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## Do Better Job Creation Subsidies Hold Real Promise for Business Incentive Reformers?

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*Corporation for Enterprise Development*



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# 7

## Do Better Job Creation Subsidies Hold Real Promise for Business Incentive Reformers?

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### INTRODUCTION: AN IMAGINARY DIALOGUE ON BUSINESS INCENTIVES

Typically, business incentive reformers win the intellectual arguments about the downsides of business incentives, but state and local policymakers refuse to stop providing incentives. The following imagined dialogue between a “wonk” reformer and a business recruiting “buffalo hunter” captures the “back-and-forth” of such a conversation. But there is one big difference: *this* conversation may offer a way out of the present impasse.

*Wonk:* Business incentives are a waste of money, nationally speaking. They only make sense if they are designed to correct a market failure or really move private investment into poorer communities. The typical recipient of public largess does not need the money to do the deal. They are instead shaking down the jurisdiction for what they can get. Continued incentive use also perpetuates an unceasing incentives “arms race” between jurisdictions and a virtual “war between the states.”

*Buffalo Hunter:* That is easy for you to say. It might be high-minded of you to take such a perspective, but I have to think “state” and “local.” These are my constituencies and my customers. Sometimes an incentive can land a deal for my state and create some much-needed jobs.

*Wonk:* That’s noble, but this is a game that you cannot win ultimately. If you also roll back your regulations and tax base to court footloose firms, it can lead to a “race to the bottom.” Eventually, you will inevitably fall behind in the incentives competition: you match your peers, and

then come up with a new fiscal gimmick only to see it copied by others. It just pushes the price tag up and up. Plus, there is also the danger of the “winner’s curse”: you land the deal, but end up paying way too much for it. Essentially, the company holds all the cards because only it knows what will tip the deal one way or the other.

*Buffalo Hunter:* Fine, but I can’t just sit on my hands. If I’m heading down the wrong path, get the Feds to stop me. Regulate subnational subsidy use, like the European Community does. Or get the World Trade Organization to pay more attention to America’s implicit industrial policies and crack down on the most egregious of these.

*Wonk:* That’s not really the point. Just looking at the deals themselves, you should be a smart investor, not a chump. When negotiating you need to be sure to add stronger performance standards, increase transparency, conduct independent cost-benefit analyses, and so forth. It will help you to be more cost-effective with your incentives and weed out the bad programs.

*Buffalo Hunter:* Maybe, but my constituents can’t eat “good government.” Telling them I avoided some bad deals only goes so far. They want jobs.

*Wonk:* Of course they do, but the most important way to create jobs and wealth is to invest wisely in early childhood and K-12 education, research and development, higher education, infrastructure, and workforce retraining. Modernize the tax structure and provide professional and predictable regulation.

*Buffalo Hunter:* I completely agree, but it takes so long to generate the jobs and enterprises that are yielded by these public investments. Plus, it is kind of invisible, compared to cutting ribbons at the construction site of a new 100-job project.

*Wonk:* Well, what if I were to tell you that I have a viable alternative to the limited promise of that ribbon cutting ceremony? What if I can give you an option that generates real returns in one year or less? It is guaranteed to foster development in all counties of a state—not just the most affluent places, such as the metro areas (though it can help them, too). It is a game that everybody can play and win. It can really aid small businesses and help those workers and communities that are losing jobs today. The option that I propose is a smarter approach: growth tax credits and direct grant incentives for targeted job creation.

*Buffalo Hunter:* I’m listening. Please continue.

Such, in microcosm, is our current policy and political situation regarding business incentive reform. We are making headway. More cities and states are adopting performance standards, disclosure, and other accountability mechanisms. But, at the same time, the costs of incentives and the expectations of business for public dollars are constantly escalating.

We also win most of the policy arguments. Most technical policy experts believe that state and local business incentive competition is a zero sum (and at times a negative sum) game. Incentives are a waste of money, nationally speaking. They typically subsidize companies for jobs that they were already going to create. Incentives are unfair to firms that do not receive the subsidies. They divert scarce public dollars from wiser investments in the workforce or infrastructure. And they frequently fail to even generate a positive fiscal impact. But sadly, state and local policymakers keep on providing them, thereby weakening the tax base and escalating the costs of the incentives customarily offered. Ultimately, the only way to turn this situation around is via Congressional action and complementary litigation on Interstate Commerce grounds.

What can be pursued at the subnational level? Several things. We should strengthen performance standards, accountability, and disclosure. In addition, reform advocates must advance and provide evidence for the thesis that the best climate for private investment and job creation is not one loaded with incentives, but one with good schools, quality higher education, a modern infrastructure, predictable and professional regulation, research and development, a fair but not excessive tax system, amenities, and good public services and governance. More policy attention to entrepreneurship and the existing business base is needed as well.

Yet, there are problems, politically, with this approach. The citizens cannot “eat good government”: they want jobs. Moreover, the payoff on many of the preferred foundational investments take time. Constituents and their elected leaders want “jobs now.” Therefore, what is needed is a viable alternative to the ribbon-cutting that accompanies “successful” business attraction efforts.

We need an alternative that generates a return in one year or less, that is guaranteed to foster development in all parts of a state (not just the most affluent areas), and that is a game that every community can

play and win. In short, we need to generate jobs in a fashion that dwarfs the output of the standard business capital subsidy.

That is essentially what I propose in this chapter. And I have two questions for all readers: 1) Could this be a “shut them up” alternative to the final points that business recruiters and chambers typically make—that although what we say is right, our alternatives to incentives (school reform, entrepreneurship, etc.) take too long to generate results, and although incentives may not be a good thing, they are a necessary option? And 2) Should we have our own subsidy preferences, which could build a new political constituency base for reform, beyond the usual suspects, based on rural areas, small and existing business, and economically struggling cities? Distilled into its essence: Could more fine-tuned job creation subsidies be a promising new direction for the business incentive reform field? It’s a sort of “if you can’t beat them then join them” notion.

I will start by describing the situation in my home state of North Carolina. Next, I describe my alternative business subsidy alternatives. The chapter closes with a few summary points and questions.<sup>1</sup>

## **THE NORTH CAROLINA CASE**

The North Carolina economy is struggling. Compared to its state peers, it ranks as follows: unemployment rate (45th), short-term employment growth (44th), involuntary part-time employment (37th) and rural/urban disparity (47th). Nineteen North Carolina counties have jobless rates with more than 10 percent unemployment. Black unemployment was 10.7 percent in 2002; Hispanic was 10.8 percent. In the last few years, 121,000 manufacturing jobs have been lost. Obviously, the recent recession and a weak recovery have hit the state hard, and more jobs are desperately needed. And like most states, North Carolina has a weakened fiscal base. Further cuts in public services are strong possibilities.

When an economy is stalled like North Carolina’s, state and local officials often try to jump-start economic renewal by using tax and other business incentives to attract footloose facilities. Their hope is that these will sweeten the deal and help their state or community stand

apart from the other competitors who are also trying to entice private investment. Economic development professionals also believe that these subsidies will send firms the message that this jurisdiction is a good place to do business.

## **THE WILLIAM S. LEE ACT**

Prior to the mid-1990s, North Carolina had not been known as an incentive-providing state. Its first entry in this all-too-crowded field was a grant program, with a number of strong job quality and environmental standards. But, as the competition for trophy facilities heated up and the state lost out on some high-profile projects, its policymakers felt compelled to enter the sweepstakes. Created in 1996, the William S. Lee Quality Jobs and Business Expansion Act has been the principal incentive tool used by the state of North Carolina for business recruitment and expansion. Businesses may qualify for the Lee Act tax credits by

- creating new jobs,
- investing in machinery and equipment,
- incurring the expenses of training workers,
- undertaking research and development efforts, and/or
- establishing a headquarters or central administrative offices.

The act has been amended repeatedly since its inception in order to update and refine its tier targeting approach and to make the credits available for specific projects. It has three main goals:

- 1) help existing firms stay competitive by encouraging modernization and investment in new technologies,
- 2) encourage new investment in North Carolina's economy from both new and existing industries, and
- 3) ensure that economic growth reaches all people in all parts of the state, particularly distressed rural counties and high-poverty urban areas.

Counties are divided into five economic distress tiers based on unemployment rate, per capita income, and population growth of the

county. For many of the credits, the lower the tier of the county, the more favorable the incentive.

In summary, an official summary and assessment document on the law states the following:

Before 1996, North Carolina made little use of tax incentives to lure businesses to the state. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. In 1999, the General Assembly extended the 2002 sunset to 2006. (Luger 2003)

## CONTROVERSY OVER INCENTIVES

The Lee Act was created by the North Carolina legislature as an *experiment* to see whether tax incentives could successfully create jobs and increase private investment, especially in economically distressed parts of the state. Recently, the North Carolina Department of Commerce's own commissioned research has concluded that only about 4 percent of the jobs claimed under the act were induced by the Lee tax credits and that most of the incentives and private investment are going to the *least distressed* areas of the state (Luger 2003, p. 1). The Corporation for Enterprise Development's (CFED) research further emphasized that the state had already cost North Carolina taxpayers \$208 million with an ultimate liability of over \$1 billion.<sup>2</sup>

Despite these damning findings and a fair amount of press coverage, the governor called a special session for the North Carolina General Assembly to approve specialized grant-based incentive packages for a handful of hot prospects.<sup>3</sup> The legislature complied with his wishes.

It is also important to note here that the focus of incentive policy has shifted from the Lee Act to another grant-based tool: the Job Development Investment Grant (JDIG). The Department of Commerce can award up to 15 grants annually to strategically important new and expanding businesses and industrial projects. The subsidy is deep—up to

70 percent of the personal state withholding taxes are derived from the creation of new jobs. JDIG has a performance-based dimension—money is only released when jobs are created. An offer by the state, along with the grant awarded to the firm, only occurs after a fiscal analysis has been conducted. Its purpose is to make sure that fiscal benefits exceed costs. Theoretically, these grants are only given to projects that would otherwise not locate in the state. JDIG has a cap on costs per job created and a cumulative annual ceiling of \$10 million.<sup>4</sup>

Simultaneously, legislative leadership, worried about North Carolina's current economic misfortunes, including a high-profile 5,000-worker textile firm closing, created a Joint Select Committee on Economic Growth and Development. This committee is charged with examining the state's economic conditions and opportunities and developing new ideas. The governor's office has responded with a laundry list of actions, including—you guessed it—more incentives and a corporate tax cut.

Ironically, in December 2003, North Carolina was named the best business climate in the United States by *Site Selection* magazine (Arend 2006). This occurred approximately at the same time as the special session, which sought to earmark money for trophy projects like Merck, Reynolds, and Boeing.

At roughly the same time, bipartisan leadership in the general assembly asked CFED to develop some incentive reform models, which they hoped to include in the select committee's deliberations. As a result, we pursued three courses: 1) arguing for improved services for displaced workers, their families, and their communities (including rapid action on mortgage foreclosure mitigation); 2) crafting a variety of incrementalist refinements of the Lee Act and the other two grant-based incentives; and 3) developing more job creation-focused incentive alternatives.

We argued that the Lee Act was a noble experiment, but in our view, the results are clear: the experiment has failed. The William S. Lee Act has already cost North Carolina taxpayers \$208 million. In these tough economic times, the state cannot afford to finance these failing tax giveaways any longer. It is time to end or seriously restructure the Lee Act.<sup>5</sup>

## FOCUSING ON JOB CREATION: THE TWO MODELS

We have developed two new options for the state. Firms must elect to participate in one program or the other, not both.<sup>6</sup>

- 1) A new Job Growth Tax Credit, which would provide a 30 percent tax credit of the first \$14,700 of wages paid to each additional employee over and above 102 percent of the baseline employment. In other words, the state would only subsidize additional employment for a firm. This incentive would be offered statewide to all sizes of business only in years of high unemployment.<sup>7</sup>
- 2) A Targeted Job Creation Grant Program, which would offer private employers direct wage and benefit subsidies in Tier 1 counties (the most economically disadvantaged) for hiring unemployed job seekers.<sup>8</sup>

It is important to state at the start that the term—job creation, hiring, wage, and employment subsidies—are sometimes used as equivalent expressions. In this chapter, they are not. A hiring subsidy refers to funds used to offset wage costs in the initial part of an employee's period of employment with a firm. A wage subsidy is one whose purpose is to raise an employee's income. This chapter focuses on job creation or employment subsidies. We are exploring ways to increase employment. This strategy may use wage subsidies, but the purpose is different. Both of our options try to create net new employment relative to the nation as a whole.

### **The Job Growth Tax Credit**

The first option, the Job Growth Tax Credit, is a refinement of the New Job Tax Credit, one that is tailored to the state of North Carolina. During years in which the state's unemployment rate exceeds 5 percent, it would provide subsidies for employment only on the margin (and not finance all current employment). It would apply to for-profit firms that expand employment and be paid to the firms.<sup>9</sup> In so doing, the tax credit lowers the cost of labor for employers, hopefully spurring a substitution of labor for capital. The structure of the credit safeguards against a firm

firing all of its current employees and hiring twice as many half-time workers who qualify for the tax credit and minimizes the advantages of hiring additional part-time workers.

Under this proposal, the credit would be available for firms that increase their employment beyond some percentage (say, 2 percent) over the base year's employment level; the base year is that year in which the state's unemployment first exceeds 5 percent. The credit would exist until the state's unemployment rate falls below 4.5 percent. Based on typical business cycles, we expect the credit to exist for multiyear stretches (probably three or four years at a stretch). Assuming that the baseline year is announced after January 1, the period in which the credit may be applied should be free of gaming behavior by firms; that is, firms will be unable to adjust their baseline employment to maximize their later tax credits. During that period, any firm that increases its employment *more than* the prescribed percentage will receive the credit. The multiyear period would help firms make investments that require more time, investments that support increased employment (e.g., expansion of a plant). The credit would be available for each year that the firm increases its employment above the targeted amount.

The design is antirecessionary and countercyclical. By encouraging expansions in employment during high unemployment periods, the state is rewarding firms that act, perhaps hastening the recovery. It is possible that firms may delay expansions until recessionary years (assuming that the credit is made permanent and known to kick in during times of high unemployment), but there are few firms that will postpone expansions for years in hopes of gaining a tax credit.

The credit would be applied only to an individual's wages up to some cap (such as 30 percent of the first \$14,700 of wages<sup>10</sup>), which would tend to provide an above-average subsidy of jobs for lower-skill and lower-wage workers. More specifically, under the tax credit, the credit to a firm will be equal to: 30 percent of the first \$14,700 of wages paid to each additional employee over and above 102 percent of the baseline employment with no cap. Ideally, new firms will receive a smaller credit: the lesser of 15 percent of the above quantity.<sup>11</sup> Ideally, this would lower the costs of the credit, because there is a higher chance of windfalls with startups that were already planned by their owners.

## The Targeted Job Creation Grant Program

The second approach, the Targeted Job Creation Grant Program, would be a refinement of the Minnesota Emergency Employment Development Act strategy. On a pilot basis, North Carolina policymakers would make a targeted discretionary grant program available to Tier 1 counties. (If successful, it could be expanded statewide.)

The state would offer private employers \$6.75 per hour in wage subsidies and \$1.75 per hour in benefits (these figures represent 2003 inflation-adjusted amounts of the original MEED figures) for a 26-week period to employ certified job applicants suffering severe economic distress. Local or regional Workforce Investment Boards would award subsidies, on a discretionary basis, to identified employers that hire selected individuals from disadvantaged groups. To be eligible, a worker must have been a state resident for at least one month, be unemployed, and be currently ineligible for unemployment insurance (or have exhausted his or her six-month UI payments), *or* be a currently UI-eligible individual who has been displaced by a mass layoff (as certified by the Worker Adjustment and Retraining Notification law) or a member of a household with no other source of income than UI benefits.<sup>12</sup> To reduce displacement of current workers, the subsidies would be available only for newly created jobs.

Preference would be given to firms that can provide good on-the-job training in both “soft” and “hard” skills and that are committed to “rolling over” these subsidized hires into permanent jobs with some prospect for advancement. Indeed, as an incentive for long-term placements, if an employee continues in the job for at least one year after the initial six-month subsidy, employers will pay no reimbursement to the state. However, for employees that are hired for fewer than 18 months, employers will be required to repay up to 70 percent of the subsidy (the actual amount will be prorated).

Since these are grants, not tax credits, these subsidies are ideal for new, young, and/or small firms. (They can be used immediately, not just when the firms have profits or when they file their taxes.) Moreover, there is little uncertainty about such a program: potentially participating businesses already exist in North Carolina; they do not have to be coaxed to come. They must only have expansion plans that require a little financial boost. The upfront grant nature of the subsidy also means

that it could improve an enterprise's financial position for obtaining bank loans.

Like MEED, it also probably makes sense to provide these grants to nonprofits and local public agencies. Except for the requirements to create a permanent job and to pay back some of the subsidy, all the same rules would apply.

Furthermore, having this temporary public job alternative is important for a number of reasons. In many Tier 1 counties, government payrolls are one of the major sources of jobs, and recent economic distress is forcing some local and county governments to terminate some positions. Secondly, there are a number of community improvement projects that could be implemented and that would not significantly compete with the private sector.<sup>13</sup>

## **HOW MANY JOBS, AND WHAT WILL THEY COST?**

What sort of impact might these two strategies have on the North Carolina economy? It is difficult to say. We can only make an educated projection (and a highly speculative one at that). Here is our reasoning and data work.

We estimate on a net basis that our Job Growth Tax Credit, after subtracting jobs that would have happened anyway, will generate 26,806 jobs per year.<sup>14</sup> The cost is roughly \$14,800 per job.<sup>15</sup>

For the Targeted Job Creation Grant Program, we project costs and benefits for a program restricted to Tier 1 counties so as to keep costs down and help the most troubled places. If we further deal only with net jobs (employment that occurred because of the grant), we estimate that it would create about 2,291 net jobs annually in Tier 1. The cost is \$16,370 per job. If one was citing gross jobs created, the quantity of jobs would be doubled and the cost would be roughly halved. Let's compare this net number to the data for the Lee Act as cited in the Luger and Stewart report.<sup>16</sup> In 2002, 7,702 jobs were created across the state. Of these, 465 were in Tier 1 counties (Luger and Stewart 2003). Thus, our figures are approximately 5 times greater than the Lee Act outcomes.

Now, to look at the full picture: Our two options create jobs at a blended cost of \$15,527 per job. In the latest in-house assessment of the Lee Act, the author comes up with a range of job creation figures, from 87,000 to 147,000 (Luger 2003). A paltry 4 percent of these (i.e., 3,400 to 5,900) are estimated to have been induced by the Lee Act (Luger and Bae 2005). The cost is about \$39,475 (Table 7.1).

Our employment numbers are much bigger than those attributed to the Lee Act, reflecting that these proposed programs are targeted to job creation and labor intensity and that they would apply to startups, business expansions, and new recruitment projects, not just the footloose facility waiting to land somewhere.<sup>17</sup>

Doesn't this proposal generate proportionately more low-wage jobs? Yes, it does. There are times when more jobs (any job) are needed. In addition, not all job seekers will have the time, the capacity, or the opportunity to get retrained and find a better job. The creation of more jobs pushes all wages up. The Job Growth Tax Credit is also meant to be a countercyclical tool. It is triggered when it is most needed—during a recession and the early recovery period. The availability of federal Trade Adjustment Assistance supplements mitigates the low-wage problem for jobless workers over 55 years old. If they have lost their jobs due to imports or trade-induced relocations and have landed new jobs that pay less than the old wage and less than \$50,000, they may receive 50 percent of the difference between their old and new wages for up to two years.

## **DESIRABLE PROGRAM FEATURES**

*The fundamental virtue of these two alternatives is that a strong rationale could be made for them even if there was no incentive competition.* The Job Growth Tax Credit is promoting economic activity during a recession and strengthening the early stage of the recovery. On the other hand, the Targeted Job Creation Grant is trying to encourage more private employment in economically disadvantaged and depressed counties.

Analogous employment programs have been run successfully both here and abroad. Research documents that wage subsidies for the job-

**Table 7.1 Incentive Comparisons**

Program	Subsidy type	Objectives	Mechanism	Number of jobs	Cost per job
Targeted Job Creation	Grant	<ul style="list-style-type: none"><li>• Foster job creation in poor tier 1 counties</li><li>• Promote the expansion of small business</li></ul>	<ul style="list-style-type: none"><li>• Grant subsidy for 6 months to firms hiring unemployed job seekers</li><li>• Up to \$6.75 for wages/\$1.75 for benefits</li><li>• Penalty for jobs terminated before 18 months</li></ul>	2,291 jobs for tier 1 counties	\$16,370
Job Growth Tax Credit	Tax credit	<ul style="list-style-type: none"><li>• Encourage job creation during recessions and early recoveries</li></ul>	<ul style="list-style-type: none"><li>• 30% tax credit per employee of first \$14,700 of salary above 102% of baseline employment</li><li>• Triggered by 5% unemployment</li></ul>	26,806 jobs statewide	\$14,700
Lee Act Tax Credit	Tax credit	<ul style="list-style-type: none"><li>• Drive private investment into poor counties</li><li>• Encourage job creation</li><li>• Attract premier property</li><li>• Foster R&amp;D</li><li>• Training credit</li></ul>	<ul style="list-style-type: none"><li>• For machinery and equipment 4–7% of investment above threshold</li><li>• Job creation credit up to \$12,500 per job</li></ul>	3,400 jobs statewide	\$39,425

less or less-skilled workers are likely to be more effective when utilized in conjunction with labor market intermediaries that help provide some training, placement services, and job retention assistance.<sup>18</sup> The benefit/cost ratio can be increased, and the overall expenses can be limited by targeting the program to certain communities and potential workers. If the recession truly ends, the strategy can be easily converted into a welfare-to-work operation and even use welfare monies as a means of funding these wage subsidies.

This strategy is appealing because it does not fit conveniently into any one of the boxes typically used to describe comparable programs.<sup>19</sup> It is an economic development tool. It supports small businesses that will be the main users of the program. (Larger firms are eligible as well.) It is a temporary, countercyclical adjustment program for mainstream workers. And it balances the above with more of a focus on the harder-to-employ, disadvantaged worker.

This program would also help level the playing field for all communities. Many will never land a prime business attraction project, but all have indigenous firms that might expand with an injection of money. All can play and win in this game. Further, it focuses on aiding those workers who are suffering right now, unlike the approach of the Lee Act, which is structurally indifferent to who gets hired.

The two proposed programs also complement each other. The first is administratively less demanding and will be attractive to more established firms. The second will require more oversight but will be very attractive to small firms and startups; it targets those needing new employment. Moreover, the two have different funding advantages and disadvantages. The first option does not require any real out-of-pocket revenues from the state, while the second will entail a specific appropriation.

A further comparison with the Lee Act is especially telling. Given what's been happening to the state since it was enacted, a policymaker could come up with a new litmus test for new program development. For example,

- 1) Does the development reform or new option encourage investment in those communities that are being hardest hit by economic restructuring and dislocation?
- 2) Does it improve the reemployment prospects of displaced workers?

- 3) Does it help the state's businesses and sectors compete successfully on the basis of innovation, productivity, timeliness, flexibility, and quality in the new global economy?
- 4) Do development strategies help to ensure an adequate revenue base for financing essential public services?

The Lee Act only compares favorably with our proposals on the third item. But it does so at an unacceptable cost relative to benefits.<sup>20</sup>

Lastly, our two approaches can be linked with a statewide First Source hiring program.<sup>21</sup> Such agreements help local/state governments target more of the jobs resulting from new business projects to local residents, the unemployed and the economically disadvantaged. Such agreements require private companies that receive public monies to use the public sector or designated nonprofit contractor as the "first source" for new job hires. The state or local government (or a nonprofit broker and job training/placement "shop") acts as the "job developer" on behalf of the private firm, identifying and screening potential workers, arranging training services, and so forth. The private sector is under no obligation to hire these workers, but must interview them before seeking any other possible employees. Such programs have been run very successfully in Portland, Oregon; Berkeley, California; and Minneapolis, Minnesota. Berkeley's program, for example, has been used since 1986 to meet business and construction contractors' needs for workers, while giving special attention to filling entry-level and intermediate-level jobs with qualified local workers (particularly, unemployed and underemployed minorities, women, youth, and disabled persons).<sup>22</sup>

## **A BUFFALO HUNTER'S REBUTTAL?**

Continuing the argument in the prologue, the proponent of using fewer performance-based incentives might argue as follows.

- You can put so many conditions and complexities on an incentive that it becomes a disincentive.
- The local developer can claim that she needs a more attractive incentive to do her job. (Of course, if the state government is footing the bill, she has nothing to lose and everything to gain.)

- Furthermore, the incentive proponent can argue that the Job Growth Tax Credit is not really equivalent to a conventional job creation or machine and equipment credit, because it is not available at all times. The grant program is mainly a small business subsidy, targeted at the most needy areas. So, it too is not helpful for attraction purposes.

Does this leave the author of this paper with no ammo for a counter-argument? Here is my response:

My critics are right: the alternatives proposed in this chapter are less attractive to business. This is inevitable, because the financial interest of the shareholders of the business prospect and the state government are not completely in sync. The shareholders want to maximize the incentive offer, get it in cash rather than in-kind, and have the least strings attached. The state (or local, if it's financing the incentive) government has a different bottom-line: it wants jobs and private investment on its terms, which includes, most importantly, a fiscal surplus generated by their incentive investment.

But there is a political dimension as well. If the citizenry understands and supports cost-effective incentives offered by fiscally responsible public officials that are targeted at priority economic development and employment challenges, then this chapter's proposals look stronger.

The Buffalo Hunter still has a final response. He points out that his way of working still possesses more political muscle and it is more widely understood. "Unilateral disarmament is not an option," he says. "I assure you, citizens, that I will never leave you undefended. I will court every opportunity for jobs."

He also has a constituency base that can be more easily mobilized. Local developers, chambers of commerce, and county officials, along with governors and secretaries of commerce want tools for deal making. At this time, they are rewarded for winning or losing this game. They are deeply interested and engaged in keeping incentives around while other constituencies, such as school teachers, unions, communities that will never land a plum plant, environmentalists, and advocates for the poor and progressive taxation are only marginally engaged in this fight.

Looking again at the North Carolina case surfaces another dimension that should be discussed. There *is* growing interest in reforming the Lee Act. Some, even in the mainstream economic development com-

munity, may be willing to let William S. Lee go. *But this is only acceptable if JDIG gets more resources.*

The state's relatively new JDIG has some good elements.<sup>23</sup> The committee that manages the JDIG funds has authored an excellent series of guidelines for making decisions and holding firms accountable for private investment and job creation. I especially like the required upfront fiscal impact analysis, the cap on the costs per job, the limit on number of projects per year, disclosure and reporting requirements, quality job and company standards, employment-triggered releases of funds, the contractual breach language, and the sanctions for noncompliance.<sup>24</sup>

The virtue of this program is its vice: it is very flexible, which means that it allows for highly tailored incentive packages. This customization, along with the size of the subsidy, makes it extremely attractive to prospects. But there's a downside: it also raises the specter of the "winner's curse"—in the heat of the state-to-state competition and in the absence of knowing what the firm's bottom line is or what other communities may be offering, you pay too much for the honor of hosting this firm.

This is why I argue that the upfront fiscal impact analysis is so important. These fiscal projections must be conservative and must not use inflated multipliers. They must count all the state and local incentives on the table and recognize that a certain number of jobs will go to non-natives. They must use a reasonable discount rate over time, and they must factor in somehow and subtract the percentage of jobs that would have happened anyway.

Given the importance of the fiscal impact analysis in avoiding the winner's curse, its credibility and integrity might be increased if the analysis were conducted not by the Commerce Department, but instead by the Department of Revenue or Fiscal Research in the General Assembly. (There are no accusations here of wrongdoing; the change, however, could remove any potential doubts and concerns.)

The likelihood of a favorable ratio of benefits over costs is much more likely if the unemployed or the working poor get a shot at these jobs. This is why imposing a "First Source" hiring requirement on JDIG or any other subsidy is so important.

In my view, any expansion in dollars and numbers of projects annually must be contingent on these reforms of JDIG.

One further recommendation: I strongly suggest that any new incentives proposed to the General Assembly must have a fiscal note at-

tached to them and must specify the management information system and outcome measures that must be in place before the incentive is open for business. This would greatly aid the General Assembly and commerce staff in monitoring and evaluating the incentive's results.

So, who won the argument? In some ways, it looks like the buffalo hunter once again had the last word, but hopefully not the last laugh. That's why it all comes down to innovative accountability reforms for the short-term and civic education, advocacy, and politics for the long haul.

## CONCLUSION

Business incentives for attracting private capital are, at best, a necessary evil. Indeed, in giving away public resources, states are trying to influence *where* the jobs will be located, not *whether* the jobs are created. The offer typically is not: "If you can help us financially, then we can afford to take a risk to build a new line of profitable business." Rather, it is: "We have a new line of profitable business, so we're going to build a new plant. How much will you give us to build it near you." This whole "auction" is largely a waste of limited public resources.

To conclude, this is the current situation in North Carolina. CFED's two "models" are being translated into legislation by General Assembly staff. CFED was asked to testify before the Joint Select Committee on February 19, 2004. Some progress has been made in getting this Committee concerned about the recent rise in mortgage foreclosures. Plans are in the works to establish an ad hoc coalition for incentive reform and improved displaced worker services. The jury is still out regarding the substance and political viability of a more job creation-focused approach to business incentives.

## Notes

1. Many of these ideas were developed in collaboration with a CFED colleague, Lillian “Beadsie” Woo. We also received a great deal of good advice from economists John Bishop, Tim Bartik, and Robert Haveman.
2. Between 1996 and 2001, the accumulated value of the tax credits generated was \$1.16 billion, of which \$208 million were claimed. “Generated” credits are ones in which a business has successfully applied for a credit. “Claimed” credits are ones where a business has actually invoked the credit and is paying fewer taxes. Some credits can actually expire over time if they are not claimed.
3. Sample projects included Boeing and Merck. These might be called ad hoc subsidies rather than “statutory-based” subsidies.
4. To date, North Carolina has funded six projects. Most were located in Tier 5 counties, the most affluent. They include General Dynamics Armament and Technical Products (headquarters and light manufacturing); Infineon Technologies North American Corporation (semiconductor company from Germany, with U.S. headquarters in California and operations across the United States); R.H. Donnelley Corporation (publishing company, headquarters relocating from Vermont); GE Nuclear Energy (headquarters moving to North Carolina); and Goodrich Corporation (expansion of existing facility, moving from Illinois and New Jersey).
5. For a much more detailed critique, see Schweke and Woo (2003a). We have also crafted a more incrementalist reform of the Lee Act.
6. For a thorough description and defense of these models, see Schweke and Woo (2003b).
7. This option was an adaptation of the federal New Jobs Tax Credit (1977–1978). The background literature on it is cited in Schweke and Woo (2003b).
8. The grant program is based on the successful Minnesota Emergency Employment Development Act in the 1980s.
9. In the interests of fairness and the potential to create a larger employment impact, when enacted, the tax credit should be limited to firms in those sectors that produce goods and services that are either exported to other states or countries or are substitutes for goods and services that would otherwise have to be imported. The Lee Act has some eligibility wording that could be used or adapted. Moreover, CFED has a list of those industries that should be eligible for the tax credit and will gladly make it available upon request.
10. The mathematical rationale is as follows: a firm that chooses to hire 10 people for a total cost of \$250,000 in salaries gets a better tax deal than a firm that hires 5 people for \$250,000. Firm 1 can take a credit of \$44,100, while firm 2 only gets \$22,050. The tax credit’s structure, therefore, subsidizes a higher percentage of lower-waged employees’ salaries. \$14,700 is the figure for North Carolina’s FUTA wages. This is for the unemployment insurance tax that firms pay.
11. There may be legality issues with having two rates, so this may not be possible.

12. The Targeted Job Creation Grant could be made administratively simpler by being available for hiring any unemployed North Carolinian, but we were trying to address those people in greatest need.
13. For more detail about public versus private job creation, see Johnson, Schweke, and Hull (1999).
14. We assume that 30 percent of the job growth is directly attributable to the tax credit. The typical time for the national economy to go from peak to trough is seven years. We can assume, then, that the tax credit would be operational for about half that time, or three years. That brings the total number of jobs created to 80,417.
15. This figure may be too high because some of the firms that might use the Job Growth Tax Credit will use the grant program. So, we may be counting the type of firm with potential to add some jobs twice. However, we qualify this possible overcounting worry by noting that the two options target different sized firms to some extent. The grant program is more attractive to small, new and young firms. The tax credit is more of a winner for large and established enterprises.
16. It should be noted here that the Institute for Economic Development at the University of North Carolina has authored two reports evaluating the Lee Act, one in 2001 and another in 2003, plus an interesting report on the North Carolina economic development system (see next footnote). In each report, different estimates are given for the Lee Act. Sometimes they are only statewide numbers. Other times they look at Lee tax credits, in particular, Tiers. Sometimes they are citing net jobs, other times they are gross jobs. The 2001 and 2003 Lee assessments used different numbers to derive net jobs. In 2001, the authors claimed that 50 percent of the jobs were due to the Lee Act. In 2003, the number was 4 percent. So, it is often difficult to get comparable benchmarks.
17. We think both options are wise and complementary, but if you can only do one, the Targeted Job Creation Grant is the most compelling, because it focuses on citizens most in need.
18. See Katz and Molina publications in Schweke and Woo (2003b). Also go to "Job Initiative" program of Anne E. Casey Foundation at <http://www.aecf.org>. There is an extensive list of relevant publications to consult for more research on the role of labor market intermediaries.
19. In short, the programs are synergistic. Their creators (Haveman, Bishop, Bartik, and others) sought to "think outside the box" when they were developed.
20. Some might argue that the 4 percent figure is too low. It might be, but Luger's (2003) calculation is the best number we have at this point. And it does underscore the danger and reality of inevitable windfalls in any subsidy program.
21. The administrative monies for implementing the direct grant program can also cover much of the expenses of upgrading county and regional job placement services.
22. Excellent discussions of First Source Agreements can be found in Molina (1998) and Lyall and Schweke (1996).
23. JDIG has been catching some heat because four of its first five deals have gone to Tier 5 (affluent) counties. In addition, there is still the inevitable problem that

eventually North Carolina competitor states will replicate JDIG or come up with another incentive “gizmo.” The whole process starts again.

24. JDIG could still be strengthened in the areas of performance contracting and sanctions for noncompliance.

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