Incentives Opportunities for Companies in Transition

For decades the primary goal of state and municipal governments offering economic incentives was to induce job creation. It was felt that economic incentives such as tax credits and exemptions, cash grants, gap financing, and in-kind services could only be justified if companies receiving the incentives provided new jobs and earnings in exchange. State and local participation in proposed business investment required incremental economic activity. States and communities would compete in the domestic marketplace to attract new jobs for the most part.

During the past several decades, global competition facing U.S. companies accelerated as lower cost foreign labor became more accessible. Domestic companies were faced with two primary options in order to remain competitive; shift operations to lower labor cost regions off-shore or invest in technologies that reduced the need for more expensive labor in this country. Both alternatives brought widespread reductions in jobs and earnings within states and municipalities and these jurisdictions found themselves competing for fewer incremental job opportunities.

This resulted in a shift in emphasis by public officials to include job retention as a primary public goal. Business outreach programs sprung up among states and communities throughout the nation a means for public officials to identify companies that were likely to relocate operations overseas or close domestic facilities. Great effort was undertaken to head-off relocations and closures in advance of final corporate decisions.

However, these attempts to forestall plant closures were not, for the most part, complimented by financial incentives that may have impacted corporate decision making. State and local governments were slow to expand incentive programs to include tools for retaining existing business and subsequent jobs and earnings. This was mainly due to the traditional structure of incentives programs. Historically, state and local governments were willing to induce new development with incremental tax dollars that these developments would generate. This type of incentive was easier to justify because it did not diminish the existing tax base. Using current tax dollars to induce business and job retention, however, was unacceptable to many states and communities.

In particular, the slowness of state and local officials to change incentives programs impacted the ability of automotive manufacturers and their suppliers to use incentives to aid in increasing the competitiveness of their domestic operations. Concurrently, foreign governments were enhancing economic incentive programs to attract he operations of these same businesses.

Although states and communities were experiencing some jobs growth from certain industrial sectors, in many areas of the Midwest and East these gains were offset by automotive related companies reducing operations or closing facilities. Still government officials were unwilling to draw upon the public treasury to keep the jobs and subsequent economic impact already present within their jurisdictions.

Slowly, however, the thinking has changed to support local companies facing the global competition that has been devastating to many communities. During the past several years, a number of public officials in states and communities most heavily impacted by the loss of facilities and jobs, such as those in the automotive dominated states, have begun to structure economic incentives for the purpose of retaining automotive operations and their associated jobs and payroll. This has occurred even when the basis for these incentives is the existing tax base.

As an example, the State of Illinois has expanded its EDGE tax credits to include retained employees when it can be demonstrated that existing jobs would be lost without the inducement (along with other eligibility requirements). Traditionally, the EDGE tax credits were funded by offsets from new individual income tax revenues generated by new jobs within the Illinois economy, so that the tax incentive was revenue neutral from the state's perspective. However, using a portion of existing individual income tax proceeds to provide incentives that retain jobs is now seen as minimizing the potential tax loss if the jobs would otherwise be removed from the state economy.

Another approach has been to use one stream of incremental tax revenues to offset the loss of existing taxes due to an operational event such as a workforce reduction, while protecting the remaining jobs at a facility. An automotive component supplier in the Midwest was faced with the necessity of upgrading technologies at its domestic plants. This meant a reduction in jobs at each of its plants in order to remain globally competitive. The average plant job reduction ranged between 20% and 30%. However, even with the new technologies, the company realized that it would need to identify other avenues for addressing foreign competitive pressure. Included in this was the pursuit of state and local financial incentives to help off-set the significant new capital expenditures it was proposing and to make the facilities more viable over the long term. This would, in turn, aid in ensuring that the remaining jobs would be protected.

The majority of the communities which were approached by the company accepted the legitimacy of the company's request for community support. These communities recognized the logic in addressing the company's long-term needs to remain competitive well in advance of a future critical juncture where the company may be faced with no alternative but to relocate or close its operations entirely. Consequently, the company received partial incremental property tax incentives from these municipalities, generated by the new capital expenditures. The tax incentives aided the company in off-setting its technology upgrade costs, while enabling the community to off-set its loss of individual municipal income taxes due from the job reduction with the portion of the incremental property taxes not returned to the company in the form of tax incentives .

But specifically, how does an automotive manufacturer or supplier convince a state or community that economic incentives will play a vital role in enhancing the competitiveness and long term viability of its operations. First, it must begin by demonstrating the global competitive realities of the automotive industry. Statistics pertaining to the out migration of automotive plants and jobs is useful. But, specific examples of the company's own offshore relocation of operations or that of its competitors drives the point home and shows that the company is aware of its location options.

Second, the use of incentives can only be justified by public officials if there is a demonstrated benefit to the local or state economy. The direct jobs retained by a challenged facility comprise only part of such benefit. The true extent of the benefits to the economy, go well beyond the four walls of the plant. The economic impacts of automotive manufacturing operations and their suppliers are among the highest in the U.S. economy. Each automotive job typically creates between 2.5 and 6 other jobs within the economy. Likewise, the higher compensation of automotive employees drives additional indirect and induced earnings within the state or community. Automotive operations are also responsible for extensive secondary economic output in terms of real dollars. Presenting these impacts, as well as, the long term positive fiscal effects upon the public treasury show that there are mutual benefits to be shared by the company and community.

Finally, companies should be more active in seeking incentive package structures that provide immediate benefit to the community or state. Since new capital investment typically generates incremental tax revenues, even when job levels remain the same or are reduced, incentive packages can be structured to provide benefits to the company, as well as the public treasury. As an example, incentive structures can allow for added benefits to entities such as school districts while providing meaningful value to the company's operations through such mechanisms as Payment-in-Lieu-of Taxes (PILOTs) or by integrating state school funding formulas into the incentive structure. These tools were used in the automotive supplier example presented above.

Global competition that has reduced jobs and earnings in many U.S. jurisdictions has impacted a far wider range of industries than automotive. State and local economic development officials, legislators, and administrators must continue to look at the use of economic development tools that address the retention needs of the highly valuable automotive industry, as well as corporations within all competitive industries well in advance of events that necessitate corporate decisions resulting in unfavorable jobs consequences. And companies should be more aware of incentives opportunities that may aid them in retaining operations and the associated jobs.