Dramatic improvements have been made in the State of Georgia's overall economic development program during the 1990s. When judged against extant empirical evidence, as well as economic logic, the current program has many laudable features (The Governor's Development Council, 1997; Ihlanti, 1995). Nevertheless, it also possesses some important weaknesses which may hinder the achievement of the state's economic development objectives and its ability to compete with other states. These weaknesses fall into five categories: (1) a misplaced emphasis on capital as opposed to labor cost subsidies; (2) poor targeting of the state's economic development incentives; (3) the absence of state monitoring of property tax abatements at the local level; (4) the use of a jobs tax credit having little value to businesses, and; (5) the failure to properly evaluate the state's economic development programs. This Policy Brief highlights these weaknesses and recommends policies to overcome them with an eye toward bringing further improvement to the state's economic development program.

**Capital versus Labor Cost Subsidies**

Both capital and labor cost subsidies have a place in the state's overall economic development program, but there is an issue whether the existing subsidies are properly placed. Capital cost subsidies are known to attract new investment and capital-intensive industries (Bosworth and Burtless, 1992; Auerbach and Hassett, 1992). Empirical evidence suggests that capital-intensive investment is most compatible with jobs for skilled workers, and that capital generally substitutes for low-skilled workers.

Labor cost subsidies of the type emphasized in Georgia (i.e., tax credits based upon the number of jobs created rather than a subsidy in the form of a percentage of the wage bill) reduces the cost of lower-paid workers compared to higher-paid workers and encourages the substitution of lower skilled for more highly skilled, better-paid workers.

Due to their differing effects, capital and labor cost subsidies should be targeted as follows: (1) where there is a ready supply of skilled workers or where appropriate training could bring forth such a supply within a reasonable time period, capital cost subsidies should be used, and (2) where jobs are needed for lower-skilled workers, labor cost subsidies are the preferred alternative.

These targeting rules are only partially followed within Georgia's overall economic development programs. Two examples are illustrative. First, the incentive contained in the state's new enterprise zone legislation is the abatement of property taxes, which is a capital cost subsidy. But the primary need within distressed areas that are eligible for zone designation is jobs for lower-skilled workers. This argues for the use of a labor cost subsidy. Second, firms locating or expanding employment in Georgia can take either a job tax credit or an investment tax credit, but not both. The amounts of the credits are larger and eligibility criteria are weaker in the state's
least developed counties, which is desirable. But the relative attractiveness and availability of investment versus job tax credits might also be made to vary across counties, with the latter emphasized in Tier One (least developed) counties.

More Precise Targeting

There are a number of facts relevant to state and local economic development that should be kept in the forefront in deciding which businesses are eligible for tax incentives and other financial subsidies:

- On average, about three-quarters of the jobs created by economic growth go to in-migrants from other states and countries (Bartik, 1991).
- Economic development incentives are costly per job created. Bartik (1994) has estimated that the average net government cost per job created by incentives is equivalent to around $4,000 annually.
- Economic research shows that there are marked differences in the quality of jobs across different industries as well as within given industries for workers with similar education, age, and other characteristics.
- Different industries have widely different employment and multiplier effects.

To maximize the benefits of incentives relative to their costs, it is imperative that the state more finely target its incentives. Some targeting is already done. However, in recent years many other states have fine-tuned the targeting of their economic development incentives in recognition of their high costs; Georgia should follow their lead.

Property Tax Abatements at the Local Level

There is no statewide property tax abatement program in Georgia. However, local governments in Georgia frequently employ property tax reductions and abatements to attract employers to their communities. But there are major concerns with these incentives. First, local communities within the state are pitted against one another, which enhances the bargaining power of firms’ relative to that of the communities. Second, communities are highly unequal in their ability to offer property tax incentives. Third, there is a common perception, which may or may not be accurate, that some communities are playing unfairly by offering abatements without the legal authority to do so. Finally, there is the concern that some communities are trading better schools and other public services for jobs, which may jeopardize the long-run competitive position of the community and state.

Unfortunately, no information is collected by the state or other entity from local communities on the use of property tax abatements. Georgia should follow the lead of the State of Tennessee and pass a disclosure law that would provide the data necessary for possible statewide reform.

The Jobs Tax Credit: A Critique

Georgia’s principal labor cost subsidy is the jobs tax credit (JTC). Recent evidence suggests that the JTC has little, if any, effect on job expansion or job location within the state. Faulk (1998) found that:

- Over the years 1993-1995 only 0.01 percent of all taxable firms in the state took the JTC.
- The participation rate among eligible firms (i.e., those that had created the minimum number of jobs and sustained them over the required two year time period) during 1993-1995 was only 19 percent.
- On average, among the firms that took the JTC, the savings in labor costs was less than 1 percent.

The first two facts indicate that the JTC program is highly underutilized. There are two possible reasons for this: firms are unaware of the program and/or the net benefits (benefits less costs) from program participation are negligible.

If a labor cost subsidy is to succeed in creating jobs, at a minimum it must be valuable to businesses. A labor cost subsidy more valuable than the current JTC could be constructed in one of two ways: (1) allow the JTC to be taken against other tax liabilities of the business and not just its corporate income tax liability or (2) provide a subsidy per job created rather than a tax expenditure.

Evaluation of Economic Development Programs

Like most other states, Georgia does little to evaluate the cost-effectiveness of its tax incentives and other economic development programs. One approach to evaluation that has grown in popularity is “benchmarking”; benchmarking refer to measurable indicators of progress made toward accomplishing long-run goals, or to both goals and outcomes. Benchmarking was proposed by the Governor’s Development Council (Governor’s Development Council, 1994), and while it has been introduced as part of the state budget process, a more detailed and extensive benchmarking effort is needed if it is to serve as a basis for evaluation.
Benchmarking has a number of attractive features. First, it forces the state to envision what it wishes to become, an essential element in any long-run plan. Second, it permits progress toward long-range strategic goals to be monitored. There are also important limitations of benchmarking. First, benchmarking does not directly link the amount of progress to specific state programs or policies; it is therefore limited in its ability to serve as an evaluation instrument. Second, much of the variation in benchmarks over time can be attributed to changes in the national economy.

In addition to benchmarking, there are two other strategies for evaluating state and local economic development programs that are worthwhile, namely, firm surveys and hypothetical firm techniques.

Many of Georgia's economic development programs involve providing services to firms—information, training, advice, etc. These programs can be evaluated relatively inexpensively by written surveys of the businesses that are clients of these programs, asking them to rate the quality and effectiveness of the assistance they received.

The hypothetical firm technique allows reliable calculations of the relative values of different financial subsidies to firms within a particular industry. Models are built that replicate the operation ratios, balance sheets, and income and tax statements of real, or at least "potentially" real firms. This allows researches to simulate the impact on a firm's income of a state's, city's, or county's taxes and economic development incentives.

References


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