Intelligence MEMOS

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To: Canada's provincial Finance Ministers

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Re: **THE COSTS AND LIMITED BENEFITS OF FIRM-SPECIFIC SUBSIDIES**

Canadian governments are taking a close look at their business incentives. The Alberta government recently eliminated a number of tax credits in favour of a lower general corporate tax rate, and Ontario is reviewing its business supports to make them more efficient, accountable and responsive to the needs of companies.

In general, it remains unclear whether the high costs of business incentives are justified, or if the tax competition they produce at the local level harms national economic interests. These concerns, alongside public outcries around large, high-profile incentive packages like those offered to Amazon, have led some US policymakers to propose banning these incentives.

In a paper forthcoming in the *Journal of Economic Perspectives*, we use a new dataset to describe and evaluate state and local business tax incentives across the United States. Firm-specific incentives can attract marginal firms at lower fiscal cost than a corporate tax cut for all firms, but local discretion reduces transparency and its effectiveness relies on politicians picking winners based on economic rather than political reasons.

We estimate the spillover effect of firm-specific incentive deals by comparing outcomes in the "winning" US county (the locality where the firm decided to locate with an incentive) and the reported "runner-up" county in the competition. While we find some evidence of direct employment gains from attracting a firm via incentives, we do not find strong evidence that firm-specific tax incentives increase broader economic growth at the state and local level. We document an average growth of roughly 1,500 jobs within the specific industry of each deal. We do not, however, see strong evidence of job growth in other industries or an effect on county-wide employment.

We estimate that US state and local governments spend at least $30 billion a year on business tax incentives. There are substantial differences in the policy instruments that states employ; in 2014, states spent between $5 and $216 per capita on incentives for firms in the form of firm-specific subsidies and general tax credits, which mostly target investment, job creation, and research and development. States tend to increase incentive spending when employment has decreased and in years which the governor faces re-election.

About one quarter of all business tax incentives are channeled to a very small collection of firms opening offices in new locations – fewer than .01 percent of them in 2014 – in the form of firm-specific subsidies. One recent example of the phenomenon was the array of benefits offered to Amazon by different regions when the company was seeking a second headquarters site.

And indeed, recipients of firm-specific incentives are usually large establishments in manufacturing, technology, and high-skilled service industries, and the average discretionary subsidy is $178 million for 1,500 promised jobs. Firms tend to accept subsidy deals from places that are richer, larger, and more urban than the average county. This may explain why poorer jurisdictions provide larger incentives and spend more per job.

Given the large sums state and local governments spend on these incentives and the limited evidence of spillover effects, our findings suggest that any argument for the continuation of local business tax incentives must demonstrate that they increase equity, either by improving economic conditions in distressed locations, or by improving the well-being of underemployed and low-income workers.

Whether these incentives achieve these goals more effectively than other policies remains an open question, but our evidence suggests that firm-specific supports are not a recipe for broad economic growth.

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