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The Future of Economic Development Subsidies

By Greg LeRoy

MORE TRANSPARENT, LOCATION-EFFICIENT, AND RISK-AVERSE

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the future of economic DEVELOPMENT SUBSIDIES

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States, counties, and cities spend an estimated $70 billion per year on company-specific economic development subsidies (a.k.a. "incentives," as computed by Prof. Kenneth Thomas). But they can ill afford to keep wasting much of that money, as has been documented by a large body of performance audits, investigative journalism, academic findings, and non-profit research.

New tools and new thinking are enabling public officials to chart a smarter course. Subsidies are becoming more transparent, at both state and local levels of government. Subsidies are changing to align better with transportation and land use planning, making them more "location-efficient." Subsidies are also becoming more risk-averse: there is a growing consensus that spending money in ways that put a few eggs in many baskets – instead of the opposite – is, in times of heightened economic volatility, the most prudent and cost-effective strategy.

New strategies are also critical because there are fewer deals for which states and cities can compete. In a polarizing trend, a tiny share of deals is growing much more costly, hogging precious resources that would be better spent benefiting many small and targeted employers.

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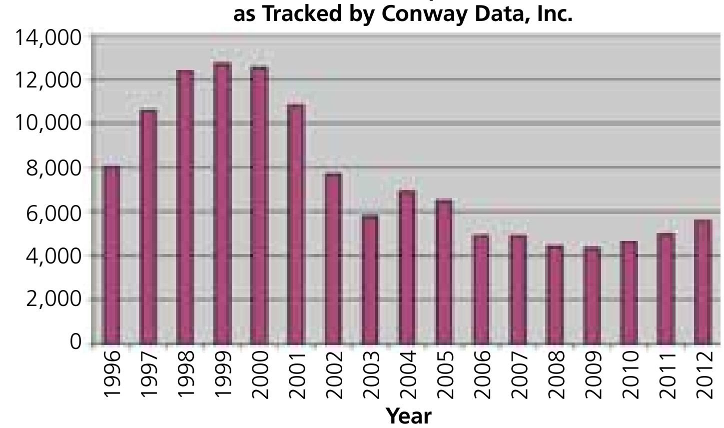
FIGURE 1

New U.S. Facilities and Expansions 1996 - 2011 as Tracked by Conway Data, Inc.



(Conway Data, Inc. is a global provider of business data and services, including Site Selection magazine, for which these annual tallies are created.)

DEAL FLOW TODAY: STILL DEPRESSED

The overall number of economic development deals for which states and cities can compete is well below its peak, which pre-dated *the 2001 recession*. As Figure 1 details: even in the non-recessionary years of 2003-2006, the number of major new projects averaged barely half the rate of 1998-2000. From that already low base, the number of projects dipped in 2008-2009 and then recovered only modestly in 2010 through 2012. By 2012, the number of deals had still not recovered to *half* the levels seen between 1998 and 2000.

In other words, cities and states have been competing for a shrunken number of economic development projects for many years, and it could be many more years before deal flow recovers to levels seen in the 1990s.

Consistent with this picture, as the U.S. economy continues to recover slowly from the Great Recession of 2007-2009, many states are suffer-

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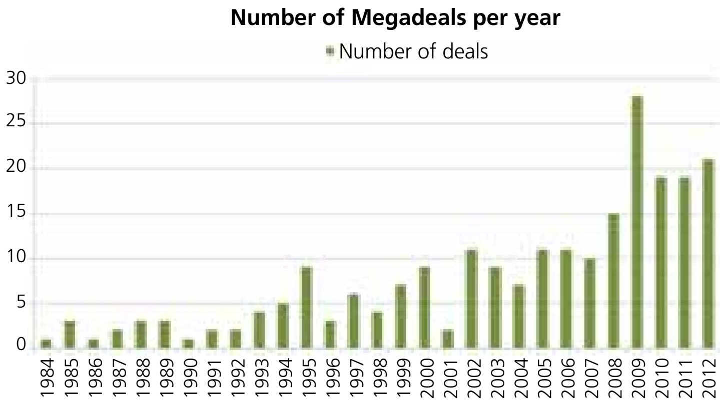
FIGURE 2



Source: Good Jobs First, *Megadeals*, May 2013.

ing persistently high unemployment rates. This prompts public officials to be more aggressive than usual in promoting job creation, creating pressure to spend more on attraction deals, and making officials more sensitive to relocation threats.

A simple supply and demand analysis suggests more anxious politicians chasing a shrunken number of deals, thereby driving more costly "megadeals."

MEGADEALS MIRROR RISING INEQUALITY

In a trend that resembles growing income polarization in the United States, the number and cost of the very largest economic development "megadeals" (those incentive deals valued at $75 million or more) have risen substantially since the 1980s. As the accompanying chart details, the trend accelerated in every decade, and starting in 2008, the average number of megadeals per year doubled (compared to the previous decade) to about 20 per year (see Figure 2).

In dollar terms, the up-trend is also sharp. The total annual cost of megadeals remained well below $1 billion until 1991. Since 2002, the total has been over $2 billion every year, with a high of $8.3 billion in 2007. Since 2009, their costs have averaged about $5 billion annually. This pace continued in the first half of 2013 (see Figure 3) and in November 2013, the Washington legislature voted an $8.7 billion tax-break package for Boeing and its suppliers (if it plays out, it would be the biggest megadeal in U.S. history).

But as a share of all deals, these 20 megadeals a year out of more than 5,000 deals overall represent less than 0.4 percent of recipients – akin to the CEO-income strata of personal income. This high-end concentration of subsidy awards suggests that those large corporations with the ability to invest have become more aggressive and sophisticated in exploiting the depressed deal flow to extract ever-larger subsidies. Like the growing income inequality that is undermining middle-class institutions, this megadeals trend is unwise and unsustainable.

TRANSPARENCY: THE CORNERSTONE REFORM

No matter what one's concerns are about economic development spending, everyone needs disclosure: company-specific, deal-specific reporting online of the amount and source of funds, the project site street address, the commitments agreed to by the recipient, and the actual benefits – or shortfalls – over time such as job creation, wages and/or capital investment.

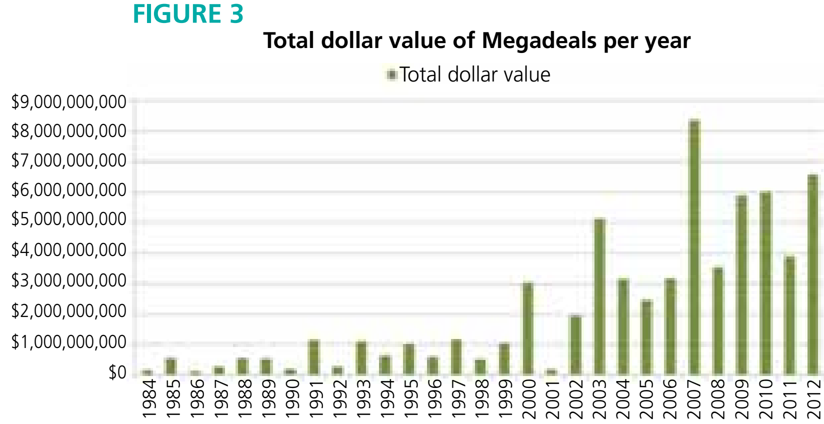
Public information on where the money is going, how much, and what it is producing is the most fundamental cornerstone reform. That is true if you are a local businessperson concerned about megadeals and fairness to small firms, a budget watchdog keen on government efficiency, a transit or planning nerd advocating for smarter land use, a public official who fears his or her district is getting shortchanged, or a journalist looking at the relationship between subsidy awards and political campaign contributions.

On this front, there is a great deal of good news. Six years ago, only 23 states had any form of online subsidy disclosure. That is, only 23 states disclosed online for at least one program any company-specific data. Today, 45 states and the District of Columbia disclose online; only Alaska, Arkansas, Delaware, Kansas, and Idaho do not. The top-rated state transparency websites in the most recent ratings were in Illinois, Wisconsin, and North Carolina.

At the local government level, the overall rate of disclosure is lower: among big-city and big-county programs, only one third are disclosed online. But there are some outstanding performers, such as: Austin, Texas (Economic Development Grants/Chapter 380 Incentives); Chicago (Tax Increment Financing districts); Memphis/Shelby County (Payments in Lieu of Taxes); and New York City (Industrial Incentive program).

Just because state or local data are not online does not mean that they are unavailable. Most development agencies have spreadsheets with data on at least the deals as they were originally awarded, even if outcome data are

FIGURE 3



Source: Good Jobs First, *Megadeals*, May 2013.

less often tracked. As well, some states consider income tax-based credits as confidential (though many others do not). Good Jobs First's Subsidy Tracker, which captures all such data that are published online, also solicits data using Freedom of Information Act requests and other procedures. To date, it has about 250,000 entries from 470 programs in all 50 states and DC. Public officials are among its biggest users, according to a self-reporting user survey.

There is no evidence from any quarter that sunshine on development spending harms the "business climate" of a state or locality. Indeed, history suggests that preventing or reducing sunshine on economic development spending enables abuse, or at least the hiding of job-creation shortfalls, which in turn can weaken programs, or even generate calls for defunding. Recent examples of this problem are evident in three states – Indiana, Wisconsin, and Ohio – where the privatization of development agencies has resulted in less transparency, and where performance audits or investigative journalists have found big hidden problems, including discrepancies between official claims of job creation and actual results.

With rising public expectations about government transparency, as evidenced by the non-partisan "Google government" movement, economic development spending is hardly immune. Public officials may also welcome competing businesses looking up each other's incentives as both an oversight and fairness safeguard.

LOCATION EFFICIENCY: ALIGNING SUBSIDIES WITH LAND USE PLANNING

Smart growth lost some of its luster as an issue during the Great Recession; governors and mayors said in so many words: we don't care where the jobs go as long as we get some. But its long-term wisdom endures: aligning the location of jobs with land-use objectives such as transportation choices makes more efficient use of infrastructure investments, strengthens the tax base, reduces air pollution, and reduces poverty by creating economic opportunity for workers who do not own cars.

Unfortunately, all but a few economic development subsidy programs – including those that are enabled under state law and administered locally – are geographically agnostic. A small subset has targeting criteria that may have the de facto effect of placing jobs in location-efficient places, but there is precious little history of states intentionally aligning development incentives with land use planning. In fact, there is more history of two kinds of programs – enterprise zones and tax increment financing (TIF) districts – being deregulated in ways that reduce their benefit to inner cities and inner-ring suburbs. Two of the most troubling examples are New York's Empire Zones program (with its non-contiguous gerrymandering) and Virginia's TIF program (where a district may be started wherever it "will create commerce and prosperity").

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Indeed, research indicates that economic development subsidies are not just geographically agnostic but actually pro-sprawl and anti-urban. Six studies by Good Jobs First mapping 5,000 company-specific subsidy deals in 12 metro areas in five states (Illinois, Michigan, Minnesota, New York, and Ohio) have repeatedly found the deals' geographic distributions to be pro-sprawl. That is, the deals shortchange central cities and inner-ring suburbs, areas hardest hit by plant closings, communities with the most impoverished tax base, workplaces accessible via public transit, and communities of color.

Two states, Ohio and Minnesota, have disclosure data that track intra-state relocations, enabling the analysis of about 250 companies that merely relocated within a given metro area. In the Twin Cities, Cleveland, and Cincinnati metro areas, these relocations were decidedly pro-sprawl.

Four states have attempted modest steps toward better aligning economic development subsidies with public transportation and smart land-use planning. None of them stands out yet as an exemplary model, but three states' innovations bear noting.

Illinois' Business Location Efficiency Incentive Act gives a 10 percent higher corporate income tax credit under a common state incentive (the Economic Development in a Growing Economy, or EDGE program) for deals in which the job site is accessible by public transportation and/or proximate to affordable workforce housing.

The Act generously defines transit access as regular service within a mile of the worksite plus pedestrian access to the transit stop. Housing affordability is pegged to 35 percent of the median salary of the workforce (excluding the highest-paid 10 percent of the employees), located within three miles of the job site. Projects that do not initially qualify can qualify later with a site remediation plan using measures such as an employer-assisted housing plan, shuttle services, pre-tax transit cards, and carpooling assistance.

Despite having been enacted in 2006, the location efficiency bonus has been utilized remarkably few times. This reflects the Illinois Department of Commerce and Economic Opportunity's apparent disinterest in promoting its use. A DCEO report issued in December 2010 listed just 13 total location-efficient recipients. Even though seven of these 13 awards were issued in the Chicago metropolitan area, the Chicago Metropolitan Agency for Planning was unaware that a single use had occurred.

The **California Infrastructure and Economic Development Bank** applies land use and other efficiency and equity-targeting standards to its Infrastructure State Revolving Fund Program. Its 200-point application scoring system gives preference to projects that:

- Serve environmental and housing goals by being located in or adjacent to already developed areas, protecting the environment in any of several ways, and being located in a jurisdiction with an approved General Plan Housing Element (up to 40 points);
- Are "located in or adjacent to and directly affecting, areas with high unemployment rates, low median family income, declining or slow growth in labor force employment, and high poverty rates"(up to 55 points);
- Improve the quality of life by contributing to benefits such as public safety, healthcare, education, day care, greater use of public transit, or downtown revitalization(up to 30 points);
- Are most cost-effective in job creation or retention (ranging from 30 points for less than $35,000 per job to 0 points for more than $65,000 per job); and
- Have "established relationship with local employment and training entities… to link local job seekers with employment opportunities" (up to 10 points).

Other criteria that can generate points include: the local poverty rate; whether the deal involves "Economic Base Employers" (that generate income coming from outside the area); the ratio of private dollars being leveraged per dollar of public investment; and project readiness.

Maryland's Smart Growth Act is part of a package of laws aimed at revitalizing older communities and making more efficient use of state funds for infrastructure and economic development. The Act restricts state spending for infrastructure and services to existing communities and other areas targeted for growth known as Priority Funding Areas (PFAs are essentially places that already have infrastructure or are designated to receive it). The law does not prohibit development outside PFAs; that decision remains the prerogative of local governments. Rather, under the Smart Growth law, certain state funds for economic development are prohibited for projects outside the PFAs. The intent is to encourage development inside PFAs by making such projects eligible for subsidies.

There are no formal evaluations of the land-use impact of the Illinois, California or Maryland acts, although one study suggested a positive impact on certain white-collar job classifications in Maryland.

The other state experiment that must be cited here was **New Jersey's Urban Hub Tax Credit Program**, which was discontinued in September 2013 as part of a broad overhaul of that state's major incentive programs. Tragically, the Urban Hub Tax Credit Program was so loosely constructed, and it was deregulated so quickly and so thoroughly, that it became a poster child for government waste. While it was never actually intended to function as a new-job creation incentive, its singular focus on providing incentives to businesses making large investments accessible by transit is noteworthy. Unfortunately, a lack of safeguards in the original legislation, excessive awarding practices, and significant legislative weakening of Hub eligibility rules badly perverted the program.

Enacted with bipartisan support, the Hub credit was originally intended to bring capital investment into depressed urban areas around transit terminal stations, limited to Camden, East Orange, Elizabeth, Hoboken, Jersey City, Newark, New Brunswick, Paterson, and Trenton. Projects had to build within a half-mile of a transit hub and employ at least 250 people.

The subsidy was exceptionally generous: under the commercial section of the program, corporate income credits could be issued worth up to 100 percent of qualified capital investments. The credits were also transferable; that is, recipient companies could sell them to other companies. But starting in 2009, the Hub program was repeatedly amended: geographic eligibility was expanded to locations served by freight rail (not passenger rail); the capital investment threshold was lowered; and a 20 percent low- and moderate-income housing set-aside was eliminated.

The program also became very controversial for nine-figure packages given to companies moving within the state: $250.8 million to Prudential Financial, Inc. for moving just a few blocks within Newark and $102 million to Panasonic North America to leave Secaucus for other New Jersey locations.

The admittedly modest location-efficiency results in these four states are not an argument against the concept. Rather they reflect the longstanding "siloization" of state programs in different cabinet agencies, so that economic development subsidies can sometimes play out at odds with planning objectives. With some governors convening coordinated sub-groups of cabinet secretaries

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to better coordinate state resources, some progress may be occurring outside of statutory frameworks. The other long-term trend here is the growing share of transit funding that comes from state and local sources: as they take greater ownership of public transportation, states and cities will hopefully leverage their economic development resources to maximize the utilization of their transit investments.

FEWER EGGS IN MORE BASKETS: REDUCING RISK

A recurring criticism of job subsidies is that they are dominated by large companies that have the greatest resources to employ site location consultants, lawyers, and accountants and which also have the most capital to move and therefore have the greatest ability to play places against each other to demand the largest packages. When large, high-profile deals fail (e.g., Dell in North Carolina, 38 Studios in Rhode Island, or A123 in Michigan), this criticism becomes louder.

The policy solution is to avoid putting “eggs” valued at eight or nine figures in a handful of “baskets.” Two other economic trends are also causing policymakers to reduce their levels of risk in individual deals. First is economic volatility or churn: the rate of corporate mergers, acquisitions, and technology-driven births and deaths has greatly accelerated and shows no sign of abating. Giving a long-term loan or property tax abatement to a company that may not be there in five years is risky. Second is the long-observed finding that small businesses create most new jobs; there are data and definition debates here, but start-ups and small-business expansions absolutely matter.

The policy takeaways are clear: taxpayer investments are safest and most cost-effective when they benefit clusters of strategically chosen businesses, especially small businesses with growth potential. That means intentionally targeting sectors in which a state or region has a comparative advantage (or a reasonable chance of achieving an advantage). It means prioritizing forms of technical assistance that benefit multiple employers, and that in turn, often means a focus not on company-specific deals but rather on improving public institutions that provide aid such as technology adoption, export assistance, or associate degree-level training.

Despite this strong empirical case for a reallocation of resources, unpublished research led by small-business advocate and author Michael Shuman found that the share of deals and dollars going from state subsidy programs to locally owned businesses in 15 states is very small, sometimes in single-digit percentages.

CONCLUSION: ECONOMIC DEVELOPMENT AMIDST AUSTERITY

Guiding all of these considerations is budget austerity. Federal spending on non-entitlement programs, including economic development, is certainly going to shrink for the foreseeable future. Many states have yet to regain their pre-Great Recession revenue levels, and state lawmakers are chastened by the painful decisions they had to make across many program lines. Local governments suffered state aid cutbacks and the loss of property tax revenues driven by the mortgage foreclosure crisis and declining property values.

That all means that economic developers will need to do more with less; that every expenditure needs to generate as much impact as possible; that synergy with planning, transit and infrastructure matters more than ever; and that public scrutiny will grow. Transparency, location efficiency, and risk aversion will be the developer’s best friends.