North Carolina Cooperative Extension Service

NC STATE UNIVERSITY

COLLEGE OF AGRICULTURE & LIFE SCIENCES

NC STATE UNIVERSITY
A&T STATE UNIVERSITY
COOPERATIVE EXTENSION
Helping People Put Knowledge to Work

NC State Economist

Agricultural and Resource Economics • March/April 2008

Local Incentive Packages for Economic Development

Mitch Renkow, *Professor and Extension Specialist*

In January 2007 it was announced that the county and municipal governments in Caldwell County had offered Google Inc. an incentive package totaling $165 million. These incentives included, among other things, refunds to the company of 100% of business personal property taxes and 80% of real property taxes over 30 years. In exchange, Google committed to locate a $600 million dollar data center in Caldwell County expected to create up to 210 new jobs averaging $48,000 per year.

The size of the package, as well as the cloud of secrecy under which it was negotiated, provoked significant public debate (and a lawsuit) over the desirability of using local tax revenues to promote local economic activity. To some, attracting Google to Caldwell County was a much-needed boost to a local economy that has been battered in recent years by job losses and plant closings in the furniture industry due to intense foreign competition. Others viewed the magnitude of the tax breaks and other incentives offered to Google as a monumental misuse of public money.

The incentive package offered to Google by Caldwell County is unusually large, but it is only one of hundreds of incentive packages made available by municipal and county governments throughout North Carolina over the past few years. This issue of the *NC State Economist* discusses the impacts of local incentive packages on local economies and how the local economic benefits that they produce stack up against their costs to the taxpayers of the communities that offer them.

Local Incentives and Firm Location Decisions

Economists who study firm location decisions generally agree on the primary factors driving those decisions: the availability and quality of transportation, communication, energy and water infrastructure, along with a suitable local labor force. Not surprisingly, several of these factors were cited by Google as figuring prominently in their decision to locate in Caldwell County. Of course, the relative importance of each of these factors will depend on the type of firm involved.

Local governments have varying degrees of influence over these factors in the short run. Transportation infrastructure is both costly and time-consuming to build, and is generally dependent on state-level approval and funding. Energy and communications infrastructure are privately provided and subject to state regulation. Payoffs to investments in education and worker training similarly bear returns only over a relatively long period of time. Moreover, given that workers are highly mobile, there is no guarantee that workers whose skills have been upgraded will remain in the location in which they resided while being trained.

In short, the attractiveness of a given community to a firm considering relocation or expansion depends primarily on whether or not these community assets are in place. But just because the attributes of a particular community dovetail with the needs of a prospective firm in no way guarantees that there are not <u>other</u> communities with similar characteristics that are comparably attractive.

This is where local incentive packages come into play. Incentive packages tend to be comprised of elements that are more immediately implementable and more directly under the control of local government officials. These include financial incentives like grants of lands and industrial revenue bonds; tax concessions of the sort that were offered to Google; and land use incentives (for example, exemptions from zoning regulations). Increasingly, local governments throughout the country have shown substantial willingness to expend resources to attract new businesses or expand existing ones; at the same time, firms have demonstrated remarkable savvy in pitting different localities against one another in order to secure the best financial terms for themselves.

According to a recent study by the NC Institute for Constitutional Law, local governments in sixty-six North Carolina counties approved 353 separate incentive packages totaling over $403 million in economic development incentives during the period 2004 - 2006 (NCICL 2007). Of this total amount – which includes the Google package – roughly two-thirds (65%) went to new operations, 31% helped finance expansions of existing operations, and the balance went to facilitate firm relocations from elsewhere in the state (3%) or from another state (1%). Excluding the Google package, just under three-quarters of the total incentive money originated in counties comprising the Research Triangle, Piedmont Triad, and Charlotte regions – that is, counties that are relatively well endowed with the desirable infrastructure and workforce assets noted above.

Impacts of Local Employment Growth

Incentive packages typically require that newly locating firms meet some sort of target employment level. Indeed, the number of new jobs that a new firm will create generally features prominently in news accounts of what landing a new firm will mean to a given community. But a variety of factors must be considered in order to weigh the positive effects of that job growth against the cost to the community of the incentives offered to promote it.

A range of positive economic impacts can be linked to new jobs that are created as a result of the new firm locating (or an existing firm expanding its operations) in a community. First, there is the direct impact of the earnings of workers who get the new jobs. Second, there is the additional positive stimulus to the economy that results from newly employed workers spending those earnings locally (so-called multiplier effects). Third, newly located businesses may well purchase goods and services from local suppliers – an additional source of multiplier effects – and over the longer term may stimulate the formation of new businesses to satisfy demands for those same goods and services. Finally, firm relocations or expansions typically engender significant construction activity in the short run. As the jobs associated with these sorts of construction "booms" are often taken by local residents, they represent something of a short-term stimulus package for the local economy.

It is important to note, however, that several factors will tend to diminish the size of these positive impacts on the community in which the employment growth occurs. First, it is by no means clear how many of those new jobs will actually be taken by residents of that community – and in particular, unemployed or underemployed residents. Evidence from twelve southern states (including North Carolina) reported in an earlier issue of the *NC State Economist* indicated that the impact of job growth on the unemployment rate in the county in which that job growth occurs is actually quite small (Renkow 2002). Rather, the bulk of newly created jobs were found to have gone to new residents migrating in from elsewhere; commuters residing in nearby counties; or county residents currently working in some other county. The reasons for this finding are numerous, but center largely on the substantial (and increasing) willingness of workers to change residence or to travel ever greater distances between where they live and where they work.

A second and related issue is that the positive impacts of increased consumer spending attributable to the earnings of newly-hired workers at newly-locating firms are also likely to spill across community boundaries. All too frequently, estimates of multiplier effects associated with increased earnings within a community fail to take account of the fact that non-resident workers tend to spend those earnings at establishments located outside of the community. This too overstates the benefits of job growth to the community in which that job growth takes place

Third, incentives provided to a particular business may have offsetting negative effects on the profitability of nearby competing firms in the same locality. Depending on the location and the specific types of firms provided with incentives, these offsetting effects can be important. For example, a widely noted study in Ohio found that these effects nearly canceled out the number of new jobs created by that state's incentives programs (Gabe and Kraybill 2002). On the other hand, in some cases location of one or a few firms in a particular location can serve to draw in other firms in related businesses – the Research Triangle Park being a notable example. Which of these effects dominates a particular location will of course vary from one community to another.

Local Public Finance Considerations

Some proponents of incentive packages argue that when firm relocations or expansions bring new workers to a community, increases in housing demand and house construction lead to a desirable increase in property tax base and, ultimately, to increased local government revenues. In addition, the increased business activity attributable to the newly locating firm plus any additional business and commercial activity associated with it is frequently cited as another increment to the local revenue stream flowing into county or municipal coffers.

However, it is commonly the case that the costs of publicly financed services that residential land uses receive – schools, police protection, etc. – exceed the contribution of those residential land uses to county revenues. Correspondingly, revenues attributable to commercial and industrial land uses tend to exceed the cost of public services provided to them. In other words, from a local budgetary perspective, commercial and industrial land uses tend to subsidize residential land uses.

Given this, local incentive packages may in many instances compromise the ability of local governments to balance their budgets. Tax concessions will reduce the extent to which recipient firms contribute to this cross-subsidization process on the revenue side, while payments of industrial revenue bonds or provision of services at subsidized rates will similarly squeeze budget managers on the expenditure side. And depending on the form it takes, new residential development that accompanies firm locations or firm expansions could lead to greater costs of public service provision than the property tax and other revenues that residential development generates. Only if the positive shock to local economic activity generates revenues sufficiently large to compensate for these various countervailing factors will the impacts of local incentive packages on local budgets be positive.

Conclusion

Recent high-profile incentive packages awarded in North Carolina and elsewhere in the country have garnered significant attention. Whether the net economic benefits attributable to a firm relocation or expansion facilitated by such packages outweigh the costs will no doubt vary widely from location to location. This article has highlighted some of the key factors underlying reasonable assessment of those costs and benefits. In particular, attention must be paid to who actually receives the new jobs associated with those relocations or expansions; the impacts, both positive and negative, on other firms within the local economy; and the impacts on demands for costly public service provision that are often coupled with limitations imposed by the incentive package itself on local governments' ability to raise revenue.

References

Gabe, Todd M. and David S. Kraybill. 2002. "The Effect of State Economic Development Incentives on Employment Growth of Establishments." *Journal of Regional Science* 42(4): 703-730.

NC Institute for Constitutional Law. 2007. "The Incentives Game: North Carolina Local Economic Development Incentives." Raleigh: NC Institute for Constitutional Law.

Renkow, Mitch. 2002. "Rural Employment Growth: Who Gets the Jobs?" *NC State Economist* (July).

McCurry, John. 2007. "Google Arrival Boosts a North Carolina County." *Site Selection* (March). http://www.siteselection.com/issues/2007/mar/american/.

N.C. State Economist

Published bi-monthly by the Department of Agricultural and Resource Economics and the Cooperative Extension Service.

Address Corespondence to: The Editor,
NC State Economist, Box 8109,
NC State University, Raleigh, NC 27695

The NC State Economist is on-line at:
http://www.ag-econ.ncsu.edu/extension/economist.html

North Carolina Cooperative Extension Service
North Carolina State University
Agricultural and Resource Economics
Box 8109
Raleigh, North Carolina 27695-8109