Optimizing the Use of Economic Development Incentives

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Introduction

State and local incentives to stimulate economic development have increased in North Carolina as they have across the United States. State and local governments continue to deal with the realities of economic transition created by globalization and technological advances. The quest for private investment and jobs in an increasingly competitive global economy is raising the stakes of economic development. The jurisdictions that aggressively use incentives to succeed in the "job wars" can potentially win big—but at what cost and toward what end?

The proliferation of business incentives for economic development is controversial, in part, because public officials often fail to adequately assess the net return on the public investment in incentive deals. Other concerns about the growing use of incentives center on the fundamental question of whether they work and the rationale for using them in the first place. That incentives actually influence business location decisions is the strongest argument offered by proponents for their continued and expanded use. While there is some evidence to support this claim, skeptics counter with numerous studies that show incentives having little to no positive direct effect on investment decisions.[1] How does one interpret and reconcile this apparent discrepancy in the research findings on the effectiveness of incentives? What are the implications for economic development practice?

The purpose of this paper is to provide public officials with a roadmap for navigating the debate surrounding economic development incentives. The intent is not to take a position in favor or against incentives, but rather to discuss the enduring arguments from both sides and the latest research findings on what we, in fact, know about them so that readers can make informed decisions. It is very likely that many jurisdictions will continue offering business incentives into the foreseeable future. As such, the point of the paper is to demonstrate how state and local officials can be more strategic and judicious in using incentives to bring about desired economic development outcomes. Using North Carolina as a case study, the paper illustrates how incentives are used to land major industrial facilities, discusses the controversy surrounding their use, and

[1] For a review of these studies see Alan Peters and Peter Fisher, *The Failures of Economic Development Incentives*, 70 Journal of the American Planning Association 27 (2004).

recommends how public officials might make better use of incentives by taking steps to maximize public benefits and enhance accountability.

Types of Incentives

State governments offer both tax and non-tax incentives to companies. North Carolina's state-level tax incentives consist primarily of corporate income and franchise tax credits and sales tax exemptions and refunds.[2] The Article 3J Program, which replaces the William S. Lee Act effective January 1, 2007, provides state tax credits to eligible businesses that create jobs, invest in business property (machinery and equipment), or invest in real property (buildings and land). The credit for investing in real property is only available to companies that invest at least $10 million and create at least 200 jobs in the most economically distressed Tier 1 counties. Article 3J tax credits are non-discretionary, meaning that any taxpayer that meets the eligibility criteria is entitled to claim the credits. By contrast, certain non-tax incentives are discretionary grant programs in which funds are awarded on a case-by-case basis. Examples include the JDIG program and the One North Carolina Fund. Companies must apply to receive JDIG grants. A five member Economic Investment Committee makes funding decisions and awards grants based on a percentage of the state income tax withholdings generated from eligible positions. The One North Carolina Fund receives a non-recurring appropriation from the General Assembly to enable the Governor to close deals that are strategically important.[3] Other state-level non-tax incentives in North Carolina most often come in the form of low-interest loans through industrial revenue bonds, job training, and infrastructure assistance.

Many local governments outside North Carolina frequently use property tax abatements as a discretionary tax incentive to promote economic development.[4] Local property tax abatement is not legal in North Carolina[5] so local governments provide discretionary cash grants to businesses instead. A recent analysis of local cash grant incentive packages approved by North Carolina counties during 2004-2006 found that most were supporting new facility locations rather than existing business expansions.[6] Cash grants are typically paid out over a number of years, though some amount is often provided upfront. The grants are usually performance-based, which means that they tied to the number of jobs and level of capital investment the business creates. The company may be required to forfeit some or all of the grant if it fails to meet certain performance thresholds in a given year. Some cities and counties base the amount of the grant on a percentage of property taxes paid by a company. According to a recent survey of North

[2] Jonathan Q. Morgan and David M. Lawrence, *Economic Development*, Article 26, County and Municipal Government in North Carolina, UNC School of Government (2007).
[3] Units of local governments must provide a match to the One North Carolina Fund grant award.
[4] Steven G. Koven and Thomas S. Lyons, *Economic development: What local governments do*, ICMA Special Data Issue 2: 1-12.
[5] Article V, Section 2(2) of the North Carolina Constitution states that "Only the General Assembly shall have the power to classify property for taxation, which power shall be exercised only on a State-wide basis and shall not be delegated…"
[6] NC Institute for Constitutional Law, *The Incentives Game: North Carolina Local Economic Development Incentives*, 2007.

Carolina local governments, only zoning and infrastructure improvements are used more readily than cash grant incentives (see Table 1). Other common local incentives include low interest loans, subsidized worker training, and relocation assistance. Tax increment financing, a tool used widely in other states is relatively new to North Carolina and has not been widely used by local governments in the state to date.[7]

Recruiting Dell and Google to North Carolina

Though not typical of the scale and scope of most routine incentive offers, two recent major business recruitment projects in North Carolina illustrate how public officials combine various state and local incentives in order to create a "winning" package. Dell and Google are two household names connected to the knowledge-based economy that any state or community would want to land. North Carolina public officials and economic developers aggressively pursued these projects in order to bring jobs and investment to areas of the state that badly needed them and mitigate the loss of textile and furniture industries. Estimates of the state and local incentive packages offered to lure the new facilities of these two major corporations are detailed in Table 2.

The largest part of the state package for Dell is a tax credit tied to the number of computers produced at the new North Carolina facility. The General Assembly enacted this special tax credit in 2004 during an extra legislative session in order to ensure that Dell would locate somewhere in the Piedmont Triad Region of the state.[8] Once Dell chose North Carolina, local governments in the Triad region—Davidson County, City of Greensboro and Guilford County, and City of Winston-Salem and Forsyth County—proposed separate local incentive packages to lure the facility to their respective jurisdictions.[9] Winston-Salem/Forsyth had been rumored to be the favorite and offered the largest package, which consisted of cash grants, land costs, and funds for surveying, grading, paving, road construction, public utilities, and other site improvements. It is not entirely clear how influential the local incentives were, but Dell decided on the Winston-Salem site in Forsyth County. The state and local incentives for Dell are largely dependent on the company meeting certain performance targets with respect to employment (1,500-1,700 jobs) and capital investment ($100 million). Most of the incentive dollars will be paid out annually over a period of time. Dell did not receive a check upfront for $280 million.

By contrast, Google's state incentives are mostly in the form of a full exemption from the sales taxes it would pay on electric power and certain equipment purchases for up to 30 years (see Table 2). The sales tax exemption on electricity is important for Google because a server farm uses an enormous amount of electricity to keep its many computers

[7] Joseph Blocher and Jonathan Q. Morgan, *Questions About Tax Increment Financing in North Carolina*, Community & Economic Development Bulletin, No. 5 (2008).
[8] S.L. 2004-204 Extra Session (S 2).
[9] See Matt Harrington, *Regional Plan Won't Happen for Dell Deal*, The Business Journal of the Greater Triad Area, November 29, 2004; Also Matt Harrington, *With Dell Confirmed for the Triad, Economic Developers Must Now Compete with Each Other*, The Business Journal of the Greater Triad Area, November 9, 2004.

running around the clock. The exemption also matters because the company apparently would not have to pay this tax in many other states under consideration. The local incentives offered by the City of Lenoir and Caldwell County are 30-year cash grants based on 100% of business property taxes and on 80% of real property taxes paid by Google. These incentive grants are estimated to total as much as $165 million over 30 years, which prompts some to think that Lenoir and Caldwell County "gave away the farm", so to speak, to get a server farm.[10]

The amount of public dollars put on the table for Dell and Google is significant. However, the cost of each incentive package must be considered in relation to the economic and fiscal benefits that the companies will generate (see Table 3). In order to receive the full amount of incentives, Dell must employ at least 1,500-1,700 workers at the facility in Winston-Salem. The jobs are expected to pay an average annual salary of $28,000. Critics point out that this is lower than the average salary for all workers in Forsyth County. Proponents of the Dell project contend that it will have a strong multiplier effect on the state and region because of the ability to attract supplier firms to locate nearby. The state Commerce Department estimates that Dell's initial direct capital investment of $100 million and ongoing operations will translate into more than $24 billion in economic output (gross state product) and net state revenue of $743 million over 20 years. Dell's "ripple effect" within the region is projected to generate an additional 6,000 indirect jobs at suppliers, service companies, retailers, hotels, restaurants, etc.

Google expects to directly employ 210 workers in Lenoir with an average annual salary of $48,300—significantly higher than the average salary of Caldwell County. Yet, there is concern that the company will not hire local residents and will bring in workers from elsewhere because much of the local workforce lacks the education and skills required for the jobs at the Google facility. Although Google will employ far fewer workers than Dell, its level of capital investment—$600 million—is much higher. The state Commerce Department estimates that Google will contribute about $1 billion to the state's economy and generate $37 million in net state revenues over a 12-year period. At the local level, Google will purchase a substantial amount of electricity from Duke Energy, help increase revenues from the utility franchise tax, and become Lenoir's second largest water customer.[11] The company might end up as the city's third largest taxpayer even after accounting for the incentive grants it will receive.[12]

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The Incentives Debate

The Dell and Google projects raise important questions about the role of incentives in the process of economic development. These and other recent incentive offers including the new grant program aimed at Bridgestone/Firestone and Goodyear underscore why the

[10] Jonathan B. Cox, *Lenoir Gets Google, at a Cost*, News & Observer, Jan. 20, 2007.
[11] W. Lane Bailey (Lenoir City Manager), *Economic Development Incentives*, Presentation at the annual conference of the North Carolina City/County Managers Association, January 2008.
[12] Ibid.

debate over incentives rages on. There are at least four points of contention that fuel the debate. They are the extent to which economic development incentives are fair, efficient, effective, and accountable. It is important for state and local officials to understand incentives within the context of these four issues if they are to make better and wiser use of incentives as tools for fueling economic growth and prosperity.

Fairness. The concern about whether or not incentives are fair has to do with who reaps the benefits and who bears the costs of economic development policies. With incentives, some businesses clearly benefit, but others may lose out. When government provides tax concessions, grants, and other assistance to certain businesses and not others it has the appearance, if not the effect, of treating comparable taxpayers unequally.[13] The perception that incentives go mostly to new companies locating in a community can breed resentment among existing firms, particularly if they are direct competitors with the companies receiving aid. Moreover, the minimum job creation and investment requirements of most incentive programs typically make small businesses ineligible to participate. The counterargument is that it is sensible to discriminate among taxpayers and provide special treatment to those who create large numbers of jobs and make significant investments in a community because it benefits the greater good. For example, there is some evidence to suggest that when economic development policies stimulate local growth they also improve the distribution of income by enhancing job opportunities for minorities and persons with lower education levels.[14]

If economic development incentives do indeed serve a larger public purpose, then their benefits should extend beyond private companies and industries to other taxpayers. This is more likely to occur if the companies receiving incentives hire local residents and invest in distressed areas with high unemployment.[15] The Google project in Caldwell County will certainly increase economic activity in a part of the state with above average unemployment, but it remains to be seen if local residents will get many of the new jobs. Google will tap into the county's excess water and electric power capacity created by the loss of major textile and furniture industries, which yields important public benefits. In the case of both Dell and Google, if the incentives convinced the companies to build facilities in places where they otherwise would not have done so, taxpayers will gain economic opportunities and resources that might justify the millions of dollars of incentives promised.

On the other hand, if the incentives were not the determining factor, they might be an inequitable transfer of business costs from selected corporations to other taxpayers. Is it "fair" for taxpayers in one jurisdiction to subsidize a business for creating jobs that go to the residents of other jurisdictions? This question hovers over the Dell project given that the taxpayers in Winston-Salem and Forsyth County are on the hook for the local

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[13] David Brunori, *Principles of Tax Policy and Targeted Tax Incentives*, 29 State and Local Government Review 50 (1997).
[14] Timothy J. Bartik, Who Benefits from State and Local Economic Development Policies?, Kalamazoo, MI: W.E. Upjohn Institute for Employment Research (1991).
[15] Timothy J. Bartik, *Jobs for the Poor: Can Labor Demand Policies Help?*, New York: Russell Sage Foundation and Kalamazoo, MI: W.E. Upjohn Institute for Employment Research (2001).

incentives despite the fact the plant surely employs people from various other cities and counties. Ultimately, the fairness of incentives is in the eye of the beholder and is a separate (though not unrelated) issue from whether they are effective, efficient, or worth the cost.

Efficiency. In one sense, inter-jurisdictional tax competition, including incentives, is thought to be an efficient way to allocate public resources as firms seek the best locations to achieve the optimal balance of taxes and government services.[16] State and local governments offer incentives in order to make their jurisdictions more attractive to firms. Some argue that the efficiency effects of tax incentives are negated because incentive competition is a zero-sum game: one jurisdiction gains at the loss of another. From a national perspective, such "beggar-thy-neighbor" behavior produces no net economic gains since capital merely relocates from place to place. Others refute the zero-sum game argument and suggest that "State and local economic development competition may increase productivity, redistribute jobs towards the high unemployment areas that need jobs the most, and increase national employment by using previously unemployed labor."[17] In practice, there is the potential for any incentive to be zero-sum, positive-sum (e.g. benefits exceed costs), or negative-sum (e.g. costs exceed benefits) depending on how the inducement is applied.[18] The important point is that any incentive amount offered above the absolute minimum required to attract a business is inefficient from a public sector perspective.[19]

When jurisdictions use incentives to compete with one another for jobs and investment, they can face a situation known in negotiation/decision-making theory as the "prisoner's dilemma". In this view, incentive competition becomes a counterproductive "race to the bottom" that could jeopardize the long-term fiscal capacity of states and localities. As the former mayor of Indianapolis, Stephen Goldsmith notes: "You can't say no, but you can't afford to say yes" when companies request incentives.[20] Moreover, the intense competition among jurisdictions can ratchet up the scale of incentive packages to the point of overpayment and result in excessive costs per job created. Additional inefficiencies arise from the high opportunity costs of incentives and potential revenue shortfalls that might cause state and local governments to under-provide critical public services such as education and infrastructure.[21]

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[16] Wallace E. Oates and Robert M. Schwab, *Economic Competition Among Jurisdictions: Efficiency-Enhancing or Distortion-Inducing?*, 35 Journal of Public Economics 333 (1988).
[17] Bartik, Who Benefits from State and Local Economic Development Policies, at 201.
[18] John P. Blair and Rishi Kumar, *Is Local Economic Development a Zero-Sum Game?*, in Dilemmas of Urban Economic Development (Richard Bingham and Robert Mier, eds., Thousand Oaks, CA: Sage Publications, 1997).
[19] Charles J. Spindler, *Winners and Losers in Industrial Recruitment: Mercedes-Benz and Alabama*, 26 State and Local Government Review 192, 198 (1994).
[20] Mary Jo Waits, *Economic Development Strategies in the American States*, in Handbook of Economic Development 191 (Kuotsai Tom Liou, ed., New York: Marcel Dekker, Inc., 1998).
[21] George R. Zodrow, *Reflections on the Economic Theory of Local Tax Incentives*, State Tax Today 110-5 (2003).

The argument that incentives are inefficient because they erode the tax base and undermine the provision of essential public services ignores a key assumption about how incentives should work. Incentives are supposed to help create new tax revenues. The revenues cannot be diverted from other uses if they never materialize in the first place. Writing in a letter to the editor, Secretary of Commerce, Jim Fain correctly notes that Google's incentives represent a claim on tax revenues that would not be realized unless the company decided to locate in the state:

> Incentives offered by the state are dependent on future tax receipts paid by the company. They are primarily reductions of future tax revenues that we do not now receive, nor would we ever receive if Google does not locate here. Google will receive future incentive benefits only if it creates the jobs and makes the investments that generate this tax revenue for their incentives.[22]

This logic holds up as long as it can be demonstrated that Google would not have located in North Carolina *but for* the incentives it was offered. If not, then the state is merely subsidizing a business decision that would have happened without any incentive and forgoing tax revenues it would have otherwise received. Those forgone revenues are then not available for spending on education, infrastructure, and other public services or to facilitate lower tax rates overall. It is conceivable that the incentive package made the difference with Google, but it is difficult to know for sure. That Google announced plans for a similar facility in neighboring South Carolina within weeks of its North Carolina announcement casts some doubt on the extent of the competition and how decisive the incentives might have been.[23]

Effectiveness. The debate about whether incentives work is where legal justifications and theoretical arguments must pass muster with the facts from empirical research. Unfortunately, the research findings on effectiveness are not conclusive and provide ammunition for both sides of the debate.[24] However, they offer some insights when considered in the proper context. Part of the inconsistency arises from differences in measures and methods across studies. There is also the difficulty of isolating the effects of incentives on economic outcomes, which requires controlling for many other variables. But a more fundamental problem is knowing precisely what it means for a particular economic development incentive to be effective or not. The real question is: effective at what?

A proper assessment of the effectiveness of incentives must take into account how specific tools are supposed to work and what they can realistically be expected to achieve. It is also important to distinguish between the micro-level effects on firms and

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[22] Secretary of Commerce James T. Fain III, *Google's Benefits*, The News & Observer, Feb. 11, 2007.
[23] See Bruce Smith, The Associated Press, *South Carolina Lands Google Site Similar to Lenoir's*, The News & Observer, April 5, 2007. Available at: http://www.newsobserver.com/104/story/560997.html.
[24] See Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature*, 15 Economic Development Quarterly 90 (2001); Robert G. Lynch, *The Effectiveness of State and Local Tax Cuts and Incentives*: *A Review of the Literature*, 11 State Tax Notes 949 (1996).

macro-level effects on states, regions, and communities. At the firm level, incentives aim to lower the cost of doing business in a way that boosts profitability.[25] This is a fairly immediate and direct effect on which there is little disagreement. The next concern, then, is the extent to which incentives influence business location decisions. At the heart of this question is whether incentives actually function as incentives/inducements, or are they mere subsidies to business. An incentive incites or spurs action and an inducement stimulates or moves by persuasion.[26] By contrast, a subsidy is defined simply as a grant or gift of money.

If tax and other financial incentives are to be considered as economic stimulus tools rather than "corporate welfare" they should directly sway business investment and job creation decisions. Here again, there is a lack of certainty and clarity in the research findings. A study of state incentives in Ohio identified different effects on the *actual* employment growth of firms versus the employment levels they initially promise.[27] The researchers found that incentives had a negligible effect on actual employment growth in firms but that they were positively correlated with *announced* job growth. These findings suggest that incentives will cause firms to overstate the number of new jobs they will create. A recent analysis of North Carolina's Lee Act tax credits suggests that "tax incentives go to firms without significantly influencing their decisions on investment and employment".[28] A possible explanation for this is that taxes and incentives account for only a small portion of business operating costs and therefore do not matter all that much. However, in surveys, companies tend to emphasize the importance of incentives and they have a vested interest in doing so. But Table 4 shows that incentives are only one of several factors that businesses consider when making a location decision. In *Area Development Magazine's* most recent corporate survey, incentives ranked 7th out of a possible 25 site selection factors.

Despite the ambiguity about whether incentives induce jobs and investment by firms (micro-level) that would not otherwise exist, most studies conducted through the 1980s found that taxes and incentives have little to no effect on macro-level economic growth.[29] This is counterintuitive since lower business tax burdens are thought to be more conducive for growth. Later research indicates that taxes might matter more than initially thought, particularly that higher taxes can hinder economic growth.[30] If true, then by easing the tax burden on firms, incentives could make a place more competitive for business investment and thereby spur economic growth.

Assuming that incentives are effective at promoting state and local economic growth, to what extent do they work for the people and places most in need? This question is

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[25] Robert L. Bland, A Revenue Guide for Local Government 49 (Washington, DC: International City/County Management Association, 2005).
[26] Merriam-Webster's Collegiate Dictionary, Tenth Edition.
[27] Todd M. Gabe and David S. Kraybill, *The Effect of State Economic Development Incentives on Employment Growth of Establishments*, 42 Journal of Regional Science 703 (2002).
[28] Michael I. Luger and Suho Bae, *The Effectiveness of State Business Tax Incentive Programs*: *The Case of North Carolina*, 19 Economic Development Quarterly 327, 339 (2005).
[29] Peters and Fisher, *The Failures of Economic Development Incentives*; Lynch, The Effectiveness of State and Local Tax Cuts and Incentives.
[30] Bartik, Who Benefits.

related to the fairness/equity concern discussed above, but also has implications for the overall effectiveness of incentives, especially those that target economically distressed areas. Some studies demonstrate that poor people and places can experience the greatest gains from economic development incentives.[31] In North Carolina, the Lee Act tax credits attempt to steer jobs and investment to poorer communities by offering larger credits to businesses that locate in counties with higher unemployment rates and lower income levels. There is evidence that this aspect of the incentive program is "particularly effective in encouraging firms to invest more and hire more workers in economically distressed areas".[32] In some other states, traditional incentives appear to only stimulate growth in prosperous areas such that growth begets growth.[33]

In sum, the research to date suggests that economic development incentives do not always induce firms to create substantial jobs and investment that *would not occur without the incentives*. This appears to be the case despite the fact that companies say incentives are important factors in the business location decision. The case for using incentives to promote growth at a macro-level and in lagging areas is more compelling.

Ultimately, the empirical research findings must be interpreted in light of the economic and political realities that states and localities face in the new economy. Facing intense global competition, manufacturing plants continue to close and move off-shore and people continue to lose jobs. When this happens local governments lose revenues and are sometimes left with underutilized public infrastructure. The political pressure grows to do something or at least appear to be taking action to improve economic conditions. In this context, economic development incentives might prove "effective" in ways that are difficult to capture in numbers.

If nothing else, it appears likely that incentives improve the competitive positions of states and localities and help them close deals. To appreciate this requires an understanding of the site selection process that businesses—often assisted by hired consultants—use when making the decision about where to locate or expand.[34] Incentives do not typically matter until a firm has narrowed the list of possible locations to a few that meet all of its other requirements for a site/building, infrastructure, workforce, etc. At that point, the incentives offered can tip the scale in favor of one location over another. From a competitiveness perspective, a jurisdiction has to decide whether to play to win or sit it out. Given how the game is played, incentives can help states and localities win, at least in the short run. Winning some of the time is better than always losing. In this way, incentives become a necessary evil in the process of attracting and retaining businesses and securing the jobs and investment they create.[35]

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[31] Ibid.
[32] Luger, *The Effectiveness of State Business Tax Incentive Programs*, at 338.
[33] See Ernest P. Goss and Joseph M. Phillips, *Do Business Tax Incentives Contribute to a Divergence in Economic Growth?*, 13 Economic Development Quarterly 217 (1999).
[34] See Mark Sweeney, *The Challenge of Business Incentives for State Policymakers: A Practitioner's Perspective*, 77 Spectrum: The Journal of State Government 8 (Winter 2004); Phillip D. Phillips, *Site Selection: Corporate Perspective and Community Response*, 9 Economic Development Review 4 (1991).
[35] Ann Markusen, *A Market- for-Jobs Approach for Analyzing the Competition for Capital*, 43 State Tax Notes 39 (2007).

Against the odds, public officials might be willing to tolerate the inefficiency of incentives if they provide an edge no matter how slight:

> For every 10 plants offered such an incentive, the incentive would be decisive for about 3 of them. The incentives given to the other 7 plants would have no effects on business location or employment growth. The only effect would be an extra cost to state and local governments of these unneeded 7 incentives. Unless economic developers can somehow determine which of the 10 plants "needs" the incentive to tip its location decision, this loss on 7 of the 10 plants is a necessary cost to tip the location decision of the other 3 plants.[36]

Returning to a question posed at the outset: are the incentives worth it? A good cost-benefit analysis will provide a quantitative answer to this question for a given project. Ideally, the public benefits from incentive deals should exceed their costs. However, a major business location/expansion project can benefit communities in quantitative and more qualitative ways. It can serve as a beacon of hope that prosperity will return to communities hard hit by job loss. It can restore self-respect to displaced manufacturing workers who need employment to support their families. For these folks, the debate over the effectiveness of economic development incentives is an academic exercise. Referring to the Google project, Lenoir Mayor David Barlow put it this way, "Psychologically, the impact of this for our community would be greater than the reality".[37] Projects like Dell and Google also have symbolic value to the extent that they put communities "on the map" for future economic development opportunities.

Accountability. One of the most common criticisms of incentives is that they are frequently provided without being sufficiently accountable to taxpayers and the broader public interest. Corporate mergers, changing economic conditions, and intense global competition can lead companies to drastically change their investment plans over time. This can create the possibility that companies will fail to deliver on their promises to create a certain number of jobs and make a certain amount of capital investment. For example, in 1999 the state offered $35 million in incentives to Wisconsin Tissue to build a $180 million tissue mill and paper recycling plant in Halifax County with 150 employees. But a few months after the deal was announced, the company scrapped plans for the facility after being bought by Georgia-Pacific and received no incentives.[38] In the same year Corning opened a $600 million fiber-optic cable production facility in the Cabarrus County town of Midland after being offered state and local incentives. The facility expanded to employ as many as 800 workers at one point and had 550 when it shut down in 2002 in the face of a steep downturn in the telecommunications industry. In 2007, Corning decided to gradually restore a limited amount of production at the

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[36] Timothy J. Bartik, *Solving the Problems of Economic Development Incentives*, 36 Growth and Change 139, 143 (2005).

[37] Nanette Byrnes, *The High Cost of Wooing Google*, Business Week, July 23, 2007. Also see Shaila Dewan, *Google is Reviving Hopes for Ex-Furniture Makers*, The New York Times, March 15, 2007.

[38] N.C. Coastal Federation, *Industrializing Rural Coast*, State of the Coast Report, p. 17, 1999. Available at http://www.nccoast.org/publication/socreports/soc_99/RuralCoast.pdf; Arlen Boardman, *Wisconsin Tissue Mills Plans New Operation in Northeastern North Carolina*, The Post-Crescent (Appleton, WI), January 27, 1999.

Cabarrus facility in response to improved market demand.[39] In an interesting twist of fate, Dell, Inc. is reportedly seeking to sell off all of its plants, including the one in Winston-Salem, in response to shifting corporate strategy. It is unclear how this might affect its incentive deal or operations in North Carolina.[40]

Even when companies fulfill employment and investment expectations, the impact estimates of the ripple effect on a community are mere forecasts based on imperfect economic models. For example, a recent report suggests that the model used by the state Commerce Department to assess incentive packages tends to overstate the economic benefits that firms will provide and leads to overbidding.[41] Using more conservative assumptions, the authors show the Dell project having a much smaller effect on the state's economy and a *negative* fiscal impact on state revenues. This demonstrates that economic and fiscal impact analysis is imprecise and must be used with care and interpreted with caution.

Another accountability concern is the secretive nature of early incentive negotiations. Companies require that their investment plans be kept confidential in order to protect trade secrets and avoid tipping their hand to competitors. State law allows for confidentiality, withholding of public records, and protection of trade secrets on economic development projects under certain conditions.[42] As a result, state and local officials often commit public dollars before the details of a deal are widely known. Companies also demand confidentiality because they do not want information on pending plant closures elsewhere to leak out[43] and to avoid excessive real estate speculation that might drive up the costs of land acquisition.[44] Public officials face the dilemma of balancing the company's need for confidentiality and anonymity against the public's right to know.

Public officials are at a disadvantage in incentive negotiations because companies have access to a great deal more information on what other jurisdictions are offering and which alternative locations are viable. Only the company knows for sure the amount of incentives that will tip the decision in favor of one place over another. Google is alleged

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[39] Jordan Green, *The Tar Heel Corporate Incentives Hustle: How Local Governments Fight Each Other for Disappearing Jobs*, Southern Exposure, p. 4, September 2005. Available at http://southernstudies.org/CorpIncentivesMain2005.pdf; Adam Bell, *Corning to Reopen Part of Plant in Midland*, Charlotte Observer, April 26, 2007.

[40] Justin Scheck, *Dell Plans to Sell Factories in Effort to Cut Costs*, The Wall Street Journal, p. A1, Sept. 5, 2008; Jonathan B. Cox, *Dell May Sell Triad Plant that Gained Tax Breaks*, The News & Observer, Sept. 6, 2008.

[41] See Elaine Mejia, Kristopher Nordstrom, and William Schweke, *Getting Our Money's Worth?: An Evaluation of the Economic Model Used for Awarding State Business Subsidies*. NC Budget & Tax Center and CFED, March 2007.

[42] N.C. GEN. STAT §132-1.2 (Public Records Law); N.C. GEN. STAT §66-152 (Trade Secrets Protection Act); N.C. GEN. STAT §132-6(d).

[43] Lawrence, Economic Development Law at 90.

[44] Zach Patton, *Hush Money: Why are Tax Incentive Deals almost always Negotiated in Private?*, 21 Governing 50 (August 2008). Available at: www.governing.com.

to have exploited this information imbalance in the negotiations with state and local officials over its incentive package.[45]

Several mechanisms exist that might help jurisdictions win using incentives but avoid the "winners curse"[46] of paying too much for too little in return. As shown in Table 5, these include some safeguards already adopted in many states and localities, such as clawback provisions, tying incentives to company performance, requiring performance contracts, cost-benefit analysis, targeting distressed areas, and wage/job quality standards.

Conclusion: Getting the Most Out of Incentives

Despite the ongoing controversy over economic development incentives there is no end in sight to the escalating competition among jurisdictions that has been likened to an arms race. It is foolhardy to the think that state and local governments will unilaterally disarm and stop using incentives in the near future. National legislation calling for a cease-fire to the economic war among the states has been introduced periodically in the U.S. Congress but is unlikely to be enacted any time soon. So where does this leave public officials?

As others have aptly noted, incentives are not inherently good or evil, right or wrong, wise or foolish. They are tools that public officials can use more prudently—or less so—depending on their application. Public officials should clearly understand the trade-offs among fairness, efficiency, effectiveness, and accountability in using incentives to promote job creation and private investment. While current practice in North Carolina and beyond incorporates many good reforms, they can be expanded to improve the use of incentives through: 1) more enforceable contracts; 2) greater transparency and disclosure; 3) more rigorous cost-benefit analysis; 4) more regional cooperation; 5) stronger inducements for hiring local residents and the unemployed; and 6) greater focus on small businesses, existing industry, and job training.[47] Taken together, these incentive policy enhancements will help jurisdictions strengthen their negotiating position with companies, maximize public benefits, and protect the public investment in incentive deals.

[45] See Jonathan B. Cox, *Google Muscled N.C. Officials*, The News & Observer, February 1, 2007.
[46] Spindler, *Winners and Losers*, at 192.
[47] Bartik, *Solving the Problems of Economic Development Incentives;* Greg LeRoy, *Nine Concrete Ways to Curtail the Economic War Among the States*, in Reining in the Competition for Capital (Ann Markusen, ed., Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2007); Scott J. Ziance, *Making Economic Development Incentives More Efficient*, 30 Urban Lawyer 33(1998); Rachel Weber, *Do Better Contracts Make Better Economic Development Incentives*, 68 Journal of the American Planning Association 43 (2002).

Tables

Table 1. Incentive Tools Used by Local Governments in North Carolina

	Percent Reporting
Zoning and permit assistance	59.0
Infrastructure improvements	56.2
Cash grant incentives	**42.4**
One-stop permitting	30.0
State development zone	24.0
Land or building acquisition	23.0
Site preparation	19.4
Subsidized land or buildings	17.5
Subsidized worker training	16.1
Low-interest loans	11.1
Relocation assistance	9.2
Employee screening	9.2
Regulatory flexibility	7.8
Incentives for retail projects	7.4

n = 217

Source: Jonathan Q. Morgan, The Role of Local Government in Economic Development, UNC School of Government, 2009

Table 2. Incentives for Dell and Google

(numbers in millions)

	Dell	Google
State Incentives		
Computer manufacturing tax credit[a]	$200.0	n/a
Tax credits (Lee Act, Article 3J)	21.4	2.6
Job Development Investment Grant (JDIG)	8.8	4.8
Job training[c]	8.3	n/a
Infrastructure	3.0	0.7
Sales tax refund	1.0	n/a
Sales tax exemption	n/a	89.0
State Package	242.5	97.1
Local Incentives (City and County)		
Cash grants	[a]17.2	[b]165.0
Site preparation and improvements	13.0	n/a
Land	7.0	n/a
Local Package	37.2	165.0
Total State and Local Incentives	**$279.7**	**$262.1**

[a]paid out over 15 years; [b]paid out over 30 years

[c]includes $3.3 million from the Golden Leaf Foundation

Source: Author compilations from various news reports; NC Department of Commerce

Table 3. Estimated Economic and Fiscal Impacts of Dell and Google on North Carolina

	Dell	Google
Jobs (direct)	1,500	210
Average salary	$28,000	$48,300
Capital investment	$100M	$600M
Jobs (indirect)	6,000	372
Gross state product	$24.5B	$1.06B
State revenue (net)	$743M	$37M

Source: NC Department of Commerce

Table 4. Top Site Selection Factors for Industrial Facilities

1. Highway accessibility	95.4
2. Labor costs	91.4
3. Occupancy and construction costs	90.4
4. Tax exemptions	88.6
5. Energy availability and costs	87.9
6. Availability of skilled labor	87.7
7. State and local incentives	**87.2**
8. Corporate tax rate	85.3
9. Low union profile	82.7
10. Available land	82.0
11. Availability of buildings	80.8
12. Proximity to major markets	78.7

Source: 23rd Annual Corporate Survey, Area Development, 2008.

Table 5. Accountability Mechanisms Used by North Carolina Local Governments

	Percent Reporting	n
Always require performance agreement	51.2	217
Never require performance agreement	16.1	217
Cost-benefit analysis	59.5	173
Formal policy for eligibility	51.1	178
Provision for hiring local residents	18.3	175
Clawbacks	60.7	173

Source: Jonathan Q. Morgan, The Role of Local Government in Economic Development, UNC School of Government, 2009