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A New Business Incentives Database: Implications for Michigan

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A New Business Incentives Database: Implications for Michigan

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Presentation to Michigan House Tax Policy Committee

Based on new report:

**“A New Panel Database on Business Incentives for
Economic Development Offered by State and
Local Governments in the United States”**

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What is new about this new incentives database?

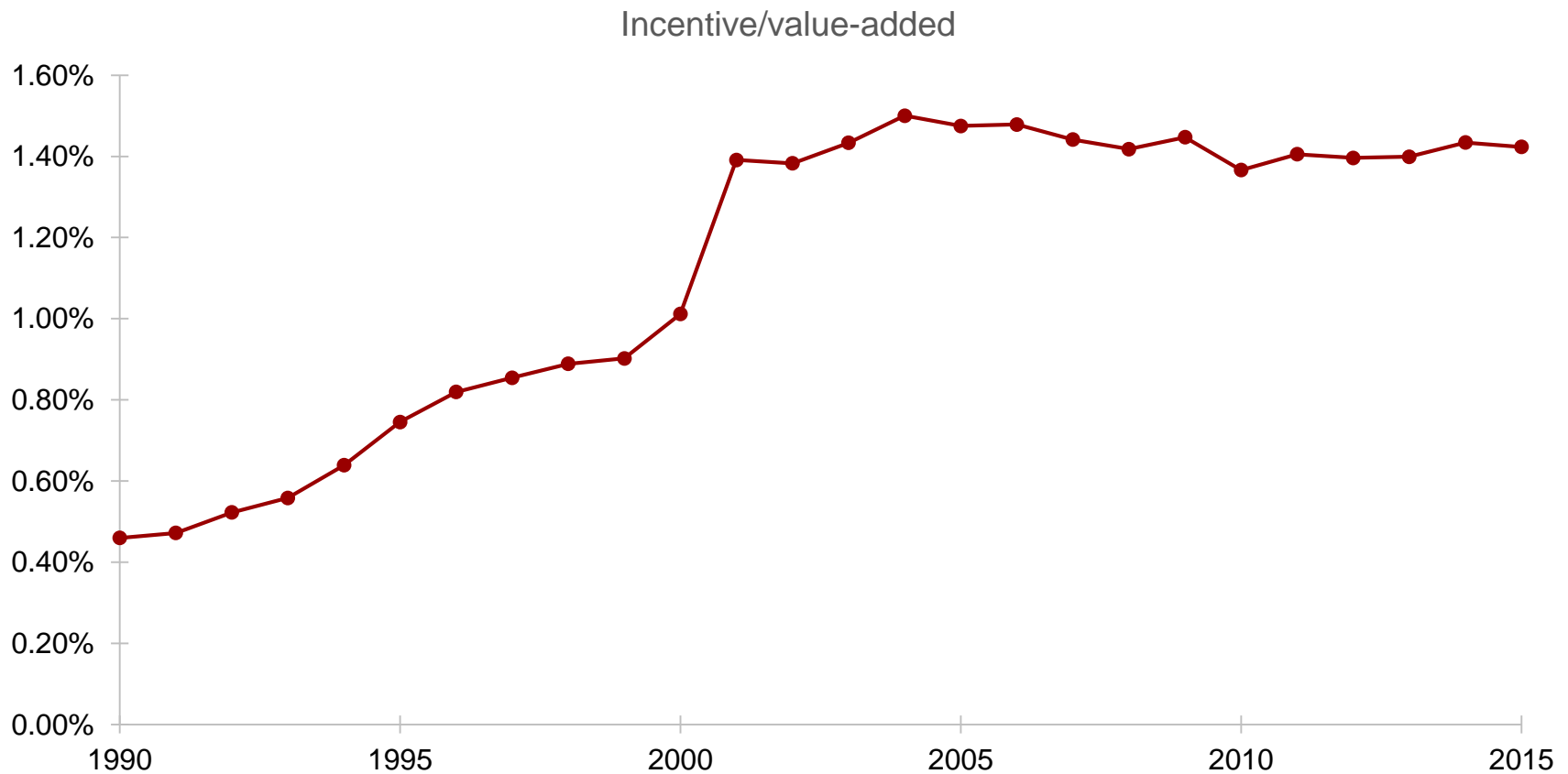
- More industry detail (45 industries, over 90% of wages)
- More years (26 years, 1990-2015)
- 33 states (over 90% of US output)
- More detail on types of incentives, and on timing over life of firms: do states use most effective incentive designs?
- Allows for more analysis of whether states appropriately target industries offering higher benefits for state residents.
- Allows for analysis of effects of proposed incentive reforms.
- Open-access to researchers, policymakers, public.

Average state/local Incentives for “export-base” industries are large. As of 2015, such incentives in average state are:

- 1.42% of business value-added (value-added=sales minus purchases from other businesses= measure of production)
- 5.83% of business profits.
- 30.1% of state/local business taxes.
- \$2,457 per worker “job-year”.
- Estimated annual national cost of \$45 billion.
- Note: “export-base” industries sell goods or services out of state, bringing new \$ into state, which yield multiplier effects. Export-base= manufacturing plus some services

Nationally, incentives have tripled since 1990

Incentives as Percentage of Export-Base Industries' Value-Added



2/3rds of incentive growth due to “job creation tax credits,” which frequently exceed business taxes

Table 31 Types of Incentives Used, National Average, Different Start Years

Incentive type	1990 start	2000 start	2001 start	2007 start	2015 start
All incentives	0.46	1.01	1.39	1.44	1.42
Job creation tax credit	0.01	0.24	0.37	0.47	0.64
Property tax abatement	0.32	0.39	0.50	0.46	0.39
Investment tax credit	0.06	0.21	0.35	0.32	0.20
R&D tax credit	0.04	0.12	0.12	0.13	0.13
Customized job training	0.03	0.05	0.06	0.06	0.07
NOTE: These figures show present value of different types of incentives, as percent of present value of value-added, averaged over 33 states and 31 export-base industries, for five selected start years for a new facility.					
SOURCE: Author's calculations.					

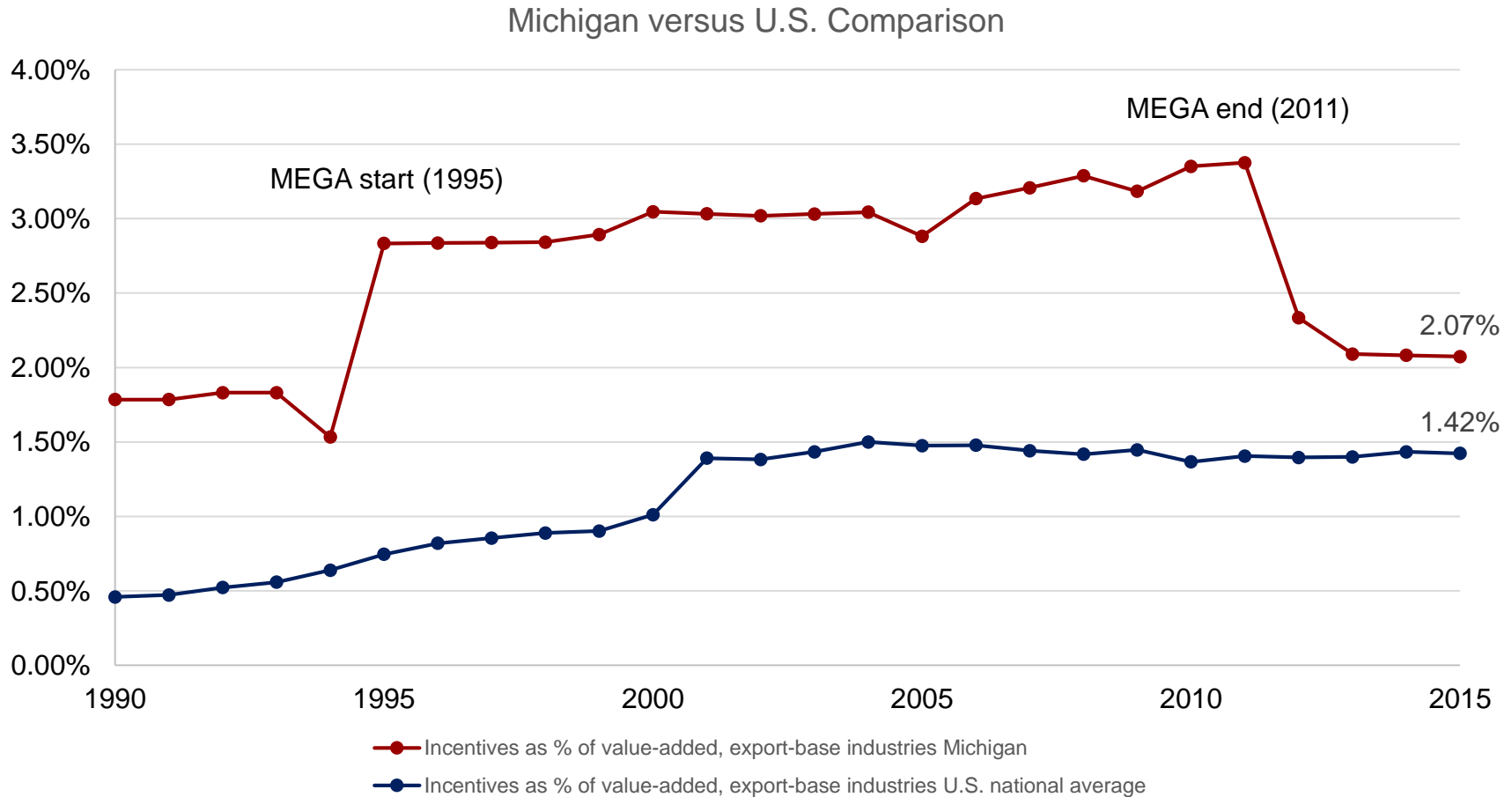
Incentives vary a lot even across nearby states. Incentives are not strongly correlated with past or future economic outcomes by state.

- New Mexico: 4.23% of value-added; Arizona: 1.06%.
- New York: 3.53%; Connecticut: 0.65%.
- Louisiana: 3.33%; Texas: 1.24%.
- Indiana: 2.68%; Illinois: 1.35%.
- S. Carolina: 2.39%; N. Carolina: 0.93%.
- Wisconsin: 1.52%; Minnesota: 1.14%.
- Oregon: 0.70%; Washington: 0.09%.

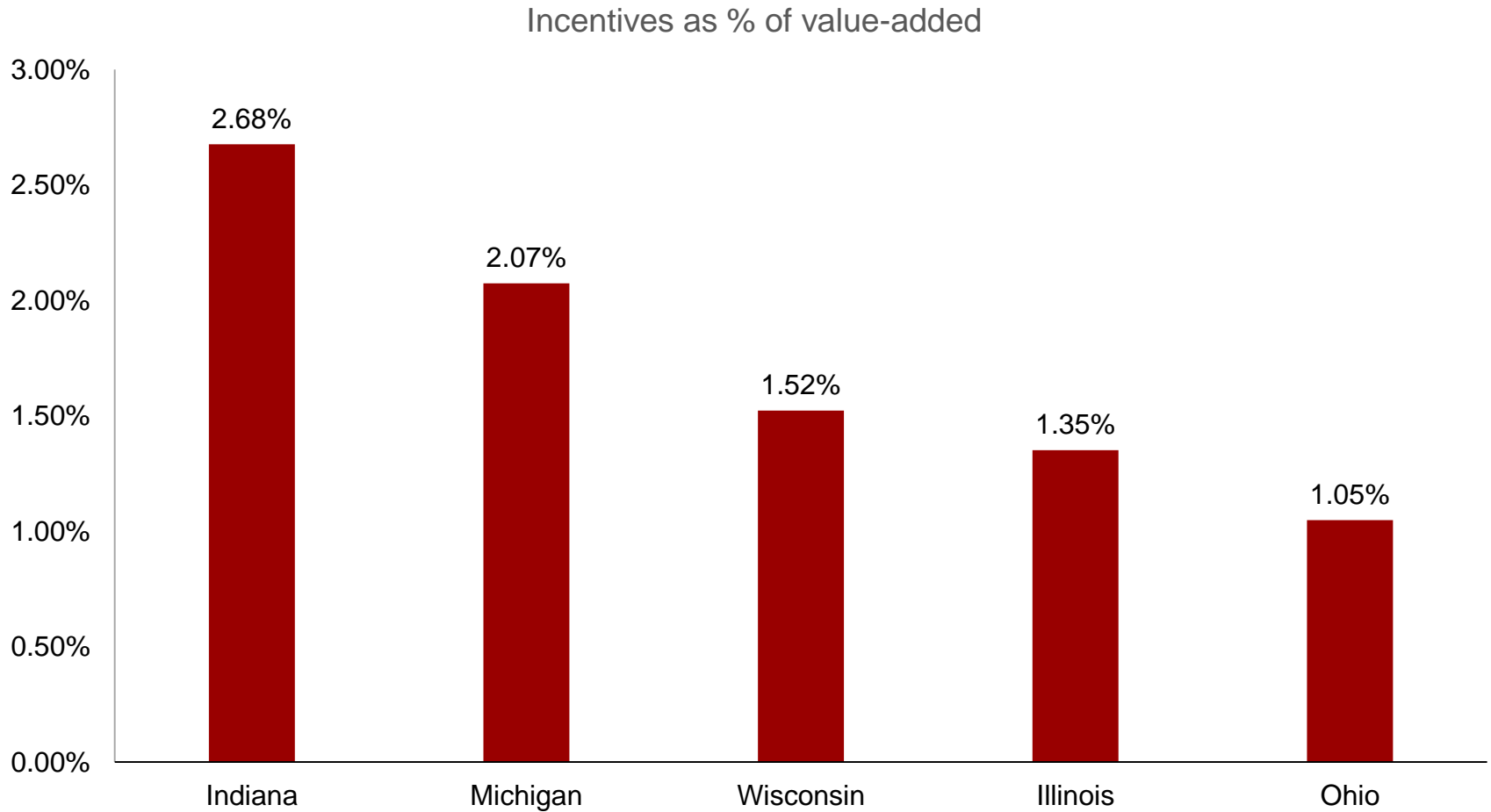
Because incentives don't have huge effects on business location decisions, need to pick incentive targets, designs, and types that have above-average benefit-cost ratios

- New database suggests that avg national incentives of 1.4% of value-added will at most tip 6% of incented location decisions.
- Therefore, for benefits to exceed costs, must target industries with high benefits, and choose incentive designs/types to have high effect
- High multiplier effects on local workers from high-tech industries (multipliers of 6 to 1) and high-wage industries
- Given short-term focus of location decision-makers, upfront incentives more effective (long-term incentives have little effect)
- Incentives that are customized services, such as customized training, have effects per dollar that are 10 times as great as tax and other cash incentives, due to targeting service needs of small/medium businesses

Michigan has larger-than-average incentives, but with ups and downs



Michigan incentives are smaller than Indiana, but larger than Ohio, Illinois, and Wisconsin



Michigan incentives are larger than national average due to property tax abatements

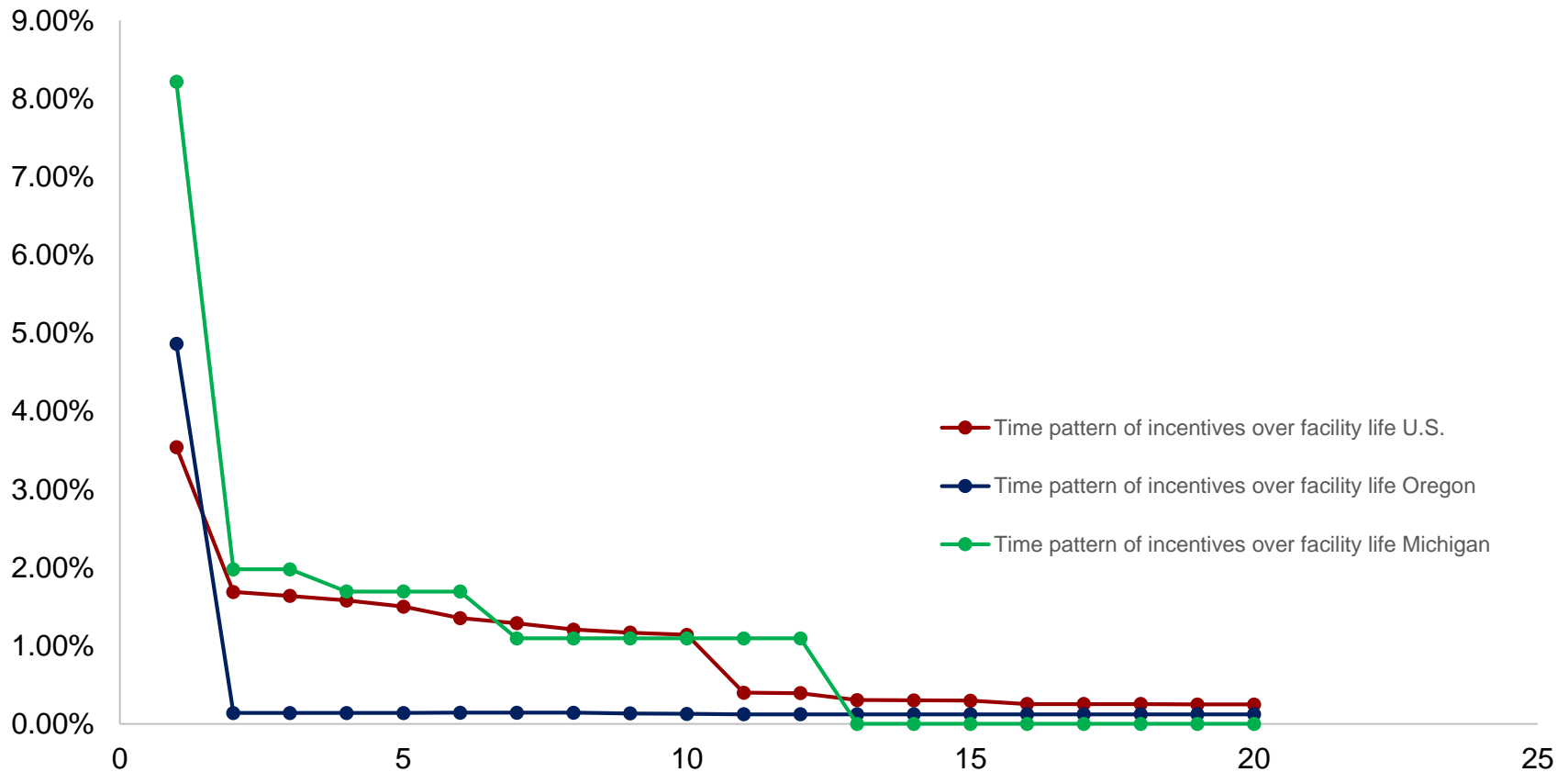
Nation or MI	Total	Job creation tax credit	Property tax abatement	Investment tax credit	R&D tax credit	Customized job training
National average, 2015	1.42%	0.64%	0.39%	0.20%	0.13%	0.07%
Michigan	2.07%	0.52%	1.33%	0.00%	0.00%	0.22%

Michigan incentives even less responsive than average state to wages or R&D – no evidence of targeting for greater benefits

	% change in total state/local incentives for 10% increase in an industry's	
	<u>Wage rates</u>	<u>R&D</u>
Nation	2.7%	0.3%
Michigan	-0.9%	-0.5%

Michigan incentives are significantly front-loaded, but persist too long – incentives after year 5 have little effect

Comparing Michigan, U.S. and Oregon by Time Pattern



Michigan under-invests in customized services to small and medium sized businesses

- Studies by Holzer et al (1993), Hoyt et al. (2008) & Hollenbeck (2008) suggest large effects of customized training on business growth.
- Ratio of effects on business activity to costs may be over 10 times as great as for tax incentives.
- Other studies suggest large effects of other customized services, such as manufacturing extension (Jarmin, 1999).
- Why such services effective: small/medium businesses easier to affect; upfront assistance more effective; services difficult for small/medium sized businesses to access on their own; information is cheap and effective.
- Michigan invests more in customized training than average state, but still less than 1 in 9 of the state's incentive \$ go to customized training.

Summary of ideas for incentive reforms

- Target high-wage and high R&D industries
- Make incentives more up-front, with clawbacks
- Increase share of incentives that are customized services to small and medium sized export-base businesses
- Avoid cash incentives that are not limited by business taxes paid, as such incentives are difficult to control
- Evaluate all incentives as rigorously as possible, ideally using comparison groups
- All these measures taken together will increase economic impact of Michigan incentives, while reducing long-term costs