



# Increasing the Benefit-Cost Ratio for Michigan's Economic Development Policies

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# My focus today: how to reduce costs and increase benefits of Michigan's economic development policies

- “State economic development”: increases in per capita earnings of original state residents
- “State economic development policies”: **Customized assistance** to individual businesses or persons that has large spillover benefits for per-capita earnings.
- **Customized business assistance:** Creates jobs to boost employment opportunities (example, business tax incentives).
- **Customized household assistance:** Boosts effective labor supply of residents to boost state jobs and wages (example: selective talent attraction).

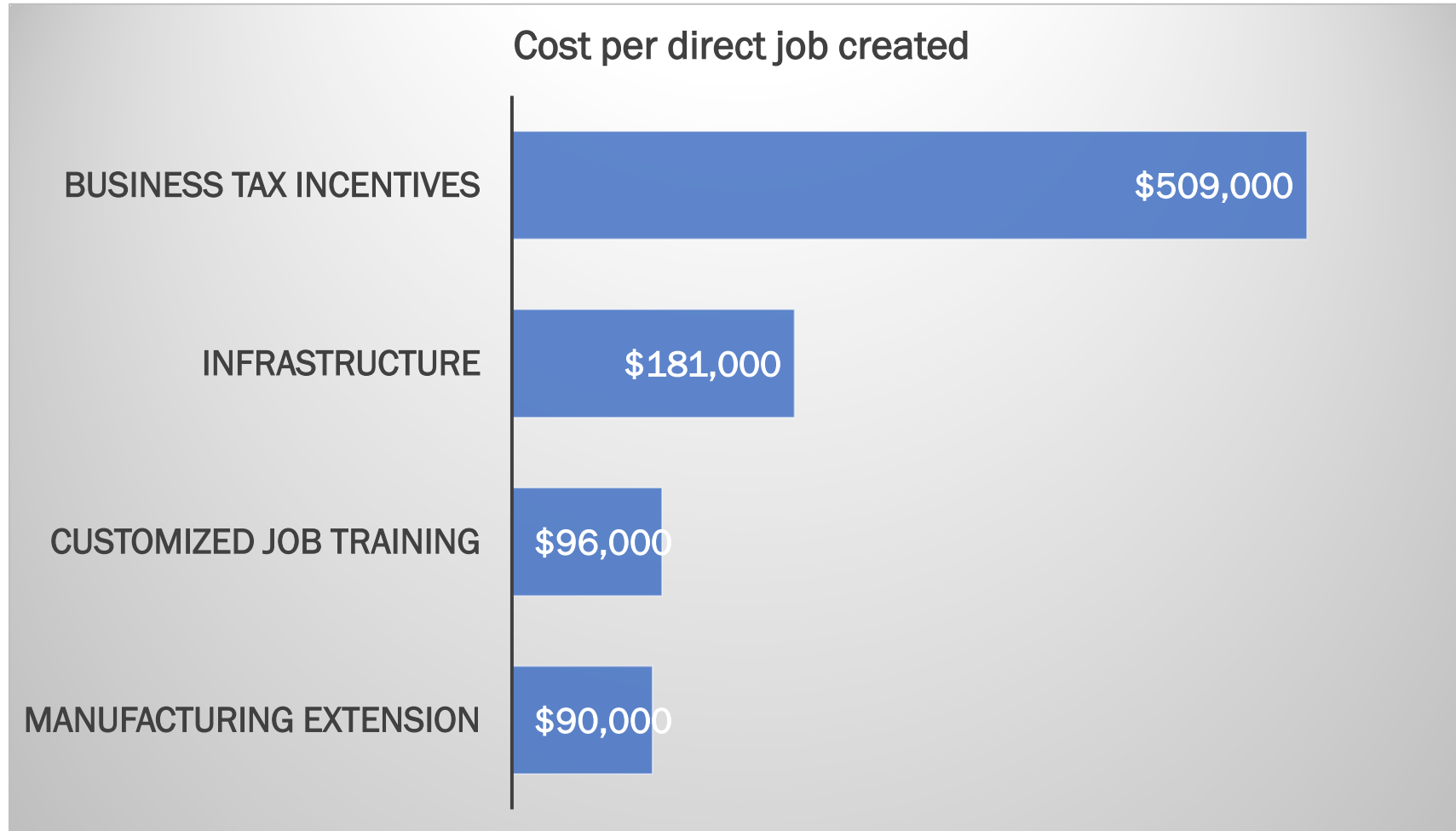


# Business incentives: Large costs & **POTENTIALLY** large benefits

- Business tax incentives have true cost of \$500,000 per direct job actually induced.
- Why costly: For typical incentives, >75% of jobs would have been created anyway.
- But job creation can have benefits with present value of up to \$2 million per direct job.
- Why so high: Job creation may boost employment/population ratios (“employment rates”) for many decades. Increases earnings per capita both directly & via wage increases.
- Short-run job experience boosts skills and self-confidence, and reduces substance abuse, crime, & family break-ups. Intergenerational effects (Mississippi 1936 example).
- But job creation may also have zero employment rate effects, and zero benefits.



# Customized business services have lower costs/job created than tax incentives



# Incentives vs. customized services

- Customized services are more effective because they overcome key barriers to business expansion and location: finding a site, finding labor, finding new markets and new technologies.
- But customized business services have **SOME** limit to scale; cash incentives can easily be scaled up.
- However, Michigan has not exhausted potential of infrastructure, customized training, and business advice to promote job growth.
- Policy recommendation: Make sure that have plenty of quality sites, full availability of quality training programs, and that all small businesses can receive quality advice. Then can devote remainder of economic development budget to incentives.



# Reducing the costs per induced job of cash incentives

- Upfront incentives are more cost-effective than long-term incentives because firms heavily discount future. Example: the tax incentive beyond 10 years has almost no effect on business location decisions.
- Therefore, to increase effectiveness, **frontload** the cash incentives – no more than 5-year term.
- But, for accountability, include **clawbacks** if jobs do not persist.
- Virginia's incentives to Amazon HQ2: \$22,000 per job, but paid out only after 4 years and only if job persists.
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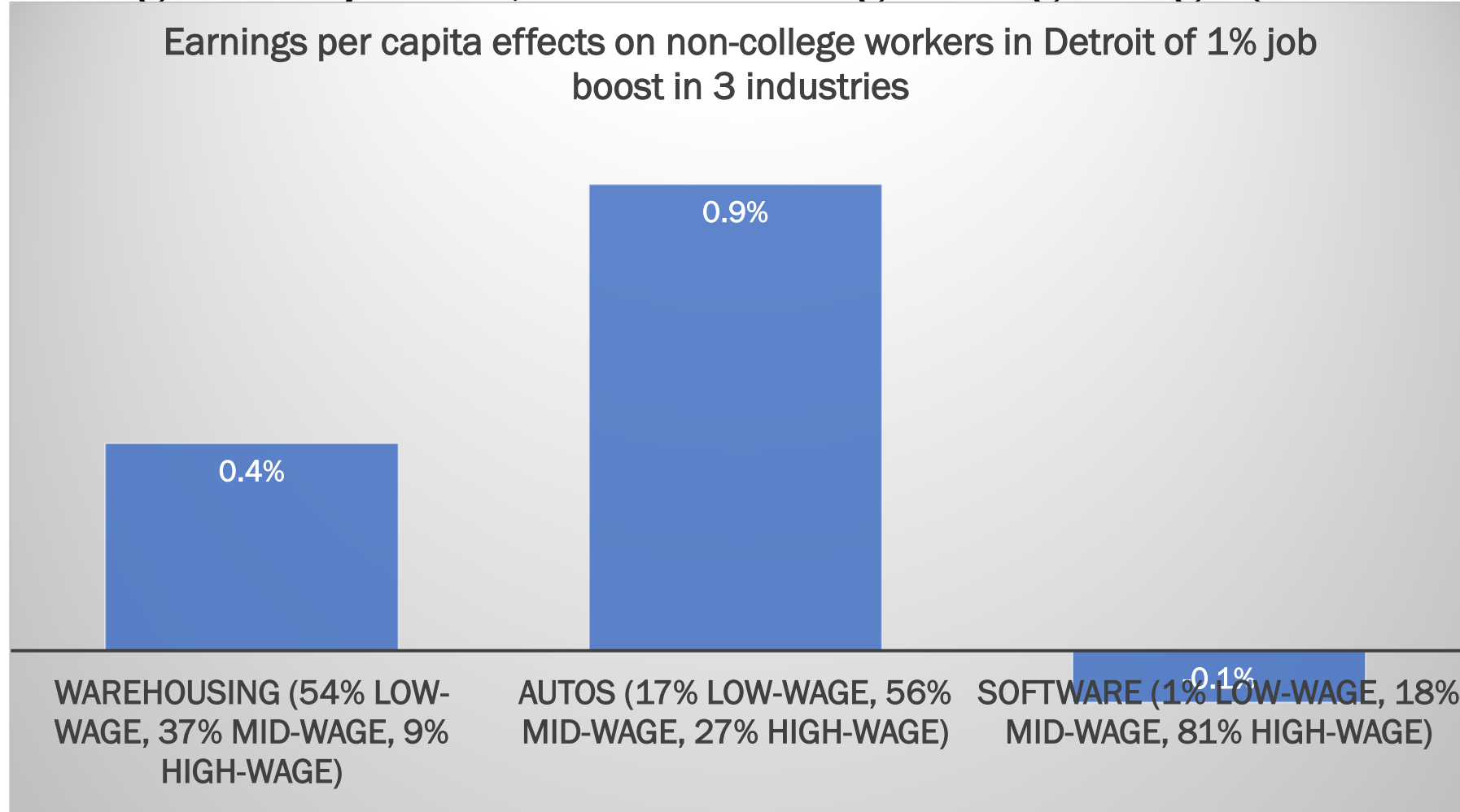


# Increasing employment rate effects of induced jobs

- Jobs ultimately either boost the employment/population ratio or boost the population.
- Jobs are immediately filled by: (1) employed local residents; (2) unemployed local residents; (3) in-migrants. But source (1) yields job vacancy, filled in same 3 ways. At end of this vacancy chain, jobs either go to non-employed, or to in-migrants.
- Most of employment rate effects of induced jobs are on persons without 4-year college degree, as they are more tied to local labor markets; college grads are more tied to national labor market.
- Employment rate effects vs. in-migrant effects depends on: whether job type is good opportunity for non-college grads; local distress – are there lots of non-employed?; policies to encourage local hiring of non-employed

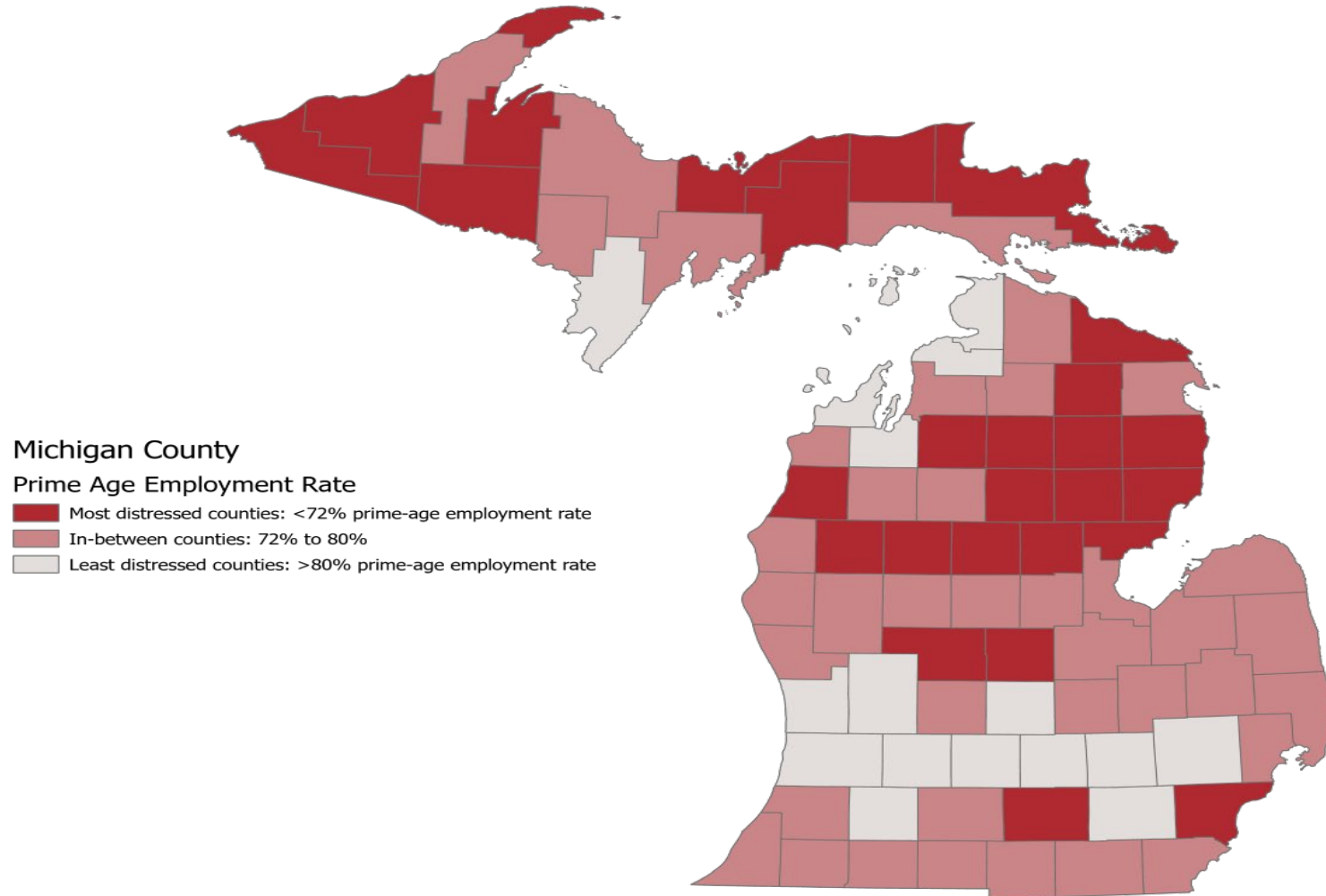


# Earnings of non-college workers boosted more by local job growth in industries with “mid-wage” occupations, versus low-wage or high-wage (Bartik 2022b)





Local job creation has much larger effects in more distressed counties: in Michigan, most distressed counties have 45% of jobs go to boost employment rates; least distressed have 10%; in-between counties, 26%.



# Policies can affect local hiring

- **Carrot approach:** Customized job training can encourage a greater % of jobs to be filled by local non-employed.
- **Mild stick approach:** “First source” hiring agreements require assisted employers to “consider” persons referred via local workforce system for entry-level jobs.
- **Stick approach:** Explicit local hiring requirements.
- In general, stronger local workforce system can affect local hiring all along the vacancy chain.
- **Neighborhood employment hubs:** Discussed next

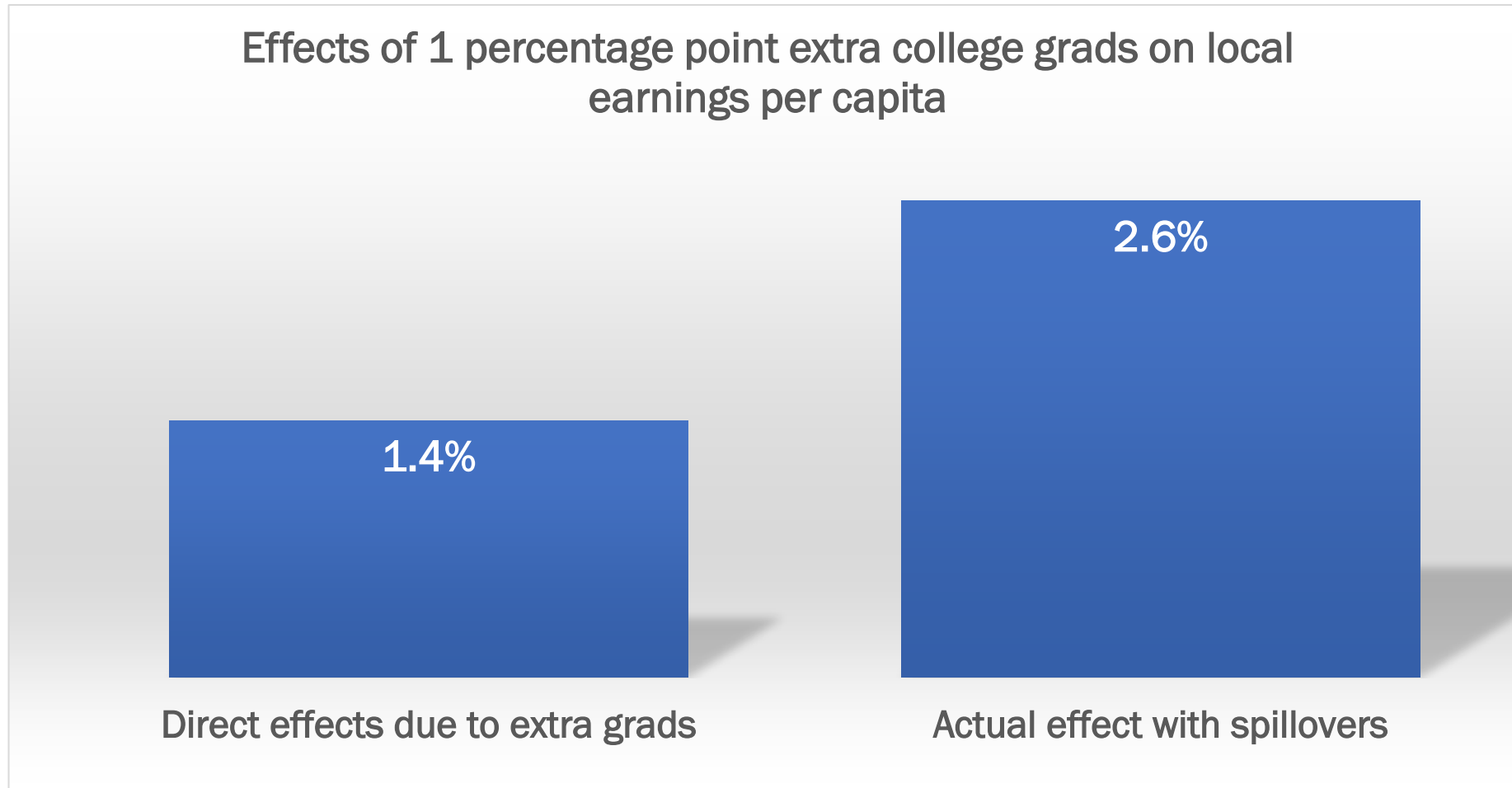


# Neighborhood programs can promote economic development

- About 10% of all Americans live in neighborhoods whose prime-age employment rate is more than 10 percentage points below that of the surrounding local labor market.
- Such neighborhoods have worse outcomes for children growing up in such neighborhoods, with lower adult earnings. Why? Among other things, fewer employed adults to serve as role models and job contacts.
- Plopping jobs down in neighborhoods is not particularly effective in helping neighborhood residents. Neighborhoods are NOT local labor markets. Most Americans do not work in the neighborhood they live in, and most jobs in any neighborhood are not held by residents. Residents of distressed neighborhoods need access to jobs throughout local labor market.
- One option for helping neighborhood residents get and keep jobs: **Neighborhood Employment Hubs**. Upjohn Institute runs hubs in distressed neighborhoods in Battle Creek, at trusted neighborhood institutions (community groups, subsidized housing projects, churches).
- **Hubs** can link residents to info on job openings, training, childcare, and provide help in finding reliable used cars. Success coaches can help improve job retention.



College grads have spillover earnings effects, due to: team production, idea sharing, entrepreneurship. College grads earn 140% more than non-grads, but observed earnings effects of 1 percentage point extra grads exceeds predicted 1.4%.



# What can cost-effectively attract and retain college grads?

- **Relatively costly approach:** provide cash bonuses for highly-educated remote workers – such programs are proliferating. No rigorous benefit-cost evaluations as of yet.
- **Low-cost option:** Facilitate or even subsidize college student internships with local employers, to affect proportion of graduates of Michigan college graduates who stay in the state. State should experiment with this approach at a large scale, to see what effects it has on retention, and what extra retained graduates end up contributing to Michigan economy.



# Benefit-cost ratio for state economic development policies can be increased by:

- Full funding of customized business services.
- Upfront cash incentives with clawbacks.
- Target industries with many mid-wage occupations.
- Target distressed local labor markets.
- Encourage local hiring via customized job training.
- Link residents of distressed neighborhoods with jobs via Neighborhood Employment Hubs.
- Retain more college grads via internship programs.

