Testimony on proposed reforms to Michigan’s economic development programs

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I will briefly summarize what research has shown about the types of economic development reforms that will best create broadly shared prosperity for a state’s residents. More extensive discussion is in my [March 2 testimony before this Committee](https://www.upjohn.org/about/news-events/tim-bartik-provides-senate-insight-economic-development-policies), and in my [September 27 testimony before the Legislative Finance Committee of the New Mexico Legislature](https://www.upjohn.org/about/news-events/tim-bartik-testifies-new-mexico-legislature-economic-development-benefits).

The first research finding is that providing business incentives that are customized services and infrastructure is more effective than handing out cash. States overly rely on handing out tax incentives and other cash incentives and should shift their mix towards customized services.   
  
Customized services are better than cash for three reasons. First, research has shown that customized service incentives are more cost-effective than handing out cash. As this chart shows, the cost per job created of infrastructure, customized job training, or business advice programs such as manufacturing extension are one-fifth to one-third of the cost per job created of handing out cash via business tax incentives.

Second, customized services have to some extent an “automatic clawback”. Even if the assisted business leaves the state, the infrastructure and many of the trained workers will remain.   
  
Third, services such as customized job training can get more local workers, particularly unemployed or under-employed workers, into the hiring queue. This increases the true economic impact of inducing job creation, which is based not just on jobs created, but on who gets the jobs.

Therefore, the proposed Make It In Michigan Fund, which revamps the current SOAR program to require that 20% of these funds go to various types of infrastructure and services, is a significant step in the right direction. Assuming the state takes this step, I hope over time we can move to providing these economic development customized services in any distressed county, without tying their provision to a specific large project. These SOAR reforms provide the potential for a real-world proof-of-concept of the potential for economic development services.   
  
A similar comment applies to the proposed Michigan Strategic Tax Capture Program. If this program is adopted, it would be wise to require that 20% of the payroll tax recaptures go into economic development services.

Another important research finding is that the benefits of economic development programs depend not just on the jobs created, or even on the quality of the jobs created, but on getting more Michigan residents into those jobs.   
  
One way to do this is to target more incentive projects at distressed places. As this chart shows, the percentage of jobs created that ultimately go to Michigan residents ranges from 45% in highly distressed counties to 26% in the average Michigan county to 10% in the counties with the lowest unemployment. The true “economic impact” of job creation is therefore over 4 times higher in a distressed county versus a booming county, other things equal.

But we can also target more jobs at unemployed or under-employed Michigan residents by tying incentive projects to our state’s job training programs, and by making sure that these job training programs have tools such as child care assistance or transportation assistance to help unemployment residents get and keep good jobs.

Therefore, the language in the proposed Make It In Michigan Fund, which favors projects in high unemployment areas, or projects with ties to LEO job training programs, are sensible reforms. Our goal should not be simply job growth, but job growth for Michigan residents.   
  
In addition, the language in the proposed Michigan Strategic Tax Capture Program that incentivized businesses coordinate with local workforce agencies is a good provision. It is also good that this program mentions prioritizing disadvantaged communities. This could be further strengthened by clarifying that the “economic impact” of a proposed project, which is required to be considered in making project award decisions, is not simply the number of jobs created, but rather how the jobs are likely to impact the median household income of Michigan residents.  
  
A final policy recommendation based on research is that state incentive programs should be subject to a mandatory budget constraint. Why is this important? The rationale for a budget constraint is that we want to avoid the danger that economic development incentives will squeeze out dollars from important public services that also support economic development, such as public schools, universities, and child care.

Ideally, this budget constraint should be designed so it is some percentage of gross state business tax revenues. Why that structure? We need to recognize that while economic development programs can provide broad public benefits, if they are designed to be cost-effective and target jobs at the unemployed, a considerable portion of the benefits of these programs directly go to the Michigan business sector. Therefore, it makes sense that the budget constraint should be a percentage of state business tax revenues, to make sure that net state business tax collections, after considering offsets from economic development program funding, are sufficient to help support overall state public services.   
  
Therefore, I would urge that both the proposed Make It In Michigan Fund, and the proposed Michigan Strategic Tax Capture Program, and for that matter any other proposed incentive program, have a funding structure that has an overall budget constraint that is some proportion of gross state business tax revenue. My understanding is that this was the formula for providing deposits to the SOAR fund for fiscal years 2022-23 and 2023-24. A similar formula should be used to cap all state resources going into economic development incentives and related programs.

In summary, research supports reforms to Michigan’s economic development programs that would put more resources into customized services to support economic development, that would target the unemployed/underemployed in job creation, and that would set a cap on spending for economic development incentives to ensure adequate spending for the state’s public services. All of these reforms would make the state’s economic development programs more cost-effective in creating jobs for Michigan’s residents and prevent economic development programs from squeezing out other priorities in the state budget.