local economic development. As evidence, many local governments have merged housing, economic development, and community development into a single department. Common tools like tax increment financing or property tax abatements often have the express intent of incentivizing physical redevelopment in poor neighborhoods. The rationale being that once communities have reached some baseline level of physical redevelopment it makes them more attractive to broader private sector investments. This *physical* redevelopment mandate is somewhat distinct from economic development's goals related to business support and overall economic growth.

Indeed, growth and opportunity within a regional economy is likely a necessary, but not sufficient, condition for addressing neighborhood disparities.

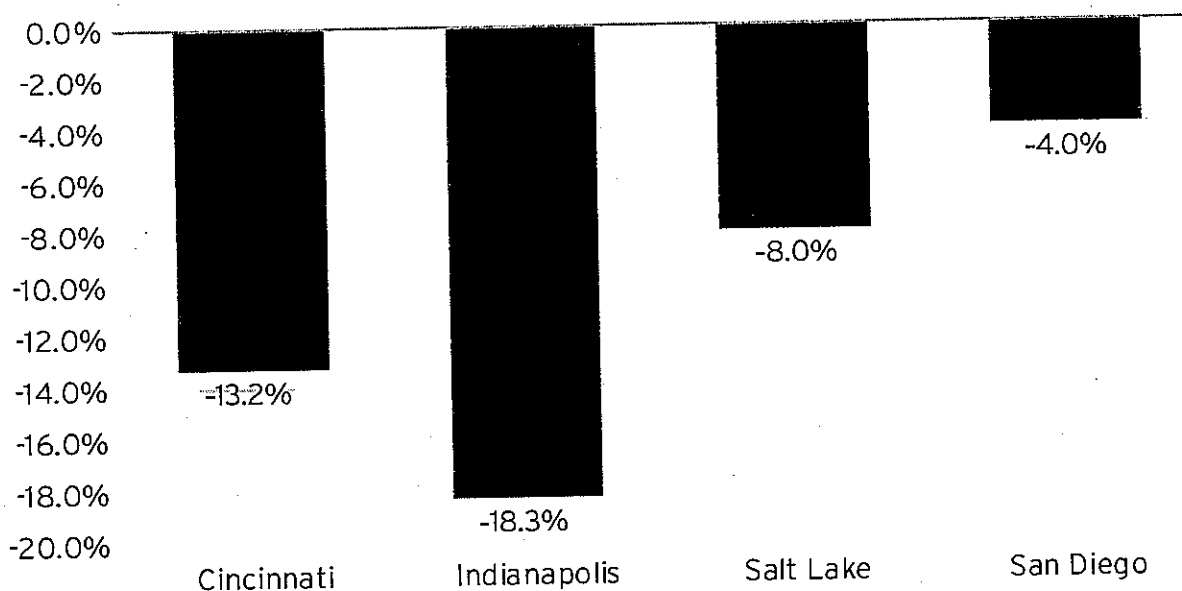
Residents in neighborhoods of concentrated poverty must have a basic level of education and training to fill available jobs afforded by more growth. But even with a supply of good jobs and the requisite skills to fill them, workers must be able to physically access employment. This is becoming more difficult as jobs continue to move further from workers, especially those with lower-incomes. Between 2000 and 2012, access to jobs within an average commute distance dropped faster for poor Americans than for the population as a whole, including in all four of the metropolitan areas in this study.⁴³

The focus on disadvantaged neighborhoods becomes clear in the geographic distribution of incentives in at least in two of the cities. Across all four cities, about 28 percent of the population lives in high-poverty neighborhoods, defined as census tracts with poverty rates exceeding 20 percent. About 57 percent of incentives landed

FIGURE 9

Job growth is not proximate to high-poverty neighborhoods

Change in share of accessible jobs to high poverty neighborhoods, 2000-2012



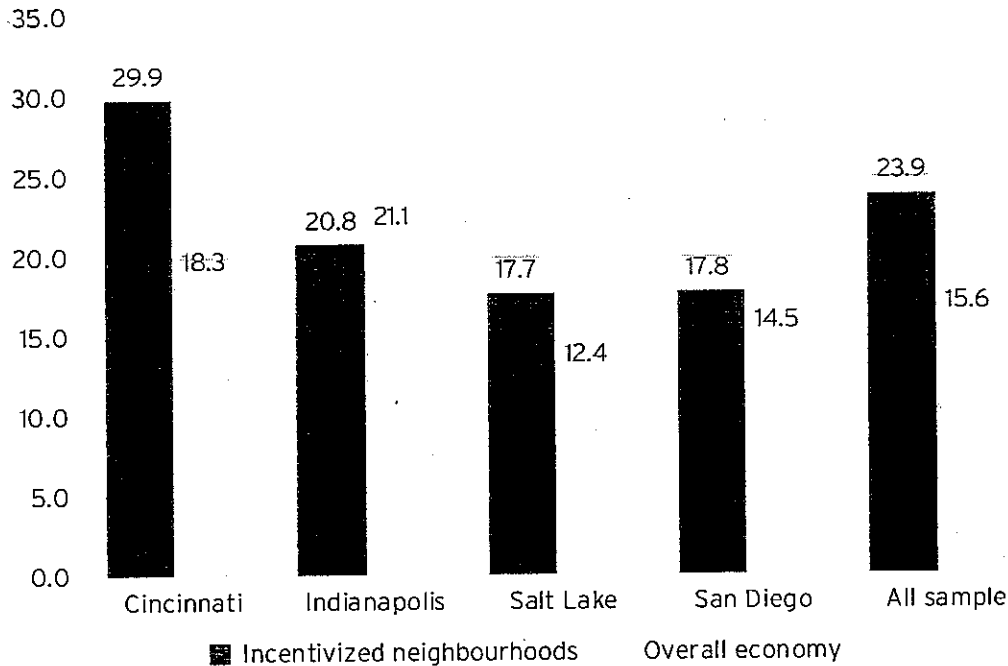
Source: Martha Ross and Natalie Holmes, "Employment by Race and Place: Snapshots of America, Brookings Institution, (February 27, 2017)

38x

FIGURE 10

Incentives target poor neighborhoods in Cincinnati and Salt Lake

Average poverty rate in incentivized neighborhoods/ overall economy, weighted by incentive amounts



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

in communities with poverty rates exceeding that threshold.

However, the sample average masks the fact that incentives go to businesses and developments in high-poverty neighborhoods in Cincinnati and Salt Lake much more so than in Indianapolis and San Diego. The average poverty rate of a neighborhood in which a business or redevelopment receives incentives is nearly 30 percent in Cincinnati and 18 percent in Salt Lake, compared to jurisdiction-wide poverty rates of 18 percent and 12 percent, respectively. By contrast, in Indianapolis, the poverty rate in incentivized neighborhoods is actually lower than in the county as a whole.

Tax increment financing has been one specific tool aimed at neighborhood revitalization. In the

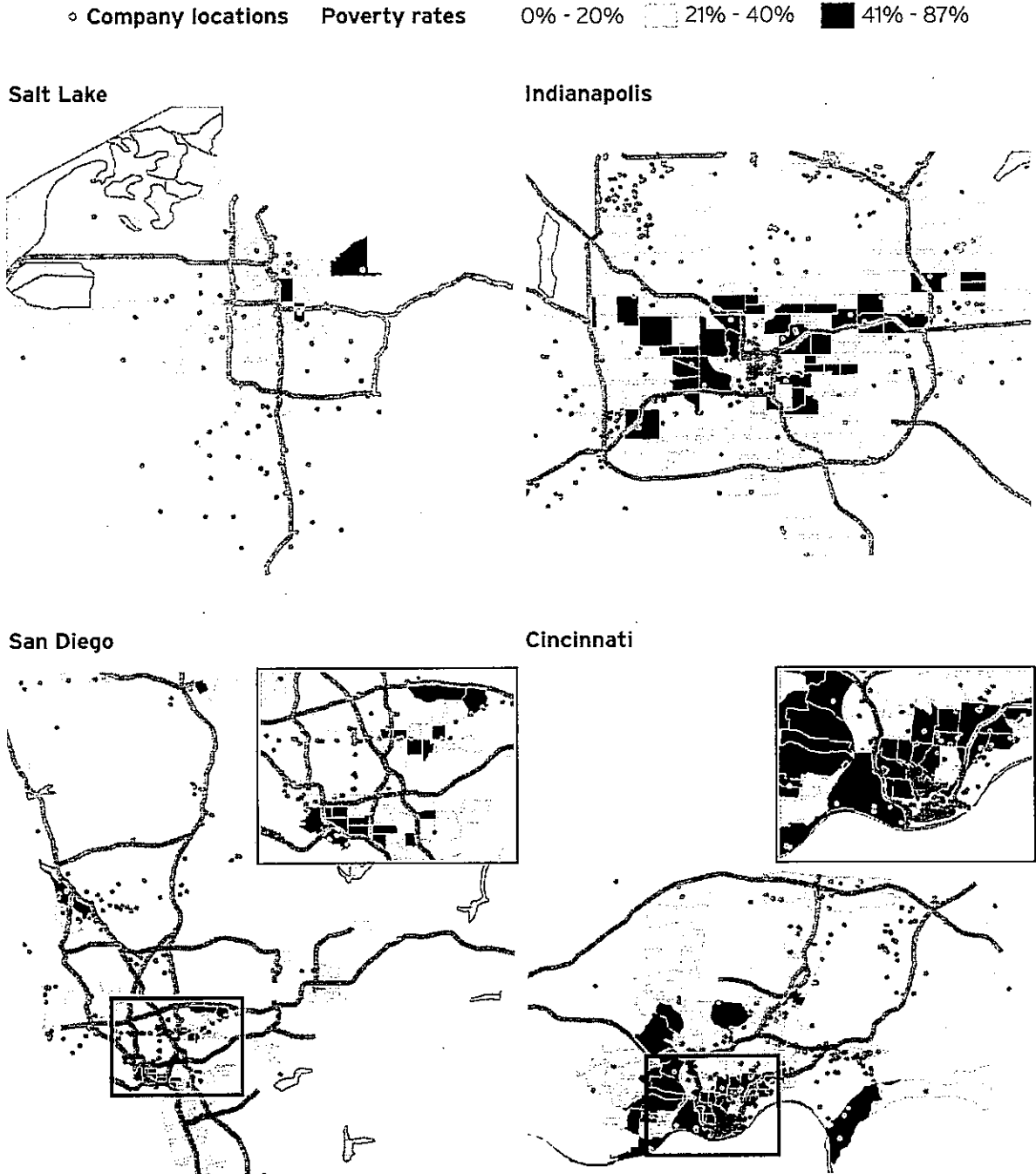
three cities operating TIFs, they exhibit a clear focus on higher poverty neighborhoods. Of the incentives provided to TIF projects, high-poverty neighborhoods received 86 percent in Cincinnati, 77 percent in Indianapolis and 39 percent in Salt Lake County. In Cincinnati, these incentives have targeted neighborhoods like Over-the-Rhine, which has undergone an economic and demographic transformation.

Notably, our finding on neighborhoods differs from previous studies investigating the geography incentives across broader regions. Good Jobs First has conducted six studies investigating land use patterns and economic development incentives in 13 metropolitan areas. They conclude that the typical subsidized economic development deal incentivizes "economic activity in a way that concentrates poverty at the urban

39x

FIGURE 11

Locations of companies that received state and local economic incentives in four cities



Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

40x

core and rapidly consumes land at the fringe."⁴⁴ Our findings do not necessarily contradict that conclusion. It is entirely possible that economic development incentives provided by the local governments to firms in *central cities* skews

toward more marginalized communities while the regional pattern still advantages suburban and exurban areas with plentiful greenfield land and fewer economic challenges.

VI. Implications

The previous section draws on unique transaction-level information to examine how local and state governments deploy economic development incentives in Cincinnati, Indianapolis, Salt Lake, and San Diego. The analysis fills knowledge gaps in how cities and states target economic development incentives to firms, industries, and communities. Economists argue that better incentive targeting could lead to better incentive outcomes, but little consistent information exists across cities on these basic trends. Yet, across the four cities our analysis reveals a few key patterns, including how incentives disproportionately target:

- Firms in industries that are technology-intensive and export-intensive
- Firms in industries that pay above average wages
- Firms in industries in which black and Hispanic workers are underrepresented, and are rarely directed to firms for job training purposes
- Firms and/or developments located in high-poverty neighborhood in Cincinnati and Salt Lake but not in Indianapolis and San Diego

These findings examine local and state incentives together, which offers policymakers a glimpse of how an entire incentives portfolio aligns with the principles of inclusive economic development. We examine these principles, in particular, because of the strong evidence base for targeting incentives toward innovative and exporting industries and toward activities that will benefit disadvantaged populations. Of course, this does not mean that every incentive transaction aligns with all of these principles. Quite the contrary. Local and state governments operate different incentive programs with different purposes, which means there are undoubtedly tensions between some of these principles. The challenge is how to achieve both these goals simultaneously when disadvantaged populations tend to be

underrepresented in the most innovative and advanced portions of the economy.

Equally important is acknowledging what these findings *cannot* conclude. Our study is not an impact analysis. In other words, we are unable to determine whether incentives altered the trajectory of businesses, industries, people, or communities in these four cities, only that incentives were targeted to them. Previous evidence suggests incentives may achieve better outcomes if targeted to firms that export, conduct R&D, and pay high wages, or to communities in which market failures impede development. We have offered new evidence that, at least in these four cities, incentives do align with many of these principles. But we cannot conclude that any successes experienced by firms, industries, or communities are the direct result of incentives or that incentives are the best way to achieve these outcomes given other possible policy interventions. Indeed, there is a substantial body of evidence that incentives—for several reasons outlined in the literature review—are often *not* the most effective way to achieve outcomes related to these four principles of high-road economic development.

Combined with this analysis, a review of the existing literature and discussions with dozens of local economic development officials from over a dozen U.S. cities reveal the following implications for economic development policy and practice.

SITUATE INCENTIVES WITHIN BROADER ECONOMIC OBJECTIVES.

What is the objective of economic development incentives? Broadly, incentives are one policy tool cities and states can place in service of broader efforts to create environments in which firms can be productive and grow in ways that raise living standards for local residents.

But hidden below that broad objective are a series of sub-objectives that vary with each city's local economic and political factors. Cities oftentimes want to use incentives to bolster job creation, but the characteristics of the desired jobs may vary depending on local labor market conditions and the education and skills of the local workforce. Cities may want to use incentives to enhance the tax base but, depending on the fiscal structure, vary in their reliance on property taxes, sales taxes, or income taxes. Cities may want to address neighborhood-level disparities, and therefore the focus on specific neighborhoods may be warranted. And cities may want to bolster a niche in specific industries, and therefore use incentives to favor firms that will enhance industrial clustering.

The notion that incentives should reflect broader objectives may seem obvious, but the reality is that incentive programs often do not meet this basic standard. Part of this is politics; elected officials (mayors, city council members, etc.) at times introduce new incentives divorced from previously agreed upon economic priorities. In other instances, the interests of real estate developers and local chambers of commerce hold considerable sway as local officials introduce or reform incentive tools. And community activists and the informed public play a role as well in lobbying directly to economic development departments or applying pressure to their elected officials. To be sure, private and civic engagement improves the policymaking process, but that reality also complicates the task of addressing stakeholder interests while also aligning incentives with broader economic objectives.

EMBRACE INCENTIVE TRANSPARENCY AND EVALUATION.

Evaluating and publicly sharing outcomes of incentive programs, in turn, ensures that city leaders understand whether their policies are contributing to strategic objectives, offers an evidence base from which to make necessary reforms, and can enhance civic and community trust.

Increased incentive spending has led to calls for high-quality information about its effectiveness. Against this backdrop, there is considerable variation in the capacity and commitment to evaluation. States tend to be further along in evaluation and transparency than municipalities. At the state level, the Pew Charitable Trusts has documented that more than half of states "have made progress in gathering evidence on the results of their economic development tax incentives" and they consider 12 of these states to be evaluation "leaders."⁴⁵

While no similar comprehensive analysis of local governments has been undertaken, our sense is that local governments are operating at a somewhat different point than their states when it comes to evaluation. To be sure, many cities do undertake incentive evaluations, including recent or ongoing efforts in Austin, Cincinnati, Columbus, Kansas City, Philadelphia, and St. Louis. In these instances, evaluations were motivated either by internal economic development department concerns that incentives were not competitive as compared to peers or by external pressure from city councils or community groups.

Our experience is that most (although not all) economic development officials embrace evaluations as a means to improve existing policies and programs, but they remain uncommon. Evaluations require resources, including a baseline level of internal data capabilities and the willingness to sponsor an actual evaluation (oftentimes by an external consultant). Overcoming these barriers requires a local commitment to basic data management and analysis in the spirit of broader data-driven policymaking. As compared to the total amount of money being spent on incentives themselves, the resources needed for tracking and evaluation are quite small, and it seems imprudent to skimp on this marginal cost when the benefits of understanding what works are potentially significant. Indeed, evaluation and monitoring is a critical component of implementing best practices like clawbacks, which recoup incentives if companies do not meet their commitments.

The challenge is that economic development departments have resource constraints. One way to raise resources is to institute a fee for firms that apply for incentives that specifically supports research and evaluation expenditures.

Local governments can draw on the deeper body of research on state incentives evaluation to identify best practice. The Pew review of leading state incentive evaluations observes three key elements:

1) Develop a plan that institutionalizes the process of regular evaluation and monitoring;

2) Measure the impact of incentives on the local economy, including estimates of if/how incentives changed firm behavior (see the National Conference of State Legislatures' state tax evaluation [database](#) for examples); and

3) Inform policy choices by city councils and other local officials based on the findings of the results.⁴⁶

Further investments in data tools not only support backward-looking evaluations, but also forward-looking incentives targeting (see sidebar).

ALIGNING ECONOMIC OBJECTIVES WITH TRANSPARENT INCENTIVES IN AUSTIN

The city of Austin offers a promising local example of how to align incentives with broader economic objectives, and then refine those incentives using transparency and evaluation. Austin has enjoyed an incredible decade of economic growth. Among the 100 largest metro areas, Austin topped the Brookings Metro Monitor's combined index of employment, GDP, and entrepreneurship growth between 2005 and 2015. These successes, largely driven by a vigorous innovation economy, accompany new challenges: rising housing prices, traffic congestion and, most pressingly, economic and racial disparities.

Today, Austin maintains dual priorities related to growth and opportunity, and reflect those priorities in its economic development incentives policy, known as [Chapter 380](#). At one level, incentives reflect an industrial diversification strategy that safeguards Austin's economy against massive layoffs during unexpected downturns in key industry sectors. The fourth iteration of the region's Opportunity Austin strategy identifies several target industries, each of which receive special weight when determining the amount of incentives the city chooses to

provide to a particular project. Moreover, the city gives extra weight to firms that agree to collaborate with local schools or civic groups in service of a citywide goal to bring 40,000 children out of poverty.

The city codified these criteria in a firm-based incentive scorecard (Project Scoring Matrix) and evaluates each potential transaction using [LOCI](#), an online fiscal impact tool developed at the Georgia Institute of Technology, to evaluate the merits of every potential incentive transaction based on an agreed upon set of economic, fiscal, and social criteria. Projects must meet all minimum criteria and score at least 60 points in order to receive a performance-based contract.

Overall, the Austin Economic Development Department's [criteria](#) include the following:

- **Overall economic and fiscal impact:** Measuring the size of net profit to the city and the level of desirable public benefits.
- **Linkages to the local economy:** Assessing whether the project is

44x

a targeted industry, making use of underutilized labor force or office space, creating significant contracting opportunities for local firms including small and disadvantaged businesses, filling a hole in the Austin economic base, seeding new industry clusters, or competing for resources with existing firms.

- **Infrastructure impact:** Determining whether the project will make a disproportionate demand on Austin's infrastructure.
- **Character of jobs/labor force practices:** Analyzing the share of local hires, average wages paid as compared to local and industry averages including: distribution of job categories and wages within the overall structure, job training,

education funding, opportunities for employee advancement, and the company's policies toward diversity in hiring and promotion.

- **Quality of life/cultural vitality:** Assessing the company's cultural outreach program and company's policy toward employee volunteer/charitable efforts.

Better targeting offers better public returns. The city claims a 239 percent return on investment from the incentives it has provided to Austin-based companies. Understanding that firm-based incentive scoring is one promising way to standardize targeting, officials in Kansas City have adopted a similar approach based on the Austin model.

For more information: <http://www.austintexas.gov/economic-development-compliance>
Source: City of Austin Economic Development Department, "Annual Report" <http://www.austintexas.gov/edims/document.cfm?id=246430>; Amy Evans, "More Bang for the Buck?" *Shelterforce* (February 4, 2016); Christiana McFarland, "The New Equity Imperative for Local Economic Development," *CitiesSpeak* (March 3, 2016)

A commitment to evaluation requires a simultaneous commitment to transparency. Greater incentives transparency not only prepares cities to evaluate, but it also can enhance local trust and engagement among community stakeholders. Community advocates and government watchdogs have been calling for greater incentives transparency for several decades, but local governments have lagged their state counterparts in providing timely, accurate, and widely available information about the effectiveness of incentives tools. In a recent review of the 85 incentives programs in 50 localities, Good Jobs First found that about half of those programs have basic recipient information posted online.⁴⁷

The reality is that activists and neighborhood groups in local communities are demanding greater transparency. But even if they were not, a new accounting rule, Government Accounting Standards Board Statement No. 77 on Tax Abatement Disclosures, requires that local (and state) governments disclose the amount of revenue they are forgoing through tax incentive programs. Most cities will begin reporting their GASB No. 77 data in 2018.

While the GASB requirement will force cities to provide a top-line number for incentives spending, local governments can and should go further by publicly posting data online about their incentives activities. Increasingly, cities are publicly

disclosing data on municipal systems. These "open data" efforts serve as both a way to ensure public accountability but also to crowdsource analysis on performance. Incentives are a particularly politically controversial municipal issue, to be sure, but there are benefits for local governments that embrace greater transparency. While it requires a willingness of policymakers to open themselves to the possibility of poor results and critiques, accessible incentives information would likely attract researchers from local policy institutes or universities to support evaluation. We have observed that, simply to get access to local incentives data, academic economists have offered to conduct pro bono evaluations, which reveals both how hard it is to gather incentives data and the demand for rigorous research to better understand what incentive policies work best.

Per Good Jobs First, online disclosure best practices offer several key pieces of information, including the incentive recipient (name, address), amount, duration, projected jobs created, actual jobs created, and wage levels for created jobs. Several cities, ranging from Austin to New York to Memphis, have built user-friendly interfaces from which the public can download data for analysis.⁴⁸

TARGET INCENTIVES TO ENHANCE PRODUCTIVE, INCLUSIVE GROWTH.

Rigorous evaluations, enabled by more transparency, can yield greater knowledge about what works given a city's local incentive offerings, tax structures, and economic conditions. Armed with this information, cities can make more effective decisions about how to target incentives to their highest and best use. Indeed, limiting incentives to only those companies or activities that can contribute to broad-based economic opportunities is one way to ensure that incentives align with local objectives and maximize cost-effectiveness.

Three targeting principles can advance more productive and inclusive economies:

- **Incentivize opportunity-rich firms.** Firms and industries differ in the earnings and career pathways they offer. Reflecting this reality, cities as different from each other as Austin, Louisville, and Portland, among others, have instituted wage thresholds as a key criterion for determining whether to offer firms incentives. Furthermore, industries not only vary in how much they pay but also the degree of earnings mobility they provide entry-level workers. Richard Shearer and his co-authors have identified that these "opportunity industries" offer a greater chance of upward mobility, and therefore warrant special attention from economic developers.⁴⁹ As this analysis has shown, firms and industries that export outside of the region and drive innovation should also be considerations when providing incentives as cities seek to build and maintain industry strengths. These targeting criteria can help ensure that public resources are not spent subsidizing low-opportunity industries and activities.
- **Incentivize firms to provide more opportunity.** This principle acknowledges how publicly provided incentives can influence private sector decisions that enhance opportunity, particularly for marginalized groups. This can take two forms. First, for tax incentives such as credits or abatements, the transaction between the city and the company can include more employer requirements in order to receive the tax relief. For instance, in exchange for property tax abatements, Prosper Portland, the city of Portland's economic development arm, has shifted to equity-focused, co-developed public benefit agreements with employers in which they commit to opportunity-enhancing activities such as hosting job fairs and career days, partnering with local schools, reserving internship slots for disadvantaged youth, and supporting other business creation through participation and sponsorship of local incubators (see sidebar).

Second, cities (along with states) can offer incentives that support companies through customized services such as job training, technology adoption and extension, and entrepreneurship mentoring and networking. Local government investment in these types of customized services, whether provided directly by the city or more often through partnerships with civic or private providers, moves economic development activities away from simply altering the physical location of the firm through the tax code to actually enhancing the productivity of businesses and workers.⁵⁰ A review by Timothy Bartik suggests that these types of customized services offer a much better return on investment than traditional tax incentives like job creation tax credits or property tax abatements.⁵¹ Cities are experimenting with promising models. Cuyahoga County's SkillUp initiative, for instance, helps firms define their skill needs, creates plans to train employees, and connects them with providers of training. The program has had promising results: Workers enrolled in it had a median wage increase of about \$3,000, and the greater earnings contributed local tax revenues that were double those of the public investment in the program.⁵²

- **Incentivize firms with place in mind—from region to neighborhood.** For several reasons, place matters for economic growth and opportunity, which in turn has implications for incentives targeting. The first is regional in nature. Local governments that join regional agreements that outlaw jurisdictions from using incentives to poach businesses from each other will ease the pressure to subsidize firms that are simply moving jobs from one part of the region to another. Dayton, OH and Denver, CO are both examples of regions that have effectively brokered intraregional incentive ceasefires.⁵³ Moreover, when employment opportunities are physically

isolated from workers, it reduces the productive potential of the regional economy by undermining efficient matching of openings with workers who would provide the best fit. Conversely, individuals' geographic proximity to employment centers increases their likelihood of employment.⁵⁴ Site selection decisions, therefore, ought to consider how workers and communities will access the new source of employment. Incentivizing sites for corporate relocations or business expansions in the context of regional transportation, land use, and housing policies could bring more spatially efficient growth.⁵⁵

The second reason is neighborhood-based. Incentives will likely remain necessary to correct for market failures that impede private sector activity in neighborhoods suffering from concentrated blight and distress. Yet, evaluations of many place-based efforts have been disappointing because local residents have not always benefited even as the physical and business environment change around them.⁵⁶ For development to benefit neighborhoods and residents, members of the community must be engaged in the process and prepared to benefit from new opportunities. Successful neighborhood economic development involves not only physical revitalization of buildings but investments in people to help them reach their potential as workers or entrepreneurs. Incentives can support place-conscious strategies that target economic opportunities for the people and businesses within them. The city of Chicago has launched a Neighborhood Opportunity Fund with this intention. Supported by revenues from downtown development, the fund reinvests resources to business owners in neighborhoods on Chicago's South and West Sides, encouraging small business to expand and hire.⁵⁷

TARGETING INCENTIVES IN PORTLAND: FROM FIRM TRANSACTIONS TO FIRM RELATIONSHIPS?

Despite a strong recovery from the Great Recession, Portland is experiencing wide disparities in employment, income, and wealth between white communities and communities of color. In the context of this growing divide, Prosper Portland's 2015-20 strategic plan required the agency to think deeply about the evolution of its work to better serve and benefit the entire community.

As the economic development arm of the city of Portland, Prosper Portland plays an integral role in the city's economic growth. Its five-year strategic plan calls for an intentional focus on addressing the growing gaps within the city to ensure that benefits from physical and economic growth are equitably shared among all communities. The agency's vision is a Portland that is globally competitive, equitable, and healthy. Recognizing the need for change, Prosper Portland has shifted its strategic direction, adopted an agency-wide equity statement and practices, repositioned key programs, and initiated new approaches specifically focused on meeting the needs of diverse Portlanders, with the overarching goal of building an equitable economy.

One such program, the Portland Enterprise Zone, incentivizes firms to invest major capital outlays and to create or retain quality jobs by allowing for property tax exemptions designed to encourage existing and new businesses. State of Oregon statute also empowers localities to impose certain requirements to target the incentive to firms, and Portland has chosen a "public benefit agreement" as the vehicle. Prosper Portland defines a public benefit agreement as a legally binding agreement between a governmental organization and a business with the goal of creating shared value and

partnership, where the competitiveness of a company and the health of the public are interdependent. This is distinct from a community benefit agreement, which is typically designed as a place-based agreement.

The benefit agreement outlines the level of incentive the firm will receive and the expected outcomes. Among other factors, these outcomes include:

- Threshold levels for **wages** (\$15 per hour within one year) or **total compensation** (\$20 per hour within one year)
- A **business procurement plan** that outlines good faith efforts to localize supply chain purchases, specifically from business owned by people of color or business owners located in designated neighborhoods
- A contribution of 15 percent of tax savings to a **Workforce Training and Business Development Fund (WTBDF) and Employee Support Fund (ESF)**

Managed by Prosper Portland, the WTBDF provides the economic development team with a flexible fund that supports programming to build an equitable economy and that enhances economic and social opportunity through partnerships with existing systems related to filling worker skills gaps, business technical assistance (e.g. lean consulting, business planning, etc.), and other firm-specific needs. The fund can be responsive to the needs of *existing* businesses in addition to providing incentives for new entrants. The ESF is similar in its flexibility but it specifically allows Prosper Portland to work with employers to address

two of the most significant barriers to employment for lower income workers: transit and child care support.

In addition to creating jobs, making significant capital investment, and buying locally, recipients of property tax exemptions are also required to make additional investments in Portland toward community economic development activities. For instance, companies like Jaguar Land Rover have committed to several activities:

- Reserve internship slots for high school and college students
- Support the development of 10-12 technology-based startups per year through the firm's investment in a technology incubator (including reserved slots for entrepreneurs from underrepresented communities)
- Host events at Jaguar facilities in partnership with local non-profits and social justice organizations
- Engage with technology clubs in local high schools

While the list may seem long, Prosper Portland argues that these commitments are actually in the enlightened self-interest of a firm like Jaguar Land Rover as they improve the quality of local talent, ideas, suppliers,

and community. The challenge is that firms struggle to engage with what can be a complex thicket of community organizations and potential partnerships that service these shared commitments. Prosper Portland engages with dozens of non-profits related to entrepreneurship, workforce development, education, and social justice and community building so businesses can quickly find the right partnerships. This significant shift toward building social equity practices into all of its efforts has taken several years but has now positioned the organization to be a bridge between firms and the broader ecosystem of community players that they need to remain productive and competitive.

Moving economic development toward this bridging function may ultimately bring more shared value to both employers and communities. Rather than a one-off tax break, this concept suggests that connecting firms to a broader system of supportive business and social groups can yield higher profits while bringing more economic opportunities to struggling families and communities. It represents a shift from transaction-oriented economic development to a more relationship-oriented economic development. Executing this approach, however, requires locally rooted partnerships and organized stakeholders that can actually deliver shared value to businesses, workers, and communities. This is the role that Prosper Portland aims to fill.

For more information:

<https://prosperportland.us/portfolio-items/portland-enterprise-zone/>

<https://prosperportland.us/social-equity/>

Source: Author's own communication with Prosper Portland staff

VII. Conclusion

This report draws on unique transaction-level information to examine how local and state governments deploy economic development incentives to businesses in Cincinnati, Indianapolis, Salt Lake, and San Diego. Across these four cities, this analysis reveals that economic development incentives align with several key principles of high-road economic development but fall short on others.

On the positive side, economic development incentives in these four cities disproportionately go to firms in industries that are both technology-intensive and export-intensive, two notable dynamics that drive productivity and wage growth. Partly due to this, incentivized industries pay about 25 percent higher wages than the economy as a whole across the four cities.

Yet, economic development incentives in these four cities do not always align with tenets of economic and racial inclusion. The same innovative and tradable industries that incentives target because of their high wages and strong fundamentals are often inaccessible to workers of color due to skills and other structural barriers, a finding reinforced by the fact that incentives infrequently promote employer-based job training in these four cities.

While not a full analysis of economic impact, our findings offer some implications for economic development incentives policy and practice. First, local and state leaders should ensure incentives reflect local and regional economic objectives. This census of incentives provides one guide for how cities can situate their incentives practices within four principles of inclusive economic development. Second, localities must commit to making incentives information publicly transparent, and then rigorously evaluate their impact on firm outcomes to determine what works. Clearer criteria and more effective targeting should reserve incentives only for those firms that will advance broad-based opportunity, either by incentivizing opportunity-rich firms and industries, incentivizing firms to provide workers more opportunity, or by addressing place-based disparities in opportunity.

Fortunately, we observe progress toward a more responsible and rigorous incentives approach in many U.S. cities, signaling a nascent but necessary progression in the practice of economic development. We hope this report can help provide insights and tools to local leaders as they undertake that important and needed evolution.

Appendix

Table A

List of incentive programs

2012 - 2016

City	Source of fund	Type	Amount (thousands)
Cincinnati	local	Project TIF	\$119,787
		Job Creation Tax Credit	\$70,131
		LEED Community Redevelopment Area Abatement	\$57,301
		TIF Grant	\$25,173
		Property Investment Reimbursements	\$24,021
		Below Market Rate Sale	\$18,034
		Capital Grant	\$15,307
		Other City Grant	\$14,600
		District TIF	\$2,105
	state	Job Creation Tax Credit	\$150,506
		Ohio Historic Preservation Tax Credit	\$99,739
		JRTC-R Job Retention Tax Credit Refundable	\$22,000
		Research & Development	\$9,000
		Incumbent Workforce Training Voucher	\$7,398
		Third Frontier Research & Development Project	\$3,338
		Roadwork Development	\$1,811
		Legacy Projects	\$1,450
		Industrial Training Grants	\$903
		Tech Target Investment Program	\$750
		Local Government Innovation Fund	\$532
		Workforce Training Grant	\$527
		Business Assistance Programs	\$462
		Economic Development Contingency Funds	\$400
		Rapid Outreach Grants	\$350
		Business Incentive Grants	\$325
		Energy Programs	\$141
		Small Business And Export Assistance	\$115
		Career Exploration Internship	\$18
		Energy Sector Training Grants	\$17
		Vacant Facilities Grant	\$7
		Global Markets	\$2

City	Source of fund	Type	Amount (thousands)
Indianapolis	<i>local</i>	Abatement	\$124,111
		TIF - Grant	\$29,060
		Community Revitalization Enhancement District Tax Credit	\$1,644
		TIF - Infrastructure	\$255
		IT Equipment Tax Exemption	\$-
	<i>state</i>	Economic Development for a Growing Economy Tax Credit	\$382,271
		Skill Enhancement Fund	\$26,684
		Hoosier Business Investment Tax Credit	\$24,637
		21Fund	\$10,883
		Industrial Development Grant Fund	\$4,310
	21Fund_SBIR_STTR	\$825	
Salt Lake	<i>local</i>	TIF - Redevelopment Area	\$214,096
		TIF - Economic Development Area	\$43,896
		TIF - Community Development Area	\$23,536
		TIF - Urban Renewal Area	\$1,458
	<i>state</i>	EDTIF Tax Credit	\$140,934
		Life Science Refundable Tax Credit Awards	\$30
San Diego	<i>local</i>	Business Cooperation Program	\$1,249
		Storefront Improvement Program	\$609
	<i>state</i>	Tax Credit	\$44,980
		Employment Training Reimbursement	\$3,446

Source: Brookings analysis of data from city of Cincinnati, city of San Diego, Indy Chamber, Salt Lake County, Indiana Economic Development Corporation, Ohio Development Services Agency, and Good Jobs First

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For More Information

Joseph Parilla

Fellow

Metropolitan Policy Program at Brookings

jparilla@brookings.edu

B | Metropolitan Policy Program
at BROOKINGS

1775 Massachusetts Avenue, NW
Washington, D.C. 20036-2188
telephone: 202.797.6139
fax 202.797.2965
www.brookings.edu/metro



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Tax Expenditure Budgets and Reports: Best Practices

What is a "tax expenditure"?

A tax expenditure is an exemption, deduction, credit, exclusion, or other deviation from the normal tax structure. Tax expenditures may be used to economically benefit taxpayers who the government has identified as needing assistance. They may also serve as an incentive for certain economic or social behavior.

Until recently, tax expenditures were largely invisible to the public and even to policymakers. Some states still have no accounting of tax expenditures and, even in states where reports are issued, these preferential tax provisions have largely escaped the annual or periodic review considered normal and essential for direct appropriations. Increasingly, the public and policymakers agree that an accounting and review of tax expenditures should be part of regular sound budget practices.

What is a tax expenditure report?

More than two-thirds of the states now prepare regular tax expenditure budgets or reports to provide the public and policymakers with up-to-date information on the impact of preferential tax provisions (both "tax expenditures" and elements of "normal" taxation) in the tax code. In many states, tax expenditure reports simply list statutory exemptions, credits, and exclusions without identifying those provisions that are part of the normal tax structure. This is one reason why, in many states, tax expenditure reports have not been effective tools to help legislators review and improve the tax code. In order for it to be effective, a complete and frequently updated tax expenditure report is essential for good policymaking.

What are best practices for defining a "normal" tax provision?

While tax expenditure reports have become increasingly common, the absence of standard definitions for "tax expenditure" and "normal" tax structure has made reading tax expenditure reports complicated. The absence of a clearly identified and articulated definition of where the normal tax code ends and tax expenditures begin can lead to unsound policy choices. It has also made state-to-state comparisons exceedingly difficult.

There is no single definition of what is meant by a normal tax structure. Both within a state and across state lines, there is much debate about which provisions of a state's tax code are tax expenditures and which are part of the normal tax structure. Deductions for ordinary and necessary business expenses and sales tax exemptions for purchases of business inputs are generally considered part of the "normal" tax structure but in some states are listed as tax expenditures. Sales tax exemptions for food and clothing or property tax circuit breakers, similarly, may be considered part of the "normal" tax structure or tax expenditures.

Each state needs to determine what provisions of the tax code are foundational elements of the tax system and not deviations from it, and this requires judgment calls by policymakers. In order to create effective and useful tax expenditure reports, state legislators must play an integral role in defining the normal tax base. To assist in this effort, the Executive Committee Task Force on State and Local Taxation (SALT) has developed this list of questions for legislators to consider in developing a process to define the normal tax base:

1. Who should determine the normal tax structure? Should the normal tax structure be determined by a special legislative committee, a created commission, or some other authority?
2. Depending on the authority making the determination of the normal tax structure, what other procedures or controls should be built into the overall process. For example, if a commission has authority, should unelected stakeholders be included in the process? If the executive branch has authority, what is the role of the legislature in reviewing and approving executive branch recommendations?
3. How often should the "normal" tax structure definition be reviewed?
4. Which taxes should be included under the scope of the review? Should the review be limited to only taxes that are major state revenue sources, such as personal income, corporation income/franchise, sales and use, special industry, etc.? Should local taxes, such as the property tax, be included?

What are "best practices" for tax expenditure reports?

State tax expenditure reports should include information on all major state and local taxes (personal and corporate income taxes, sales and use taxes, real and personal property taxes, excise and gross receipts taxes, etc.)

To ensure that reports are accurate, informative, and transparent, there should be a protocol, codified in statute, which specifies the elements of the tax expenditure report.

It should:

1. Be easily accessible and available on-line;
2. Be completed in time for budget and policy decisions;
3. Define or describe the normal tax structure for each tax included in the report and identify deviations, both those that benefit and those that penalize a class of taxpayers;
4. Include, for each tax expenditure
 - a. the date the tax expenditure was enacted,
 - b. the statutory citation or federal law reference,
 - c. the tax policy rationale and desired outcome, including, where specified in law and as appropriate for each tax expenditure, clearly identified metrics for assessing the effectiveness of the expenditure (e.g. number of jobs created, low-income citizens served, conflicts with federal tax policy avoided, etc.),
 - d. information regarding the categories of taxpayers that benefit,
 - e. an updated estimate of the revenue impact (positive or negative) of the tax expenditure,
 - f. categorization of tax expenditures both by tax type and, as appropriate, budget category, and
 - g. a review schedule and/or, as desired or specified in law, an expiration or sunset date;
5. Make clear the methodology and limits of estimates provided in the report.

What are “best practices” for evaluating tax expenditures?

While better tax expenditure reports are a critical first step, the data in these reports must be reviewed and evaluated in order to produce better public policymaking. Here, too, there are some “best practices”:

1. Tax expenditures should be an integral part of the state’s budgeting process, subject to a comparable regular review and approval process as other expenditures. Each tax expenditure should be reviewed regularly, with a frequency of review taking into account the trade-off between available resources to undertake the review and the cost of the tax expenditure.
2. There should be clarity about who is responsible for this review. Should it be done by a special legislative committee, a created commission, or some other authority (such as the executive branch)?
3. Evaluations should be based on measurable goals and draw clear conclusions on the effectiveness of each tax expenditure.
4. Rigorous evaluations should determine costs and benefits of each tax expenditure, and allow policymakers to ask critical questions, including:
 - a) Is the purpose, cost and benefit of each tax expenditure clear?
 - b) Are there clear metrics to determine the tax expenditure’s effectiveness?
 - c) If no readily available data exists to measure a tax expenditure, how should it be evaluated?
 - d) To what extent did the tax expenditure affect choices made by taxpayers?
 - e) Did the expenditure achieve its purpose?
 - f) Who was affected by the tax expenditure?
 - g) Did the benefits of the tax expenditure outweigh the effects of the tax increases or spending cuts needed to offset it?
5. The Governor and appropriate legislative committees should review the reports to determine whether tax expenditures should be continued, modified or eliminated. This should be part of the state’s normal budgeting process.

Adopted by the NCSL Executive Committee Task Force on State and Local Taxation on January 14, 2017.

What Should the State of New Jersey Do about Incentives?

Date: September 5, 2019

Testimony to: New Jersey State Senate Select Committee on Economic Growth Strategies,

Testimony of: Michael L. Lahr, Director of Rutgers Economic Advisory Service (R/ECON™)

Mr. Chairman and members of the Select Committee, it is a pleasure to share R/ECON's research findings and policy recommendations on how New Jersey might structure business recruitment and retention incentives. I am Michael Lahr, a Professor at the Edward J. Bloustein School of Planning & Public Policy on the New Brunswick Campus of Rutgers University. I am undoubtedly here before you today because I co-authored a report released a bit over a year ago that reviewed the way New Jersey (NJ) Economic Development Authority (EDA) evaluates applications for incentives. In the not-so-distant past, I have also sat in on a Legislative workgroup or two as well.

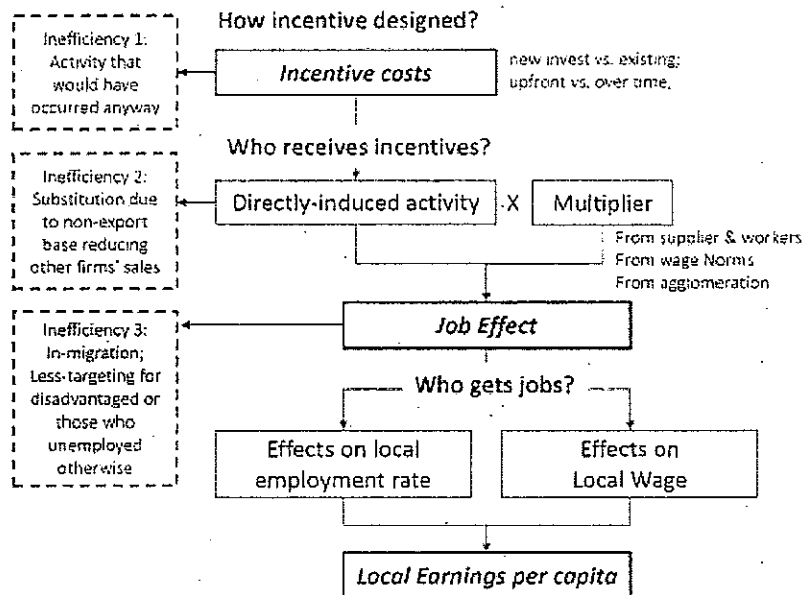
Recently a local news journalist called to ask me what now will happen that the Governor opted not to extend our state's business tax incentive system. The answer is rather simple: not much, and close to nothing in the short run. This is because taxes are not as critical as other cost items to businesses—the costs of labor, logistics, and space are much more important. Items like energy costs and taxes are lower on the list. That said, congestion remains an issue and our labor costs are high, largely due to the costs of living close to New York City and Philadelphia. Basically, our state's prime advantages have costs attached to it. Still, we should remain competitive with our neighboring states; we need to keep up with the Jones'. This is because, as Amazon's Chinese auction showed, firms select a general region in which they wish to locate based on gross criteria like supply chains and markets and then, after, select among jurisdictions within that region that present lowest costs. In the case of producer services and high-tech firms, they even include their workers' private costs in that decision, e.g., school quality, ease of commute, etc. This means that taxes make a difference, but only at the margin. This suggests that we must be vigilant about what the State of New York and the Commonwealth of Pennsylvania are doing with respect to business recruitment.

Part of the reason that my answer to the journalist was "not much" was that credits in NJ are provided after rather than before the firm makes the investment for which it applies the incentives. The incentives might be more urgent if they were given in advance of the investments. Firms like money earlier rather than later; it makes their investment less risky to investors. Of course, the State incurs risk if it pays the incentives without realizing promised outcomes.

Three Points of Inefficiency.

There are three possible points of error or inefficiency in incentive systems. One is giving incentives to firms that would have come to or stayed in NJ, even if they had not received the incentive. A second is giving the incentive to a firm that reduces the presence of existing firms in NJ. And a third is recruiting firms that will undoubtedly mostly employ nonresidents of the state. Figure 1 below shows the logic. I discuss each in turn.

<Figure 1> Logic Model for how incentive affect job effect and economic health of residents



Note. This diagram is based on Bartik's (2015) diagram

62x

How can a state know that the requested incentive is really needed? Is the set of promised "new jobs" the firm's natural growth or are they truly new jobs being brought into the state? Are the costs of laid out in the application truly those of alternative locations that the firm is considering or just something they paid a consultant to dig up for the EDA application? The bottom line is that even if someone asks the firm's CEO to affirm the truthfulness of his/her answers to these questions, the state cannot know the answers to these questions. The firm is after all ultimately getting hundreds of thousands of dollars, if not millions, as a result of the application for incentives. The best a state can do is legislate a disclosure requirement in which the firm legally affirms that it could not proceed without the incentive, and then assure that incentives are credited only after the firm has delivered on promised measures. Requiring a state-oriented benefit/cost ratio that tolerates a less-than-truthful response of the firm's agent (say, a ratio of 4.0 or more) goes a long way toward making this potential inefficiency in the decision less of a concern.

The State of NJ should not provide incentives to firms that will clearly cause other NJ firms to falter or fail. Except in rare circumstances, incentives offered to firms in retail trade, hospitality services, entertainment and amusement services, and personal services do just that. The same can generally be said of residential developments. After all, there are only so many consumer dollars in NJ; that is, people do not spend much more with the advent of new spending venues.

This then begs the question of what types of firms should receive incentives. The *first part* of a general answer to this question is that incentives should be targeted to firms that will shore up that State's export base, i.e., firms provide goods or services to organizations outside of the State. Such firms surely are less likely to compete head to head with other NJ firms, and they add wealth to the State from outside. A *second part* is that it should also be provided to firms with a supply chain that is or will become localized within the State. A stronger local supply chain suggests that the firm's multiplier effects within the State will also be stronger. A *third part* of the answer is to assure incentives align well with state industrial policy. A recent EDA report entitled *The State of Innovation: Building a Stronger and Fairer Economy in New Jersey* identifies the following types of businesses as desirable: global headquarters, life sciences, information and high tech, clean energy, advanced manufacturing, advanced transportation and logistics, finance and insurance, and food and beverage manufacturing. There is no reason that these types of businesses should not also be the focus of all types of business incentives. It also seems important that the State reward firms for developing unique sharable assets (say, an innovation center with specialized advanced manufacturing machinery). Channeling legislation so that firms have characteristics mentioned above in order to receive incentives from the State would assure viable investments via the incentives provided.

Of course, not all incentives need to be invested with a goal of overall state growth. Some may be provided to give a lift to disadvantaged neighborhoods and/or disadvantaged populations. This is the point of the third potential inefficiency. That is, a goal of overall state growth need not accommodate decreases in inequality—those hired in the new jobs prompted by State tax incentives are unlikely to be among the State's unemployed. For example, while a new headquarters would be welcome in Paulsboro, it is unlikely that such a new employer would employ many if any of the disadvantaged population in that municipality, let alone from elsewhere in Gloucester County or anywhere else nearby. It is far more likely that the highly educated workers filling the space would move in from outside of the State, perhaps from the firm's prior headquarters location. So if the goal is to reduce inequality within the state, a different sort of program should be established. This was more or less the point of Grow NJ, which had the apparent goal of inducing investment into investment-starved neighborhoods. But it had no explicit goal of securing jobs for State residents, let alone those in the municipality in which the investment was made.¹ In fact, they were not tied to job creation at all, which is why NJ had a cost per job that is twice the national average as Dr. Bartik has testified. Still, recognizing that the State cannot establish laws that assure local employment, it is worthwhile demanding that firms, which receive incentives, sign a document in which they agree to make "a good faith effort" or "substantial progress" toward hiring those in most need of employment.

¹ It is worth noting here that it is unclear that NJ Grow did not meet goals that legislators set out for that program. This is because its goals were obscured by its investment-oriented nature and low benefit/cost threshold. The State seemed to be giving disadvantaged areas a shot in the arm via new private infrastructure. I use the word "seemed" here because the state also permitted the firms to negotiate with municipalities for property tax abatements that nearly negated any possible value the investment might yield the municipality, given that few if any residents of the municipality were employed on the site.


Tying Incentives to Performance.

NJ has done rather well in tying incentives to performance, given the inefficiencies noted above. I have already discussed that the benefit/cost ratio could be shored up and that more could be done to encourage firms to hire those in the State most in need of employment. I also note in footnote 1 that local property tax abatements should be disallowed under certain circumstances. In those instances, the State should either make sure that the firm does not abuse its superior bargaining power when negotiating with municipalities within the State; that, or it probably should pay the equivalent of the taxes abated to municipalities.

There are other matters that my team at Rutgers noticed were a bit problematic when reviewing how EDA evaluated the NJ Grow and Economic Redevelopment and Growth (ERG) programs. One was the legislated over-duplication within the point system used for area types. Another was a lack of language with respect to prohibiting or penalizing earlier-than-scheduled relocation. This latter was undoubtedly a function of the manner in which incentives were backloaded, i.e., rewarded as tax credits a year after proof of promised job growth was realized. Still, recapturing incentives once paid via legally binding claw-backs or as a charge of noncompliance are at best difficult to operationalize. Still, it would be good to invoke stronger language to help the State terminate incentive agreements or at least that prohibits noncompliant firms from opportunity of receiving State funds in the future and that rescind otherwise deserved incentives as sunk costs to the firm.

Finally, there seemed to be much concern about the market for investment credits established in prior legislation. That is, firms that were slated to receive incentives and had low or no tax liability were permitted to sell their tax credits to other tax-paying entities. We suggest this should be retained in future legislation. The credits were funds promised by the State to assure the firm was retained/recruited in NJ. And in granting the incentive the State determined that the firm needed the granted incentive to make that decision. The fact that the firm had no State tax liabilities is a separate matter that should be of no consequence with respect to the State's actions on the promised incentives. The fact that firms are able to sell those credits for something within 95% of their value is certainly striking since it seems the transaction costs for selling those credits surely must be in the 5% range for the buying firm. But the bottom line is that the firm that applied for the credits does get those funds to meet the investment needs that it demonstrated to the State in its application to EDA.

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Senate Select Committee on Economic Growth Strategies

Best practices in developing state economic development programs

Professor Michael L. Lahr
Rutgers Economic Advisory Service (R/ECON™)

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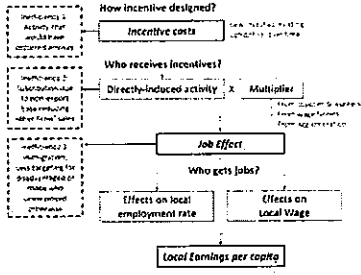
Firms React to Incentives

Taxes are typically a smaller cost consideration


1. More important are costs of
 - a. Labor (given quality)
 - b. Logistics
 - c. Land and energy are relatively expensive here too
2. So incentives a secondary consideration after deciding location of labor and market areas

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Figure 1 - Logic Model for how an incentive affects job effect and economic health of residents




The diagram is a flowchart titled 'Logic Model for how an incentive affects job effect and economic health of residents'. It starts with a box 'Incentive costs' (with sub-points: Incentive type, amount, duration, conditions). An arrow points to 'Who receives incentives?' (with sub-points: Directly-induced activity, Multiplier). From there, an arrow points to 'Job effect' (with sub-points: Who gets jobs?, Effects on local employment rate, Effects on Local Wage). A final arrow points to 'Local Earnings per capita'. A note at the bottom states: 'Note: This diagram is based on Barth's (2013) diagram.'

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Firm Knows Best


- Don't rely on NJ EDA for truthfulness of firm's agents
- Disclosure requirements are among the weaker forms of subsidy accountability

1. Firm has every incentive to not disclose full truth
 - a. Especially wrt those seeking retention incentives
 - a. Natural growth vs new jobs?
 - b. Would rebuild and relocate nearby anyway
 - b. Low cost to get true info on alternative site(s)
2. If benefit/cost used, apply threshold with reasonable margin for error

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NJ and Incentives


1. Incentives can offset some of NJ's other higher costs
 - Market for incentive credits
 - Firms like money now rather than later...risky
2. Should we ask "What is "most" worthwhile to lure/keep here?"
 - a. Keep any funds for investment-starved areas in a separate pot
 - b. Keep incentives for residential, retail trade, and personal services separate.
 - c. Will firm's supply chain follow...eventually?
 - d. Extra "points" if explicitly within NJ's industrial policy...
"Manufacturing" is too broad.

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Investment-starved Areas


1. Minimize PILOTs wrt property taxes
 - a. Make sure firm does not over-use its superior bargaining position
 - b. If PILOTs, make sure muni gets compensating funds from State
2. Minimize duplication within any point system
3. Develop unique assets, e.g., innovation or shared-resource center

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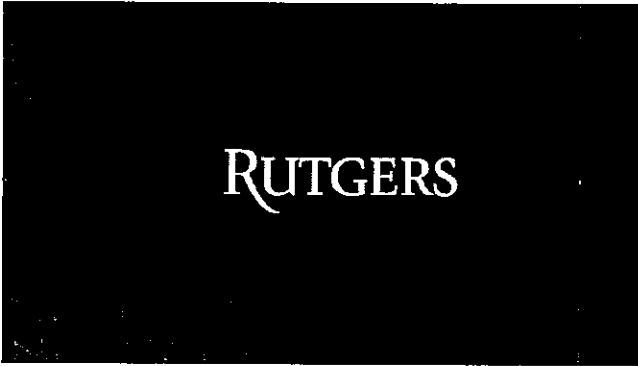
Performance Criteria

1. Added aggregate payroll and benefits as well as job requirement
2. Prohibition to relocate
 - a. Return a portion of incentive if, e.g., less than (2 x years) of incentive
 - b. If in-state, offer emp to all workers at original location
 - c. Unless it results in an expansion that does not close or substantially reduce operations at the originally subsidized facility
3. "Good faith effort" or "substantial progress" toward hiring those most in need of employment

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Tying Incentives to Performance

1. Backload incentives (not great for distressed areas)
2. Recapturing
 - a. terminate incentive agreement and/or prohibit noncompliant firms from opportunity of receiving incentives in the future and rescind otherwise deserved incentive as sunk cost,
 - b. Use legally binding claw-back or money-back measure to recoup all or some of incentive paid
 - c. Imposing additional charges for nonperformance or relocation



67x