

Increasing the Effectiveness of Economic Development Incentives

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May 14, 2014

Presentation at conference, “Reinventing Older Communities: Bridging Growth and Opportunity”, sponsored by Federal Reserve Bank of Philadelphia

Tax incentives: relatively costly per job created, so effectiveness depends on high multipliers

- Benefit of local job growth is higher per capita local earnings, which is about 40% of earnings of created jobs (e.g., per capita earnings go up by \$20K for each job created paying \$50K)
- Tax incentives induce jobs at average cost of \$30K in annual incentives per directly induced job (e.g., tax incentives of \$3K per year per job will tip 10% of location decisions)
- Cost per local job created = (Cost per directly induced job) times (directly induced jobs/total local jobs created)
- To reduce cost per job created, need to increase ratio of total local jobs created to directly induced jobs, by increasing multiplier effects of induced jobs, and reducing displacement effects.

Multipliers can be increased and displacement reduced by targeting tax incentives

- **Multiplier higher if:**
 - Higher wages of direct jobs, yielding higher consumption multiplier;
 - Direct jobs have strong local supplier network, because part of cluster;
 - Direct jobs are high tech jobs that have Silicon Valley-style spillovers due to mobility of ideas and workers.
- **Displacement lower if:**
 - Avoid targeting “non-export-base” firms, which hurts other local businesses;
 - Direct jobs use more under-utilized land and labor.

Customized services are more cost-effective than tax incentives

- Information services such as manufacturing extension, and customized job training services, can create jobs at cost per direct job created of \$6K per year or less, less than one-fifth of cost per direct job of tax incentives.
- Why info services work? Information is cheap to provide, yet is often quite valuable to smaller businesses.
- Why customized training works? New hires frequently under-perform, community colleges have some economies of scale in screening/training services.
- Implication: tax incentives should be used sparingly and in targeted way, and well-run customized services should be expanded.