

## **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 incented 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 incented 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.