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Why Some State Incentives for Business Work—And Others Don't

A $46 million Connecticut deal with a pharmaceutical company meant spending $230,000 per new job.

By TOM FOLEY AND BEN ZIMMER

Every state does it, to one degree or another: pays incentives to private companies to keep jobs in-state. Supporters say this is necessary for job creation, detractors call it corporate welfare, and nationwide it costs more than $80 billion a year. So when are such incentives sound economic policy, and when do they merely serve certain firms, lobbyists and politicians?

Jobs created with incentives are good when they are net contributors to the economy. They are bad—handouts, effectively—when the incentives cost the state more than the jobs contribute back to the economy.

The Connecticut Policy Institute has identified three criteria for determining when job incentives go from good to bad:

• Does the total cost of the incentive exceed the amount that would be paid back through incremental tax revenues over 10 years? In most states, this threshold is crossed when the total cost of the incentive rises above 50% of the annual compensation for jobs kept or created.

• Do the incentives provide only for jobs that would not otherwise come to the state, or would otherwise leave?

• Do the incentives promote jobs that will remain viable and stay in-state after the incentives expire?

Some state incentive programs meet these criteria. In October 2012, Kentucky offered Berry Plastics $10 million to refurbish and reopen a manufacturing plant in Madisonville, about 150 miles southwest of Louisville. Berry committed to bring 400 jobs to Kentucky, a reasonable rate of $25,000 per job. The plant had closed in 2011 because the products it produced could be more competitively produced elsewhere. But the refurbished plant will produce a

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different product that can be competitively produced in Kentucky.

Most incentive programs aren't so effective. In 2011, Connecticut agreed to pay The Jackson Laboratory, a genetics research institute, $300 million in exchange for a promise to bring 300 new jobs to Connecticut. That cost a whopping $1 million per job. The same year, Connecticut paid Alexion Pharmaceuticals $46 million to commit to hiring 200 new employees. At $230,000 per job, this still far exceeds the threshold for a sound investment in the state's economy.

In 2007, Michigan announced a film-industry incentive program that would reimburse 50% of production costs spent in the state. The program brought hundreds of jobs to Michigan, according to local records, but when the incentives expired in 2011 the movie producers relocated and the jobs disappeared.

Incentive programs can be problematic even when not targeted at particular companies or industries. Oklahoma's Small Business Capital Formation Incentive Act provides a 20% tax credit for investments in Oklahoma small businesses. In 2009, reported the Oklahoma Tax Commission, the program cost the state $17 million but generated only 21 new jobs.

Connecticut recently passed a Job Expansion Tax Credit awarding businesses a subsidy of up to $32,000 per employee for every new hire between Jan. 1, 2012 and Jan. 1, 2014. This subsidy will induce businesses to hire some employees they otherwise wouldn't, but much of the cost will be wasted paying companies for hires they would have made anyway. Meanwhile, there is no guarantee that any of the new employees will still have jobs once the subsidy expires three years after their date of hire.

If many job incentives are poor public investments, why do states get away with offering them? Because good policy and good politics are often at odds. Politicians want to be re-elected, and a solid record on nominal job growth—regardless of the cost—tends to be more important to officials' re-election prospects than is the prudent management of public funds. That is one reason most such programs are structured to yield job creation immediately while deferring the cost of the incentive into the future—preferably when other politicians will be in office.

State competition for jobs should be a good thing that promotes fiscal stability, low tax rates, dynamic labor markets, balanced regulatory environments and responsible investment in infrastructure and human capital. These—and not one-time tax breaks—are the factors that are most likely to attract employers and drive good jobs policy.

Mr. Foley, the 2010 Republican nominee for governor of Connecticut, is founder of the Connecticut Policy Institute, of which Mr. Zimmer is executive director.

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