Responsible Economic Development Incentives, LLC

Helping communities and businesses find mutually beneficial solutions for the greater good.

Examining the efficacy of the "but for"

This is the first in a series of articles where we will study why discretionary economic development incentives are not functioning as intended, reforms that need to be implemented, and tactics that can be used to build consensus for changes to the systemic issues.

Background

Discretionary economic development incentives are supposed to be subject to the "but for" provision, that is, "but for the availability of the incentive, the project (e.g., capital investment, job creation, etc.), will not proceed." This requirement is in place to prevent waste, or incentivizing projects that will occur regardless of the incentive award. Yet research indicates, for incentivized projects, the same decision would have been made 75% to 98% of the time without the incentive.[1] But why is this so?

We will dive into this answer, cover policy and process improvements that will put an end to this madness, and discuss strategies to help us move beyond the prisoner's dilemma by covering a variety of topics, the first of which is "leverage."

Leverage: A key ingredient to incentive maximization

Have you ever read any site selection literature about how to "maximize incentives?" If not, just Google the topic and you will find enough to keep you busy for a while, not to mention a blurb or two on how one can "create competition" for a project in order to, of course, "maximize incentives." We will leave this latter point on "competition" for our next article though.

Now back to leverage. The key to maximizing incentives is to have leverage, but how do companies gain leverage? If you have done your Googling homework already, you know it is by starting incentive discussions early. Companies have the most leverage when the location decision for their project is the most uncertain, which intuitively is at or near the beginning of the "site selection" process. For larger, more established firms, leverage can also be at its best before the project has received internal funding approval.

The further a company gets down the path with a particular site or area, leverage erodes. Some examples of actions that can reduce leverage, and thus cause challenges for incentive maximization, include:

- Receiving internal funding approval for a project with no competing location
- Issuing purchase orders
- Entering into contracts for engineering or environmental studies, or site work
- Signing a letter of intent, purchase contract, or lease for real property
- Filing permit applications
- Advertising job openings

However, in the current system, not all of these items necessarily negate the opportunity for discretionary incentives, nor should some of them. For example, it makes perfect sense that engineering and environmental studies would need to be performed on a site prior to a company selecting it; there could be wetlands issues or an intolerable delay caused by endangered Indiana bats, for example. In addition, long lead time items (e.g., specialized equipment) may need to be ordered prior to the final location decision.

But what about the more prickly undertakings, like signing a real estate purchase contract or lease? Surely that would severely damage a company's incentive leverage, correct? Not so fast, have you not heard of incentive contingency language? Well it is quite simple, put some vague language in the contract or lease that indicates the agreement is contingent upon the purchaser/lessee receiving approval for a "satisfactory amount" of incentives within a specified period of time, and voila, the game continues. It should be noted that sellers and landlords hate these types of exit clauses. It also should be noted that sellers and landlords only agree to their inclusion because sellers and landlords know there is almost zero chance the exit clause will be exercised; it is simply included to preserve the "but for" for the purchaser/lessee, or what scant amount of perceived leverage remains.

Short of publicly announcing or confirming a project location decision or sticking a shovel in the ground before incentive approvals, it is apparently very hard for companies to conclusively surrender leverage. Purchased the land already? We do not have to build anything. Advertising job openings? Due diligence to confirm workforce availability and suitability. Filed zoning, variance, or permit applications? Due diligence. Started clearing the site or relocating a road? Just in case.

So what is the point of this article, to provide a roadmap for more companies to extract incentives from state and local governments for noncompetitive projects and location decisions that were made long ago? No, the point is that if we start asking more of the right questions and taking a collective view of the answers and predictive actions taken by companies during the "site selection" process, perhaps we can start to ferret out the 75% to 98% of historically incentivized projects where incentives will not impact the location decision whatsoever, not subsidize them, and instead invest limited public funds in improving our schools, infrastructure, and services -- thereby making our communities more desirable locations to live, work, and play; that is what attracts talent and "wins" projects anyway, not incentives.

Next up, "Competition: Real or purposefully concocted to maximize incentives." Stay tuned.

By C.J. Girod | February 6, 2021

[1]Bartik, Timothy J. 2018. "'But For' Percentages for Economic Development Incentives: What percentage estimates are plausible based on the research literature?" Upjohn Institute Working Paper 18-289. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.