A New Business Incentives Database

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A New Business Incentives Database

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Based on: “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)
- Detail on 5 incentive types: job creation tax credits, property tax abatements, investment tax credits, R&D credits, customized training
- Detail on incentive time pattern: how varies from Year One to Year 20 for new facility
- Free, open-access database
Database helps address these questions

- Is magnitude of incentives enough to significantly affect business location decisions?
- Do high-unemployment states offer more incentives?
- Do states target high-wage industries?
- Do states emphasize more “efficient” incentives?
  - e.g., frontloaded incentives, customized services
- How much do incentives matter for growth?
- For evaluation of an individual state, database provides useful context, and model for what questions to ask and what methodological tools to use.
Methodology of database

• Hypothetical firm model
• Assumes new facility that opens up in base year, stays at same scale for 20 years. Taxes & incentives of base year projected forward
• Tax & incentive calculations based on BEA/IRS data on how mix of jobs, real property, machinery/equipment, R&D, and wage rates vary by industry.
• Taxes included are property taxes, sales tax on business inputs, and corporate income tax.
• Incentives included are job creation tax credits, property tax abatements, investment tax credits, R&D credits, and customized job training.
• Incentives only included if they are part of “usual deal.”
Database’s outputs

- Taxes and incentives of each type for each of 20 years of facility operation, for 45 industries, 33 states, and 26 starting years.

- Taxes/incentives calculated as % of “value-added” = measure of firm’s production = value of firm’s sales minus its inputs from other businesses.

- Also calculate weighted average for 31 “export-base” industries: industries that sell goods/services outside state, bringing new $ into state.

- Report/database focus on “present value” of taxes/incentives as % of present value of value-added over those 20 years.

- Present value is calculated using very high 12% real discount rate. Why? Research evidence that this is discount rate corporate executives use in evaluating investment decisions.

- Implications of 12%: future heavily discounted. $ in year 10 worth only $0.36 in Year One.
2015 National Average for Incentives: 1.42% of value-added for export-base industries

Is 1.42% of value-added large?

- Large? 5.83% of business profits, 30.1% of state/local business taxes, annual national cost of $45 billion

- Small? 0.63% of sales, 3.07% of regular wages, $2,326 per worker “job-year”

- Based on literature on how taxes affect location decisions, reduced costs of 1% of value-added increases location decisions by 3 to 17 times as much

- Therefore, 1.42% cost reduction as % of value-added should tip between 4% and 24% of location decisions.
Incentives vary a lot across states, even nearby states

- 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%
Incentives have tripled since 1990

Incentives as Percentage of State and Local Business Taxes

SOURCE: Author's calculations.
Incentives don’t vary enough with industry characteristics that predict how much new industry will benefit state residents. For example, not much variation with wages:

![Graph showing relationship between incentives as a percentage of value-added and industry wages per FTE worker.](graph)

Average Incentives as % of Value-added for 31 Industries, versus Industry Wages per FTE Worker
What determines incentives? Doesn’t have much to do with a state’s unemployment rate.
Job growth increases employment to population ratios more when unemployment is high: This increases labor market and fiscal benefits of new jobs.

% of Job Growth to Local Non-employed

- 94% when unemployment is high (10.0%)
- 67% when unemployment is average (6.2%)
- 54% when unemployment is low (4.2%)

Year

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10

Biggest determinant of a state’s incentives is its past incentives

Comparing State Incentives in 2015 vs. 2007
What are effects of incentives? No obvious strong effects of incentives on state growth

![State Growth & Incentives](image)

% Real GSP Growth, 2007-16

Incentives
What is time pattern of incentives? Front-loaded, but full incentive payout still delayed, which is economically inefficient and politically problematic.
What types of incentives are most important? JCTCs & abatements

Size of Different Incentives, 2015

<table>
<thead>
<tr>
<th>Incentive</th>
<th>Size of Incentive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Job creation tax credit</td>
<td>0.60%</td>
</tr>
<tr>
<td>Property tax abatement</td>
<td>0.40%</td>
</tr>
<tr>
<td>Investment tax credit</td>
<td>0.20%</td>
</tr>
<tr>
<td>R&amp;D tax credit</td>
<td>0.10%</td>
</tr>
<tr>
<td>Customized job training</td>
<td>0.00%</td>
</tr>
</tbody>
</table>
Time structure of different incentives: JCTCs, abatements, & R&D have lengthy payouts; ITCs & customized training more front-loaded.

How Different Incentives are Structured Over Time

- JCTC
- Ptax abatement
- ITC
- R&D
- CJT
Research on customized services

• Some research on customized job training find effects per dollar on job creation decisions of perhaps 10 times tax incentives: Hollenbeck (2008), Holzer et al. (1993), and Hoyt, Jepsen, and Troske (2008).


• Why? (1) Targeted at small/medium-sized businesses, which are easier to affect; (2) Upfront, so more salient; (3) Overcoming market failures in information & education markets, so can have value greater than cost.

• Why don’t states use more? (1) Harder to deliver; (2) Less politically visible; (3) Doesn’t help larger businesses as much.
Conclusions

• Incentives are large relative to state budgets, not necessarily large relative to private economy. But probably some incentives large enough to have significant effect on specific location decisions.

• Vary a lot across states (based more on political inertia than economic need?)

• Don’t vary enough across industries (the “reverse potato chip” rule?)

• Too long-term, not front-loaded enough

• Over-emphasis on tax incentives, under-emphasis on services to smaller businesses