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Why Cities Make Different Choices about Business Incentives and Economic Development Policies

Eric Stokan, University of Maryland-Baltimore County

Amazon's decision about where to locate a second headquarters made national news for several months, and highlighted the extreme lengths to which state and local governments would go to attract the biggest online retailer. With the promise of 50,000 jobs, many of which would command salaries in excess of $100,000, governments vied to convince Amazon to locate its second headquarters within their district.

Publicity stunts abounded. The prospect of Stonecrest, Georgia changing its name to Amazon, Georgia led to many jokes. Onlookers mocked the decision of officials in Tucson, Arizona to send a 21-foot cactus to Seattle, where it would certainly not survive in the local climate. Reviewing more than 1,000 Amazon products on behalf of Kansas City, Missouri, Mayor Sly James received media attention, but did not successfully attract the behemoth.

In addition to the stunts, state and local governments offered incentives worth billions of dollars. Although this is far from the first deal of its type, local governments usually do not compete this publicly. Most deals of this kind do not command the attention of John Oliver and *Saturday Night Live.*

Going beyond the Amazon case, this brief explains the varying types of policies local governments use to attract businesses and promote economic growth – and to what effect.

Economic Growth Strategies

Local governments have many strategies and policy tools from which to choose as they pursue economic growth. Researchers tend to classify the aims of these strategies:

Attract new firms – The Amazon HQ 2.0 deal relied heavily on classic firm attraction strategies, where state and local governments offer, among other things, extensive tax breaks. In 2012, the *New York Times* estimated that state and local governments spend nearly $80 billion in tax incentives per year.

Expand or retain businesses – Some governments offer employee training to maintain a strong business environment with a skilled labor pool. Cities like San Francisco, New York City, and Boston, among many others, build on thriving economies by making their location especially attractive to high-tech workers.

Foster entrepreneurship – Others try to spur growth from within by offering subsidized rent and business services to entrepreneurs in municipal-led business incubators.

Support community development or sustainability activities – Community development efforts focus on ensuring that disinvested communities and low-income individuals share in the economic benefits to the city. This may involve policies like community development loans or the organization of community development corporations. Commitments to sustainability vary greatly as they can include everything from setting a fuel efficiency standard for government vehicles to installing solar panels on government buildings to incentivizing weatherization for local businesses.

Most governments pursue a mixed strategy – attempting to attract new firms while also supporting local entrepreneurship and developing local infrastructure. Some cities use community benefits agreements to pursue new investments and simultaneously provide more affordable housing and adjust local hiring requirements.

What Explains Decisions to Offer Development Incentives?

Using a large sample of city governments from across the United States over several years, my colleagues and I find evidence that governments make tradeoffs, depending on their resources.

- Governments that have little access to additional revenue or face steep competition for economic development activity tend to focus on attracting businesses with tax abatements, tax credits, and tax increment financing.
- Governments that rely on resources or revenue from chambers of commerce or quasi-governmental agencies are less likely to pursue projects supporting new entrepreneurs, community development projects, or sustainability policies.
- Governments that have access to additional revenue streams, face less competition to attract investments, and are part of stronger governmental networks are more likely to create entrepreneurship, community development, and sustainability policies.

These decisions are important because, as communities rely more heavily on efforts to attract business investments, they often divert attention and resources from efforts to deal with growing inequality, the preservation of natural resources and amenities, and instabilities in employment and housing. To address these challenges and avoid a zero-sum competition for new firms, neighboring governments need to work together to attract and support businesses in their region. There are two promising approaches states can use to further such cooperation:

- ***Regional tax-base sharing*** – State legislation can allow municipalities or other local governments to share tax proceeds from a new development project.
- ***State-level anti-poaching legislation*** – prohibits local governments from getting involved in bidding wars using tax breaks to attract firms. If local governments do not have the possibility or incentive to outbid their neighbors to attract firms with tax breaks, they can pursue other development strategies more compatible with investments in education, community development, and sustainability programs.

Read more in Eric Stokan, Lyke Thompson, and Robert J. Mahu, "Testing the Differential Effect of Business Incubators on Firm Growth," *Economic Development Quarterly* 29, no. 4 (2015): 317-327.; Aaron Deslatte and Eric Stokan, "Hierarchies of Need in Sustainable Development: A Resource Dependence Approach for Local Governance," *Urban Affairs Review* 55, no. 4 (2017): 1125-1152.