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Economic Development Teams That Win, Win Big

A new study finds that...on average, the cities that win contests to lure new businesses to their area by offering tax breaks, low-cost land, infrastructure and other handouts seem to benefit from the arrangement.

The study was conducted by Michael Greenstone of M.I.T. and Enrico Moretti of U.C.L.A., two rising young stars in economics. What makes their study different, and unusually compelling, is that they looked at cities that won competitions for plants and carefully compared them with cities that made it to the final step of the selection process but just lost out.

When a large company considers opening a plant, it typically begins with dozens of possible cities and eventually narrows the list to two or three possible sites. It is impossible to know all the factors a company considers, and they [the factors] differ from industry to industry. Professors Greenstone and Moretti argue that the runner-up cities provide the closest comparison for those selected, after all, they were almost picked by the company, which knew what it was seeking...

Key findings of the study:

After the plant location decision was announced, the winning counties had faster payroll and job growth in that plant's industry than did the runner-up counties...[and]

The average property value in the winning counties increased relative to that in the runner-up counties after the announcement. [According to the studies authors, "...at the end of the (6 year) examined period...property values in winner counties had increased by 6.6-10.2 percent relative to the loser counties"].

This finding is significant because economists believe that property values reflect the desirability of living in a particular location, encompassing the future job opportunities, physical amenities and tax liabilities. So the increase in property value implies that the benefits of winning the plant exceeded the cost of the subsidy the city incurred to attract it.

And one of their findings suggests that there are spillover benefits to other businesses and workers from attracting an industry leader: employment and payroll tended to grow in that industry in neighboring counties when a major plant moved next door.

Individual companies have no incentive to take into account benefits that spill over to others in choosing where to locate, but public officials do in formulating their bids.

It is unclear — whether cities should expand the amount of bidding they do. The numbers are murky, but public subsidies to attract new companies probably account for around three percent of state and local government expenditures. On this scale, subsidies might be worthwhile, but the benefits might disappear on a larger scale.

At a minimum, though, the Greenstone-Moretti study indicates that it would not have been in the winning cities' interests to have unilaterally refrained from bidding for prized plants.

Source: Alan B. Krueger, "Study on Cities That Woo Industry," New York Times, December 11, 2003, Reprinted with Permission. The New York Times Company