



FEDERAL RESERVE BANK *of* KANSAS CITY

# Borders War: Insights on Economic Development Incentives

10<sup>th</sup> Annual Real Estate Conference

Integra Realty Resources

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January 10, 2012

# Disclaimer

The views expressed in this presentation are those of the presenter and not necessarily those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

# Do Incentives Work?

- Generally, within a nation:
  - factors of production are highly mobile
  - trade barriers are nonexistent or highly unrestrictive
  - factors of production, climatic conditions, and the general business environment tend to be *similar*
- Implies that small changes in industrial policy can potentially have large effects on firm location

# What is the Question?

- Key question is not if they are successful in luring companies, but
- Are they a cost-effective strategy for achieving growth (e.g., jobs) – is it a sensible use of economic development dollars?

# Questions further defined:

- Do business incentives cause states or localities to grow more rapidly than they would have otherwise?
- Are the costs justified?
- Who get the benefits?

# Do Incentives Work?

- Consensus view: incentives matter, but not much (and not as much as thought)
  - often they are too small to matter much to firms (asymmetric information)
  - actual hires tends to be much less than announced hires
  - the *net* impact of the actual hires often is less than the number of actual hires

# Net Impacts of Firm Locations

- Positive Spillovers
  - input-output linkages
  - agglomeration effects
    - labor pooling
    - knowledge spillovers
  - employment and income multipliers
- Negative Spillovers – “crowding out”
  - infrastructure congestion
  - wage and rent pressure
  - reduced supply of resources
  - perception that this might occur

Source: Kelly D. Edmiston, 2004, “The Net Effects of Large Plant Locations and Expansions on County Employment,” *Journal of Regional Science*, 44 (2), 289 – 319.

# Do Incentives Work?

- Also . . .
  - Redundancy
  - Jobs taken by emigrants
  - For tax incentives
    - Shift in the tax burden to other individuals and/or businesses (or spending cuts)
    - Complexity in the tax code



# Economic Rationale for Incentives

- Infant Industry
- Improvement of Distressed Areas
- Leveling the Playing Field

# Infant Industry Argument

- may be an emerging industry in which the region believes it may in the future have a comparative advantage
- Support may be offered to an emerging industry in which substantial agglomeration economies exist

# Infant Industry Argument

- But . . .
  - governments have tended to be very unsuccessful at picking winners and losers.
  - may require continual support of industries in which the region has a comparative disadvantage

# Improvement in Distressed Areas

- a way to stimulate economic activity in depressed areas
  - presumes that better alternatives are not available.
  - efforts to improve the quality of the labor force and the level and quality of public infrastructure are likely to have much stronger *long-term* effects.
  - People prosperity vs. place prosperity

# Leveling the Playing Field?

- distortions may offset existing distortions
- but there may be a race to the bottom

# Competition

- Firms may play one region against another (asymmetric information)
- A gain in one region often means a loss for others (a zero-sum game)
- Incentives offered by multiple jurisdictions are likely to cancel each other out (a negative sum game)

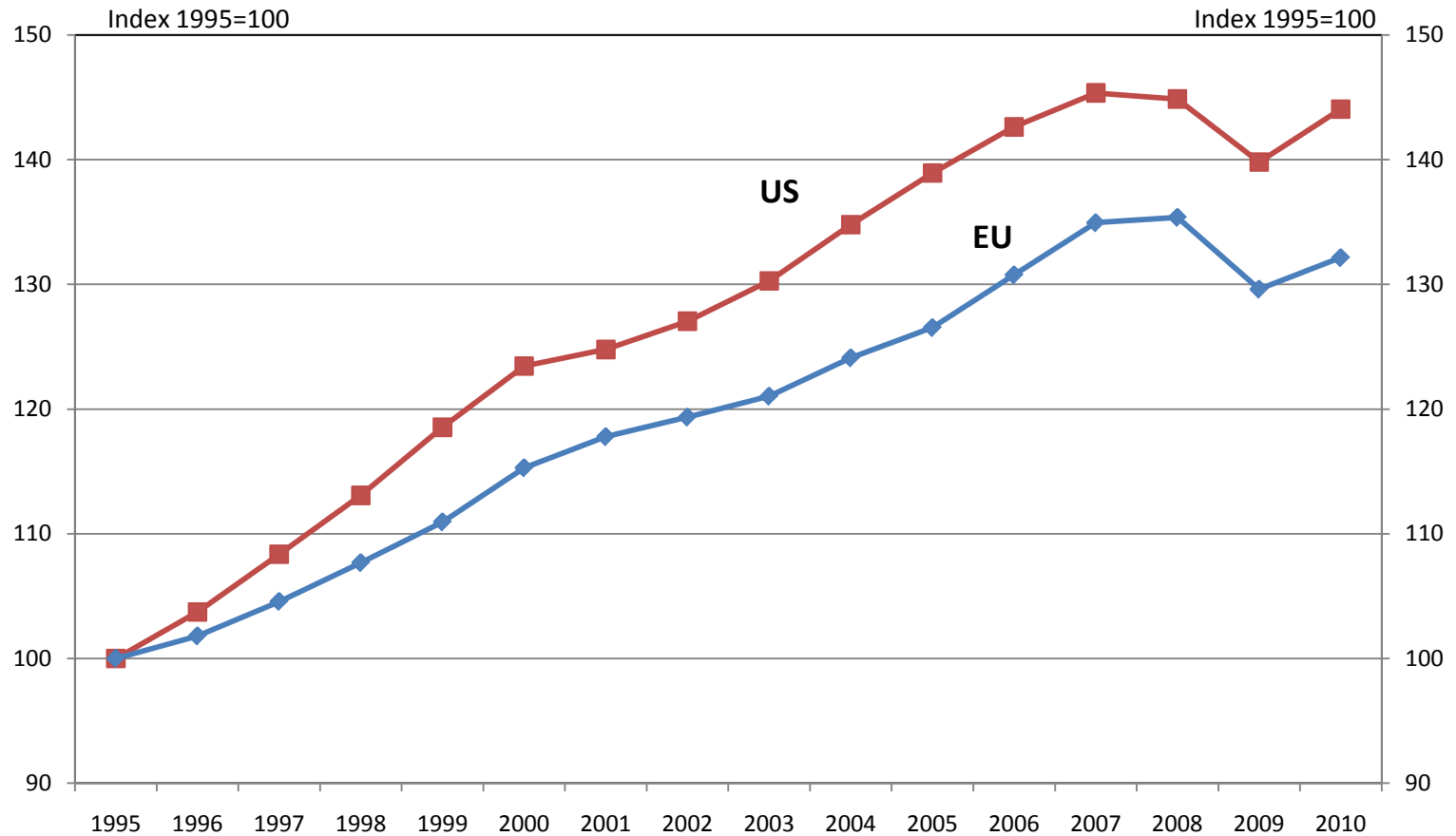
# Economic Development Policy

## What Makes Sense?

- General business environment that is conducive to business
- Quality of life
- Workforce development efforts
- Retention and expansion
- Bids for incentives?

# Closing Thought

## GDP Growth in the U.S. and EU







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