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Incentives 2.0

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REWARDING SUSTAINABLE DEVELOPMENT AND SOCIAL ACCOUNTABILITY

This article discusses the need for more sensitive rubrics to guide economic development incentive awards. Many existing local incentive policies contain limited explicit criteria to be used in evaluating incentive eligibility, often resulting in incentive deals that do not support communities' long-term economic, social, and environmental vitality. The article describes why leaders in Chatham County, North Carolina, saw the need to revise the county's old incentive plan, the process that shaped a new approach to incentive awards, and new metrics that were included in the county's revised incentive policy.

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INTRODUCTION

Incentives are a dilemma for many state and local governments. Incentives were originally intended to create jobs by increasing return on investment, but many economic developers and economists have concluded that financial incentives rarely change where businesses invest. And yet, incentives have become an accepted part of the economic development landscape, part of the ante to the high-stakes game of business retention and attraction.

It is time to recalibrate how incentives are awarded. Many local incentive plans base eligibility only on the number of new jobs and/or level of capital investment. These criteria do address two critical issues for local governments, job creation and increased property tax revenues, but they do not fully capture a project's costs and benefits to the local community. Incentive policy should reward companies that treat their workers well, are good corporate citizens, and support long-term economic vitality.

Chatham County, North Carolina, recently adopted a new incentive policy designed to target sustainable development and reward social accountability. Just south of Chapel Hill and west of Raleigh, Chatham County has absorbed a huge amount of the housing and population boom that came as North Carolina's Research Triangle Park emerged. Like so many communities, the county has been reevaluating its economic development strategy and, along the way, developed a new approach to awarding incentives.

The article begins with a broad discussion of why many local incentive policies need to be rethought. The next several sections recount why Chatham County decided that its old policy needed to go, how it developed a new plan, and review the content of that new policy. It concludes with principles which can help other communities that want to revamp their incentive policies.

Photo credit: Uniboard

Uniboard USA LLC facility in Moncure, which received incentives under Chatham County's previous policy, where only total investment and raw number of jobs were identified as criteria.

PANDORA'S BOX IS OPEN

The overwhelming evidence is that, in most instances, financial incentives do not substantially change where businesses locate or expand operations (Peters & Fisher, 2004; Schwartz, Pelzman, & Keren, 2008; Gabe & Kraybill, 2002). A recent survey of incented and non-incented companies in North Carolina found that incentives ranked 12th and 13th respectively out of 19 priorities for business climate (Lane & Jolley, 2009). Businesses are more concerned about availability of skilled labor, state tax rates, local property tax rates, logistical assets, and availability of educational institutions.

So why should governments, at all levels, continue to offer incentives? Simply put, incentives are around to stay because everyone offers them. Many

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Developing a strategic plan made it clear that the county's old incentive policy was not in line with the community's vision for sustainable economic development. Changes had to be made.

companies make the availability of incentives a requisite in the site selection process, eliminating communities that flatly refuse to negotiate incentive deals. When leaders in one city, county, state, or nation know that their counterparts are crafting incentive deals, they feel pressured to offer enticements of their own.

The strategic pressures for local governments to offer incentives are particularly strong. Research has shown that incentives can influence where businesses invest within the same metropolitan area (Bartik, 1991; Wassmer & Anderson, 2001), so local leaders are right to worry that refusing to offer incentives can be costly. Because incentives are a mainstay of economic development practice, localities need to adopt a more strategic approach to investing public funds. The next section reviews Chatham County's old incentive policy and why local leaders decided that it needed to be changed.

CHATHAM COUNTY'S OLD INCENTIVE POLICY: A Policy Similar to Many Existing Local Plans

Like many existing incentive policies, Chatham County's old plan provided very limited guidance about what projects merited investment of public resources. In the old plan, which is reviewed here, only total investment and raw number of jobs were identified as criteria. Table 1 shows the schedule of tax relief, in the form of grants, firms could secure for investing in the county.

In 2007-2008, Chatham County engaged upon a strategic planning process to generate sustainable economic development. This process surveyed local needs, targeted specific industry clusters for attraction and expansion, and clarified the values that anchor the community's economic development policy. Developing a strategic plan made it clear that the county's old incentive policy was not in line with the community's vision for sustainable economic development. Changes had to be made.

THE PATH TO SUSTAINABLE AND SOCIALLY RESPONSIBLE INCENTIVE POLICY

Chatham County's new incentives plan evolved through collaboration among community leaders, residents, and the University of North Carolina's Center for Competitive Economies. The Center for Competitive Economies was hired to create a strategic economic development plan for Chatham County, which served as the foundation for revising the county's incentive policy. This section highlights the critical elements of the process that led to adopting a more sustainable, socially conscious, and strategic incentive policy.

Community Engagement

Socially conscious sustainable development starts with community discussion. The Chatham County Economic Development Corporation knew that it was essential to gather local wisdom and to give community members an active role in charting the county's development strategy. Five town hall meetings were held where attendees were asked "what types of jobs and businesses would you most like to see in your community?" All responses were recorded and then everyone was asked to identify five goals they supported and one they opposed.

Four areas of broad agreement emerged:

1. County policy should support green business, both businesses that produce green products and firms that limit their environmental impact.
2. County policy should support buying local and sustainable agriculture.
3. County policy should encourage tourism, arts, and recreation.
4. The county should identify and cultivate promising industry clusters.

There was substantial disagreement over the need to expand retail options, particularly chain stores.

Next, interviews were held with community and business leaders. Business owners identified the need for improved water, sewer, and broadband infrastructure, echoing worries that emerged at the community meetings. Stakeholder representatives were also divided over the importance of expanding retail.

TABLE 1

Chatham County's Previous Incentive Policy

	Number of New Jobs			
New or Expansion Investment	Less than 40	40 but less than 75	75 but less than 100	100 and over
$500,000 but less than $2.5 million	50%*	55%	60%	65%
$2.5 millon but less than $7.5 million	55%	65%	70%	75%
$7.5 million and up	60%	70%	75%	80%

* Percent of county taxes granted back to approved companies for first five years after location or expansion.

Strengths, Weaknesses, Opportunities, and Threats Analysis

Sustainable development policy requires clear understanding of where a community stands, where danger looms, and where opportunities exist. As such, the Center for Competitive Economies analyzed the county's strengths, weaknesses, opportunities, and threats (SWOT) to form a baseline for sustainable development planning.

Photo credit: Jenny Tenny

An innovative existing biofuels company leads Chatham County's renewable energy targeted cluster.

Chatham County is located on the urban fringe of the Research Triangle region of North Carolina, which includes the growing Raleigh-Cary and Durham-Chapel Hill metropolitan regions. The area is home to three world class universities: Duke University, North Carolina State University, and the University of North Carolina at Chapel Hill and the famed Research Triangle Park, a major employer and driver of regional and state economic growth. While the county's population is expanding, economic growth in the county has been limited, creating a series of challenges for local governments.

The purpose of cluster analysis is to identify groupings of businesses that have economic reasons to co-locate in a given community and have the potential to create good jobs for local residents.

The SWOT analysis identified several challenges that must be overcome to create sustainable growth in the county:

- Chatham County is in danger of becoming a bedroom community. It has the highest out-commute rate in the region and its commuters travel farther to work than any neighboring community.
- The county needs more good-paying jobs. Jobs within the county pay less than in neighboring communities and less than the state average. This income disparity holds true across nearly every business sector, with those residents commuting outside the county earning substantially more than residents working in the county.
- The county leaks retail business to neighboring counties. Retail leakage costs the county government tax revenue and decreases the employment multiplier attached to high-wage employment.
- Chatham County's infrastructure has been stretched by rapid development in recent decades. As the county's population has swelled, its roads, water facilities, and school system have struggled to keep pace. Unfettered residential development threatens to undermine the county's ability to maintain current levels of service.
- Historically, the county has not benefitted directly from the region's industry clusters.

As will be seen later, the specifics of the SWOT analysis shaped the incentive policy that was ultimately adopted.

Cluster Analysis

The purpose of cluster analysis is to identify groupings of businesses that have economic reasons to co-locate in a given community and have the potential to create good jobs for local residents. Industry clusters refocus economic development away from specific firms or single industry sectors toward a more holistic treatment of industry groups that can benefit from government actions such as regulatory relief, economic incentives, or worker training programs.

The Center for Competitive Economies used the "national benchmark clusters" as defined by Professor Ed Feser, which have become the gold standard in cluster classification, in part because of the ability to replicate and track cluster changes over time using publicly available data (Feser 2004; Brun and Jolley 2011). The desirability of each cluster was evaluated based on the feasibility of creating the cluster and the expected benefits of employment in that cluster. This analysis identified seven industry clusters that are good bets for Chatham County. These clusters are not particularly well-represented in the county, but they are well represented by the region:

- Architectural and engineering services,
- Technical and research services,
- Basic health services,
- Pharmaceuticals,
- Information services,
- Higher education and hospitals, and
- Renewable energy (not a traditional cluster as defined by Feser).

Additionally, four industry clusters were identified for Chatham County's retention efforts. These clusters have lower wage rates but employ many local residents. Retention was important to ensure continuing employment for the county's less skilled and most vulnerable residents. These clusters are:

- Food processing,
- Wood products,
- Non-residential building products, and
- Concrete and brick-building products.

As shown in the next section, the new incentive policy in Chatham County rewards firms that fall within one of these industry clusters, connecting the long range strategic plan to the specifics of incentive policy.

Reviewing Best Practices in Local Incentive Policy

To start, the Center for Competitive Economies conducted telephone interviews with county economic developers throughout North Carolina. It quickly became clear that many economic developers in North Carolina feel that businesses have them over a barrel during incentive negotiations. There is a general sense that incentives do not determine most location decisions but also fear that not offering incentives could cost investment and jobs. Several economic developers said they were considering ways to improve their policy but offered few details as to how.

Next, surveys were sent to economic developers in all 100 North Carolina counties, yielding 46 responses. This survey was designed to capture the criteria used to determine incentive eligibility, to gauge the formality of existing incentives plans, and to determine how many counties were thinking about changing their incentive policy.

Finally, the Center for Competitive Economies collected all of the formalized county incentive policies in North Carolina. Most policies looked much like Chatham County's old plan. Number of new jobs and level of capital investment were common to all of the plans that provided a specified rubric for incentive eligibility, but few plans offered additional formal guidance for how incentive grants would be calculated. A few plans did base their incentive grants on wage rates and whether a company fit within a targeted industry cluster, but these were the exception to the norm.

Overall, this process underscored the need for a better incentive policy. Local economic developers are often unsatisfied with current policy, they know that incentives rarely attract businesses that had not already targeted their communities, and they know that existing policies often fail to capture projects' real benefits and costs. The next section reviews the new incentive policy adopted in the county, a plan that provides a blueprint for localities that want to revise their existing approach.

CHATHAM COUNTY'S NEW INCENTIVE POLICY

Sustainable, socially conscious development is all about improving quality of life, which requires more sensitive measurement than raw economic activity. "Quality of life" is a nuanced and often vague term. As any social scientist would tell you, composite measures are generally the best way to capture diffuse concepts like quality of life. Therefore, Chatham County dramatically expanded the list of measurable criteria that inform incentive awards. This section reviews the components of the county's new policy and the rationale behind each element of the new plan.

As discussed already, the county's old plan only stipulated two factors (number of new jobs and capital investment), the new plan has almost 20. The new incentive policy creates a 100-point rubric to measure a project's value to the local community.

Job Creation

The new policy maintains the importance of the original purpose of incentives, to create jobs. Table 2 reviews the points allocated for raw number of new jobs created.

TABLE 2

Number of New Jobs	Points
10 – 20	2
21 – 50	5
51 – 75	7
76 – 100	9
101 – 150	12
151 – 200	15
200+	20
Total Possible Points	**20**

Capital Investment

Also held over from the first generation of local incentive policy, the new policy rewards substantial capital investment. The county government needs to generate property tax revenue, so rewarding companies that increase the tax base through investment continues to make good sense. Table 3 shows the points allocated according to level of capital investment.

TABLE 3

Level of Capital Investment	Points
Under $500,000	1
$500,000 - $4,999,999	5
$5,000,000 - $14,999,999	10
$15,000,000 - $24,999,999	15
$25,000,000 and Above	20
Total Possible Points	**20**

Wage Level

Chatham County has a particular need for high paying jobs. The SWOT analysis showed that the county's average wage is well below the state average, in spite of having a highly educated population. The old policy treated a minimum wage job the same as a job carrying a six-figure salary, which clearly belies the relative benefits of each to the local community. Table 4 shows the criteria used to identify and reward high-paying jobs.

TABLE 4

Wage Level of Jobs	Points
Less than County Average	0
County Average	1
Greater than County Average/ Less than State Average	4
State Average	8
Above State Average	10
Total Possible Points	**10**

TABLE 5

Quality of Jobs	Points
Partial Employer Paid Health Insurance	1
Entire Employer Paid Health Insurance	3
Retirement Benefits	2
Profit Sharing	2
Employer Paid Vacation	2
Employer-Owned Company	3
Total Possible Points	10

Job Quality

The new incentive policy explicitly rewards companies that are accountable to the social wellbeing of their employees. As can be seen in Table 5, the county identified a list of job quality factors that deserved to be explicitly encouraged and rewarded in its new incentive plan.

Health benefits, retirement benefits, profit sharing, and paid vacation all indicate a firm's commitment to its employees' quality of life. In addition, employee-owned firms are less likely to move because the social bonds that make a place home for individuals also tie the company to the community. While not an exhaustive list, these job quality factors reward businesses that share the community's interest in building social capital and limiting social costs.

Hiring Local Residents

Chatham County's new plan rewards firms for hiring local residents[1] (see Table 6). Many communities have experienced a troubling phenomenon, whereby jobs are created, but do not benefit local workers. This pattern does little for struggling local residents and puts the government on the hook for servicing a swelling population. This is a classic example of how increased employment may actually decrease the local quality of life.

TABLE 6

Number of Existing County Residents Hired	Points
10-20	1
21-50	3
51-75	5
76-100	7
101-200	9
200+	10
Total Possible Points	10

Moreover, the SWOT analysis demonstrated that the county has a very high out-commute rate, particularly among highly educated and skilled workers. This fact causes Chatham County to leak retail and service activity, another challenge identified by the SWOT analysis. Keeping jobs close to home increases the multiplier effect of good paying jobs, increasing the benefits to the rest of the community.

Sustainable development is not just about appeasing environmentalists, it is essential to building a vibrant and durable economy. Therefore, the new incentive policy rewards businesses that are good stewards of the physical environment.

Environmental Sustainability

Sustainable development is not just about appeasing environmentalists, it is essential to building a vibrant and durable economy. Therefore, the new incentive policy rewards businesses that are good stewards of the physical environment. Table 7 reviews some of the business practices that are supported by the new incentive policy.

TABLE 7

Environmental Impact	Points
Reuse of Existing Building	4
Location in Downtown Area	3
Location in Existing Industrial Area	3
Location in Central Carolina Business Campus	5
Location in LEED Certified Building	4
Other Sustainable Features (recycling, water reuse, etc.)	4
Total Possible Points	15

Chatham County is growing rapidly, but unmitigated growth threatens to destroy what makes it a great place to work and live. The county's environmental quality is one of its main attractions, particularly to the highly educated and skilled workers that are increasingly essential to the local economy. In a globalizing labor market, one where ingenuity and training are essential for economic growth, communities must safeguard the environmental assets that skilled workers demand.

In many cases, green business practices directly offset costs that would otherwise fall on local governments. Sustainable companies put less pressure on public wastewater services by limiting water consumption, prolong the life of landfills by recycling, and alleviate the need to extend public infrastructure to previously undeveloped areas by locating in downtowns or existing industrial areas.

Green businesses are also better positioned to survive as the days of cheap energy come to an end. As the price of energy increases, businesses that do not limit their energy consumption are going to become less and less viable. This concern is not about emotional attachment to a clean natural environment, or about believing in global warming, it is about the fundamental economics of the next 50 years. Building a local economy around businesses that are not prepared for the future of energy is like building one's home on a cliff overlooking the ocean;

it's not a question of if the foundation will crumble, it's only a question of when.

Targeting Industry Clusters

Finally, Chatham County identified specific industry clusters that it wants to cultivate. When a group of firms benefit from close proximity, like producers and consumers within the same supply chain, attracting some of these firms makes it more likely that others will follow. Table 8 shows how the new incentive plan rewards companies that fit within the targeted industry sectors that anchor the county's long-range strategic growth vision.

TABLE 8

Industry Cluster/Business Type	Points
Presence in Identified Attraction Cluster	6
Presence in Identified Retention Cluster	3
Company Headquarters	6
Verified Supply-Chain Relationship with Existing Chatham County Supplier	3
Total Possible Points	**15**

Firms that fall within one of the identified attraction or retention clusters qualify for greater support under the new incentive policy. In addition, firms that establish a headquarters in Chatham County are also rewarded, with the expectation that headquarters are less likely to relocate and are more likely to invest in the local community than subsidiary facilities. Finally, firms that will augment active supply-chain relationships in the county, buying locally at the commercial level, are preferred.

Composite Schedule of Incentive Eligibility

Table 9 shows how all of the previous point allocations combine into a general rubric for incentive eligibility. The levels of incentive eligibility reflect increasingly valuable capital projects, with a project that earns 90 of the possible 100 points falling into the rightmost column. Moving from top to bottom, the percentages reflect the tax relief eligibility attached to each incentive level. In all cases, the largest incentives are granted in the first year, decrease in size through the fifth year, and phase out afterward.

TABLE 9

Potential Rebate Schedule

Year	Level 1	Level 2	Level 3	Level 4	Level 5
1	70%	75%	80%	90%	90%
2	60%	65%	70%	80%	80%
3	50%	55%	60%	70%	75%
4	40%	45%	50%	60%	75%
5	30%	35%	40%	50%	60%
Minimum Score	**50**	**60**	**70**	**80**	**90**

Note: Percentages reflect portion of local taxes granted back to approved companies for first five years after location or expansion.

Again, this schedule is not mandated, it is a starting point for incentive negotiations. There will always be benefits, costs, and circumstances that are unique to each incentive deal that cannot be anticipated by any formalized policy. The purpose is to identify a set of important measurable criteria to anchor incentive negotiations.

PRINCIPLES FOR SUSTAINABLE ECONOMIC DEVELOPMENT INCENTIVES

This section identifies several core principles that can help to design incentives that reward sustainability and social accountability. Different communities may have different priorities, but these are all important considerations to bear in mind when designing incentive policy.

Focus on Building Quality of Life over the Long-Term

Investment today will have consequences down the road, for good and ill, that should be measured as rigorously as possible. Rather than just focusing on number of jobs and capital investment, incentives should go to projects that actually make life better for local residents. Incentive plans should not be stand alone policies. The more incentive policies are coordinated with other economic development strategies, the better. Expanding the criteria used to evaluate incentive projects allows communities to complement their broader development strategy.

Consulting local residents helps to identify what makes the place home so that these assets can be protected. Engaging the business community can help local leaders to identify how they can get the most bang for their incentive bucks.

Engage the Community

Everyone has a stake in how incentives are granted. Revisiting incentive policy gives community stakeholders an opportunity to identify priorities and to negotiate the balance that should be struck among different considerations. Consulting local residents helps to identify what makes the place home so that these assets can be protected. Engaging the business community can help local leaders to identify how they can get the most bang for their incentive bucks. Finally, opening the incentive discussion can help to demystify the process and gives community members more ownership over their collective development vision.

Create Good Jobs

Broadening perspective does not mean losing touch with the original goal of incentives, to create jobs for local residents. However, not all positions are created equal. Only a few of the county incentive plans in North Carolina explicitly incorporate job quality in their calculation of incentive eligibility, but this is starting to change. More and more local economic developers are considering ways of including job quality in their incentive decisions.

Of course, what defines a good job varies by context. Sometimes almost any new employment would be helpful. Beyond raw number of positions, many other measurable qualities make for good jobs. Wage level, health insurance benefits, retirement benefits, profit sharing, paid vacation, and employee ownership all make jobs more fruitful, economically and socially.

Support Sustainable Business Models

Incentive policy should reward firms that are planning for the future. Incentive policy, from the federal to the local level, is increasingly focused on supporting green development. However, environmental impact is absent from most local incentive plans. Many local incentive policies are generalized rubrics that do not address the environmental consequences of development. Companies that limit their environmental footprint pass fewer costs along to society and local government. As the economic advantages of sustainable businesses increase, communities are wise to support businesses that are prepared to weather the transformations that are already underway.

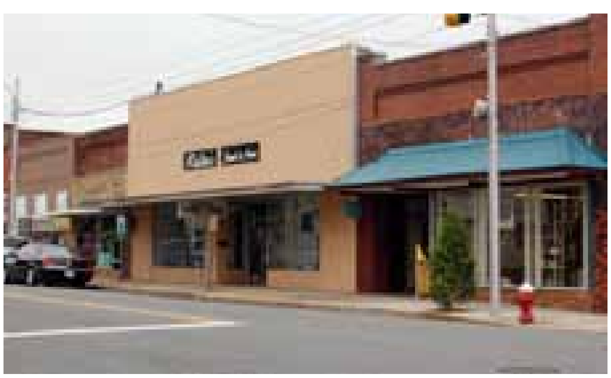
Support Economic Diversification

When level of capital investment and raw number of jobs are the only factors used to determine incentive eligibility, many small businesses cannot qualify for even the lowest level of incentive support. Sustainable incentive policy does not leave small businesses out in the cold. By creating more extensive rubrics, incentive plans can provide support to smaller businesses that are often the bedrock of local economies.

Reward Social Accountability

The concept of social equity has been less developed and more often ignored in the pursuit of sustainable development. Benchmarking in this area lags behind the

Photo credit: Mari Howe



Downtown Siler City storefronts ready for renovation. The new policy encourages reuse of existing buildings.

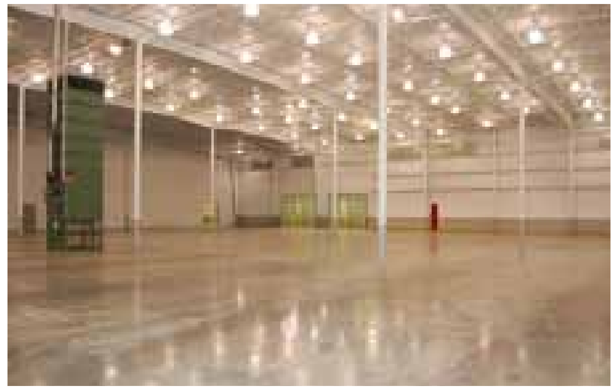


Photo credit: Jennifer Nelson.

A former textile plant in Siler City available for redevelopment – a facility that would work well for a company qualifying for incentives under the new policy.

other components of sustainable development. The key social equity goals for Chatham County were to provide jobs to county residents and to create jobs with good benefits packages. Other social equity criteria could easily be added depending on a community's goals. Additional points could be awarded providing same-sex partner benefits, offering minority contracting or hiring programs, investing in areas that are chronically underdeveloped, or a host of other important goals.

When level of capital investment and raw number of jobs are the only factors used to determine incentive eligibility, many small businesses cannot qualify for even the lowest level of incentive support. Sustainable incentive policy does not leave small businesses out in the cold.

Front-load Incentive Awards

There are two central reasons to front-load incentive deals. First, potential employers apply a significant discount rate to incentive offers; investors are usually more interested in substantial support now than incentives well down the road. Second, promising tax relief well into the future hinders communities' ability to react to changing circumstances. Promising tax relief into the distant future can lock in arrangements that will seem much more onerous down the road. Therefore, incentive plans should offer the most substantial support in the first few years, but scale back tax relief subsequently.

Balance Specificity with Flexibility and Clawbacks

While Chatham County's new plan lays out a rubric for evaluating incentive awards, it does not create an entitlement. Each project has unique costs and benefits that cannot be fully anticipated. The goal of incentive policy is to make the opening move in incentive negotiations, not to dictate an outcome. Each incentive policy should also include clawback provisions to refund economic development grants to the local governments when companies renege or fall short of their economic development commitments.

CONCLUSION

"Incentives" has become a dirty word in many circles, a synonym for governmental waste, or even corruption. Even within the economic development profession, incentives are less than universally popular. Some of this distrust is rooted in experience. Many incentive deals have failed to produce the lasting benefits that were intended. However, the pressure to offer incentives is, if anything, greater now than ever. Incentives are often the ante that gets communities into the attraction and retention game. In this context, it is often better to make smart bets than to take your chips off the table.

Local governments rarely have the resources to change where businesses locate, so incentive policy should aim to influence *how* companies do business as much as *where*. Chatham County's new model, and how it was developed, provides an example of how communities can reward business social responsibility, accountability, and sustainability. Instead of reacting to requests for tax relief, communities should use incentive policy to publicize their long-term development vision and start the incentive discussion on terms of their choosing.

ENDNOTE

1 The U.S. Constitution's "privileges and immunities clause" prohibits states from discriminating against residents of another state. This provision, along with the interstate commerce clause, may make it legally difficult to actually implement a "hiring local residents" measure as part of a local incentives agreement with a company. However, this policy goal is a clear statement of the community's preferences for hiring local residents and could likely be legally accomplished in practice through awarding points to companies willing to give some percentage of first source hiring through local job centers and/or local community colleges.

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