The Incentives Game

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Article:

In the on-going debate over economic-development incentives, two arguments stand out. One argument, generally made by reluctant supporters of incentives, holds that in spite of the unsavory nature of the incentives game, no city or county can afford not to play.

The other argument, generally made by opponents of incentives, is that they don't help the economy and hence are merely a way for businesses to extract payments from taxpayers.

The city of High Point's recent move to award $600,000 in incentives to La-Z-Boy to relocate a divisional headquarters reflects the first argument. By itself this wasn't particularly big news, because incentives are pretty common and High Point has been aggressive in granting them. What was news was that the incentives were granted to lure the headquarters away from Greensboro!

Local governments within regions compete for *new* businesses all the time. After all, that's what happened with Dell two years ago. Once the company announced that it would locate somewhere in the Triad, Greensboro and Winston-Salem and High Point all came up with rival offers. What doesn't happen all the time is when one city uses incentives to pull an existing business away from its neighbor.

How we view the incentives game depends on our geographical perspective. If the region we care about is the entire United States, then allowing, say, Michigan to use incentives to lure a company from Idaho is bad national policy. If the region we care about is North Carolina, then allowing Charlotte to use incentives to lure a company from Hickory is bad state policy. The United States is worse off when taxpayers' resources are used to make the first hypothetical deal, and North Carolina is made worse off by the second one.

One of the clarion calls in economic development in these parts is regionalism. In other words, the region we should care about is the Triad. Public officials and economic developers emphasize that the Triad economy is interconnected, with workers commuting from one city to another and companies doing business across the region. Economic growth in one part of the Triad tends to benefit the entire area. But the Triad as a whole is made worse off when one city uses incentives to lure an existing business from another.

I don't believe that High Point officials care nothing about regionalism. My point is not to condemn High Point, but to remind us of the strong strategic pull of the incentives game. When push comes to shove, incentives are hard to resist, even if it means going next door for the new business. The troubling reality of incentives makes it harder to pursue a regional economic strategy.

A 2004 piece in the Southern Economic Journal buttresses the argument made against incentives: that granting them doesn't help the economy. The authors used data from 109 new sitings of large companies during the 1980s (seven of them in North Carolina) and analyzed their effects on local employment and income growth. All companies in the study projected new employment of at least 1,000 jobs.

The authors found that on average, these "large firms fail[ed] to produce significant net benefits for their host communities." At first blush, this is a surprising result. After all, most strong regional economies are home to large companies. But do large companies make local economies strong, or do strong local economies attract large companies? The article suggests that the latter is more likely.

Most jobs are created by small and medium businesses. The siting of a large employer makes big news but has a relatively small effect on the regional economy. The introduction of a large business can improve the economy if it "fits" well, i.e. it fills an important niche. An example from the Triad might be Dell or FedEx. However, sometimes the fit isn't so great. What the SEJ article tells us is that on average, when looking across an array of metropolitan areas, the good and bad fits cancel out.

Moreover, the Triad experience confirms that large companies aren't everything. We've lost a lot of big employers in textiles and apparel. Relative to our size, the Triad has had more big layoffs and big closings than the national economy has experienced, and yet regional unemployment is keeping pace with the national rate.

The SEJ article concludes that economic-development incentives, which tend to be granted to large businesses, are ineffective. And perhaps they are, on average. But a more sensible conclusion is that winning the incentives game is not a slam-dunk. It's not about jobs, jobs, jobs. It's about understanding the regional economy and granting incentives only as part of a comprehensive economic-development strategy.

High Point officials claim that this is precisely what they did to attract La-Z-Boy. Attracting furniture companies to High Point *is* their strategy. However, it's hard to characterize such a narrowly defined goal as comprehensive. And it's certainly not regional.

The La-Z-Boy incentives remind us that it's tough for local governments to stay out of the incentives game. But then, if the game is to be played, the message of the SEJ article is that it must be played carefully and with well-understood goals.

Unfortunately, in economic development, not everyone has the same goals.