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Do State and Local Economic Developments Work?

by

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DO STATE AND LOCAL ECONOMIC DEVELOPMENT EFFORTS WORK?

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In a recent comprehensive analysis of state and local economic development efforts Timothy Bartik [2] addresses the fundamental question; Do state and local economic development efforts work? He notes that over the past 20 years, governors, mayors and local citizens have assumed responsibility for economic development. While many regions of the county have experienced high unemployment and declining wages, federal action has been constrained by budget deficits, a conservative political philosophy, and an increasing inability to enact comprehensive policies. State and local governments have had to assertively address development in various ways.

Bartik outlines that many of these efforts can be placed into either of two categories. "Old wave" economic development efforts focus primarily on attracting firms into the region. Specific policies may include area marketing, financial incentives, and infrastructure investments. "New wave" economic development efforts focus primarily on small and/or existing businesses. Typical policies include capital formation programs, educational programs for small businesses, research and technology investments, and export assistance.

These programs all share the same ultimate goal: more jobs. More jobs, in turn, lower unemployment, raise wages and property values, enhance business profit, and generate additional tax revenues. Critics, however, argue persuasively that state and local economic development efforts cannot achieve these broader goals. According to the critics, most policies are expensive and must be paid for by taxpayers, most directly benefit capitalists and the "propertied," not the unemployed and poor. The result is generally a zero-sum game.

To address these criticisms Bartik comprehensively reviews the most recent research literature and develops a set of original empirical results. Our statement of Bartik's major findings follow.

State and Local Policies Affect Local Growth

The literature review suggests that state and local policies can significantly affect local growth. Implementing a state and local business tax reduction of 10 percent, without reducing public services to business, would probably increase business activity within the region by 2.5 percent in the long-run. In short, improved state and local public services to business can increase growth, but excessive tax levels hinder growth. Some evidence suggests that the trade-off from increasing state and local taxes to finance improved business services can have a net positive effect on local economic growth. The key to the positive trade-off is the nature of the investment, which the evidence is less clear.

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[2] Timothy J. Bartik, Who Benefits from State and Local Economic Development Policies? The Upjohn Institute: Kalamazoo, MI. 1991.

Local Growth Affects Long-Run Labor Market

Bartik's empirical estimates show that faster local growth not only raises housing prices (one measure of economic growth), but also has significant and favorable long-term effects on labor markets. An increase of 1 percent in local employment reduces the long-run local unemployment rate by around 0.1 percent, raises the long-run local labor force participation rate by 0.1 percent, and allows individuals to get and keep promotions to occupations with 0.2 percent greater wages per hour. Average annual real earnings increase in the long-run by around 0.4 percent.

The theoretical explanation for these effects is provided by dynamic theories of local labor markets, which suggest that better short-run performance of a local labor market helps improve its long-run performance. A positive job growth "shock" allows current area residents to acquire valuable employment experience, an experience that in turn enhances their long-run labor market success.

Faster Local Growth Helps Minorities and Less-Educated Individuals

The empirical estimates indicate that faster local growth most strongly affects the annual real earnings of minorities (20 percent greater effect than the average) and those less-educated (15 percent greater effect for someone with three fewer years of schooling). Growth effects do not vary much with age of individual. Somewhat surprisingly, local growth's more pronounced effects on minorities and less-educated individuals generally reflect greater effects on these individuals' occupational advancement, not greater effects on their employment or labor force participation.

The greater effects on minorities and less-educated individuals are large enough that local development policies probably have progressive effects on nontransfer income distribution. However, state and local economic development policies can hurt lower-income groups if costs per job created are too high, or if such jobs are financed in a highly regressive manner.

State and Local Economic Development Policy is Not a Zero-Sum Game

The competition for economic development among state and local governments probably enhances the efficiency of our nation's economy. Generally, the most aggressive policies will be pursued in those depressed areas most in need of growth. Thus, competition for economic development geographically redistributes economic activity towards depressed areas, which is economically efficient. Furthermore, widespread economic development subsidies may encourage an expansion of national employment, leading to a lower average national unemployment rate. Finally, many state and local economic development policies are potentially able to enhance the productivity and innovativeness of private business.

Economic development competition may redistribute national income towards wealthy business owners. The undesired distributional effect could be offset by a more progressive federal tax system.

Implications for Public Policy

Bartik's research suggests three clear policy implications: state and local economic development policy can work; labor demand policies do matter; and the fate of particular places deserves attention from national policymakers. These results, however, should not be viewed as an unqualified endorsement of all state and local development programs. Many efforts to attract large branch plants simply carry too big a price while the economic benefits of the program may not outweigh the costs. However, new wave economic development programs, which encourage technology innovations, entrepreneurship, modernization and enhanced efficiency, offer the greatest promise of creating local economic growth at a relatively low cost.

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