Incentives for the Twenty-First Century

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Introduction

Members of the International Economic Development Council are interested in improving their understanding of how to use incentives efficiently, responsibly, and cost-effectively. ¹ IEDC's in-house think tank, the Economic Development Research Partners (EDRP), has issued two reports on incentives in the last year. *Incentives for the Twenty-First Century*, the final report in the EDRP "trilogy" on incentives, offers recent examples of effective and innovative incentive designs that yield high community returns.

What is an Incentive?

An *incentive* is a reward intended to induce, incite, or spur action. Economic developers aim to improve the economic and social well-being of their communities by increasing private sector investment and employment. Incentives in economic development tend to be awarded to specific businesses, in exchange for certain business actions, rather than being available to all taxpayers. ²

The State of Incentives Today

About 95 percent of localities and states in the United States offer at least one incentive for economic development. ³ However, some feel that businesses would invest anyway, despite incentives; others maintain that they are mainly used to move jobs from one location to another. But it is not easy to determine which incentives are successful in shaping corporate behavior, because companies try to protect their location decision making from competitors.

Incentives for the Twenty-First Century

The innovative incentives presented in this paper reduce business costs and have the potential to significantly increase jobs, investment, tax revenues, and consumer spending. Although not all of the incentives here are entirely "new," they present means of incentivizing business activity that have recently been recognized as particularly effective.

Promoting Entrepreneurship

Young, entrepreneurial firms create about two-thirds of new jobs. ⁴ Entrepreneurs also contribute to economic diversity and productivity in a community. ⁵ While many communities promote

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entrepreneurship as an element of their economic development strategies, some have gone further, directly incentivizing entrepreneurship. A prominent example is angel investing tax credits, which are provided to investors who make equity investments in early-stage companies. In Georgia, a state angel investing tax credit has created 200 new jobs, with a payroll of $10 million.

**Human Capital Attraction and Development**

The availability and quality of talented labor is a critical factor in the success of every business—and every community. Today, economic developers are increasingly focusing incentives on talent attraction and development. FastStart, “the silver bullet in Louisiana’s success in the site selection wars,” provides responsive, customized training to relocating companies. Kansas Rural Opportunity Zones give student loan relief to workers who relocate to rural counties.

**Accelerating Gazelles**

Growth-oriented small businesses produce most of the new jobs in the economy. Yet young, small businesses suffer from many challenges compared with larger, more experienced firms, such as obtaining financing. Economic developers have long recognized the importance of small business development, but now more than ever, they are focusing incentives on high-growth-potential “gazelles.” For example, economic developers are increasingly investing equity in growth companies, as well as leveraging the private sector’s interest in “impact investing” to spur for-profit, community-oriented venture capital funds.

**Brownfield Remediation**

Brownfields—contaminated former industrial sites—cost American cities millions in lost tax revenues every year. Remediating these lands increases property values and inner-city employment, while supporting smart growth. More than ever, economic developers are redeveloping brownfields for industry use rather than for housing. Economic developers in Philadelphia, for example, are connecting brownfield policy explicitly to business attraction. Reusing brownfields for industry takes advantage of existing infrastructure and lower standards for cleanup compared to those required for housing.

**Export Promotion**

Companies that develop their products are more resilient, innovative, and profitable, yet only 4 percent of U.S. companies export. Economic development organizations are reaping the benefits of supporting local companies to develop export readiness through small grants that incentivize businesses to undertake the planning, translations, and travel. For instance, Bluegrass Economic Advancement Movement, a regional EDO in Western Kentucky, grants up to $4,500 to small businesses wishing to increase their export activity.

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Smart Growth
Smart growth is the effort to promote compact development patterns that facilitate taking transit, bicycling, or walking between housing, workplaces, retail, and other amenities. Smart growth neighborhoods have higher property values than traditional development and are an important factor in attracting young professionals. In Detroit, the Live Midtown program seeks to increase the vitality, safety, and welfare of the Midtown neighborhood by offering institutional employees up to $20,000 toward the purchase of a home and an additional $5,000 for home improvements.  

Placemaking
Placemaking is about “creating quality places that people want to live, work, play, and learn in.” As talented workers are now increasingly relocating to areas with desirable amenities, businesses are increasingly considering livability as a component of site selection. To promote cultural vibrancy, Paducah, Kentucky’s Lowertown Artist Relocation Program offers grants to artists who apply to reuse dilapidated buildings in the Lowertown neighborhood. The program has spurred $40 million in development and 75 new business openings at a cost of only $2 million to the city.

Rehabilitating Historic and Abandoned Buildings
Historic buildings are an important component of distinctive places. From Boston’s Old State House to Los Angeles Bradbury Building, iconic buildings are critical to place image. Older buildings that lack cultural importance can still serve as relatively inexpensive locations for business activity. Many states offer tax credits for the rehabilitation of historic buildings for business use. For example, Missouri’s Historic Tax Credit has been called the “single most important incentive used in Downtown St. Louis’ revitalization.”

Local Hiring
When relocating companies attract many new residents, jurisdictions can incur high costs to provide additional public services. This underscores the need to encourage companies to hire locally. Hiring locals ensures that earnings will be spent in the community and that a new corporate facility will contribute to unemployment reduction. For example, San Francisco’s Central Market and Tenderloin Area Payroll Expense Tax Exclusion gives companies a tax break to support local workforce training and community development programs with money and gifts-in-kind of products and human resources.

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Business Retention and Expansion

Only 2 percent of new jobs come from relocations within the United States; the remainder comes from expansion of existing facilities and the birth of new companies.\(^{11}\) Business retention efforts enjoy greater success and better cost efficiency than efforts to recruit business.\(^{12}\) Louisiana, for example, offers a retention-oriented Modernization Tax Credit, which provides a refundable tax credit worth up to 5 percent of the costs of modernizing or upgrading existing facilities.\(^{13}\)

Energy Efficiency

Thirty-five percent of small business owners say that energy is one of their three largest costs.\(^{14}\) Many EDOs now concentrate on promoting energy efficiency and green building as a way to reduce business energy costs. AlabamaSAVES (Sustainable and Verifiable Energy Savings), makes loans of up to 90 percent of project costs, up to $4,000,000 for energy-saving improvements. This approach can not only improve companies' bottom lines, but also reduce government costs of generating and transmitting power, while advancing environmental goals such as reducing greenhouse gas emissions.

Conclusion

This paper has attempted to capture today's best practices in the use of incentives with descriptions and case studies of innovative and effective incentives. Although these incentives vary substantially in their form and intent, they share several characteristics. Incentives for the twenty-first century:

- Help to reduce business costs;
- Influence business decisions;
- Advance social and environmental welfare; and
- Connect with well-established best practices in economic development.

These incentives, when used properly, can help to advance community wealth and welfare. They represent today's best thinking on incentives. Economic developers should continue to innovate new ways to grow community wealth by creating an encouraging environment for private business development.

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