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Tax Policy

States use tax credits and incentives to attract business, encourage economic development, and create jobs. A recent example is the "Good Jobs for Michigan" program. In this article, Jacob Bundrick of the Arkansas Center for Research in Economics (ACRE) at the University of Central Arkansas discusses the economic effects of credits and incentives, and whether they actually create jobs and boost state economies.

Good Jobs Program or Bad Economic Policy?

BY JACOB BUNDRICK

State officials across the country are eager to land job-producing economic development projects. To recruit these projects, state legislators rely heavily on targeted tax breaks and subsidies. Recent estimates from the W.E. Upjohn Institute for Employment Research show that the total annual cost of state and local targeted economic development incentives reached $45 billion in 2015. Despite the already sizable cost, state policymakers continue to develop new programs. A recent effort comes from officials in Michigan.

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Good Jobs for Michigan

On July 12, the Michigan legislature sent a trio of economic development bills to Governor Rick Snyder's (R) desk. With Gov. Snyder's approval, Senate Bills 242, 243, and 244 created the "Good Jobs for Michigan" program. The program will allow certain businesses promising to create at least 250 jobs to retain up to 100 percent of the personal income tax withholdings of the employees filling those new positions for a maximum of ten years. The percentage and duration of the income tax withholdings retained by the employer depends on both the number of jobs created and the wages paid to those employees.

Proponents of the "Good Jobs for Michigan" program argue that the tax incentive will lure businesses that both create jobs and produce a multiplier effect that leads to even more ancillary jobs throughout the economy. Gov. Snyder praised the program saying that Michigan is "enacting forward-thinking policies that make us more competitive for new jobs and industries in a fiscally responsible fashion." State Rep. Leslie Love-(D) agreed, stating that it "is an opportunity to attract emerging industries and create thousands of new jobs in the state."

Empirical Research

However, empirical research on targeted tax incentives and job growth does not support this reckless optimism. Research published in *Regional Studies* found that the number of tax incentives offered in a state has no relationship with employment. Analyses of enter-

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prise zones published in both *Regional Science and Urban Economics* and the *Journal of Urban Economics* also found no evidence of increases in employment as a result of the tax incentive. Research from economists at the University of Tennessee found that the siting of new, large firms (1000+ employees) has no impact on regional employment growth. Research from a Georgia State University economist also suggests that ''the net economic impact of large, new firm [300+ employees] locations generally are overestimated'' and that ''local governments are not likely to receive significant long-term employment or population benefits from large new firm locations.'' Empirical evidence suggests that centering economic development efforts around the recruitment of large firms is unlikely to produce significant employment benefits.

Crowds Out Existing Businesses

Why not? One reason recruiting large businesses with targeted tax incentives fails to stimulate significant job growth is that it crowds out existing businesses. In other words, providing artificial cost advantages to select businesses through tax incentives may lead to competitive advantages that put existing establishments in the region out of business. For instance, if a politically favored firm can offer a good at a lower cost because of their tax subsidy, sales may shift from existing businesses to the new firm. Furthermore, businesses receiving tax incentives may be able to attract more and better labor at lower costs than other regional firms or obtain cheaper credit than existing establishments. Other negative consequences stemming from the use of tax incentives, such as infrastructure congestion and fiscal costs, work to make a region less compelling for businesses that do not receive incentives themselves. Put simply, tax incentives may create some jobs with the businesses that receive them, but they destroy jobs at the businesses that do not.

Distortions in Economy

Targeted tax incentives not only fail to create significant job growth, they also cause distortions in the economy that reduce broad economic growth. First, tax incentives distort the decision making processes of business leaders. Rather than making decisions based on the opportunities in their industry, business leaders focus on qualifying for tax incentives. For instance, the ''Good Jobs for Michigan'' program may encourage business leaders to forego investing in research and development in favor of hiring more employees even if investing in more R&D would make the business more productive. The business receives a tax break for job creation, but the loss of productivity from less R&D makes the overall economy worse off.

A second problem caused by limiting the benefit of tax incentives to politically favored firms is that public officials create a tempting environment for special interest lobbying. Rather than spending time and money innovating new products and services, business leaders spend their resources trying to obtain political favors. This loss of innovation makes us worse off.

Regional Unrealism

Finally, targeted tax incentives encourage the accumulation and use of resources in activities for which they are not most productive. Economists call this ''regional unrealism.'' Regional unrealism occurs when politicians use tax incentives to encourage business activity in industries that they dream their state could be good at rather than what their state is actually good at. With a large enough tax incentive, politicians can encourage any business activity to take place regardless of the economic merits of the business. Ultimately, regional unrealism leads to a state that does not produce as many goods or provide as many services as it could, making the economy less valuable than it otherwise would be.

State legislatures continue to develop new targeted economic development incentives in hopes of luring jobs to their respective states. However, the empirical evidence suggests that this policy is misguided as it is unlikely to create any meaningful employment benefit. Furthermore, targeted tax incentives create several distortions in the economy that make residents less prosperous than they otherwise would be. Instead of continuing to create incentives that focus narrowly on job creation and benefit only a few politically favored firms, state legislatures should focus their efforts on developing policy that targets economic growth more broadly. If legislators want to improve their state's economy they should consider evidence-based reforms like broadening tax bases and lowering rates or removing barriers to employment like overly burdensome occupational licensing laws. These broad based policy changes are economically sound ways to increase employment, incomes, productivity, and prosperity for all Michiganders.

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