A New Business Incentives Database

Timothy J. Bartik
W.E. Upjohn Institute, bartik@upjohn.org

Citation
http://research.upjohn.org/presentations/51
A New Business Incentives Database

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

November 17, 2017

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

Support for this project was provided by the Pew Charitable Trusts. The views expressed in this report and this presentation are those of the author, and do not necessarily reflect the views of the Pew Charitable Trusts or the Upjohn Institute.
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 it varies from Year One to Year 20 for new facility
- Free, open-access database
Database helps address key 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 affect state growth?
Methodology of database

• Hypothetical firm model
• New facility 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 industry differences in proportions of jobs, wages, real property, machinery/equipment, R&D, input purchases, and profits
• 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 calculated using 12% real discount rate. Why? Research evidence that corporate executives use this in making 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, about same as state corporate income tax revenue

- 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 not sufficiently higher for industries that offer greater benefits for state residents. For example, incentives do not go up much with wages:
What determines incentives? Doesn’t have much to do with a state’s unemployment rate

State Incentives vs. Unemployment: Each dot is a state; Figures are for 2015; Averaged over export-base industries
Biggest determinant of a state’s incentives is its past incentives

Comparing state incentives, 2015 vs. 2007: Each dot is a state; incentives measured as % of value-added
What are effects of incentives? No obvious boost to state growth from 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 national averages

Incentive % of value-added:

- Job creation tax credit
- Property tax abatement
- Investment tax credit
- R&D tax credit
- Customized job training
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, yet moderate 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