Targeted Economic Incentives

An Analysis of State Fiscal Policy and Regulatory Conditions

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Abstract

Economic development incentives by state and local governments have been shown to have little positive economic effect on employment or growth. Using a political economy approach, we investigate the characteristics associated with fiscal conditions and public policies within a state. Using data from 1993 to 2014 from Good Jobs First, we employ a Poisson model to investigate whether states with budget issues, high tax and regulatory burdens, and poorly trained labor are offering targeted incentives to potentially offset costly economic conditions. Our results indicate that unemployment rates, fiscal policy conditions, and individual income tax burden explain the granting of targeted incentives.

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1. Introduction

State and local governments justify the use of targeted economic incentives, including loan guarantees and tax abatements, by claiming they create jobs and stimulate economic growth. According to Poole and his colleagues (1999, 1), "Governors, mayors, legislators, and council members justify these public investments on the grounds that private-sector decisions to invest in a community result in jobs, income, and tax revenues that are essential to the economic and social well-being of a community or state." State and local governments use targeted incentives to attract a private firm to a new location, to help support or expand an existing business, or to prevent a company from relocating to another city or state.

While the use of targeted economic incentives is widespread among state and local governments, many scholars and policymakers have repeatedly questioned their efficacy. The literature has demonstrated that these targeted incentives do little, if anything, to promote economic growth, reduce unemployment, or increase personal income. The question, then, is why would states pursue these policies that extract revenue from their coffers with little economic return?

Public choice theory offers one explanation. Political benefits exist for politicians who are trying to maximize either votes or tax revenue (Calcagno and Hefner 2007; Jensen, Malesky, and Walsh 2015). We argue that there is another aspect to this political economy story, consistent with McCormick and Tollison (1981), of government as an interest group. State governments create public policies with high tax and regulatory burdens that are costly to

businesses, but they do not want to reform these policies. Fernandez and Rodrik (1991) argue that when economic reforms have uncertainty as to the distributional gains and losses, there is a bias toward the status quo. Thus, we argue, rather than reform various aspects of fiscal and public policy that could improve economic efficiency, government officials offer firms targeted incentives. The transference of wealth to concentrated firms from disorganized taxpayers has potentially lower political costs than reform. Our hypothesis is that states with costly fiscal, policy, and factor characteristics, including high tax burdens, high regulatory costs, and poorly trained labor, are offering these incentive packages to firms partially to offset the otherwise negative economic conditions.[1] Thuronyi (1988) makes a similar argument that governments replace tax expenditures with subsidy programs. Targeted development incentives may compensate in part for locational characteristics that make a state's economic policies and climate unattractive. Thus, if we can help to identify the conditions that lead to the offering of these targeted incentives, then perhaps we can better address the real underlying issues.

In addition to not achieving their stated goals, these incentive programs may also encourage rent-seeking behavior leading to a host of unintended and undesirable consequences. This rent-seeking behavior takes the form of firms employing resources to lobby for tax breaks and other subsidies that add to owners' profits, which can in turn result in a bidding war between two or more state or local governments that increases the value of the incentive packages and rents that the firm can extract from these government agencies. Baumol (1990) notes that entrepreneurial individuals have a choice to devote their labor efforts either toward private-sector wealth creation or toward securing wealth redistribution through political and legal processes

[1] One can think of locational characteristics as falling into three categories: (1) immutable, such as a port or mountainous terrain, (2) current policy environment, and (3) quality of factor inputs such as human capital. While the first may matter to the firms making decisions, our focus in this paper is on types two and three.

(e.g., lobbying and lawsuits). When state governments offer targeted incentives, they encourage the latter.

Studies by Bennett and DiLorenzo (1983), Esinger (1989), Buss (1999a, 2001), Ellis and Rogers (2000), Saiz (2001), Calcagno and Hefner (2007), Bartik (2005), and Jensen, Malesky, and Walsh (2015) point out that there are clear political benefits for using targeted financial incentives. Dewar (1998), Buss (1999a, 1999b), Wiewel (1999), Finkle (1999), Calcagno and Hefner (2009), and Coyne and Moberg (2014) argue that while the mainstream literature on targeted incentives acknowledges they might have a political component, the mainstream research fails to recognize that targeting industries may well be an inefficient allocation of resources.

Industries seeking preferential treatment dominate the political process because voter-taxpayers have very little incentive to be well informed about the costs associated with these economic incentive programs or to create any means of organized opposition. The jobs "created" at a new plant are easily visible to the state or local community; voters will not see the jobs that are lost elsewhere in the economy due to the higher tax burdens imposed on other businesses and consumers. Nor do they see the scarce resources that this political process is allocating away from productive ventures—resources that could produce real output and growth, which firms are instead spending on lobbying government officials to obtain these favors (Hicks and Shughart 2007).

The purpose of this paper is to examine the political, economic, and regulatory costs state governments impose to determine if they can explain firms receiving a megadeal. A megadeal is defined by the organization Good Jobs First as a firm receiving $75 million or more in targeted

incentives.[2] We use data on megadeals from 1993 to 2014 across states. Using a Poisson and negative binomial regression analysis, we investigate whether states with fiscal, tax, and regulatory policies that are costly to firms are more likely to offer a megadeal. The rest of the paper is organized as follows: Section 2 provides background on the literature of economic development incentives. Section 3 presents the data. Section 4 offers analysis and results, and the final section offers concluding remarks.

2. Background

The subject of state governments targeting industries using economic development incentives raises important questions regarding economic growth and development, which requires us to examine whether the economic benefits of these targeted economic incentives are worth the economic costs. Whether state development incentives lead to real job creation and economic growth has been the subject of much debate among economic scholars. The economics literature abounds with research studies that have examined a variety of programs across the United States at both the state and local level.

Economists and policymakers have argued that competition among states to entice companies through targeted incentives provides no net gain to the US economy.[3] "From the states' point of view each may appear better off competing for particular businesses, but the

[2] A primary source for economic development data was the National Association of State Development Agencies. However, they no longer host a webpage or report these data. Good Jobs First has created Subsidy Tracker, which is a searchable national database. Currently, this is the most comprehensive database available on economic incentives. The data source has some issues that need to be noted: first, it is continuously being added to, and second, it reports the full amount of deals even when the deals are extended over multiple years. Harpel (2014) has a detailed discussion about Subsidy Tracker. Several papers have used data from Good Jobs First to examine economic incentives, including Jensen (2017), Coyne and Moberg (2014), LeRoy (2013), Wang (2015), Alexander and Organ (2015), and Basker (2007).

[3] We need to make a distinction here between competition among states related to tax competition or fiscal federalism, as discussed in the literature by Brennan and Buchanan (1980), Tiebout (1956), and Oates (2011), and the political competition to attract firms using tax incentives that are targeted only to a specific firm. The former is a desirable form of competition thought to harmonize tax policy and restrain governments, while the latter is wasteful and ineffective.

overall economy ends up with less of both private and public goods than if such competition was prohibited"[4] (Burstein and Rolnick 1995, 7). These studies suggest that economists have long doubted the efficacy of using state-targeted incentives to induce mobile firms (Esinger 1989). Economists have found the evidence associated with the issue of tax and other development incentives generating economic growth to be unconvincing (Buss 1999a, 1999b, 2001). What follows are the findings in the literature on the effects of these policies on state economic growth, job creation, tax revenues, and the rent-seeking and corruption that appear to accompany targeted incentives.

2.1. Growth, Jobs, and Taxes

Hicks and Shughart (2007) provide a summary of the literature, which has consistently found that targeted tax incentives have little effect anywhere in the United States. Peters and Fisher (2004, 35) conduct a meta-analysis of the most commonly cited reviews of this literature, arriving at the same conclusion: "The most fundamental problem is that many public officials appear to believe that they can influence the course of their state or local economies through incentives and subsidies to a degree far beyond anything supported by even the most optimistic evidence." Saiz (2001) finds no evidence of overall growth in state gross domestic product or employment levels from offering financial incentives and finds negative impacts in certain industries. Examining the issue at the aggregate level, Goss and Phillips (1994) find that economic development agency spending has a positive relationship with state employment

[4] Mattey and Spiegel (1995) and Bartik (2002) question whether benefits outweigh these costs. Bartik (1994) argues that development incentives provide the greatest benefit to high-unemployment areas. However, he notes that state governments often attract firms to areas that have low unemployment, limiting the benefits that a state may receive from these types of incentives. Calcagno and Thompson (2004) find that targeted incentives merely reallocate resources rather than generate real economic growth.

growth. However, Bingham and Bowen (1994) find evidence suggesting that state spending on economic development has no relationship with gross state product.

Supporters of these targeted incentives claim they have one major goal—to create jobs in the state. Gabe and Kraybill (1998), in a study that examines which firms in Ohio receive targeted incentives, find that the number of new jobs promised by the targeted business is the major factor in deciding who receives the incentive. One could argue that this result is owing to political versus market decision-making. This outcome is consistent with Weingast, Shepsle, and Johnsen (1981), who find that economic costs and benefits are transformed into political costs and benefits leading to economic inefficiencies when benefits are tied to a geographical location.

Hoyt, Jepsen, and Troske (2008) analyze the impact of incentives on Kentucky's county employment by broadly categorizing incentives as either "tax incentives," "training incentives," or "financing incentives."[5] They find that the impact of Kentucky's economic development incentives is felt in counties that border neighboring states but not in interior counties. Another finding is that training incentives have a larger positive impact on county employment than tax incentives but that financing incentives have no statistical relationship with employment in any county. Finally, they find no evidence of spillover effects in adjacent counties.

Property tax incentives have also been ineffective in states. In Wisconsin, Merriman, Skidmore, and Kashian (2011) find no evidence that tax increment financing (TIF) districts increase aggregate property values in the communities that adopt them. Further, evidence from El Paso indicates that property tax abatements are "not effective at stimulating improvements in gross metropolitan product, residential housing values, personal income, retail sales, or jobs" (Fullerton and Aragones-Zamudio 2006, 86). More recently, Bruce and his coauthors (2009)

[5] Targeted incentives are plentiful, and in Hoyt, Jepsen, and Troske (2008), categories are a broad taxonomy of incentive types: tax incentives include tax credits and abatements, training incentives involve credits or subsidies for the training of employees, and financing incentives include loan guarantees and bonds.

argue that the number of tax incentives and nontax incentives that a state offers has no statistical relationship with growth in gross state product, employment, or state personal income.

2.2. Strategic Rent-Seeking and Corruption

Coyne and Moberg (2014) illustrate a variety of cases that demonstrate targeted tax incentives are a less-than-desirable policy. They present several justifications that state governments offer for providing these incentives but note that if firms would have located to an area without the economic incentives, then state governments cannot really claim that they have created these jobs. Instead, Coyne and Moberg argue that targeted incentives create a culture of cronyism and rent-seeking.

Rent-seeking firms would certainly take advantage of the possibility of playing state governments against each other where targeted incentives are available. In 1992, BMW announced that it would locate a plant in Greenville County, South Carolina, after a site selection process that ended in a bidding war between Greenville, South Carolina, and Omaha, Nebraska. The chairman of BMW stated the critical factors in the site selection were proximity to a *port* (our emphasis added), international airport, and rail; union presence; and the number of time zones between Bonn, Germany, and the site (Patrick 2014). How Nebraska became a potential site is astounding given the absence of a port, among other issues. Fundamentally, the absence of a port is an immutable characteristic that would be difficult to overcome with targeted tax incentives. The initial incentive package from South Carolina was valued at $35 million (Kurylko 1992a). However, Nebraska offered a package valued at $240 million. South Carolina countered with a package that was estimated to be $150 million (Kurylko 1992b). Patrick (2016, 1745) concludes that "Nebraska's lucrative incentive package served a useful purpose for the

company—raising South Carolina's bid from $35 million to $150 million."[6] As with any other rent-seeking activity, this process does more than simply transfer wealth from consumers to producers. The process of acquiring the rents results in the whole transaction being a welfare loss to society (Tullock 1967).

If the purpose of targeted tax incentives is to induce a company to locate in a region, then what justification exists for providing additional incentives after the location decision has been made? Firms that will extract rents to locate somewhere will continue to extract rents and attempt to capture state and local governments. This is why the rent-seeking literature often models rent-seeking contests as "all-pay auctions" in which bidders sequentially bid on a rent and—whether they win or lose—pay every penny that they bid. If firms are spending resources to collect these rents, then these resources are a deadweight loss along with the excess burden created by the transfer from the state. Jansa and Gray (2014) find evidence of what they refer to as a cultural capture hypothesis: increases in business political contributions are positively correlated with state subsidy spending. In addition, a firm that will locate in a region because of subsidies is a firm that will either leave when better subsidies are offered by another state or local government, or at least threaten to leave in an effort to extract more subsides from the state. Thus, there is a selection bias for targeted economic development incentives to systematically favor "flighty firms," which promotes a culture of cronyism.[7] Consider the example from the municipality of North Charleston, South Carolina, whose city council voted to reduce business license fees for four companies that were already in the region: Boeing, Daimler Vans

[6] As noted earlier, we are not accounting for immutable location characteristics, in part because they are time invariant and would be captured by fixed effects. We would like to account for how competition among the states causes some deals to be rejected, but unfortunately, there are no such data collected anywhere and only anecdotes exist, as described in the text above.

[7] Kennametal, a firm that had been located in Latrobe, Pennsylvania, for more than 70 years, was awarded $1 million in incentives by the state of Pennsylvania to move its headquarters to Pittsburgh. The reason for offering these incentives to move the firm's headquarters from one county to another was to keep the company in the state (Gannon and Belko 2015; Sheehan 2015).

Manufacturing, Select Health of SC, and Trident Regional Medical Center (Slade 2013). These additional incentives demonstrate Buchanan's (1986) point that once government policymakers open the door to targeted incentives, businesses have an incentive to try and influence the policy to continue to work in their favor.[8]

Good Jobs First tracks incentives offered to industries across the United States (Mattera, Traczynka, and LeRoy 2013). One subset of its list is "megadeals." As noted previously, Good Jobs First defines a megadeal as an incentive package totaling more than $75 million from state and local governments. Appendix 1 provides a list of states that have provided megadeals, with multiple firms receiving deals in some states. If the goal of incentives is to recruit industry, then clearly there is no need to offer larger packages to firms already in place. These repeated deals suggest that these firms are simply rent-seeking.

In addition to the above issues with targeted economic incentives, these incentives may generate greater corruption within a state. Glaeser and Saks (2006) found a weak negative relationship between corruption and economic development in a state. Utilizing the same data as Glaeser and Saks, Felix and Hines (2013) investigate the connection between tax incentives—in the form of tax abatements, tax credits, and tax incremental financing arrangements—and corruption. They find a positive and statistically significant relationship between these incentives and corruption; they also find that communities in states with less of a culture of corruption tend to avoid offering businesses incentive packages. While tax incentives are not necessarily structured to promote corruption, the manner in which these deals are structured opens the door. In the case of tax incentives for the film industry, a state audit in Iowa found $26 million in improperly issued tax credits. The state's former film office director was convicted of falsifying

[8] Because the data from Good Jobs First are aggregated at the state level, we cannot capture repeat incentives given to the same firm in this dataset.

public records. State prosecutors charged five independent filmmakers and a tax credit broker (Verrier 2015).

Currently, this literature focuses on whether economic incentives lead to positive outcomes (growth, jobs, or tax revenue) versus negative effects (rent-seeking, inefficiencies, and corruption). Our focus is whether states are offering these targeted incentives as a means of compensating firms for costly locational characteristics, one of which may be a culture of corruption. Rather than confront policy-oriented and factor location characteristics that impose costs on firms (e.g., high tax rates, regulatory burdens, or low-quality labor) with political reform, state and local government policymakers offer targeted incentives to make up for these deficiencies. Up to this point, the literature has not addressed this issue. We are filling a gap in the literature that helps to explain why state and local governments along with economic development agencies are able to continue to promote targeted economic development incentives that the economics literature finds overwhelmingly ineffective at best.

3. Data

Data on targeted financial incentives are often difficult to collect as not all agreements are publicly available or transparent. Good Jobs First has attempted to collect these data in the most consistent way possible. However, because almost every state and local government grants some form of incentive, we consider only large incentives packages or "megadeals." Megadeals are defined by Good Jobs First as those instances when the firm receives $75 million or more in incentives.[9] Good Jobs First admits to limits on its data collection; therefore, to avoid any issues with overstated values we used the megadeal data as a threshold to examine

[9] "Megadeals," *GoodJobsFirst.org*, accessed December 5, 2017, https://www.goodjobsfirst.org/megadeals.

whether the incentives are granted or not.[10] Our approach treats the dependent variable as a count indicating that the state's economic development package has reached the threshold of a megadeal; thus, we add up the number of megadeals in a given state in a given year. We examine the megadeals for the US states over the period 1993 to 2014 using a Poisson regression.[11] Full descriptions of the variables along with their sources can be found in table 1 (page 29), and the descriptive statistics are presented in table 2 (page 30).

To examine what determines whether a state government offers a megadeal, we examine the economic, political, policy, and labor market conditions that exist within a state. With respect to economic factors, we include the state unemployment rate, *Unemployment*, which can indicate the condition of an economy and the employability of its labor force. Higher unemployment rates suggest that economic conditions in the state may be challenging. While there can be numerous reasons for high unemployment, we argue that the poor economic conditions consistent with high unemployment rates will lead a state to offer more targeted incentives in the form of a megadeal. Fiscal conditions of a state may also affect the offering of megadeals. To measure state fiscal conditions, we follow Calcagno and Lopez (2012) in using the ratio of *G/T*, where G is total state government expenditures relative to T, the state's own-source tax revenues. This variable measures how much a state government spends, including intergovernmental transfers, for every tax dollar collected from its own in-state tax base. Higher values of *G/T* could reflect a state's ability to extract intergovernmental revenues, or it could instead indicate state deficit spending,

[10] Good Jobs First faces transparency issues in collecting these data, as noted previously. In addition, megadeals are often multiyear deals, but Good Jobs First reports the full amount in the year announced. By simply counting the megadeal, we are merely acknowledging the type of deal without reflecting on the actual dollar amount or the number of years it is supposed to last.

[11] Our data do not include Nebraska because we attempt to look at divided government as a variable in the model. Nebraska does not have a bicameral legislature, and therefore we cannot measure divided government in the same way as we can for the other states. In addition, according to the US Census state and local government finance section, 2001 and 2003 statistics are available only in a national summary by type of government and by level; there are no state-by-state statistics. The state figures are available through other data sources, but local government figures by state are unavailable.

or some combination of both. Hou and Smith (2006, 2010) argue that all balanced budget rules are not the same and that only the most stringent of the rules are actually binding. Similarly, Poterba (1995) argues that weak budget rules have no impact on balancing the state budget. In addition, Sobel and Crowley (2014) argue that receiving large federal grants can later lead to future tax increases. Thus, we argue that states that tend to have a higher *G/T*, run deficits, or extract intergovernmental revenues may be more likely to offer megadeals owing to their poor fiscal conditions, or in the hope of improving fiscal conditions.

To reflect the political conditions of a state, we introduce the following variables. First, *Corruption* is the number of public officials convicted of a corruption charge by a state per 1,000,000 of the population. This measure has been used by Glaeser and Saks (2006) to reflect the culture of corruption in a state. As noted in section 2, Felix and Hines (2013) find a positive and statistically significant relationship between offering incentives and corruption. Thus, we control for the culture of corruption and have similar expectations as to our findings. We consider the degree to which a single party may control the state. Roubini et al. (1989) and Roubini and Sachs (1989) develop an index for measuring divided government or political cohesion (*DGI*). They code the data between 0 and 2 based on coalitions within the government. Similarly, we code our data based on cohesion of political party. However, because we are using state data, we follow the divided government definitions of Calcagno and Escaleras (2007) and Alt and Lowry (1994, 2000). The index is constructed using the following values: 0 Unified Government, 1 Split Legislature Government, and 2 Split Branch Government. We have no reason to consider targeted incentives to be a partisan issue, as parties on both sides of the political spectrum have approved them. However, divided government can be slower to make fiscal adjustments and can create gridlock and indicates the ease with which political officials can create legislation and spend funds, which might affect the willingness to offer megadeals.

Thus, the more divided the government is, the less likely the government is to act, and this could lead to fewer megadeals.

We control for the degree of fiscal decentralization for each state. *Decentralization* is measured by the share of state and local government spending that local-level governments undertake. Arguments for a decentralized state focus on the theory of local knowledge through the division of knowledge to solve complex problems (Hayek 1945). Like Hayek, Oates (1972) argues that consumers of public goods can better assess which goods jurisdictions should provide and can decide which jurisdiction to live in based on the mixture of public goods offered. Thus, fiscal federalism promotes interjurisdictional competition, allowing better jurisdiction assignment over public goods, which could improve spending (Tiebout 1956; Brennan and Buchanan 1980). Evidence on the effects of decentralization at the state level is offered by Sobel, Dutta, and Roy (2013), who examine business climate measures for the US states and conclude that decentralization improves business climate. Stansel (2005) argues that decentralization leads to greater economic growth. One can argue that greater decentralization could improve economic institutions and limit the ability of state governments to offer targeted incentive packages. However, the literature on targeted incentives has shown that local governments are as likely to participate in offering targeted incentives as the state government, and in many instances, state and local governments work together. This creates competition for businesses not only between states, but potentially within a state. Therefore, greater decentralization may not lead to fewer megadeals for a state but may actually increase them by redirecting control to local governments as the ones offering the targeted incentives.

The variables that reflect the policy environment are the tax and regulation variables. Here, we include the various tax and regulation measures that can impose costs on firms above and beyond the costs of production. According to Kayne (1999), the effect of direct assistance to

firms to develop successful entrepreneurial enterprises has been minor compared to the effects of state tax and regulatory policies that affect everyone in the state. Specifically, high tax rates have been found to create distortions in markets (Harberger 1962), have negative effects on state growth (Mofidi and Stone 1990; Poulson and Kaplan 2008), and reduce entrepreneurial activity (Kreft and Sobel 2005; Kayne 1999). We examine four types of taxes that occur at the state or local level: *Income* is the state individual income tax burden, *Corporate* is the total state corporate tax burden, *Sales* is the total state and local sales tax burden, and *Property* is the state and local property tax burden. All these measures are tax burdens that measure the type of tax revenue (e.g., income tax revenue) over total personal income. It should be noted that *Property* tends to be primarily local, so again we can potentially access the degree to which the local government policy environment determines megadeals. Zodrow and Mieszkowski (1986) note that local property taxes can have distortionary effects resulting in fewer public goods. States with high tax burdens could be thought to be less desirable locations to firms, ceteris paribus. Higher taxes would impose costs on firms' owners, employees, and the customers they serve. To the extent firms might want to avoid states with high tax burdens, they might relocate to states with lower tax burdens. We would expect that state governments with higher relative tax burdens might offer targeted tax and economic incentives to attract firms rather than engage in tax reform. As noted previously, tax reform can be politically costly and does not have the immediate and visible political benefits of "creating jobs."

Our other policy environment variable is state regulatory spending, *Regulation*. Following Calcagno and Sobel (2013) and Campbell, Heriot, and Jauregui (2010), we use regulatory spending at the state and local level on the enforcement of regulation. We argue that the state direct expenditures are a good proxy for the regulatory environment that firms face. More spending could mean more regulations or stricter enforcement of existing regulations;

regardless, it reflects the regulatory environment in the state.[12] It is a stylized fact in the literature that higher regulatory burdens increase costs to businesses and can worsen economic performance. Specifically, the literature on regulation has demonstrated that higher levels of regulation are negatively correlated with business activity, entrepreneurship, and economic growth (see Djankov et al. 2002; Ardagna and Lusardi 2008; Klapper, Laeven, and Rajan 2006; Van Stel, Storey, and Thurik 2007; Dawson and Seater 2013). Again, state governments with relatively higher regulatory burdens may be more likely to approve megadeals to attract firms. All nominal variables are converted to real values.[13]

Our final category of characteristics that might affect states offering megadeals involves labor factors. States with attractive labor markets would have potential employees with high levels of human capital. The percentage of the population with a college degree, *College*, is our proxy for the quality of human capital in the state. States with high levels of college-educated individuals are thought to be less likely to offer firms megadeals. The degree to which labor markets are regulated within a state can affect a firm's costs and availability of quality labor. We use area 3 of the economic freedom index of North America, *Labor Freedom*, to account for the degree of labor market regulation.[14] The index is scored between 0 and 10, with higher values indicating greater labor market freedom. We suspect that the higher the level of labor market

[12] According to the US Census *Classification Manual*, example activities included in this spending are "inspection of plans, permits, construction, or installations related to buildings, housing, plumbing, electrical systems, gas, air conditioning, boilers, elevators, electric power plant sites, nuclear facilities, weights and measures, etc.; regulation of financial institutions, taxicabs, public service corporations, insurance companies, private utilities (telephone, electric, etc.), and other corporations; licensing, examination, and regulation of professional occupations, including health-related ones like doctors, nurses, barbers, beauticians, etc.; inspection and regulation or working conditions and occupational hazards" (US Census Bureau 2011). Revenue from the regulation of licensing or permits is not included in these data.

[13] The gross domestic product (GDP) price deflator, base year = 2009, was used to convert nominal to real values.

[14] Area 3 accounts for minimum wage legislation, the percentage of individuals employed by the state government, and union density.

freedom, with less labor market regulation, the less likely a state government would be to offer megadeals to firms.

Given the possibility of unobserved, unique local characteristics or institutions that tend to be relatively constant over time for a given state, we would like to estimate our models with state fixed effects; however, many of the variables in our sample experience little variation across time. We are more concerned with the variation between states as opposed to within a state. Under these circumstances, the use of fixed effects absorbs all the variation between states that we are trying to explain. Instead, we use regional fixed effects, which at least controls for the unobserved heterogeneity across regions. We have grouped the states into the nine US Census regions. Appendix 2 presents the states in each region.

4. Empirical Analysis and Results

To test our hypothesis that locational characteristics associated with the policy environment affect whether a state government offers a firm a megadeal, we estimate the following model:

$$Megadeal_{it} = \beta_0 + \beta_1 Economic_{it} + \beta_2 Political_{it} + \beta_3 Policy_{it} + \beta_4 Factor_{ot} + \beta_8 Regions_i + \beta_9 Time$$

where *Megadeal* is the count of targeted incentive packages offered over $75 million that occur in state *i* at time *t*. We focus on various characteristics within the state that would make it a potentially desirable or undesirable place for a firm to locate. We examine locational characteristics in four broad categories. (1) $Economic_{it}$ is a matrix of economic variables including *Unemployment*, the state's unemployment rate, and state fiscal performance, *G/T*. (2) $Politics_{it}$ includes three variables: *Corruption*, *DGI*, and *Decentralization.* (3) The $Policy_{it}$ matrix has our five key policy environment variables: *Income*, *Corporate*, *Sales*, *Property*, and

Regulation. (4) $Factor_{it}$ contains variables to reflect the labor inputs *College* and *Labor Freedom*. We use the nine US Census regions in the matrix *Regions*, and *Time* is a time trend.

Because we are interested in only the number of megadeals a state offers, the dependent variable is a count measure that ranges from 0 to 10. We estimate the equation above as a Poisson model.

Table 3, column 1 provides the marginal effects of the equation. Our economic variable *Unemployment* is positive and statistically significant at the 5 percent level, and fiscal conditions, *G/T*, is positive and statistically significant at the 10 percent level. These results are consistent with our expectations and suggest that states that have higher unemployment are more likely to offer firms a megadeal. Similarly, if government expenditures are greater than own-source tax revenue—which implies a poor fiscal condition, perhaps in the form of state shortfalls or intergovernmental grants that can increase tax burdens in the future—then state governments will increase the probability of offering a megadeal.[15] Fiscal conditions of this type have been found to have electoral effects, with the incumbent governor's party being punished (Lowry, Alt, and Ferree 1998). Thus, there may be political security in offering targeted incentives that give the impression of improving a state's budget conditions. Of our three political variables, only *Decentralization* is statistically significant. There is a positive and statistically significant relationship at the 1 percent level for decentralization and megadeals. This finding would indicate that states that are more fiscally decentralized, allowing local governments to have more control, are more likely to have megadeals. The implication here is that local governments are just as likely to engage in offering targeted economic incentives as the state government.

[15] We also examine lagged *G/T* in the equation. The results remain unchanged and are not reported here, but they are available upon request.

The findings from the first column of table 3 with respect to our tax and regulation variables are as follows. Of all the various tax burdens, only the individual income tax is positive and significant, at the 10 percent level. One reason why *Income* is significant in states offering megadeals over the other tax burdens is that individual income tax burdens are often the most visible and affect everyone in the state, more so than perhaps corporate or property taxes. Thus, state governments that have higher individual income tax burdens are more likely to offer megadeals. At the margin, for a one-unit change in the income tax burden, state governments would increase the number of megadeals offered by 2.6 units. Regulatory burdens do not appear to matter to state governments when offering megadeals, as we anticipated, although this factor is of the expected sign. Finally, our labor factor variables, *College* and *Labor Freedom*, are not statistically significant. This might suggest that state policymakers do not take into account the labor market characteristics beyond the unemployment rate when deciding whether to offer a megadeal. Our final variable, *Time*, is positive and significant at the 1 percent level, which suggests that megadeals have been increasing over time.

In addition to tax burdens, we attempted to measure the share of taxes paid. We calculated *Income*, *Corporate*, *Sales*, and *Property* as tax revenues per capita. Our economic conditions of unemployment and fiscal conditions and *Decentralization* continue to be significant. Among the tax measures, again only *Income* is statistically significant. We thought that perhaps the overall tax burden, measured as total tax revenue to total personal income, might explain offering a megadeal. Overall, tax burden is not significant, which emphasizes that it is specifically the individual income tax burden that is relevant to state governments offering a megadeal.[16]

[16] These results are not reported, but they are available from the authors upon request.

Because our dependent variable has many zeros, it can create an overdispersion or potentially be skewed in the distribution. Thus, we also estimated the equation using a negative binomial regression. The negative binomial and Poisson models are similar, but the negative binomial does not require that the mean and the variance be the same. These results are reported in column 2 of table 3. Our results are consistent with the Poisson regression, and all the statistically significant variables in that model are statistically significant in this one as well, except *Unemployment*.[17]

5. Conclusion

State and local governments continue to offer firms megadeals along with other types of targeted development incentives despite the economic literature calling the efficacy of these tools into question. While the literature has focused on the outcome of these policies, we try to explain what state characteristics might encourage state governments to offer firms a megadeal. We think that a political economy approach to examining these factors may shed light on why targeted tax incentives persist. While political economists have given attention to the political benefits to vote-maximizing politicians, we suggest a slightly different political economy view. It is argued that high tax and regulatory burdens can deter economic growth and entrepreneurship. Thus, poor economic conditions, including high unemployment, and fiscal policy issues related to both spending and tax burdens can lead to firms not wanting to locate in a particular state. We argue that rationally self-interested politicians will offer targeted incentives to in part compensate for what they perceive as negative economic and political conditions of the state. Therefore, we argue that state and local government officials,

[17] Because our variable is truncated at zero, one can imagine this as a two-part decision—first to offer a targeted incentive and then to assess how much the incentive should be. Thus, we also ran the equation as a Tobit model. Our key results did not change, and therefore we do not report them here. They are available from the authors upon request.

recognizing the political uncertainty of fiscal reform of both budgeting and tax burdens, maintain the status quo and instead use targeted tax incentives to attract firms to their states.

We test a Poisson model for megadeals for the years 1993–2014 and find some evidence to support our hypothesis. State governments with high unemployment rates and government spending in excess of state revenues are more likely to offer firms a megadeal. In addition, state individual income tax burdens lead to a higher probability of offering firms a megadeal. As individual income taxes affect the largest group of individuals in the state, this tax burden appears to have an impact. Finally, local governments are just as likely to be offering targeted incentives; therefore, as decentralization increases, so does the probability of firms receiving a megadeal. All of this suggests that when political officials perceive fiscal policy conditions and high individual income tax burden to be costly to firms, they are more willing to offer targeted incentives. Thus, offering targeted incentives in the name of "job creation" is perhaps more advantageous politically than engaging in uncertain policy reform that could make the state's economic policy environment more attractive for firms to locate there.

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Table 1. Variable Descriptions and Sources

Variable	Description	Source
Megadeal	Count of granted megadeals ($75 million or more in incentives)	Good Jobs First
Unemployment	State unemployment rate (as percentage)	Federal Reserve Bank of Saint Louis, FRED
G/T	Ratio of state total expenditures to state own-source tax revenues	State and Local Government Finances, US Census
Corruption	Public officials convicted of corruption per 1,000,000 individuals	US Department of Justice
DGI	Divided Government Index scaled from 0 to 2 indicating the degree of divided government; 0 = unified, 1 = split legislature, and 2 = split branch	Authors' calculations from the Book of the States
Decentralization	Ratio of local expenditures to state and local expenditures	State and Local Government Finances, US Census
Income	State income tax burden; ratio of income tax to personal income	State and Local Government Finances, US Census, Bureau of Economic Analysis
Corporate	State corporate tax burden; ratio of corporate income tax to personal income	State and Local Government Finances, US Census, Bureau of Economic Analysis
Sales	State sales tax burden; ratio of sales to personal income	State and Local Government Finances, US Census, Bureau of Economic Analysis
Property	State and local property tax burden; ratio of property taxes to personal income	State and Local Government Finances, US Census, Bureau of Economic Analysis
Regulation	State and local protective inspection expenditures burden; ratio of regulatory spending to personal income	State and Local Government Finances, US Census, Bureau of Economic Analysis
College Degree	Percentage of population with a college degree	US Census
Labor Freedom	Area 3 Labor Market Regulation Index	Economic Freedom of North America Index
Time	Time trend	Authors' calculation

Table 2. Descriptive Statistics

Variable	Mean	Std. Dev.	Maximum	Minimum
Megadeal	0.2931	0.7435	10.0000	0.0000
Unemployment	5.6687	1.8812	13.8000	2.3000
G/T	1.6432	0.2214	2.3695	0.7230
Corruption	3.6837	4.9078	43.5154	0.0000
DGI	0.8163	0.8701	2.0000	0.0000
Decentralization	0.4259	0.0725	0.5762	0.0001
Income	0.0196	0.0107	0.0425	0.0000
Corporate	0.0039	0.0036	0.0588	0.0000
Sales Tax	0.0305	0.0107	0.0626	0.0056
Property	0.0307	0.0102	0.0612	0.0101
Regulation	0.0012	0.0041	0.1266	0.0003
College Degree	25.3296	5.1674	40.3000	13.0500
Labor Freedom	6.8692	0.6895	8.6751	4.5963
Time	11.5	6.3472	22	1

Note: Std. Dev. = Standard Deviation

Table 3. Marginal Effects Poisson and Negative Binomial Regressions

Variable	Coefficient Poisson	Coefficient Negative Binomial
Constant	–6.550316	–6.770993
	(1.654706)	(1.837958)
Unemployment	0.0150607**	0.0114627
	(0.0076821)	(0.0085541)
G/T	0.1388467*	0.1491714*
	(0.0770318)	(0.085798)
Corruption	–0.0002965	–0.0007599
	(0.0028649)	(0.0031637)
DGI	0.0178463	0.0136366
	(0.0138068)	(0.0154729)
Decentralization	0.9024159***	1.006675***
	(0.2672838)	(0.2993784)
Income	2.632111*	3.29264**
	(1.558966)	(1.710602)
Corporate	–4.329565	–2.858133
	(7.412086)	(8.055633)
Sales	0.8194988	0.7966634
	(1.963567)	(2.146796)
Property	0.621896	0.2646158
	(2.101839)	(2.353603)
Regulation	0.8394019	–1.518565
	(12.40817)	(17.80978)
College Degree	0.0004157	0.0004954
	(0.0046274)	(0.0049873)
Labor Freedom	–0.0338328	–0.0334413
	(0.0307019)	(0.0339957)
Time	0.0748355***	0.0132278***
	(0.0223078)	(0.0039285)
Regional Fixed Effects	Yes	Yes
N	928	928
Pseudo R-squared	0.18	0.14
LR X^2	245.33	172.69

Note: Standard errors are in parentheses. *** indicates significance at the 1 percent level. ** indicates significance at the 5 percent level. * indicates significance at the 10 percent level.

Appendix 1. State Megadeals 1993–2014

State	Number of Megadeals	Total Dollar Value (2009 $)
AK	1	108,667,141
AL	14	3,417,142,658
AR	2	214,214,578
AZ	2	211,207,532
CA	4	1,347,951,343
CO	1	290,396,585
CT	11	1,758,059,539
DE	1	222,330,473
FL	9	2,002,047,691
GA	6	995,753,587
IA	7	681,779,440
ID	1	278,085,642
IL	5	654,227,553
IN	8	981,537,483
KS	4	450,564,965
KY	10	1,257,210,957
LA	22	9,591,976,012
MA	3	238,664,985
MD	2	573,379,478
ME	2	411,990,325
MI	31	10,294,509,691
MN	3	852,165,069
MO	14	4,085,464,102
MS	9	2,559,359,328
NC	9	1,753,498,511
NE	1	53,690,020
NJ	21	2,937,093,707
NM	6	4,278,363,929
NY	24	11,675,626,846
OH	18	2,108,835,505
OK	2	199,173,138
OR	8	5,508,234,983
PA	2	516,445,816
RI	2	256,639,459
SC	9	1,871,093,149
TN	15	3,195,179,624
TX	14	3,416,508,723
UT	2	253,284,542
VA	3	250,332,884
WA	2	11,878,072,626
WI	3	252,932,938
WV	2	240,439,170

Appendix 2. US Census Regions Used for Fixed Effects

New England	**East South Central**
Connecticut	Alabama
Maine	Kentucky
Massachusetts	Mississippi
New Hampshire	Tennessee
Rhode Island	
Vermont	**West South Central**
	Arkansas
Middle Atlantic	Louisiana
New Jersey	Oklahoma
New York	Texas
Pennsylvania	
	Mountain
East North Central	Arizona
Indiana	Colorado
Illinois	Idaho
Michigan	New Mexico
Ohio	Montana
Wisconsin	Utah
	Nevada
West North Central	Wyoming
Iowa	
Kansas	**Pacific**
Minnesota	Alaska
Missouri	California
Nebraska	Hawaii
North Dakota	Oregon
South Dakota	Washington
South Atlantic	
Delaware	
Florida	
Georgia	
Maryland	
North Carolina	
South Carolina	
Virginia	
West Virginia	