

# What Works in Economic Development

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# What is economic development's goal?

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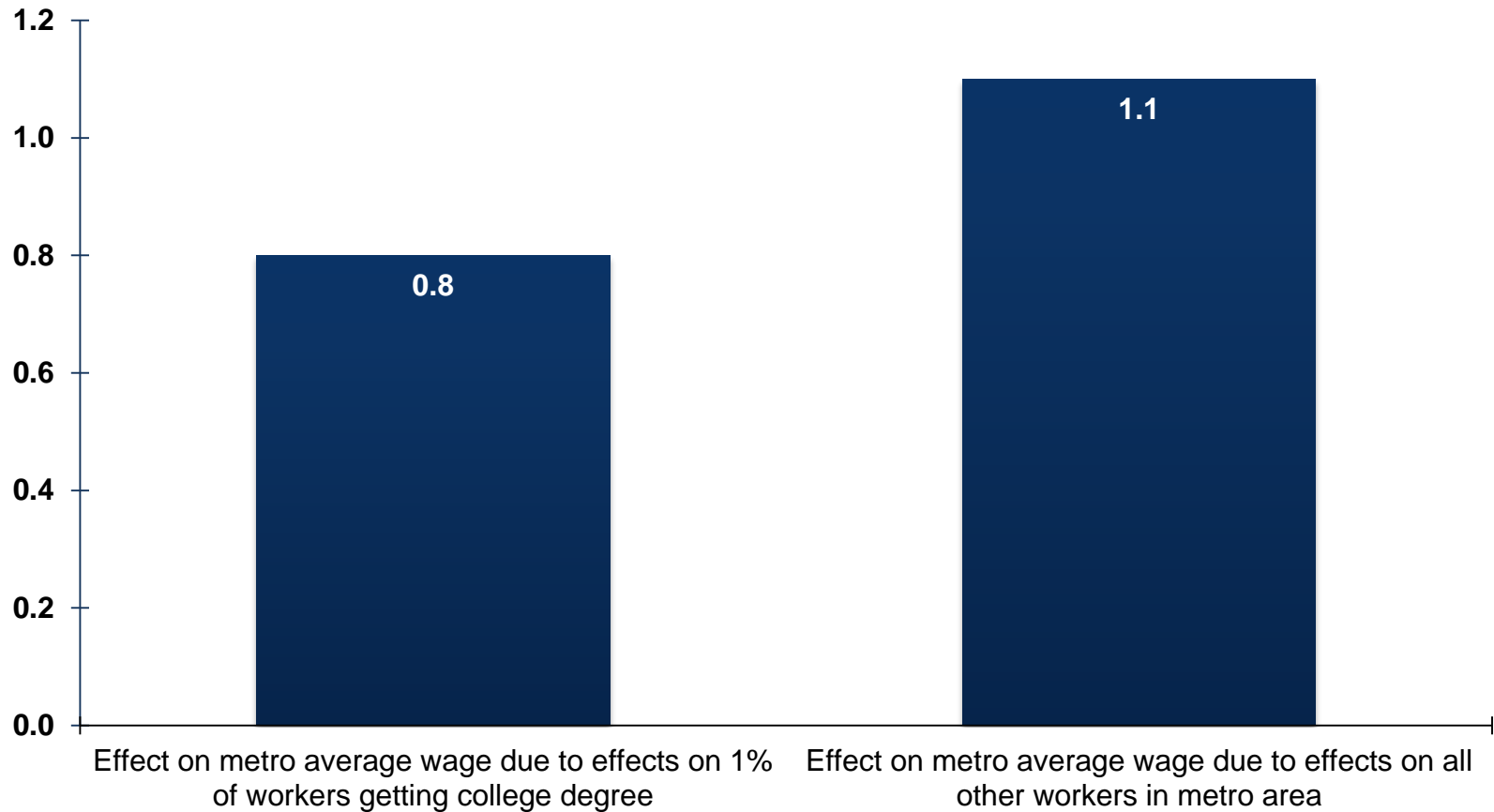
- Goal: Increase in per-cap income of original residents, mostly due to higher earnings per cap due to higher employment rates & wages.
- Why this focus? Empirically, over 70% of job growth's benefits in terms of increased income per capita comes from increased earnings per capita.
- What about fiscal benefits? Fiscal benefits small when we include extra spending to maintain public service quality as population grows. Job growth increases pop growth 80% as much, which has large fiscal costs, particularly in infrastructure.
- Fiscal benefits of job growth typically less than 10% of earnings per capita benefits.

# Implications of economic development goal of higher earnings per capita

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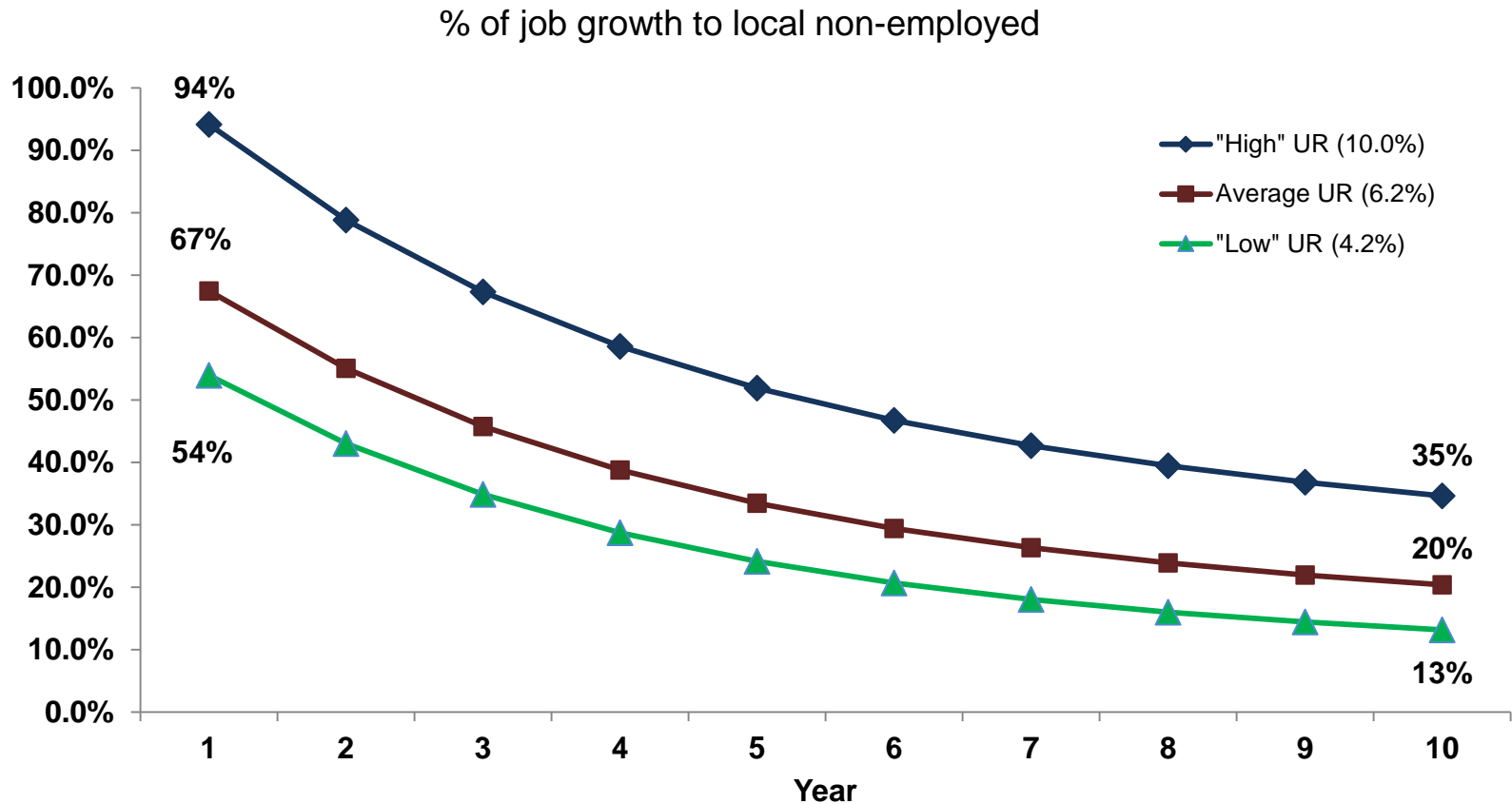
- Economic development policy must consider what jobs pay, not just number of jobs created.
- Economic development policy must consider who gets jobs, not just # and types of jobs created. (Ultimately, all new jobs in a state must go to either non-employed state residents, or in-migrants.)
- State/local economic development policy is really state/local labor market policy.
- Earnings per capita in a state can be increased either by working on “labor demand” or “labor supply” side of labor market, by increasing the quantity/quality of labor demand or supply.

# Effects of a 1% increase in college graduates on metro area average wages



SOURCE: Figure 6.1, *From Preschool to Prosperity*, 2014

# Labor demand policies have lower local benefits when UR is low



NOTE: Earnings per capita benefits end up being 40% higher when UR is 10% compared to 6.2%; 20% lower when UR is 4.2% rather than 6.2%.

# Limitations of general business tax cuts as economic development policy

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- General business tax cuts don't target only export-base firms, but rather include locally-oriented firms.
- General business tax cuts don't target only firms on margin of investing/creating jobs, but rather include all firms.
- Even without considering costs of financing tax cuts, general business tax cuts only yield increase in present value of earnings per capita of \$0.51 per \$1 of costs.
- But with spending cuts to finance business tax cuts, short-run local demand effects are negative.
- In LR, if business tax cuts financed by cutting infrastructure or education, may have negative effects on business climate.

# Business tax incentives

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- Can be more cost-effective than general business tax cuts, but only if well-designed.
- Well-designed: target export-base firms; target new investment/job creation decisions; target high-wage firms; target firms with high local multipliers (high wages, supplier networks, clusters); target firms more likely to hire local non-employed.
- If well-designed, business tax incentives can increase present value of a state's earnings per capita by \$3 per \$1 of costs.
- Tax incentives that are further restricted to only subsidizing hiring of non-employed can have ratio of earnings per capita benefits to costs that is twice as great, at \$6 per \$1 of costs.

# Customized business services

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- Customized job training and manufacturing extension have good studies showing higher cost-effectiveness than tax incentives.
- Studies suggest such customized services can increase state earnings per capita by \$10 per \$1 of costs.
- Why? These customized services target specific barriers of information, expertise, and financing in small and medium sized businesses.



# Summary: labor demand policies more cost-effective when targeted at:

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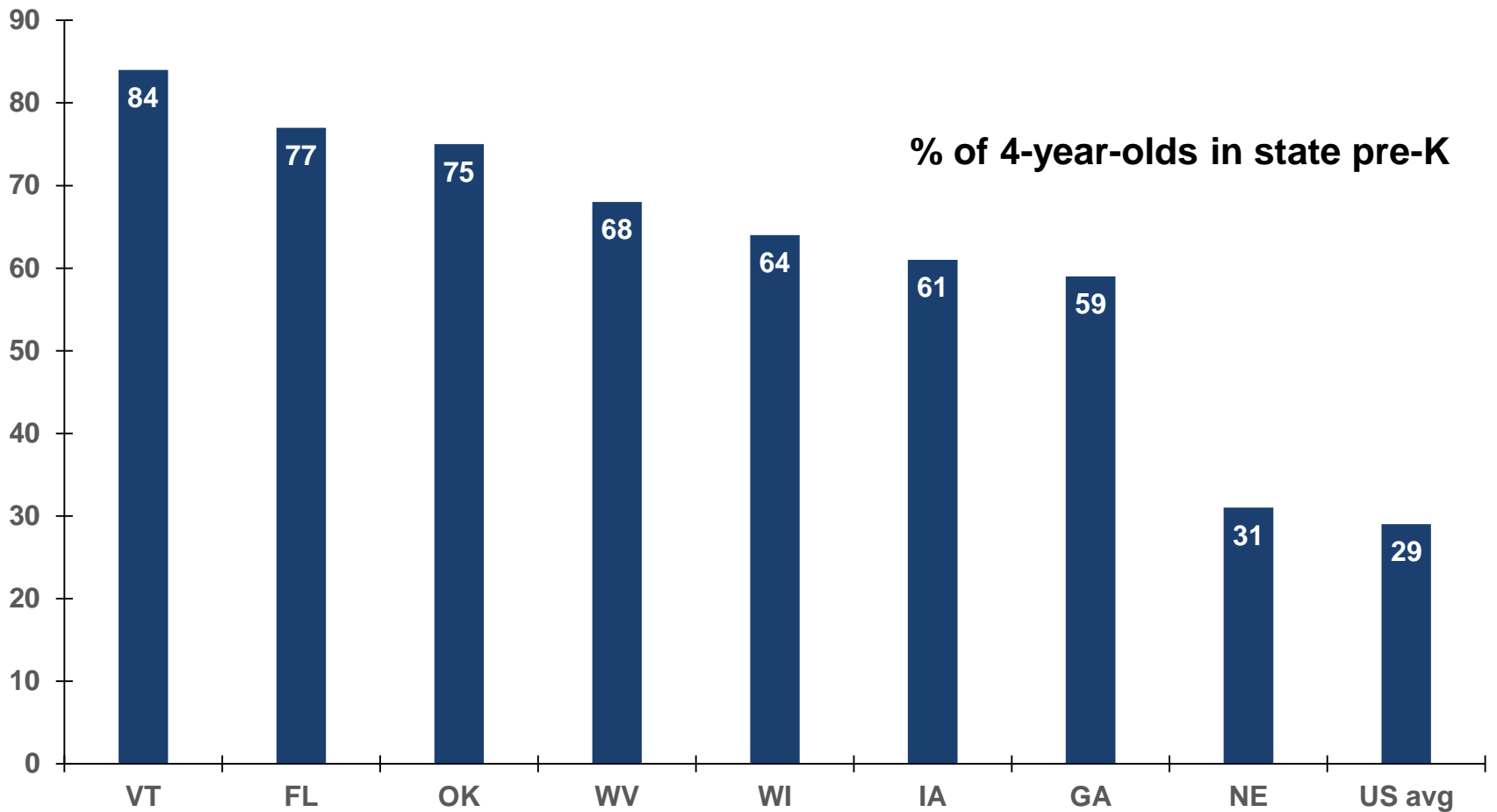
- Export-base firms
- Job creation decisions
- Higher wage jobs
- Hiring local non-employed
- Small and medium sized businesses that need particular services

# Why pre-K works, and works locally to boost local economic development

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- Much evidence from good studies of both SR and LR effects of high-quality pre-K in boosting educational attainment, and generating better adult labor market outcomes such as higher employment rates and higher wages.
- Pre-K boosts both hard skills and soft skills, and initiates cumulative process of “skills begetting skills.”
- Majority of persons spending early childhood in a state will spend most of adult career in a state. Nebraska: 56% of those born in state still live in state.
- For each \$1 a state invests in high-quality pre-K, present value of state earnings per capita increases by \$6.

# State-financed pre-K as % of 4-year-olds



# Earnings benefits of pre-K for different income groups

**Table 5.1 How Earnings Benefits of Pre-K per Child Vary for Children from Different Income Groups**

	<b>Earnings gains versus baseline earnings for a child from a</b>	
	<b>Low-income family</b>	<b>Middle-income family</b>
<b>Gains from pre-K</b>	\$53,000	\$48,000
<b>Baseline earnings</b>	\$547,000	\$997,000
<b>Percentage gain</b>	10%	5%

NOTE: Gains and baseline earnings are rounded to the nearest thousand, in present-value 2012 dollars. Baseline earnings are the present value of total career earnings without pre-K. Earnings and gains are averages per child for program participants.

SOURCE: *From Preschool to Prosperity*, 2014.

# Later-life labor supply policies that are cost-effective

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- Mandatory summer school in elementary grades: Earnings benefit to cost ratio of \$13 to \$1
- High school career academies: Earnings benefit to cost ratio of \$13 to \$1.
- Small-group math tutoring in high school: Earnings benefit to cost ratio of \$15 to \$1.
- Demand-oriented adult job training: Earnings benefit to cost ratio of \$6 to \$1.

# Summary: labor supply policies more cost-effective when targeted at:

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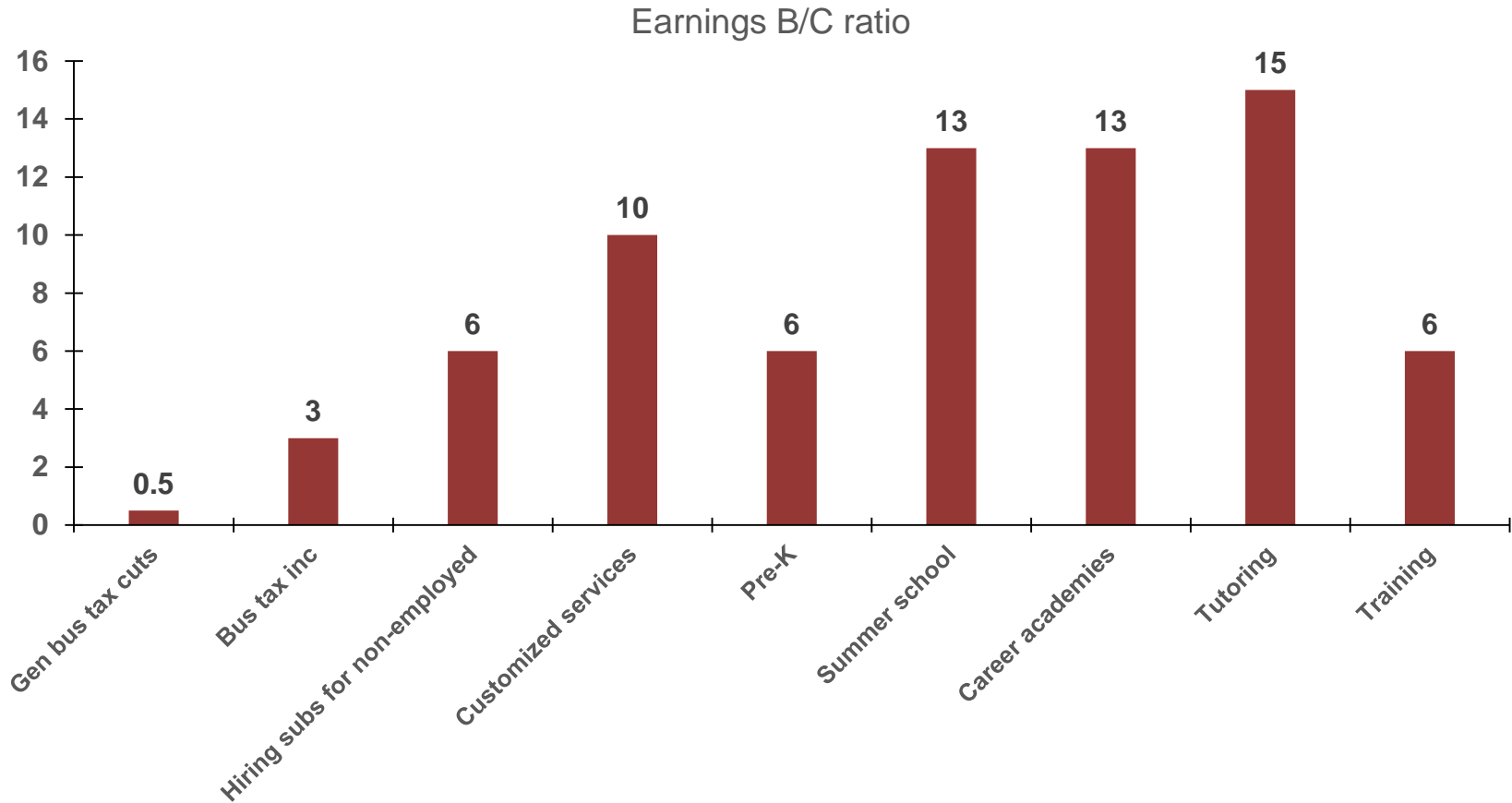
- Early childhood, when all children are more malleable.
- Later on, if targeted at specific groups with specific problems.
- Early childhood has political plus of broad benefits, political minus of deferred benefits
- Later labor supply policies provide more immediate benefits, but generally directly benefit smaller groups.

# Other potential labor supply policies: Personal income tax cuts

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- At income tax rates commonly used in U.S. , personal income tax rates do not have large effects on labor force participation rates.
- At the state level, state income tax rates do not have large effects on migration.
- Full analysis must also consider effects of how personal income tax cuts are financed: for example, public service cuts may hurt attractiveness of state, and public spending cuts may reduce demand for goods and services in the state. These financing effects may offset any positive effects of personal income tax cuts.
- Overall, state personal income tax cuts seem unlikely to have large effects on state earnings per capita, and there is no research consensus supporting such effects.

# Summary of earnings benefit to cost ratios





# Summary

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- Main benefit of state economic development policies comes from increasing earnings per capita.
- Labor demand and labor supply policies complement each other in increasing state earnings per capita.
- Policies have higher earnings benefits per dollar if targeted.
- Targeting involves either targeting businesses or households when they are more malleable (making new investment decisions, in early childhood) or targeting specific services needed by a particular group (e.g., small/medium sized businesses, disadvantaged students or workers).