Comments to Joint Select Committee on Economic Development Incentives of the North Carolina General Assembly

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Summary Conclusions of Economic Development Incentives Symposium
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Jesse L. White, Jr., Ph. D.
Director
Office of Economic and Business Development
University of North Carolina at Chapel Hill

On December 5, 2008, the Carolina Center for Competitive Economies (the Center) of the Kenan Institute of Private Enterprise (Kenan Institute) convened a remarkable seminar to discuss the state of scholarship on the use of economic development incentives and to discuss a major study being undertaken by the Center for the General Assembly. Five world-renown experts joined about 60 North Carolinians in a robust four-hour examination of incentives in general and their use in North Carolina in particular. The North Carolinians included the Secretary of Commerce and senior staff, six members of the General Assembly and staff, three presidents of regional partnerships, local economic developers, researchers in the field, and senior administrators and faculty from UNC-Chapel Hill. There were also faculty and graduate students from North Carolina State University, Western Carolina University, and Duke University. (Please see attachments for agenda and list of participants).

After a welcome by **Dr. Jack Kasarda**, Director of the Kenan Institute, **Brent Lane**, Director of the Center, laid out the general charge for the day. At that point, he turned the moderation of the rest of the day to **Dr. Jesse White**, Director of the Office of Economic and Business Development. The panel of experts included the following:

Dr. Michael Luger, Dean, Manchester Business School, Manchester, England
Dr. Ed Feser, Professor of Urban and Regional Planning, University of Illinois at Urbana-Champaign
Dr. Dagney Faulk, Director of Research, Center for Business and Economic Research, Ball State University
Brian Dabson, President, Rural Policy Research Institute, and Professor, Truman School of Public Affairs, University of Missouri, Columbia
Dr. Timothy Bartik, Senior Economist, Upjohn Institute for Employment Research, Kalamazoo, Michigan

One of the overall themes of the day was the degree to which North Carolina is willing to continuously reexamine its policy on incentives for economic development. The contract with the Center is the latest of several examinations of the effectiveness and structure of the incentive programs in this state, which date only to 1996 and the William S. Lee Act. To have assembled some of the world's best experts and to engage in public discussions about these issues is a singular and remarkable achievement.

The major substantive themes of the day are presented below. The reader should note that these conclusions are based on national research and are not North Carolina-specific, although many might apply.

1. The overall research suggests that economic development incentives are at best mixed in their effectiveness and are often cost-ineffective. Some estimate that only 5-10% of location decisions are affected by incentives.

2. There is considerable evidence that companies often play off one state or community against the other and have learned to "game" the system. Location consultants do the same, sometimes for their own pecuniary interests. These "auction" scenarios can attain a life of their own and put states and communities into quick and ill-thought-out decision modes. One scholar goes so far as to say these scenarios begin to look like "legalized bribery."

3. Other factors overwhelm incentives in terms of business relocation and growth: basic infrastructure, the quality of the workforce, high speed or broadband internet access, quality of life, the quality of the public school system, a robust system of higher education, etc. A community that neglects investing in these fundamental assets in order to fund incentives is paying a huge opportunity cost for economic development in the future

4. Statewide tax incentives appear to be the least effective form of economic development policy for several reasons: (a) their complexity, (b) their delayed impact over a long horizon, (c) the low utilization rate because most corporations do not pay income tax (up to 65% in North Carolina) and because many others are not even aware of the tax incentives, and (d) it is a broad and blunt instrument.

5. Discretionary incentives seem to work better than broad-based tax incentives for several reasons: (a) they can be deployed strategically based on the particular deal, (b) they can bolster strategic economic development policies based on clusters or other factors, and (c) they can be more effective in closing a deal because of their "up front" nature. Discretionary incentives can include specific workforce training, infrastructure, or cash grants.

6. Human resource incentives seem to provide the best return to the community. One scholar estimates that up-front customized training can be 10 times more

effective to a location decision than other types of incentives. Plus, it trains local employees for the jobs instead of relying on labor recruitment, and the human capital formation as a result of the training redounds to the benefit of the individual worker.

7. Targeting incentives to distressed areas makes policy sense; however, there is scant evidence that they *really* make a difference in location decisions. This is because distressed areas often lack the fundamentals of a good business climate (infrastructure, skilled workforce, etc.) so that they never get in the "game." A wiser use of public funds might be in building up the basic infrastructure for economic development.

8. Conversely, using incentives in growing urban or metro areas (which is often where they end up being utilized) is of marginal importance; and to the degree that incentives *do* promote growth, they actually contribute to *growth management* problems like increased congestion, housing shortages, and pollution.

9. Replacing incentives with adjustments in the corporate income tax structure should be considered.

10. Data, information, and research are critical in making these decisions about appropriations and tax expenditures. The data analysis being undertaken by the Center at the request of the Joint Committee, funded by the General Assembly, and utilized by this Joint Committee could be the most comprehensive and path breaking research every undertaken on the subject.