Economic Development Incentives: Competing Against Ourselves?

ECONOMIC DEVELOPMENT INCENTIVES: COMPETING AGAINST OURSELVES?

As Companies Seek Tax Deals, Governments Pay High Price
– Louise Story, The New York Times (Dec. 1, 2012)

Aided and abetted by the media, nearly all of us have done it. We count the number of new firms attracted to our area in a given year and then use that number as a thermometer of the economic health and vitality of the region. To be sure, we know that other things such as national economic conditions and, in the case of Hampton Roads, defense spending, are so important that they can overwhelm the efforts of even the most energetic and successful economic developers to attract new firms. Nevertheless, the number of new firms attracted to an area remains one of the most popular measures of economic health.

Counting new businesses is easy, but often is deceptive for some of the reasons just noted. Fundamentally, however, the single-minded focus of economic developers on attracting new firms may be misguided. Spending an equivalent number of dollars on helping existing firms expand, or incubating startup firms or commercializing basic research usually is a more productive strategy in terms of generating jobs and expanding the tax base. Further, as we will see, attempts to attract new firms not only can be expensive, but also can result in counterproductive bidding of one governmental unit against another. Finally, the rationale for government choosing favorites and providing financial assistance to one firm, but not another, in a roughly equivalent situation is shaky.

In this chapter, we look at our regional economic development programs at the policy level. We attempt to assess the overall productivity of our local and regional efforts (which often cooperate with those of the Commonwealth of Virginia) and then ask the obvious questions: Do these programs represent a sound investment of scarce public and private funds? Are they worth it? And, what are the alternatives?

The longstanding premise that has motivated most local, regional and state economic development programs – "Let's go out and attract new firms in order to bolster the economy" – now is being challenged by those who argue that it is more productive to: (1) "garden" and expand existing firms; (2) incubate startup firms; and (3) commercialize and bring to market the basic research emanating from the Jefferson Laboratory, NASA Langley, Eastern Virginia Medical School and Old Dominion University. In this new, emerging view, the efforts of organizations such as the Hampton Roads Economic Development Alliance (HREDA) either should be refocused, or a new hybrid organization capable of these broader mandates should be created.

Nationally, the most economically dynamic regions tend to do all of these things well. They cultivate existing firms and incubate new firms even while attempting to attract new firms. They simultaneously stimulate and encourage the commercialization of basic research being undertaken at their academic institutions. They may also utilize economic development incentives as a part of their growth strategy, but this is not the centerpiece of their overall approach to economic development.

What is meant when one talks about the "gardening" of existing firms? The notion originated in Littleton, Colo., in the 1980s and was popularized by MIT's David Birch ("The Job Generation Process," 1979), who argued that most new jobs in any community are generated by a small cadre of local businesses, which he later termed "gazelles." Littleton and other "gardening communities" made life easier for their small businesses by giving them access to information and high-speed Internet connections, arranging sessions for them with financial institutions and venture capital firms, connecting them to academic, engineering, computer, Internet and accounting expertise, and providing them with very short-term tax incentives. A frequent example involves raising the visibility of a small firm on the Internet by optimizing its presence in Internet search engine activities. The focus is on second-stage firms that have demonstrated solid possibilities for growth, but now could benefit from assistance. Today, the Edward Lowe Foundation is a particularly energetic supporter of economic gardening and states that it is "an entrepreneur-oriented approach to economic prosperity." www.edwardlowe.org

A current hot concept in economic development is the "innovation district," which Fortune magazine describes as the clustering of "cutting-edge research institutions and R&D-intensive companies with start-ups and business incubators. They are physically compact, transit-accessible, and offer mixed-use housing, office, and retail." (Katz and Wagner in Fortune, June 13, 2014). The only area of Hampton Roads that even approaches this description currently is the Old Dominion University/Eastern Virginia Medical School/Granby Street corridor, though some of these building blocks exist on the Peninsula because of the existence of NASA Langley Research Center, the Thomas Jefferson National Accelerator Facility and the incipient Virginia Tech development; and in Virginia Beach along Princess Anne Road because of the burgeoning medical complex and the Virginia Beach Higher Education Center. Cultivation and promotion of these developments, rather than attempting to attract a large corporation, would require a reorientation of our regional economic development efforts.

A Quick Scan Of Our Economic Development Efforts

Virginia, along with its cities, counties and regions, works aggressively to lure new businesses and in 2012 spent an estimated $1.89 billion on such efforts. Even so, the Commonwealth has eschewed very large economic incentives such as those that assisted South Carolina in attracting a BMW production facility and Alabama in attracting a Mercedes production plant.

Media campaigns, recruiting trips, worldwide offices, conventions and a variety of incentives all are utilized by the Commonwealth and Hampton Roads to attract new business activity. **Nevertheless, even though the 50 states are spending an estimated $50 billion per year on economic development incentives, and regional and local governments an estimated $30 billion more, there is surprisingly little agreement as to what works best, or even what works at all, in attracting new businesses from other locations.[1]** Indeed, the academic consensus on the subject is that economic development incentives seldom determine company locational decisions.

Virginia typically has not chosen to play in the "let's pay out large incentives to attract a new firm" arena. The actual financial grants awarded for economic development purposes by the Commonwealth usually have not been sizable.

[1] Institute on Taxation and Economic Policy, "Tax Incentives: Costly for States, Drag on the Nation," http://itep.org/itep_reports/2013/08/tax-incentives-costly-for-states-drag-on-the-nation.php#.U4XKpXy-l5cl, for the $50 million figure, and Louise Story, *The New York Times*, Dec. 1, 2012, for the remaining regional and local $30 billion. For additional evidence on the questionable productivity of economic development financial incentives, see Yoonsoo Lee, "Geographical Redistribution of U.S. Manufacturing and the Role of State Development Policy," *Journal of Urban Economics*, 64 (2008); Terry F. Buss, "The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature," *Economic Development Quarterly*, 15 (2001); and Carlos F. Liard-Muriente, "U.S. and E.U. Experiences of Tax Incentives," Area 186 (2007).

A November 2012 study by the Virginia Joint Legislative Audit and Review Commission (JLARC) found that most of the 3,372 financial grants for economic development awarded in the Commonwealth by state government between fiscal years 2002 to 2011 averaged only a bit more than $200,000.[2] While seven recipients received more than $20 million each, most received less than $100,000. Table 1 lists the 50 businesses in Hampton Roads that received incentive grants from the beginning of 2009 to the end of 2013.

The Commonwealth and local governmental units operate 21 primary economic development programs (see Table 2). A host of state agencies exist to administer these programs. Any city, county or region worthy of the name has an economic development agency and one or more programs designed to attract and retain businesses to that jurisdiction. Table 3 summarizes the state, regional and local agencies and groups that profess economic development to be one of their significant aims.

This veritable blizzard of programs and agencies naturally provokes the question: Are we getting our money's worth? Do these programs work? Do they invest money wisely? Can they demonstrate results?

To be sure, we are not the first to ask these questions, nor are these questions unique either to Hampton Roads or to the Commonwealth of Virginia. However, given the only "so-so" performance of our regional economy, it is appropriate once again to raise these questions and to summarize the evidence.

[2] Review of State Economic Development Grants (Richmond, Virginia: JLARC, November 2012, http://jlarc.virginia.gov/reports/Rpt431.pdf).

TABLE 1

VIRGINIA ANNOUNCEMENTS OF EMPLOYMENT CREATION AND CAPITAL INVESTMENT FOR PROJECTS RECEIVING INCENTIVES IN HAMPTON ROADS, CALENDAR YEARS 2009-2013

	Location	Mfg	Type	Employment	Investment (millions)	Date Announced	Jobs Saved	Amount of Incentive (millions)	Source
AMAC Leasing LLC	Southampton County	M	N	26	$5.60	02/2013	0	$0.300	Rail
Atomized Products Group Inc.	Chesapeake	M	N	26	$4.30	07/2013	0	$0.100	GOF
Bauer Compressors Inc.*	Norfolk	M	E	130	$15.00	03/2013	0	$0.100	EZ
Canon Virginia Inc.*	Newport News	M	E	0	$27.00	06/2013	12	$3.000	VIP
DESMI*	Chesapeake	M	E	34	$1.90	10/2013	0	$0.031	VJIP
Eska Graphic Board*	Chesapeake	M	E	18	$0.55	03/2013	0	$0.015	VJIP
Franklin Lumber LLC	Isle of Wight County	M	N	72	$14.80	06/2013	0	$0.000	
Greystone Inc.	James City County	M	E	34	$1.50	06/2013	0	$0.025	VJIP
Hamilton Consulting Corp.	Chesapeake	N	E	58	$0.50	06/2013	0	$0.058	VJIP
Hampton Farms/Severn Peanut Co.	Southampton County	M	N	60	$5.50	08/2013	0	$0.200	GOF
High Liner Foods Inc.*	Newport News	M	E	57	$6.60	05/2013	0	$0.501	GOF/VJIP/EZ
Liebherr Mining Equipment Newport News Co.*	Newport News	M	E	174	$45.43	02/2013	0	$1.300	GOF/VIP
Lipton*	Suffolk	M	E	0	$96.20	03/2013	0	$1.000	VIP
Mills Marine & Ship Repair, LLC	Suffolk	M	E	142	$3.00	04/2013	0	$0.156	VJIP
Oceaneering International Inc.	Chesapeake	M	E	67	$32.90	11/2013	463	$3.090	GOF/VIP/Road
PRUFREX Innovative Power Products GmbH*	Virginia Beach	M	N	60	$7.33	07/2013	0	$0.200	GOF/VJIP
Sutherland Global Services	Chesapeake	N	E	275	$6.87	01/2013	0	$0.193	VJIP
17				**1,233**	**$274.98**	**2013 Totals**		**$10.269**	

Notes:

*Indicates foreign affiliation
Type: New or Expansion
Mfg: Manufacturing or Nonmanufacturing
2013 announcements are preliminary.
All announcements are subject to revision.

GOF - Governor Opportunity Fund
VIP - Virginia Investment Partnership Grant
VEDIG - Virginia Economic Development Incentive Grant
VJIP - Virginia Jobs Investment Program
Rail - Rail Industrial Access Program

MBFJTC - Major Business Facility Job Tax Credit
EZ - Enterprise Zone Job Creation Grant
Road - Economic Development Access Program

Source: Virginia Economic Development Partnership

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VIRGINIA ANNOUNCEMENTS OF EMPLOYMENT CREATION AND CAPITAL INVESTMENT FOR PROJECTS RECEIVING INCENTIVES IN HAMPTON ROADS, CALENDAR YEARS 2009-2013

	Location	Mfg	Type	Employment	Investment (millions)	Date Announced	Jobs Saved	Amount of Incentive (millions)	Source
Faneuil Inc.	Portsmouth	N	N	50	$1.00	08/2012	0	$0.000	
Hobbs & Associates	Norfolk	N	E	20	$3.35	12/2012	0	$0.016	VJIP
La Tienda	James City County	N	E	32	$0.17	12/2012	0	$0.023	VJIP
Manufacturing & Design Technology Inc.	Chesapeake	M	E	21	$1.80	12/2012	0	$0.018	VJIP
Mosquito Joe	Virginia Beach	N	E	16	$0.21	12/2012	0	$0.014	VJIP
Sumitomo Machinery Corp. of America*	Chesapeake	M	E	96	$13.25	01/2012	0	$0.152	VJIP
Tak Investments Inc. (ST Tissue)	Isle of Wight County	M	N	85	$60.00	07/2012	0	$0.889	GOF/VJIP/EZ
Virginia Packing LLC	James City County	M	E	18	$0.12	12/2012	0	$0.013	VJIP
Virginia Toy and Novelty Co.	Virginia Beach	N	E	52	$0.13	12/2012	0	$0.037	VJIP
9				**390**	**$80.03**	**2012 Totals**		**$1.161**	
Ace Hardware Corp.	Suffolk	N	E	75	$14.00	09/2011	0	$0.224	GOF/VJIP
Applied Process Technology International, LLC*	James City County	N	E	30	$0.35	05/2011	0	$0.030	VJIP
Bay Diesel & Generator	Chesapeake	N	E	18	$1.00	04/2011	0	$0.018	VJIP
California Cartage Co., LLC	Suffolk	N	N	75	$12.50	08/2011	0	$0.056	VJIP
CDYNE Corp.	Chesapeake	N	E	88	$0.10	04/2011	0	$0.071	VJIP
Eagle Aviation Technologies Inc.	Hampton	M	E	30	$0.10	09/2011	0	$0.030	VJIP
Enviva LP	Southampton County	M	N	72	$91.00	11/2011	0	$0.989	GOF/MBFJTC/ Road
IMS:GEAR Virginia Inc.*	Virginia Beach	M	E	80	$35.50	12/2011	0	$0.500	GOF/VIP

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International Paper	Isle of Wight County	M	N	213	$83.00	05/2011	0	$0.563	GOF/VJIP
Katoen Natie*	Norfolk	N	N	225	$12.00	03/2011	0	$0.466	VJIP/EZ
Keurig Green Mountain Inc.	Isle of Wight County	M	N	800	$180.00	10/2011	0	$6.640	GOF/VJIP/EZ
KITCO Fiber Optics	Virginia Beach	M	E	128	$0.10	04/2011	0	$0.103	VJIP
Scientific Research Corp.	Chesapeake	N	E	89	$2.20	03/2011	0	$0.082	VJIP
13				**1,923**	**$431.85**	**2011 Totals**		**$9.772**	
InMotion Hosting Inc.	Virginia Beach	N	E	275	$0.25	09/2010	0	$0.399	VJIP/MBFJTC
KmX USA*	Accomack County	M	E	9	$5.25	09/2010	0	$0.102	Rail
MYMIC LLC	Portsmouth	N	E	90	$0.30	06/2010	0	$0.090	VJIP
Orion Air Group	Newport News	N	E	51	$4.00	05/2010	57	$0.051	VJIP
Solutionz Conferencing Inc.	Williamsburg	N	E	19	$2.00	12/2010	0	$0.030	VJIP
5				**444**	**$11.80**	**2010 Totals**		**$0.671**	
Alcoa Howmet	Hampton	M	E	25	$25.00	06/2009	0	$0.519	VIP/VJIP
Avis Budget Group Inc.	Virginia Beach	N	E	70	$0.60	03/2009	0	$0.036	VJIP
Cobham Composite Products*	Suffolk	M	N	198	$13.20	03/2009	0	$0.839	GOF/VJIP/EZ
Greenwood RRST, LLC	Southampton County	N	N	10	$2.20	12/2009	0	$0.047	Rail
Owens-Illinois Inc.	James City County	M	E	0	$20.00	04/2009	180	$0.054	VJIP
Southampton Terminal, LLC	Southampton County	N	E	35	$3.20	05/2009	0	$0.000	
6				**338**	**$64.20**	**2009 Totals**		**$1.494**	
50				**4,328**	**$862.86**	**Grand Totals**		**$23.367**	

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TABLE 2 INCENTIVES FOR BUSINESS LOCATION AND EXPANSION		
Governor's Opportunity Fund	The Governor's Opportunity Fund (GOF) is a discretionary incentive available to the governor to secure a business location or expansion project for Virginia. Grants are awarded to localities on a local matching basis with the expectation that the grant will result in a favorable location decision for the Commonwealth.	
Governor's Agriculture and Forestry Industries Development Fund	The Governor's Agriculture and Forestry Industries Development Fund (AFID) offers strategic grants made to businesses that add value to Virginia-grown agricultural and forest products. AFID grants are made at the discretion of the governor with the expectation that a grant awarded to a political subdivision will result in a new or expanded processing/value-added facility for Virginia-grown agricultural or forest products, and with the expectation that the grant will be critical to the success of the project.	
Virginia Investment Partnership Act	The Virginia Investment Partnership (VIP) Grant and the Major Eligible Employer Grant (MEE) are discretionary performance incentives designed to encourage continued capital investment by Virginia companies, resulting in added capacity, modernization, increased productivity or the creation, development and utilization of advanced technology.	
Virginia Economic Development Incentive Grant	The Virginia Economic Development Incentive Grant (VEDIG) is a discretionary performance incentive, designed to assist and encourage companies to invest and create new employment opportunities by locating significant headquarters, administrative or service-sector operations in Virginia.	
Clean Energy Manufacturing Incentive Grant	The Clean Energy Manufacturing Incentive Grant (CEMIG) is a discretionary performance incentive, designed to encourage clean-energy manufacturers to grow in Virginia.	
Virginia Jobs Investment Program	The Virginia Jobs Investment Program (VJIP) offers customized recruiting and training assistance to companies that are creating new jobs or experiencing technological change. The program is designed to reduce the human resource development cost of new and expanding companies.	
Corporate Income Tax Credits	Major Business Facility Job Tax Credit	Recycling Equipment Tax Credit
	Day Care Facility Investment Tax Credit	Worker Retraining Tax Credit
	Virginia Port Tax Credit Programs	Research and Development Tax Credit
	Green Job Creation Tax Credit	
Sales and Use Tax Exemptions	Virginia offers some of the broadest sales and use tax exemptions in the United States.	
Property Tax Exemptions	Virginia does not tax intangible property, manufacturers' inventory and manufacturers' furniture, fixtures and corporate aircraft.	
Economic Development Access Program	Administered by the Virginia Department of Transportation, this program assists localities in providing adequate road access to new and expanding basic employers.	
Sources: Virginia Economic Development Partnership (VEDP) and the Joint Legislative Audit Review Commission (JLARC). Additional information is available at www.yesvirginia.org.		

TABLE 2 INCENTIVES FOR BUSINESS LOCATION AND EXPANSION	
Rail Industrial Access Program	This program provides funds to construct railroad tracks to new or substantially expanded industrial and commercial projects.
Transportation Partnership Opportunity Fund	TPOF is a discretionary grant available for transportation issues related to unique economic development projects.
Virginia Small Business Financing Authority	VSBFA offers programs to provide businesses with access to capital needed for growth and expansion.
Enterprise Zones	Virginia's Enterprise Zone program provides state and local incentives to businesses that invest and create jobs within Virginia's enterprise zones, which are located throughout the state.
Technology Zones	Virginia authorizes its communities to establish technology zones to encourage growth in targeted industries. Currently, 30 cities and counties and six towns have created zones throughout the state.
Foreign Trade Zones	Virginia offers six foreign trade zones designed to encourage businesses to participate in international trade by effectively eliminating or reducing customs duties. Also, numerous subzones are provided and additional ones can be designated to enhance the trade capabilities of specific companies.
Defense Production Zones	Virginia authorizes its communities to establish local defense production zones to benefit businesses engaged in the design, development or production of materials, components or equipment required to meet the needs of national defense. Companies deemed ancillary to or in support of the aforementioned categories would also apply.
Tobacco Indemnification and Community Revitalization Commission	Tobacco Region Opportunity Fund
Virginia Film Office	Governor's Motion Picture Opportunity Fund
Virginia Coalfield Economic Development Authority	Coalfield Regional Opportunity Fund
Virginia Port Tax Credits	Port Volume Increase Tax Credit available to companies that increase port cargo through public or private facilities in Virginia by a minimum of 5 percent in a single year.
	Barge and Rail Usage Tax Credit for companies that move cargo by barge or rail.
	International Trade Facility Tax Credit for new job creation or capital investment in an international trade facility as a result of moving 10 percent more cargo through a Virginia Port Authority facility.
	Port of Virginia Economic and Infrastructure Development Grant Program for companies that locate in the port zone and create at least 25 new jobs involved in maritime commerce.
Sources: Virginia Economic Development Partnership (VEDP) and the Joint Legislative Audit Review Commission (JLARC). Additional information is available at www.yesvirginia.org.	

<table>
<tr><th colspan="3">TABLE 3
MAJOR AGENCIES INVOLVED IN ECONOMIC DEVELOPMENT ACTIVITIES IN HAMPTON ROADS</th></tr>
<tr><td rowspan="8">State Level</td><td colspan="2">Virginia Economic Development Partnership</td></tr>
<tr><td colspan="2">Department of Business Assistance</td></tr>
<tr><td colspan="2">Department of Housing and Community Development</td></tr>
<tr><td colspan="2">Department of Rail and Public Transportation</td></tr>
<tr><td colspan="2">Tobacco Indemnification and Community Revitalization Commission</td></tr>
<tr><td colspan="2">Virginia Coalfield Economic Development Authority</td></tr>
<tr><td colspan="2">Virginia Film Office</td></tr>
<tr><td colspan="2">Center for Innovative Technology</td></tr>
<tr><td rowspan="4">Regional Level</td><td colspan="2">Hampton Roads Chamber of Commerce</td></tr>
<tr><td colspan="2">Hampton Roads Economic Development Alliance</td></tr>
<tr><td colspan="2">Hampton Roads Planning District Commission</td></tr>
<tr><td colspan="2">Port of Virginia</td></tr>
<tr><td rowspan="8">Local Level</td><td>Local Chambers of Commerce</td><td>City of Virginia Beach Economic Development</td></tr>
<tr><td>City of Chesapeake Economic Development</td><td>City of Williamsburg Economic Development Authority</td></tr>
<tr><td>City of Hampton Economic Development</td><td>County of Gloucester Economic Development</td></tr>
<tr><td>City of Newport News Economic Development Authority</td><td>County of Isle of Wight Economic Development</td></tr>
<tr><td>City of Norfolk Economic Development</td><td>County of James City Economic Development</td></tr>
<tr><td>City of Poquoson Economic Development</td><td>County of Surry Economic Development</td></tr>
<tr><td>City of Portsmouth Economic Development</td><td>County of York Economic Development</td></tr>
<tr><td>City of Suffolk Economic Development</td><td>Franklin Southampton Economic Development</td></tr>
<tr><td rowspan="4">Other Organizations</td><td colspan="2">Future of Hampton Roads Inc.</td></tr>
<tr><td colspan="2">Hampton Roads Community Foundation and constituent committees</td></tr>
<tr><td colspan="2">Hampton Roads Planning District Commission</td></tr>
<tr><td colspan="2">Technology Council of Hampton Roads</td></tr>
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The Economic Development Incentive Scorecard for Hampton Roads

A logical place for us to start our analysis is with the Hampton Roads Economic Development Alliance (HREDA), which describes itself as "the recruitment organization tasked with attracting new opportunities for the entire Hampton Roads region." HREDA's future is uncertain for three reasons. First, the Great Recession that began in 2008 understandably diminished the Alliance's ability to "score" in terms of attracting new firms to the region. Second, and not unrelated, HREDA's financial viability depends substantially upon a per citizen assessment paid by each of the region's cities; it seems likely that several cities will reduce or eliminate their payments to HREDA. Third, as noted above, some observers believe that HREDA's focus on attracting new firms to the region is off target and that either HREDA or a successor organization instead should place emphasis on the "gardening" of existing firms, incubation of new firms and commercialization of research.

This past year (2013) was a more active one for the Alliance, however. Staff report they met with 342 corporate decision makers and 140 site selection consultants in 12 countries and 16 states.

Many recruitment efforts take years to reach fruition and therefore one should not place undue emphasis on the performance of an economic development authority in any single year. In 2013, HREDA (which has a proposed budget of $2.59 million for 2014) announced six significant successful firms with whom it had worked to convince them to locate in Hampton Roads. In addition, 47 other announcements were made by the Commonwealth of new or expanded businesses for the region. Table 4 traces the number of announcements and resulting expected job growth and investment for the region for the past five years. There has been a consistency in the number of new companies attracted to the region, but the number of new employees and the capital investment have varied over the years without any apparent trend.

TABLE 4

COMMONWEALTH OF VIRGINIA ANNOUNCEMENTS OF JOB CREATION AND CAPITAL INVESTMENT IN HAMPTON ROADS, CALENDAR YEARS 2009-2013

Year	Companies	Employment	Investment
2009	61	3,023	$467.14 million
2010	51	2,430	$129.10 million
2011	56	3,125	$599.33 million
2012	57	1,852	$176.14 million
2013	53	2,075	$525.33 million
Totals	278	12,505	$1,897.04 million

Source: Virginia Economic Development Partnership

Table 5 summarizes the general types of economic development incentives that were offered to firms that chose to locate in Hampton Roads between 2009 and 2013. Note that some of the incentives involved road and transportation improvements, including railway improvements. The deals made in Hampton Roads involved an estimated $863 million of new investment in plant, equipment and improvements. An estimated 4,328 new jobs were generated by these projects.

These are positive results, but it's also worth noting that according to JLARC, no more than 15 percent of corporate expansion or relocation deals over the last 10 years in Virginia have included tax incentive programs. These deals were developed primarily with larger companies that JLARC estimated have created 40 percent of all new jobs in Virginia.

Table 6 provides us with a flavor of job creation results for Hampton Roads. Total "new job" announcements were made by Virginia involving 12,505 new jobs in our region. As just noted, 4,328 of these jobs (or about 35 percent) involved economic development incentives being granted to the firms creating the jobs. The remaining did not. Where new investment in plant, equipment and improvements was concerned, economic development incentives were attached

to about 45 percent of the investments announced by the Commonwealth. Only 18 percent of the companies involved in these job announcements actually received economic development incentives from state or local authorities. The total value of incentives provided from all sources during this time period was $23.367 million, or about $5,400 per job.[3]

[3] The results in Table 5 reflect the definition of Hampton Roads utilized by the Virginia Economic Development Partnership, which includes in its Region 8 (Hampton Roads) the jurisdictions of Accomack County, Chesapeake, Franklin, Gloucester County, Hampton, Isle of Wight County, James City County, Newport News, Norfolk, Northampton County, Poquoson, Portsmouth, Southampton County, Suffolk, Virginia Beach, Williamsburg and York County. This is not the same as the Metropolitan Statistical Area (MSA) definition utilized by the U.S. Census.

TABLE 5 VIRGINIA ANNOUNCEMENTS OF NEW JOB CREATION AND CAPITAL INVESTMENT INVOLVING HAMPTON ROADS, 2009-2013												
Year Announced	Companies	Employment	Investment (millions)	GOF Funding (millions)	VIP Funding (millions)	VEDIG Funding (millions)	VJIP Funding (millions)	Rail Funding (millions)	MBFJTC Funding (millions)	EZ Funding (millions)	Road Funding (millions)	TROF Funding (millions)
2013	17	1,233	$274.98	$1.920	$5.550	$0.000	$1.534	$0.300	$0.000	$0.315	$0.650	$0.000
2012	9	390	$80.03	$0.200	$0.000	$0.000	$0.437	$0.000	$0.000	$0.524	$0.000	$0.000
2011	13	1,923	$431.85	$4.950	$0.300	$0.000	$1.847	$0.000	$0.039	$1.986	$0.650	$0.000
2010	5	444	$11.80	$0.000	$0.000	$0.000	$0.345	$0.102	$0.225	$0.000	$0.000	$0.000
2009	6	338	$64.20	$0.300	$0.500	$0.000	$0.349	$0.047	$0.000	$0.299	$0.000	$0.000
Grand Total	50	4,328	$862.86	$7.370	$6.350	$0.000	$4.512	$0.448	$0.264	$3.123	$1.300	$0.000
Source: Virginia Economic Development Partnership												
Note:	2013 announcements are preliminary.			GOF - Governor Opportunity Fund					MBFJTC - Major Business Facility Job Tax Credit			
				VIP - Virginia Investment Partnership Grant					EZ - Enterprise Zone Job Creation Grant			
				VEDIG - Virginia Economic Development Incentive Grant					Road - Economic Development Access Program			
				VJIP - Virginia Jobs Investment Program					TROF - Tobacco Region Opportunity Fund			

TABLE 6 VIRGINIA ANNOUNCEMENTS OF EMPLOYMENT CREATION AND CAPITAL INVESTMENT, HAMPTON ROADS PROJECTS, CALENDAR YEARS 2009-2013									
	Total Projects			**Projects with Incentives**			**Percentages**		
Year	**Companies**	**Employment**	**Investment**	**Companies**	**Employment**	**Investment**	**Companies**	**Employment**	**Investment**
2013	53	2,075	$525.33	17	1,233	$274.98	32%	59%	52%
2012	57	1,852	$176.14	9	390	$80.03	16%	21%	45%
2011	56	3,125	$599.33	13	1,923	$431.85	23%	62%	72%
2010	51	2,430	$129.10	5	444	$11.80	10%	18%	9%
2009	61	3,023	$467.14	6	338	$64.20	10%	11%	14%
Total	278	12,505	$1,897.04	50	4,328	$862.86	18%	35%	45%
Note: Investments in millions									
Source: Virginia Economic Development Partnership									

Mixed Evidence Where Incentives Are Concerned

Virginia periodically appears on the Forbes magazine list of the Best States for Business and currently is ranked No. 1. Forbes has developed an index that looks at six factors influencing the business climate: (1) costs, (2) labor supply, (3) regulatory environment, (4) current economic climate, (5) growth prospects and (6) quality of life.[4] This past year, Virginia was the only state to rank in the top five in at least four of the six areas – the Commonwealth missed only on costs and growth prospects. Hence, it is not a difficult case for Hampton Roads economic developers to argue that the region is an attractive place to do business. In its 2013 list of 200 best places in the country for business and careers, Forbes ranked the Virginia Beach/Norfolk/Newport News SMA as No. 77. The Richmond SMA was ranked 56th and the Roanoke SMA 99th.

In many ways Hampton Roads, broadly defined, has an attractive story to tell:

- The Port of Virginia is the largest natural deepwater harbor on earth.
- The region is within a day's drive of 97 million consumers.
- Eight universities and four community colleges serve more than 100,000 students in the region.
- The growth rate of federally funded research and development expenditures in the region is high.
- The region has a high concentration of federal laboratories and installations.
- The labor force includes many military veterans, who are viewed as talented, reliable and disciplined.
- The region is rich with cultural opportunities.

In the end, are these strengths of Hampton Roads what really count, or do the economic incentives that are proffered to firms matter more? Virtually every review of existing studies that focus on economic development incentives points to factors such as those listed above as being the critical determinants of why firms choose to locate one place or another. While firms pondering a new location value incentives and often negotiate vigorously to receive them, relatively few mention incentives as being critical to their final decision. In January 2014, the Pew Research Center issued a fact sheet titled "Evaluating State Tax Incentives: How to Measure Economic Impact" (The Pew Charitable Trusts, Feb. 7, 2014) about tax incentive programs in Minnesota, Louisiana and Massachusetts, which are regarded as "models for other states to follow when measuring the results of their own incentives."[5] Pew noted:

- In Minnesota, evaluators estimated that 79 percent of the jobs created at companies receiving incentives were likely to have been generated without the incentives. Jobs created cost the state more than $26,000, or about five times more than originally estimated, according to the analysts.
- Louisiana's evaluation of its Enterprise Zone program found that in certain economic sectors, 90 percent of new jobs created in the program were displacing jobs with other employers. Evaluators concluded that the program had created about 3,000 jobs instead of the more than 9,000 jobs that participating businesses had reported.
- An analysis of the Massachusetts film industry tax credit reported by the Pew Research Center found that the more than 5,900 jobs created from 2006 through 2011 cost the state $326 million, which had to be offset by cuts elsewhere in the budget. The evaluation estimated that these cuts cost the state more than 3,700 jobs, leaving Massachusetts with a net gain of 2,200 jobs for its investment, making each job gain much more costly than had been estimated earlier.

There are other skeptical assessments of the effectiveness of economic incentives as well. An Aug. 14, 2013, report by the Institute on Taxation and Economic Policy, titled "Tax Incentives: Costly for States, Drag on the Nation," estimated that $50 billion is spent annually on tax incentives, but "the evidence suggests that tax incentives are of little benefit to the state and localities that offer them and are actually a drag on national economic growth."

[4] www.forbes.com/best-states-for-business

[5] www.pewstates.org/research/fact-sheets/evaluating-state-tax-incentives-how-to-measure-economic-impact-85899539342

In 2012, New York Times reporters spent 10 months compiling data on state and local incentives provided to business. The Times found that there is little knowledge of whether the money is worth it because rarely is there tracking of how many jobs are created, and even with tracking "it is impossible to know whether the jobs would have been created without the aid." (The New York Times, Dec. 1, 2012)

Professor Richard Florida (head of the Martin Prosperity Institute at the University of Toronto's Rotman School of Management) analyzed the data gathered by The New York Times. In a Dec. 7, 2012, issue of The Atlantic Cities, he concluded, in an article titled "The Uselessness of Economic Development Incentives," that "there is virtually no association between economic development incentives and any measure of economic performance." Florida went on to say "companies typically select locations based on factors such as workforce, proximity to markets, and access to qualified suppliers, and then pit jurisdictions against one another to extract tax benefits and other incentives."

The Tax Foundation publishes annually a State Business Tax Climate Index that ranks the states on more than 100 different variables in five areas of taxation (major business taxes, individual income taxes, sales taxes, unemployment insurance taxes and property taxes).[6] The Foundation maintains that states with more competitive tax systems score well in the Index because they are best suited to generate economic growth. **The Tax Foundation is critical of states that attempt to lure business with tax incentives and subsidies rather than broad-based tax reform that lowers rates overall and eliminates special tax breaks that suggest crony capitalism.** It cites North Carolina, which agreed to $240 million worth of tax incentives to lure Dell to the state, only to have Dell close its plant after only four years. According to the Tax Foundation, "lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business tax climate. A far more effective approach is to systematically improve the business tax climate for the long term so as to improve the state's competitiveness."

[6] taxfoundation.org/article/2014-state-business-tax-climate-index

With respect to the general tax climate in Virginia, the Tax Foundation ranks Virginia 26th among the 50 states. Only a brief look at the Tax Foundation map (Figure 1) is needed for one to conclude that low taxes, per se, are not sufficient to generate high levels of economic growth. An attractive tax climate is exactly that – attractive – but many other factors also determine where people choose to live and where firms decide to locate. Table 7 records the attempts of several reputable organizations to take these other factors into account.

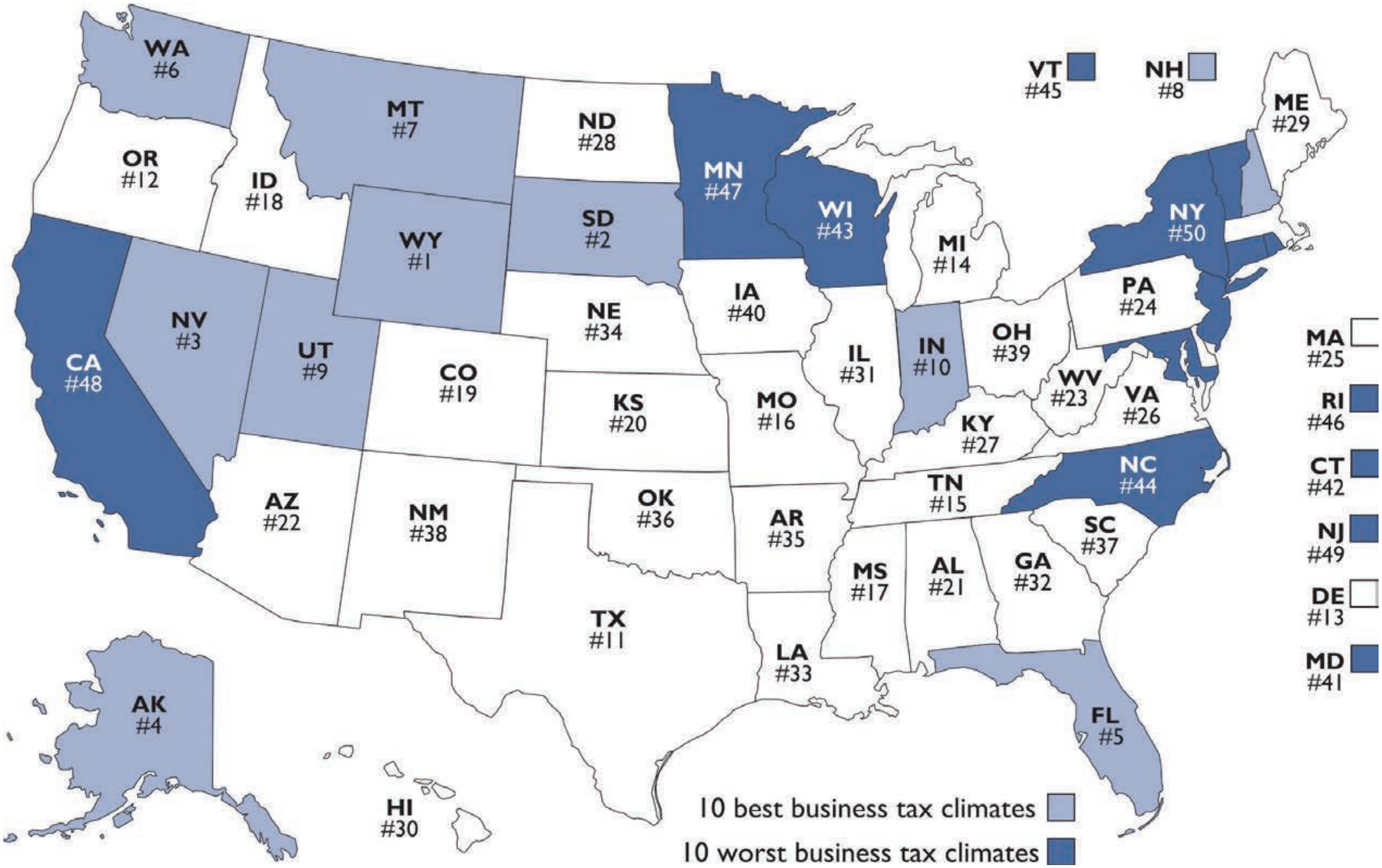
The Virginia Joint Legislative and Audit Review Commission undertook a review of the effectiveness of economic development incentive grants available in Virginia at the direction of the General Assembly and issued a report, "Review of State Economic Development Incentive Grants," in November 2012. The researchers found the plethora of economic development programs, agencies and incentives in Virginia to be both overlapping and confusing. At least eight state agencies are involved as well as regional and local officials, as documented in this chapter.

JLARC researchers looked at several meta-reviews of 80 or more econometric studies published since 1979 and found these reviews concluded that incentive grants might sway, on average, 10 percent of the site location decisions of businesses that receive an award. While this is not the last word on a still hotly debated subject, JLARC staff concluded there is no empirical evidence to suggest "most or even the majority of business location decisions are swayed by incentive grants."

While the report concluded "incentive grants appear to have a positive, but small impact on the site selection decisions of businesses relative to other considerations such as transportation and labor costs," there is not a uniformity of data or practices among the many agencies involved to make a strong case for the importance of incentives to attract businesses.

FIGURE 1

TAX FOUNDATION 2014 STATE BUSINESS TAX CLIMATE INDEX



Source: The Tax Foundation

TABLE 7

ALTERNATIVE RANKINGS OF THE STATES ON THEIR BUSINESS CLIMATES

Ranking	Forbes Best States for Business - 2013	Pollina Top 10 Pro-Business States - 2013	Tax Foundation Business Tax Climate - 2014
1	Virginia	Utah	Wyoming
2	North Dakota	Nebraska	South Dakota
3	Utah	North Dakota	Nevada
4	North Carolina	Virginia	Alaska
5	Colorado	Wyoming	Florida
6	Nebraska	Kansas	Washington
7	Texas	Indiana	Montana
8	Minnesota	South Dakota	New Hampshire
9	Washington	Missouri	Utah
10	Georgia	Alabama	Indiana
26			Virginia

Notes: Forbes says it measures costs, labor supply, regulatory environment, current economic climate, growth prospects and quality of life by examining 35 different variables. www.forbes.com/best-states-for-business
Pollina Corp. specializes in business location. It says its ranking is based on 32 factors. http://www.pollina.com
The Tax Foundation considers five different business taxes. http://taxfoundation.org/article/2014-state-business-tax-climate-index

Lessons Learned?

CURTAIL THE USE OF TAX INCENTIVES

As we have seen, the weight of empirical evidence suggests that improving a state or region's overall business climate is a more important spur to economic development than tax incentives. What are the alternatives? The old standbys surge back to the fore. We should think long term and improve K-12 schools, stimulate workforce development in community colleges and universities, promote research and development activities, enhance our transportation infrastructure, stimulate the development of cultural amenities and reduce crime, even while we ensure that our tax structure remains competitive. **In essence, we need to improve the quality of our overall environment because, in the long term, this is what most effectively attracts and retains businesses.**

Reality intrudes on a persistent basis, however. Despite their apparent ineffectiveness, cutting back on the use of governmental tax and financial incentives could be politically risky to a governor or to members of the General Assembly if this lends the impression that they are not doing everything in their power to help their regional or state economies expand. Former Gov. Bob McDonnell's "Bob's for Jobs" slogan resonated well in the voting public even though there is general agreement that a one-term governor actually cannot do very much to influence the state's economic climate during his/her term. Ironically, it usually is the next governor who either benefits from or is hurt by the previous governor's economic development actions.

A statement by any elected official that jobs and economic development are his/her highest priority is likely to be well received, and most economic incentive programs, despite their questionable impacts, give the appearance that the elected official is serious. Successful elected officials understand that impatient constituents want action and they want it now. Investments in education, transportation, and research and development may have the greatest long-term effect, but don't necessarily put food on the table today or pay mortgages. Therefore, pressures from supporters are likely to preserve and protect economic incentive payments far into the future. Economist John Maynard Keynes understood this demand for short-term action when he caustically noted, "In the long run, we are all dead."

THE PRISONER'S DILEMMA AND COOPERATION

There is, however, yet another reason why the use of economic incentives oftentimes turns out to be unproductive. It is contained in the phenomenon that has become known as the "Prisoner's Dilemma" and afflicts governments at all levels when they rush to offer financial incentives in order to attract specific businesses. **When many cities, regions or states simultaneously romance prospective businesses and offer such incentives, they compete themselves into a situation in which the eventual price of such incentives is well above what would have occurred without that competition. This is an argument in favor of the existence of organizations such as the Hampton Roads Economic Development Alliance because they have the potential to diminish the equivalent of "auction fever" on eBay, whereby cities and counties compete against each other to attract a business.**

Coordination and cooperation can occur. Business leaders in the bi-state Kansas City community have made great progress in achieving cooperation in their economic development activities.

This State of the Region report (page 95) contains a statistical matrix demonstrating that almost 65 percent of all job holders live in one city or county, but commute to another for their jobs. For example, 21,508 people holding jobs in Newport News live in Hampton, while 13,714 people holding jobs in Hampton live in Newport News. The bottom line is that one city or county's job prosperity nearly always is shared with other cities and counties.

Further, those who insist that all jobs be located in their city or county should remember that hosting certain kinds of jobs could be very expensive in terms of the infrastructure, policing and social services they require compared to the taxes they generate. The strenuous competition among the cities and counties that we sometimes now observe for jobs often turns out to impose losses on everyone involved. Cooperative economic development activities make more financial sense because they increase the probability that there will be many winners within Hampton Roads when a new firm decides to locate here or an existing firm expands.

IMPROVE THE DESIGN OF ECONOMIC DEVELOPMENT INCENTIVES

All economic development incentives should include "claw back" provisions, or money-back guarantees, whereby the governmental unit can recoup the incentive payments if the businesses in question fail to live up to their job creation or investment promises. Further, following the interesting example of the city of St. Louis with respect to the St. Louis Cardinals baseball team, economic development incentives can be accompanied by "shared appreciation" agreements. If the recipient firm prospers, and later sells a major asset (such as a stadium) that the government has subsidized, then the governmental donor should share in that prosperity in the form of receiving a proportion of the sales price when those assets eventually change hands. Cities and counties also can negotiate specific requirements to accompany their investments, for example, that a certain amount of low-income housing be constructed, or even that a specific percentage of any operating profits be devoted to designated charities.

MONITOR WHAT THE RECIPIENTS DO WITH THEIR INCENTIVES

Given the many potential pitfalls connected to tax incentives, even a comparatively well-designed incentive program may yield disappointing results. Because of this, it is important to monitor the effects of all incentives on an ongoing basis. The city of Newport News provides an example of how not to do it when it gave the developers of the convention facility attached to the Marriott at City Center $26 million in support, but amazingly did not require any public accounting of the subsequent operation and use of that facility. **Public funds must not be invested without subsequent public inspection.**

In April 2014, Gov. McAuliffe announced that Virginia would participate in the Business Incentives Initiative, a joint project of The Pew Charitable Trusts, the Center for Regional Economic Competitiveness and six other states (Indiana, Louisiana, Maryland, Michigan, Oklahoma and Tennessee), to "reform economic development incentive reporting policies and practices."

The news release announcing Virginia's involvement stated that "teams of economic development policymakers and practitioners from seven states will improve those states' ability to collect and report results from incentive investments and, as a result, develop national standards and best practices that can become road maps for other states." Eleven different state agencies are listed as participants. If this comes to fruition, it will be an important step forward.

Cities and counties in Hampton Roads should take to heart this commitment to transparency. Whether it is the convention center in Newport News, the prospective new arena in Virginia Beach or the conference/hotel complex in Norfolk, cities and counties should require recipients of their financial largesse to open their books to public inspection. Only then will citizens be able to ascertain if their tax dollars are being spent wisely.

Final Words

In another chapter in this report, "The Answer Is Always Yes," we note the perilous tendency of cities and counties to fund large, flashy convention center/arena/hotel facilities in their communities even though there is abundant evidence both that these investments typically don't pay off and that this is an especially bad time to move in this direction. Cities and counties do so, however, because they believe this is a sound economic development strategy (despite the overwhelming evidence to the contrary).

In this chapter, we cast substantial doubt on another cornerstone of city and county economic developers – the dispensing of economic development incentive payments to businesses. While the evidence on the effectiveness of such payments is not as negative as is true for public funding of convention centers/arenas/hotels, it is nonetheless mixed at best and frankly discouraging for those who mistakenly view this as the royal road to economic development.

What, then, is the appropriate approach for us to take in terms of economic development? We must take a long-term approach and improve our overall economic and social environment. This means improving our K-12 schools, stimulating workforce development in community colleges and universities, promoting research and development activities at our medical school and universities, enhancing our transportation infrastructure, stimulating the development of cultural amenities and reducing crime, even while we ensure that our tax structure remains competitive.

Too often, our economic development agencies and elected officials persist in looking for quick fixes that somehow will catapult our region forward to fame and fortune. Absent the next Microsoft fortuitously being invented by an enterprising student in the Frank Batten College of Engineering at Old Dominion University, it isn't going to happen. Instead, we must develop and implement a plan for the long run – one that may not begin to yield benefits until the next decade, but will slowly transform our region and enable it to realize its potential.