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 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?
  - 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

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:

![Incentives as % of value-added for 31 industries, versus industry wages per FTE worker: 2015 national averages; each dot is an industry](image)

- Incentives as % of value-added (%)
- Wages per FTE worker (annual $)
What determines incentives? Doesn’t have much to do with a state’s unemployment rate
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

State Growth & Incentives: Each dot is state

% Real GSP Growth, 2007-16

Incentives: average state % over 2007-2015
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

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

Size of different incentives: 2015 national averages

Incentive % of value-added
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