The Use of Incentives in Economic Development

John Sullivan, Economic Development Director, Carver County Community Development Agency, Chaska, Minnesota

Carver County Community Development Agency

There are some really great discussions taking place regarding incentives in economic development. Incentives can include, but not be limited to, such items as:

- Tax Increment Finance
- Tax Abatement
- Free or reduced costs of required infrastructure such as streets, water and sewer, curb and gutter, lighting, storm water ponds, etc.
- Grants
- Workforce Training Grants
- Tax Credits for Targeted Industries or Areas
- Low Interest or Forgivable Loans
- Free Land
- Assistance with Moving Expenses
- Utility Rebates or Fee Reductions
- Reduced development Fees in regards to numerous items such as sewer access charges, water access charges, permit fee reductions, etc.
- Technical assistance, business research, marketing assistance, etc.

And the list goes on….

In my opinion, there is apparently no clear consensus as to what the best practices really are, and some question if incentives should be used at all. Still, others believe that incentives should be used anytime it helps a company expand or locate in a particular town. I have to admit, I find it fascinating that in my 25 plus years of experience in the economic development field, I always seem to get different reactions and opinions from everyone in regards to incentives. And it doesn't seem to matter what side of the political aisle either, from our representatives in the Minnesota State Legislature, my economic development peers, our representatives in Congress, our local businesses, Joe Somebody on the street, etc. Some are strongly opposed to the use of incentives and point to the costs, yet others are strong proponents and point to the economic benefits.

I am a LinkedIn subscriber and I belong to several discussion and interest groups in economic development. I found a very interesting article written by Mark McCaskill, Senior Transportation Planner in Roanoke, Virginia. In summarizing Mr. McCaskill's comments, he asks…"Is the "prisoner's dilemma" with respect to economic development incentives real or perceived?"

By "prisoners' dilemma", McCaskill means the feeling that the authority has to offer incentives just because other states or localities offer incentives. Here is a great analogy he uses (and very timely even though I'm still disappointed at the Minnesota Wild's recent exit from the playoffs). Once upon a time, the NHL did not require helmets (I suppose it dates me because I remember watching that as a kid). The hockey players wanted to be protected but feared that the incremental loss in performance from wearing a helmet would get them cut from the team, so no one wore helmets and everyone was worse off. Once the helmet rule was implemented, everyone could be protected, and not be at a relative disadvantage. So, McCaskill asks, "Are economic development incentives like the helmets in the NHL?" Is the economic development profession in a real prisoners' dilemma? Or, is the prisoners' dilemma just a perception by some; and regions with a "think different" or a "moneyball' approach will come out ahead in the long run?

Rollie Cole, PhD, JD Founder, Fertile Ground for Startups, Small Firms, and Nonprofits and Author of "WHOLESALE ECONOMIC DEVELOPMENT" weighs in with a great response to this question that appears to make sense to me.

He suggests a two-level (or 3 or 4-level) look at "incentives." One set, hopefully low-cost and widespread, are part of signaling that the community really does want new growth and will contribute some resources to support it. Another level is to "seal the deal" if a firm is down to choosing your community or another, and the benefits will re-pay the costs.

A third level is where winning becomes more important than the overall long-run value, and the costs outweigh any likely benefits, other than the short-term benefit of a "win." He concludes the following:

- ***Level one is NOT a prisoner's dilemma situation.***
- ***Level two can be***
- ***Level three almost certainly is.***

Cole theorizes that it is possible to structure an auction so that the winning bid will almost always be above the value of the item (e.g., if both first and second place have to pay, and only first place gets the item). He feels communities need to avoid such auctions, and, as in the prisoner's dilemma, it may take collective action, such as a state law that prohibits incentives that cost more than a reasonable projection of the benefits.

In Minnesota, the State of Minnesota does have a "Business Subsidy" law and requires business subsidy policies to be adopted by local governing authorities granting them (see the State of Minnesota Department of Employment and Economic Development web site under 'Business Assistance and Business Subsidies for more details (http://mn.gov/deed/government/business-subsidy/).

The Business Subsidy Policy is basically the adopted "rules of the game' for a particular municipality or authority in dealing with how, when, why, etc. it will handle incentives or subsidies for businesses. In the Carver County CDA's Business Subsidy Policy, and from what I have seen in the 8 plus years I have been here, I believe we fit under Cole's level One or Two in regards to incentives. However, we try to give incentives a thoughtful approach. I would still argue economic development and the use of incentives is more of an art than a science. When we look at a particular project or deal, we try to ask some basic questions about the company and the transaction, and make a decision based on answers to the following:

1. Is this a good company or business?
2. Do they have other competitive offers or choices from other states or areas?
3. What are the numbers of new jobs created?
4. What do they pay as far as salary or hourly wages?
5. What are the associated benefits?
6. Will there be new or expanded tax base for the County/City/School?
7. What is the business contributing to the project?
8. Is there cost sharing in regards to incentives and what other entities are participating and in what amounts?
9. Is this business type or product already here in the County or area?
10. Is this a growing business or industry? What are its future prospects?
11. Is the company one that has a track record of respecting the environment, its employees and community?
12. What are the impacts to the local community as far as transportation, schools, labor market, existing businesses and industries, etc.?
13. Is there strong political support from the local community that will host the project?
14. Is this project consistent with the City/County Comprehensive Plan?
15. Does this project redevelop an area or clean up a contaminated site?
16. Does the proposed incentive meet the 'But For" test? i.e. can the project be feasible without the use of the incentive?

Most often, when we review potential projects at the Carver County CDA, the number of jobs, wages/associated benefits and the community benefit/tax base seems to carry the most weight.

I still find it interesting that many of my peers, development consultants, real estate professionals, site selectors, attorneys and others I have spoken to regarding incentives have vastly different views on business subsidy policies. Some feel there should be no policy whatsoever so as to remove restrictions and allow the ultimate flexibility for the municipality or authority. Others believe the actual policy should be very basic, non-specific and open to interpretation and provide some flexibility. Yet there are others who believe all rules, policies, benchmarks, requirements, etc. should be clearly laid out in detail as to leave no questions, thereby making it easier to negotiate the deal (i.e. its black or white, or a take it or leave it approach).

Oftentimes it just comes down to common sense. One of my colleagues in the field, David Armstrong, Executive Director at Barron County Economic Development Corporation (BCEDC) in Wisconsin, weighed in on the same incentives LinkedIn discussion with the following:

"We went through a 100 Full Time Equivalent (FTE) scenario two years ago here. My first question to the business was pay and benefits of the 100 FTE's. When $9.00/hr and no bennies was the answer the deal quickly moved to that of providing free land for the company to build and nothing more. With the size of some of the incentives being thrown around I tend to see it as more of a race to the bottom as far as who can give more away as an incentive. Naturally this pits community against community. What's the return on investment for the incentives is the broader question? Does the potential incoming company further exacerbate an already competitive workforce situation? Is it a good fit to a particular cluster? Many more questions on the same order need to be considered. As far as new growth for a community goes is it best to buy that growth by moving someone in or to enhance start-up, stage 1 and stage 2 (economic gardening) growth programs for generic growth?"

In the LinkedIn discussion regarding incentives, Ed Burghard, creator of the Strengthening Brand America Project, thoughtfully and eloquently challenged the traditional view of what incentives even are:

"In my mind incentives are viewed too narrowly in definition. Unique collaborations, location specific assets or infrastructure, special labor access, speed to operation through streamlined processes, all can be (and should be) thought of as incentives and the value to a company quantified. Get a company operation up and running weeks ahead of plan can result in a multi-million dollar positive impact on the project's 5-10 year net present value, making it worth more than many cash incentives. An operational efficiency that drops to the bottom line in perpetuity is typically worth significantly more than traditional deal incentives. I believe communities should focus first on creating a differentiating advantage that companies desire before they try to compete using cash or tax incentives. Better meeting the investor's needs means the power of traditional incentives is dramatically reduced. But, it is the harder right choice for both economic development professionals and elected officials to make. It requires statesmanship rather than politics to pursue that path. The easier wrong choice is to build an incentive war chest or use inability to offer a competitive incentive package as an excuse."

What do you think? What does your community do in regards to incentives?