**Rethinking Michigan’s Economic Development Policies**

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The State of Michigan currently is debating some controversies about the state’s economic development incentives. The first controversy is whether to divert some economic development incentive funds for major projects to various community development and transit projects. The second is whether to add various economic development incentives for smaller job creation projects.

What I thought today is I would outline what I think state of Michigan policymakers and policy influencers should know from research about how to maximize the net benefits of economic development incentives and economic development policies in general. So, I will first summarize the key points from research, and then return to how they are relevant both to the two current controversies, and to the broader issue of how to best improve the state’s current economic development policies.

On research, there are three things to know:

First, the benefits of state economic development policies largely depend upon whether they increase the state’s employment to population ratio, the state’s “employment rate”. How incentive policies are targeted and designed can affect what proportion of jobs go to increasing the local employment rate.

Second, it is more cost-effective to create jobs via business services than by handing out cash via business incentives, but it is easier to hand out cash than to deliver high-quality business services, which has both advantages and disadvantages.

Third, the benefits of comprehensive policies that are customized to address the “good job” needs of particular places are more than the benefits of individual projects or programs.

On the first point: when we create jobs in a state via economic development programs, the main benefits occur if the employment to population ratio goes up. New jobs in a state logically must either increase the employment to population ratio, or increase the population, largely via in-migration. There is no other alternative.

In an average local labor market in the U.S. , between 10 to 20% of the new jobs created in the area will go to increasing the local employment to population ratio, and the other 80% to 90% will increase in-migration. The effects on in-migration are larger than one might expect because of job vacancy chains. When new jobs are created, they are filled in three ways: (1) hiring local residents who are already employed; (2) hiring local residents who are not employed; (3) hiring in-migrants. But if the hires come from local residents who are already employed, this creates job vacancies, filled in the same three ways. At the end of these job vacancy chains, all new jobs created end up resulting in either more local residents employed, or in-migrants, depending upon the relative hiring of the local non-employed versus in-migrants along these vacancy chains.

New jobs provide much higher social benefits for a state if they increase local employment rates rather than population. Higher employment rates also will increase real wage rates (wages after adjusting for local prices). Both the higher employment rates and higher real wage rates increase residents’ per capita earnings. Getting more residents into jobs and higher wage jobs also provides social benefits, by reducing substance abuse, crime, and family breakups. Finally, increasing employment faster than population will provide fiscal benefits, since state and local tax revenue tends to track with employment, and the need for state services tends to track with population.

States can do two things to increase the extent to which new jobs increase local employment rates. First, they can target the most distressed counties in the state for job creation.

Research on economic development suggests that although 15% of jobs increase employment rates in the average county, 34% or over one-third increase employment rates in economically distressed counties. And in a truly booming county, only 4% of jobs increase employment rates.

This pattern occurs because in a distressed county, there are more non-employed persons available to be hired along job vacancy chains.

So, in a Michigan context, places like Detroit, Flint, Jackson, and many rural counties would clearly be in the 34% and above category, and places such as Grand Rapids and Ann Arbor would be at 15% or below. So, conservatively speaking, creating a job in some of the state’s distressed places would have twice the economic and social benefits of creating a job in some of the booming places. Benefits would be higher both for state residents, and for the state budget.

A second way that new jobs can provide higher employment rates is if we encourage more jobs to be filled via the local non-employed. This can be done by job placement and training programs, providing child care, increasing job access via better transit or reliable used cars, improving job retention through job success coaches, and many other policies. We need to do this not only for the new jobs in the firms we are directly attracting, but also in filling all the job vacancies along these job vacancy chains.

Filling more jobs from the local non-employed can be done most effectively if we target these job access services, broadly defined, on the neighborhoods where the highest proportion of non-employed live. This way, we realize economies of scale by providing the needed job access services such as child care, comprehensive workforce development services, and improved transit. And the increase in the neighborhood employment rate will have important neighborhood spillover benefits in providing adult role models and improving neighborhood job networks, which will help improve future prospects for children growing up in such neighborhoods.

So, in summary on the benefits side, the benefits of creating jobs via economic development policies can be increased if we target job creation policies towards distressed counties, and if we target job access services towards distressed neighborhoods.

On the cost side, handing out cash to encourage job creation, via tax incentives or cash grants, can work, but is relatively expensive per job created. Estimates suggest that handing out cash has a cost per job created of more than $200,000, stating costs as the one-time equivalent in present value costs.

Costs are so expensive because there are many costs that affect job creation decisions, such as labor costs and quality, and the availability of land that is properly zoned and has the right infrastructure. It takes a lot of cash to tip the location decision towards one state rather than another, considering these many other costs. In practice, when we hand out incentives, in many cases the firm would have located in the same place anyway. In other cases, even if that firm would have not made the same location decision “but for “ the incentives, some other firm would have chosen the same site and created a similar number of jobs. Therefore, for typical incentives in the U.S., only about 25% of the time are the jobs induced, that is would not have existed in the state “but for” the incentives. The other 75% of the time the jobs would have been created without the incentives. We can increase the “but for” percentage above 25% by providing larger incentives, but the cost per job actually induced will be similar.

In contrast, there is considerable evidence that well-designed business services can create jobs more cost-effectively. Providing infrastructure to create jobs – for example, infrastructure such as access roads, utilities, and site preparation -- can create jobs at less than half the costs of cash incentives. Customized job training programs, under which community colleges provide free training that is customized to the skill needs of individual firms, can create jobs at less than one-fourth the cost per job of cash incentives. And business advice programs for small and medium sized businesses, such as manufacturing extension programs and help for entrepreneurs, can also create jobs at less than one-fourth the cost of cash incentives.

These services can be so cost-effective because these services directly overcome barriers to creating jobs. These barriers cannot easily be solved by the businesses themselves, and the public sector can help in overcoming these barriers. Finding a good business site with high-quality infrastructure is hard. Finding adequately skilled labor is challenging. For smaller businesses, figuring out how to move into new markets or use new technology can be quite difficult.

Now, at some point you have sufficient infrastructure, job training programs, and business advice that the economic and social rate of return to these investments are reduced. But you should certainly make sure that you have expanded these programs until you have reached that point. Furthermore, it is easier to expand cash incentive programs than it is to deliver high-quality services, so we should certainly make sure that any services we deliver are high-quality. And the ease of handing out cash is both an advantage and disadvantage – handing out cash is easy to expand too much if you don’t have a budget constraint or a way to say No.

A third point is that the benefits of comprehensive, coordinated services to create jobs and expand job access in particular places, with those services customized to the needs of particular places, are greater than separate projects or programs, because of synergies and spillovers. For example, a firm considering a location or expansion needs both suitable sites and high-quality labor, so providing access to both is likely to have some synergy in boosting job creation effects. Similarly, if we want to maximize the increase in residents’ earnings per capita, we are likely to get greater effects if we have combined programs that both create good jobs, and increase residents’ access to those jobs. The greater job creation makes it easier to run good job access programs, and the better job access of workers is likely to make it easier to get firms to create jobs.

Furthermore, what types of comprehensive services are needed to increase Michigan residents’ employment rates in good jobs is likely to vary from place to place. We do not really have a “Michigan economy”, but rather we have a Detroit area economy, a Grand Rapids area economy, a Flint area economy, a Marquette area economy, etc. What kinds of job creation services are needed will vary county by county. What kind of job access services are most needed will vary neighborhood by neighborhood.

So, for example, to create jobs, counties will differ in whether their greatest need is more suitable sites, better infrastructure, more trained workers, or better business advice programs. In terms of job access, neighborhoods will differ in whether the greatest need is more child care centers, better public transit, more reliable used cars, or better access to workforce development services. One size does not fit all.

Returning to the current two controversies: should the state devote a greater percentage of its economic development resources to various types of services? And should the state devote more resources to economic development policies such as incentives?

If all we do is focus on these two current issues, one can answer “Yes” to both questions, but with big caveats. The devil is in the details.

On the first question, reallocating some cash incentives to economic development services can pay off more than just doing incentives. But in an ideal world, what should be funded are not just individual programs or projects, but rather a comprehensive package of high-quality services, both business services that are needed to create jobs, and job access services needed for state residents to access jobs. Local economies need comprehensive and customized strategies that address the special needs of their local labor market. Different places may need different types of business services and job access services. Ideally, the state should be offering flexible funding for these comprehensive strategies rather than just funding categorical programs for individual services. Localities can try to piece together a comprehensive strategy from state or federal categorical funding for individual services, but this is more challenging to do.

On the second question, expanding state economic development resources, including incentives, could pay off, but is far more likely to pay off if targeted at distressed counties or neighborhoods, where more people who need jobs are located. And such expansions are far more likely to pay off if this is part of a comprehensive and customized economic development program, and is not simply a single mega-project.

As my response suggests, in my view the current debates are not sufficiently focusing on what should be the main issues in the state of Michigan’s economic development policies. Those issues are: how do we make sure our state’s economic development policies are targeted to create jobs in the local labor markets that need jobs the most, and increase job access in the neighborhoods that need jobs the most? And how do we make sure the projects and programs we fund are part of comprehensive programs that are attuned to address the specific jobs problems that vary greatly across the diversity of Michigan’s distressed local labor markets and neighborhoods.

In summary, the issues I think we should be debating are targeting distressed places; making funding flexible enough to support comprehensive, customized strategies rather than simply funding single projects or programs. If we are able to target our economic development resources in those ways, then we can make sure that the limited resources we can afford for economic development purposes have the maximum effect on the goal of achieving good job access for all of Michigan’s residents.