SYRACUSE UNIVERSITY
MAXWELL SCHOOL OF CITIZENSHIP AND PUBLIC AFFAIRS

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State and Local Government Finance
Professor Yinger

CASE:
Firm Subsidies for Economic Development?[1]

Introduction

Over the last fifteen years or so, New York State (NYS) has experimented with several expensive economic development programs. The total cost of these programs to state and local governments combined was almost $10 billion in 2018.[2] A new governor has just been elected, however, and she wants to evaluate the evidence concerning the impact of existing programs and to design a new economic-development strategy moving forward.

The three main economic development programs implemented in recent years are Start-Up New York, the Excelsior Jobs Program, and the Regional Revitalization Initiative.[3]

Start-Up New York

The Start-Up New York program (SUNY), which began in 2013, provides tax breaks for firms and their workers if the firms move onto or near a university campus.[4] To be specific, a firm can operate tax-free for ten years if it (1) is a new business in NYS or an existing NYS business that is expanding or relocating, (2) partners with a NYS college or university, and (3) creates new jobs and contributes to economic development in its local community. The tax-free status applies not only to the earnings of the participating business, but also to the earnings of its employees.

As shown in Table 1, many types of business are not eligible for participation in this program. These restrictions are designed to keep the focus of the program on manufacturing, which is usually viewed as the most effective engine of economic growth.

The available evidence indicates that SUNY has not been a very effective program. The Empire State Development Corporation (ESDC), which runs the program, found that, despite a $53 million advertising campaign, SUNY had attracted just 212 companies with 1,135 jobs by 2017.[5] This jobs number falls well short of the 4,403 jobs pledged by these companies, and only

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[1] This case was written by Professor John Yinger solely for the purposes of class discussion. The description of economic development policy in this case is not complete and should not be used for other purposes.
[2] https://cbcny.org/research/10-billion-reasons-rethink-economic-development-new-york.
[3] Another NYS economic development program focused on nanotechnology, but this type of program would be very difficult to replicate. See Appendix A.
[4] See https://esd.ny.gov/startup-ny-program.
[5] https://nypost.com/2017/04/17/cuomos-failing-start-up-ny-wont-get-his-desired-rebranding/.

22 of the companies have more than 10 employees.[6] Moreover, this jobs count does not net out jobs that would have been created anyway—just not on a university campus. More recent reports from NYS claim much larger jobs gains, but these gains are not net gains and they have not been verified by independent analysts.

Despite its limited success, some universities view SUNY as a great opportunity. The University of Rochester, for example, has prepared a web site to promote the program and to encourage local businesses to apply.[7] Moreover, universities in the Upstate region have formed the Council for Supporting SUNY, which actively lobbies for the program in Albany.

Overall, "[a]dvocates say the initiative needs time to mature. Critics say it is a bad policy — made worse [in 2017] by Cuomo's decision to stop requiring companies to report publicly the jobs they create, a move lawmakers want to undo."[8] The latter view also is taken by the Empire State Taxpayer's Union, which believes that SUNY is a very wasteful program.

Excelsior Jobs Program

According to its official website, the "Excelsior Jobs Program encourages businesses to expand in and relocate to New York while maintaining strict accountability standards to guarantee that businesses deliver on job and investment commitments."[9] This program began in 2010.

Firms in the Excelsior Jobs Program (EJP) may qualify for four fully refundable tax credits. Businesses claim the credits over a benefit period of up to 10 years. The credits are: Excelsior Jobs Tax Credit (A credit of 6.85% of wages per net new job), Excelsior Investment Tax Credit (valued at 2% of qualified investments), Excelsior Research and Development Tax Credit (a credit of 50% of the Federal Research and Development credit up to six percent of research expenditures in NYS), and Excelsior Real Property Tax Credit (available to firms locating in certain distressed areas and to firms in targeted industries that meet higher employment and investment thresholds for a 'Regionally Significant Project').

Only certain types of firms are eligible to participate in this program. See Table 2. To receive the credits a firm in one of these categories must create or retain jobs and make significant capital investment in NYS. Firms in strategic industries that make significant capital investment that have at least 25 employees; manufacturing firms who retain at least 5 employees are also eligible to apply for participation in the Program

This program was the main source of proposed subsidies for Amazon to locate in NYC. Ultimately, however, elected officials decided that this subsidy was not worth it, given the increase in congestion Amazon's presence would cause and the fact that many of the new jobs would go to people who currently live in other states.[10]

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[6] https://www.stargazette.com/story/money/2017/06/07/start-up-ny-jobs-andrew-cuomo-tax-breaks/101473216/.

[7] See: https://www.rochester.edu/startup-ny/.

[8] Platsky, Jeff. "Start-Up NY: Can It Boom or Is It a Bust?" *Star-Gazette*, June 7, 2017. https://www.stargazette.com/story/money/2017/06/07/start-up-ny-jobs-andrew-cuomo-tax-breaks/101473216/.

[9] https://esd.ny.gov/excelsior-jobs-program.

[10] https://www.crainsnewyork.com/instant-expert/vast-and-lucrative-world-state-subsidies.

The New York State Comptroller conducted an evaluation of the EJP.[11] This report "sampled 25 companies for which, as of June 2015, ESDC had authorized Program tax credits on 39 occasions totaling $4.84 million. Based on our testing, ESDC could not support that the sampled companies met the agreed-upon job growth and investment benchmarks for 5 of the 39 instances (13 percent) where ESDC authorized Program tax credits totaling $214,000. Furthermore, ESDC could not support that any of the 25 sampled companies met all the eligibility requirements when initially approved for Program participation.

In four separate instances, ESDC adjusted the annual job creation requirements from the original agreement after the fact to align with the companies' actual lower job creation totals. Had these adjustments not occurred, the three companies involved would have received $358,329 less in tax credits. For two of the four revisions, ESDC could not provide evidence from the company justifying the need for the revision – including one company whose 2012 job commitment was reduced from 600 to 363 for no apparent reason. A company involved in one of the other revisions subsequently closed operations after being authorized to receive $556,446 in tax credits.

ESDC generally authorizes tax credits based on the job numbers and investment costs that are self-reported by businesses without any additional corroborating support (e.g., invoices, receipts, tax documentation). In addition, ESDC does not verify that new jobs meet the Program's 35-hour weekly work requirement and that they have not merely been shifted from existing positions at affiliated companies."

Regional Revitalization Initiatives

NYS also has implemented several programs at the regional level. The Upstate Revitalization Initiative (URI) competition, which began in 2015, is designed "to strategically focus on the economic development of Upstate NY, as part of long-term, regionally-based plans for economic growth through the state's 10 Regional Economic Development Councils (REDCs). The REDCs have changed the way NYS invests state resources, through a community-based, bottom-up approach designed to meet each region's needs, involving private-public partnerships of local experts and stakeholders. Through a competitive process for state resources, the Consolidated Funding Application (CFA), the REDCs create strategies for growth through projects and initiatives that attract private investment and create jobs. The Central New York, the Finger Lakes and the Southern Tier regions were announced as URI awardees, each committing $500 million of NYS funds, allocated in $100 million increments, to implement their strategic plans to transform their local economies over the next five years."[12] Funds were also awarded to the Buffalo region—a program often called the Buffalo Billion.

This program is popular at the regional level. For example, the Central New York Regional Economic Development Council submitted a successful proposal. Projects that

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[11] New York State Office of the State Comptroller, Division of State Government Accountability, *Performance of the Excelsior Jobs Program*, Report 2015-S-15, July 2016. Available at: https://osc.state.ny.us/audits/allaudits/093016/15s15.pdf.

[12] https://esd.ny.gov/about-us/signature-projects/upstate-revitalization-initiative.

received funds as part of this proposal include the veteran's center at Syracuse University, a spa and conference center in Aurora, and a silicone coating production line in Pulaski.[13]

The NYS regional initiatives turned out to be quite controversial, however, because one member of the State's implementation team was convicted of accepting bribes, and another was convicted of steering funds associated with the Buffalo Billion to firms that give financial support to Governor Cuomo, who has not been charged with any wrongdoing himself.[14] Corruption is, of course, a major concern in many economic development programs, not just this one.

According to an op-ed by E.J. McMahon, who is affiliated with the conservative Manhattan Institute, "the focus on Albany corruption misses an important point.[15] The overarching scandal here wasn't bid-rigging or the pay-to-play pattern in the developers' contributions to the governor's reelection campaign. At the root was a simply awful public policy — corporate welfare on steroids — that neither Cuomo nor most of his critics have definitively renounced, even now.

Most states offer tax breaks, low-interest loans, grants and other subsidies to companies they hope to attract and retain. But Cuomo has moved beyond that to state ownership of the means of production.

The linchpin of the Buffalo Billion initiative is a $750 million, 1.2 million-square-foot, state-built and -equipped "Gigafactory" for SolarCity, the solar-panel company co-founded by Elon Musk and since merged into his Tesla Inc…. [T]he completed Tesla-SolarCity plant is now run in partnership with Panasonic. By all accounts, production is ramping up slowly. But from the start, the project's shifting job-creation targets were inflated by solar-panel sales jobs that Tesla recently eliminated…

Meanwhile, the … original tenant of the Syracuse area light-bulb plant walked away from the project, into which Cuomo has plowed still more state cash to attract a startup semiconductor manufacturer. The little-used film hub failed to produce any permanent jobs and was recently conveyed by the state — for $1 — to Onondaga County…

In the final analysis, state government has no business building and equipping plants for private corporations, much less exposing taxpayers to potentially enormous losses if (or when) these investments fail to pan out."

[13] https://www.ny.gov/sites/ny.gov/files/atoms/files/CNYREDC_URI_FinalPlan.pdf.
[14] https://nypirg.org/capitolperspective/new-yorks-corruption-palooza-near-its-end/.
[15] https://nypost.com/2018/07/13/cuomos-buffalo-billion-was-beyond-corrupt/.

Recommendations by Scholars

Dr. Timothy J. Bartik, a leading economist on state and local economic development policy who works at the nonpartisan Upjohn Institute, "identifies three cost-effective development strategies:[16]

> Expand customized services to small and medium-sized manufacturers. Manufacturing can be cost-effectively promoted by manufacturing extension services and customized job training. Manufacturing extension services provide individual firms with lower-cost access to high-quality advice on improving competitiveness. Customized job-training programs provide worker training specific to the firm's skill needs.
>
> Invest in infrastructure and services that make the community's land better for business development. Job growth can be cost-effectively promoted by improving services in distressed neighborhoods, cleaning up brownfields, and investing in transportation infrastructure.
>
> Increase public spending on services that increase local workers' job skills. Better skills for local workers help attract and grow higher-wage jobs. Adult skills can be improved by programs from birth onward. Effective skills development programs include the following: high-quality child care, high-quality preschool, K-12 education, college scholarships, and adult job training."

Similar views are expressed by Professor Nathan M. Jensen of the University of Texas. An op-ed he wrote is attached as Appendix B.

In addition, a recent working paper by Professors Cailin R. Slattery (Columbia) and Owen M. Zidar (Princeton) evaluates a large data set of state and local tax incentive programs. This paper concludes:[17]

"We provide descriptive evidence that industries with larger multiplier effects are more likely to receive subsidies, and receive more subsidy dollars per job. We also find that poorer places spend more per job. In terms of local economic effects, we find limited evidence that these subsidized firms have employment spillovers in the local economy. In that case, the argument for this place-based policy rests more heavily on equity considerations.

Many questions remain unanswered. How much do these policies improve the well-being of underemployed and low-income workers? Are the most distressed places able to attract firms with tax incentives? How effective are these approaches relative to other policies? Does targeting subsidies at the largest firms have anticompetitive effects in the product market? At the local level, is the newly-attracted firm stimulating hiring of local residents that were previously unemployed and working in low-wage jobs? Or as was argued in the case of Amazon's proposal

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[16] Timothy J. Bartik, "Helping Manufacturing-Intensive Communities: What Works?" Center for Budget and Policy Priorities, May 9, 2018. https://www.cbpp.org/research/full-employment/helping-manufacturing-intensive-communities-what-works.

[17] Cailin R. Slattery and Owen M. Zidar. 2020. "Evaluating State and Local Business Tax Incentives" National Bureau of Economic Research Working Paper 26603, January.

for putting a headquarters in New York City, are all the good jobs going to people moving in from other locations, while leaving locals with more congestion and higher prices?

Policymakers can design incentives with these considerations in mind and evaluate the extent to which these policies actually 'trickle down.' Bartik calls for targeting tax incentives to hard-hit regions, and to employers who promise to hire local residents. He also notes that targeting marginal investments and job creation in tradable industries with high multipliers, instead of individual firms, could reduce political influence.

More evidence on the conditions under which these policies are effective and for whom would help improve policy recommendations. To the extent that well-targeted and effective policy is not feasible, recent harmonization efforts at the state and local level could also enhance efficiency. New York state lawmakers have proposed the 'End Corporate Welfare Act' to outlaw firm-specific state tax incentives, and have urged other states to do the same. Of course, an incentives truce is much more attractive to a state like New York than it is to states with distressed regions that are struggling to attract firms and grow their local economies."

The Hearings

The new governor has convened hearings to elicit the views of various parties with an interest in New York State's economic development policy. She has asked each participant to present his or her preferred approach to economic development policy in NYS going forward. Although participants should focus on the strengths of their preferred approach, they may also briefly indicate the disadvantages, if any, of existing programs. Preferred programs need not be limited to the ones currently in place in NYS.

You may also present your views in a two-page memo to the governor.

Table 1. Types of Businesses that Are Not Eligible for Start-Up New York

Retail and wholesale businesses

Restaurants

Law and accounting firms

Medical or dental practices

Real estate management companies/brokers

Hospitality

Retail banking

Utilities and energy production

Finance and financial services

Businesses providing personal services

Businesses providing business administration support and services

Source: https://esd.ny.gov/startup-ny-program.

Table 2. Types of Businesses that are Eligible for the Excelsior Jobs Credit

Scientific Research and Development firms creating at least 5 net new jobs
Software Development firms creating at least 5 net new jobs
Financial services (customer service) back office operations creating at least 25 net new jobs
Agriculture firms creating at least 5 net new jobs
Manufacturing firms creating at least 5 net new jobs
Back office firms creating at least 25 net new jobs
Distribution firms creating at least 50 net new jobs
Music Production firms creating at least 5 net new jobs
Entertainment Companies creating at least 100 net new jobs
Life Sciences Companies creating at least 5 net new jobs
Other firms creating at least 150 net new jobs and investing at least $3 million

Source: https://esd.ny.gov/excelsior-jobs-program.

Appendix A: The Nanotechnology Initiative

Another major economic development initiative, which was started during the Pataki Administration, involves nanotechnology, which is defined as technology operating at the scale of atoms. This type of technology has many applications, particularly in semi-conductors.

This initiative built on existing strengths in nanotechnology at SUNY-Albany and in several New York firms. It appears to have been quite successful. However, it was able to take advantage of some unique circumstances and would be virtually impossible to replicate for another industry.

According to a recent report, the "lessons learned" are as follows:[18]

> The New York nanotechnology initiative is an example of state-level industrial policy on a scale comparable to that observable on a national level outside the U.S. In this case, however, the driving force was not a government ministry but the SUNY university system and the flagship SUNY Albany. Through investments in SUNY Albany, the state of New York leveraged far more substantial private financial investments, facilitating the establishment of an enormously expensive, state-of-the-art research infrastructure at the university with a powerful gravitational pull on leading semiconductor devices, equipment, and service infrastructural companies. In little over a decade a semiconductor industry supply chain has been assembled in upstate New York, which is poised to lead the global industry into a new era based on 450mm wafer technology. While many actors played important roles in this effort, including government and industry leaders, regional development organizations, and private firms such as IBM and Global Foundries, the initial catalyst was arguably the university itself.
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> Few would argue that New York's nanotechnology development model has widespread applicability elsewhere. Most states cannot afford investments on a comparable scale, and New York may be unable or unwilling to do so itself going forward. However, some aspects of the New York experience are noteworthy and relevant to other states and regions:
>
> New York's commitment to this effort was focused, substantial, and sustained by a bipartisan consensus through successive state administrations.
>
> While state incentives were provided, much of the state money was invested in a build-out of university research infrastructure that attracted private investment. State investments were matched by private sector investments through a cohesive, well-run public-private partnership.
>
> The state's educational system attracted not only high technology companies but key individuals, able to provide high level research and institutional leadership.
>
> The thematic era in which the largest initial investments were made (microelectronics) is a large, developed market. These investments now permit SUNY

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[18] National Research Council (US) Committee on Competing in the 21st Century. *Best Practice in State and Regional Innovation Initiatives*. Wessner CW, editor. Washington (DC): National Academies Press (US); 2013. https://www.ncbi.nlm.nih.gov/books/NBK158826/.

Albany to leverage its success into more nascent technology areas such as biomedicine and energy that hold great promise.

Appendix B: Why Are Your State Tax Dollars Subsidizing Corporations?

Nathan M. Jensen, *The New York Times*, Op-Ed Page, March 6, 2018

Last year, the state of Georgia entered the competition for Amazon's second headquarters. The state put billions on the table to woo the company and its potential 50,000-job, $5 billion investment.

This year, not long after Atlanta was named one of the 20 finalists for Amazon HQ2, Lt. Gov. Casey Cagle of Georgia lashed out at Delta Air Lines after it suspended discounts for members of the National Rifle Association. Mr. Cagle declared he would kill state tax breaks for the airline, and the Republican State Legislature followed through by removing about $40 million in tax incentives from Delta.

The Amazon offer was an effort to attract business, while the Delta punishment will probably have the opposite effect. But they are both really about the same thing: political theater.

Politicians are using public policies, from renaming a city to offering billions of dollars in grants, infrastructure improvements and tax abatements, to take credit for companies' location decisions. If Amazon chooses Atlanta, politicians will point to all that they have done to attract it.

But in fact it is most likely the quality of the work force that will be the deciding factor for Amazon, not the billions in incentives. Proponents of incentives often claim that these subsidies pay for themselves, and voters often support these efforts, believing the promises of good jobs. But this is possible only if governments perfectly target the companies that require incentives and pay just enough, and not a penny more, to sway a company's decision.

In all likelihood, incentives are overpaying firms, leading to lost resources that could be used for other purposes. If the incentives don't pay for themselves, they must be paid for by either higher taxes or decreases on government spending. Local school districts are vocal opponents of incentives; they see their tax base being given away in the name of economic development.

Politicians can minimize blame for losing an investment. For the 237 locations that won't get Amazon HQ2, putting a big offer on the table, such as decades of tax reductions for Amazon, can help state politicians say something like, "We did everything we could to get them."

The frenzy over Amazon isn't the only example of this political game. It is easy to forget the story of Carrier Corporation in Indiana. In the first days of the Trump administration, Carrier announced the company's intent to close some Indiana operations and move production to Mexico. But politicians swooped in to save the day, and a deal was struck in which the state offered $7 million (over a decade) in economic development incentives. After a few photo ops with President Trump and other state politicians, interest in the story died down.

Today Carrier has already cut many of its Indiana jobs because the $7 million incentive wasn't enough to offset the much lower production costs in Mexico. The incentive may have delayed Carrier's decision long enough to confer some political credit, but many of the "saved" Carrier jobs are now lost.

Spending $7 million for no real impact may sound expensive, but other recent economic development offers are staggering, even for those of us who think we have seen everything. The

State of Wisconsin is offering Foxconn $3 billion for electrical-component manufacturing operations. The price tag for Amazon HQ2 is unknown, but the offers will most likely be in the billions for many locations.

What is troubling is that these giant incentives may also be setting a new benchmark for companies. In Wisconsin, Gov. Scott Walker is offering Kimberly-Clark, the maker of paper-based products, a Foxconn-size deal (in cost per job) simply to help keep an existing business from closing shop — in essence, to do nothing.

The chairman of JPMorgan Chase, Jamie Dimon, recently said that he will be pushing for the same deal received by Amazon. And this is even before any announcement of where Amazon is investing and what is being offered. Mr. Dimon would like to pre-order some Amazon incentives.

Political pandering is behind this explosion. But there is also some of what Brink Lindsey of the Niskanen Center and the political scientist Steven Teles call the "captured economy." In between these politicians and corporations are economic incentive consultants, tax professionals and lobbyists all providing ways for businesses to maximize their take, and getting a percentage of these incentives in return. Some consultancies are clearly offering valuable services to governments and companies attempting to manage the complex decisions and operations across various locations in the country.

Others are experts at extracting as many incentives from governments as possible, in some cases moving businesses a few miles away, say, from Kansas City, Mo., to Kansas City, Kan., to qualify them as new investments.

What is to be done? One call is to push for more transparency in these policies, requiring governments to provide details on the support they are offering business. If the Amazon HQ2 competition is any guide, many governments will use creative ways to avoid disclosing their bids. Contact your city government and ask whether it sent a proposal to Amazon. I bet the answer will be something like, "We offered some details but the actual proposal was sent by X, which isn't a government agency. We don't have a copy of the final proposal."

The best hope is bipartisan reform of these programs. On the left, critics of economic development programs don't like "corporate welfare" or the use of taxpayer money to reduce the taxes of select businesses; on the right, numerous groups have rallied against "governments picking winners and losers."

There is a role for government in economic development. State and local governments can help businesses without access to finance survive and expand, provide worker training that is valuable to residents and companies, and invest in traditional education from pre-K to college. There are certainly worthy investments that can be made. But $7 million for Carrier, $3 billion for Foxconn and billions for Amazon is just using the public coffers for political theater.

Nathan M. Jensen is a professor of government at the University of Texas, Austin, and a co-author of "Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain."