

Location Incentives Are Unfair And Poorly Justified

by Jeffrey A. Finkle
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With this issue, SS introduces its new Forum feature, presenting provocative debates on today's hottest business issues. This installment centers on the intense incentives controversy, with contrasting views from two strong advocates: Kentucky Gov. Paul Patton and National Council for Urban Economic Development Executive Director Jeffrey Finkle.

Incentives are generally inequitable, poorly justified and damaging to existing industry. Areas should adopt a policy to ensure that incentives optimize public investment.

There is nothing fair about business location incentives: They are not generally administered equally or justified well, and existing competitors are often harmed.

Most companies should react negatively when they analyze incentives. Each year, only a few will receive incentives. Taxes those firms don't pay will be paid by some other company — probably yours. And it galls long-time corporate citizens to learn of a competitor being wooed with great gobs of local tax dollars.

Incentives have snowballed tremendously. From the deep and protracted economic recession and restructuring of the 1970s and early 1980s, when many areas lost their manufacturing base, incentives have become increasingly controversial as competition has intensified.

Reacting to fierce global competition and telecommunications and information infrastructure, corporations have also broadened their search for cost-cutting measures. With the incentives upsurge, firms

can now shop for packages that best fit strategic location plans.

An 'Up-Front' Consideration

Traditionally, incentives were considered last in location decision-making, a "deal sweetener" that made a difference only after a search narrowed to two or three locations. Companies generally gave more weight to a location's business climate, quality of life and its ability to meet specific needs.

Considering these factors first is *still* the

case in most corporate location decisions. In recent years, however, many large site-seeking firms have made incentives more of an early, "up-front" consideration. Locations lacking competitive incentives aren't likely to receive serious consideration for those projects.

Another incentives-escalating trend has been states' more active roles in recruiting "Super Deals." For example, in five major auto deals negotiated between 1980-87, incentives escalated from \$33 million to \$150 million, and estimated cost per job increased from \$8,000 to \$50,000 by our calculations (see accompanying chart).

Some areas have largely themselves to blame for today's very costly situation. They've entered bidding wars and attempted to "steal" from nearby states.

Major Auto Location Incentive Packages

Company/State	Total Incentive Package (Estimated)	Cost Per Job (Estimated)
Nissan/Tennessee	\$33 Million +	\$8,000
Mazda/Michigan	\$49 Million +	\$14,000
Saturn/Tennessee	\$70 Million +	\$23,000
DiamondStar/Illinois	\$118 Million +	\$40,700
Toyota/Kentucky	\$150 Million +	\$50,000

Source: National Council for Urban Economic Development

The problem has been exacerbated by incentives being offered that were not justified by job quality, return on investment or high community costs.

For example, Rio Rancho, N.M., traded on the community's basic services to entice Intel and other businesses. Today, Rio Rancho has little remaining tax base to pay for infrastructure improvements to support a burgeoning population drawn by local job demand. Financial analysts question the long-term fiscal capacity of such areas.

But areas can't afford *not* to offer incentives. They will continue as economic development tools. What's needed is a realistic incentives limitation, with built-in cost/benefit and fiscal impact analyses on projected return on investment.

Principles and Guidelines

When *properly* used, incentives optimize public investment. Toward that end, communities should adopt a policy guided by the following principles:

1. *Use incentives within an economic development strategy for attraction and retention, not as a separate tool for an individual firm.* At the same time, the area shouldn't rule out a company not fitting its strategy — e.g., a relocation or an existing firm's expansion into a new product market.

2. *Build and maintain a strong business climate which by itself is attractive to com-*

panies and encourages new investment/retention consistent with strategic economic development. An area with a strong business climate has a better chance with a more moderate incentive package. By standing on its business climate, the area has a better idea of its competitive position *sans incentives*, and it feels less pressure to offer enticements.

3. *Develop, foster and encourage quality of life, enhancing prospects of attracting and retaining businesses.*

4. *Offer incentives only after the company narrows the search to a few finalists.* With the possible exception of baseline training and infrastructure incentives, the area shouldn't participate in early bidding that may encourage a push for the best possible package. The area should be competitive *before* incentives.

5. *Assist only businesses that otherwise would not locate or expand locally.* The area should be certain the firm needs incentives to relocate or expand, and would do so regardless of incentives availability.

Identify the Gaps

6. *Offer incentives only to fill financing, costs or assistance gaps which cannot be filled from conventional sources and which firms are required to identify.*

7. *Utilize a portion of incentives to encourage business growth promoting special area goals, including development in economically distressed or underdevel-*

oped areas, targeted investments or area exports.

8. *Offer incentives only when justified by positive cost/benefit and return-on-investment analyses.*

9. *Offer incentives only to companies that: 1) make long-term capital investment commitments and 2) create jobs paying family-supporting, or higher, wages.*

10. *Give preference to firms that will export products and services, bringing new dollars, providing job growth and bolstering the area's image for quality.*

11. *Offer existing businesses the same incentives offered outside firms.* This fosters broad support for area economic development and strengthens business climate.

12. *Award incentives using performance-based systems providing for recovery and/or adjustment through an agreed-upon performance schedule.* Such a system, including clawbacks, rescissions and calibrations, protects the public investment.

13. *In applying performance-based systems, work cooperatively, and be sensitive to conditions that hinder meeting targets.* Suspicion, an anti-business attitude and a "gotcha" mentality could discourage future area expansion. Continued mutual respect should characterize the system, differentiating between those conscientiously pursuing objectives despite difficulties and those making excuses or paying only lip service.

Development Incentives Are a ‘Win-Win’ Proposition for Companies, Communities

by Paul E. Patton, Governor of Kentucky

The Bluegrass State offers a comprehensive package of performance-based incentives to help attract new jobs and investment. Those incentives can often make the difference in winning and losing in today’s highly competitive economic development climate.

As the newly elected governor of the Commonwealth of Kentucky and author of most of the state’s current business incentive programs, I have seen firsthand the benefits of incentives in attracting new business to our state. I can say without hesitation that while incentives are not the most important factor affecting location decisions, incentives can tip the scales in favor of a location that might otherwise have been nosed out by another site.

For years, Kentucky had an unemployment rate consistently above the national average. Companies were bypassing Kentucky in favor of states with more favorable business climates. In addition, many of the best and brightest Kentuckians left our state to find jobs elsewhere because there weren’t enough opportunities at home.

‘Sweeping Change’ In Development Efforts

In 1988, I was County Judge/Executive of Pike County, Ky., struggling to improve the economy of a region of the state which needed jobs very badly. I developed an incentive program — subsequently approved by the Kentucky Legislature — to attract new jobs. The program permitted a company to keep its Kentucky corporate income tax and some of the Kentucky individual income tax of

its employees for up to 25 years to help pay for its investments.

Four years ago, while serving as lieutenant governor, I also had the opportunity to serve as secretary of the Kentucky Cabinet for Economic Development. It was then that we persuaded the Kentucky Legislature to approve a sweeping change in the state’s economic development efforts.

Now the Cabinet is run by a public/private partnership board, and the secretary of the Cabinet is hired by the board. This allows stability and continuity of our economic development policies from one administration to the next. Gene Strong, who has served as secretary since 1993, will continue to hold that position in our administration. Thus, the basic economic policies begun four years ago will remain constant for at least the next four years.

A Comprehensive Incentives Package

Our aggressive approach to economic development includes a comprehensive package of incentives that has now become the standard by which all such programs are judged.

For instance, we have programs to assist manufacturing and non-manufacturing companies. We can aid businesses which choose to locate where jobs are scarce and the work force plentiful in either rural or urban areas. We can provide

incentives to new businesses moving in, to those needing to expand, and to those in danger of closing. In short, we can address the specific needs of specific businesses.

In the past, Kentucky and many other states offered “giveaways,” up-front cash to companies based on what the companies said they intended to do and what we hoped would be repaid through increased tax collections. But now our incentive programs are performance-based. Instead of cash in advance, we’re paying c.o.d.

We’re telling companies, “You deliver the tax revenue, we’ll let you keep some of it.” Specifically, we offer companies a reduction in tax burden during the early years of their activity in Kentucky to amortize some of their investment. Companies that participate must meet certain performance levels, and they must be willing to invest in Kentucky and hire Kentucky workers.

The Ford, Lexmark Successes

Consider the case stories of two of our more successful industries, Ford Motor Co. and Lexmark.

“The state has given us a tremendous amount of help in terms of incentives,” says George Kormanis, plant manager for Ford’s sprawling truck manufacturing facility in Louisville. “The state has

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allowed us to take advantage of certain tax credits or abatements on products we're going to build during the next ten years."

Ford is applying those abatements to its expansion of what is already the largest manufacturing facility of medium and heavy-duty trucks in the Western Hemisphere. When completed, the plant will contain 5.3 million sq. ft. (492,000 sq. m.) under one roof and employ approximately 4,800 workers. The expansion will boost production of Ford's heavy-duty pickup trucks.

"Both Ford and the Commonwealth of Kentucky wanted the plant to be in this state," Kormanis says. "The economic development thrust that (then) Gov. Jones and Gov. Patton have been spearheading is very gratifying. In my mind, they make Kentucky a very attractive place to locate or expand a business."

In September 1995, Lexmark International announced plans to expand employment in Lexington by 1,000 jobs during the next two years. The company is renovating a large building on site to accommodate expansion of its inkjet printer product line.

"We considered other locations, but the economics of expanding in Lexington were very attractive," Lexmark Chairman and CEO Marvin Mann says. "The incen-

tives and the support of the state government, in addition to the quality of the work force and the proximity to our development lab, were significant factors in making our choice."

Incentives 'Can And Do Make the Difference'

Kentucky's incentives lower the cost of doing business, thus allowing a company to increase the return on its investment. However, I want to make it clear that providing an incentive for a business to expand or locate in Kentucky is not the most important factor in economic development. The key is education.

In addition, work force, location and infrastructure are also more important than incentives. However, many different locations can have these elements in very nearly equal quality. In these instances, incentives can and do make the difference in the final decision.

The results of our economic development efforts in Kentucky have been phenomenal. More than 200,000 additional Kentuckians have jobs now vs. four years ago. Over the past several years, Kentucky has led all adjoining states in the number and growth rate of new manufacturing jobs. In addition, Kentucky's unemployment rate has consistently remained

below the national average for more than 3 1/2 years.

As we look to the future, Kentucky is positioned for continued growth in all areas of business. Our incentive packages help us open the door with companies — then we can close the sale by showing them our location advantages.

Those advantages include the strong partnership between government and business that now exists; our strategic location (within one day's drive of 70 percent of the U.S. market); a work force whose productivity consistently exceeds the national average; worker training programs that are among the best in the country; a nationally recognized education-reform movement; and a quality of life that is unsurpassed.

In Kentucky, our mission is to create more and higher-quality opportunities for all Kentuckians by building an expanding, sustainable economy. We are achieving our mission by offering incentive packages that help employ our people and, at the same time, help our companies compete globally. These incentives are proof that in Kentucky, we're serious about jobs.

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About the Author

Gov. Paul E. Patton has a wealth of experience in working with companies on site selection projects. He was Kentucky's lieutenant governor and secretary of the Kentucky Cabinet for Economic Development before his election to the state's top post.