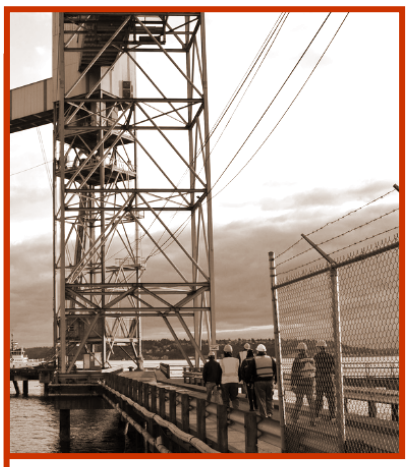

PRIORITIZING APPROACHES TO ECONOMIC DEVELOPMENT IN NEW ENGLAND: SKILLS, INFRASTRUCTURE, AND TAX INCENTIVES

FINDINGS IN BRIEF

Jeffrey Thompson

POLITICAL ECONOMY RESEARCH INSTITUTE
PERI
University of Massachusetts Amherst

Political Economy Research Institute
University of Massachusetts, Amherst

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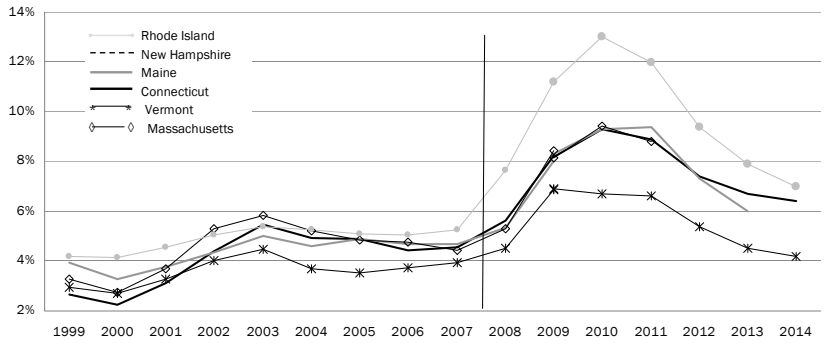
FINDINGS IN BRIEF

Along with the rest of the country, New England is beginning to pull out of the "Great Recession," but the recovery is expected to be slow and uneven. With hundreds of thousands of workers having lost their jobs, tens of thousands of families having lost their homes, and the prospect of continued high rates of unemployment in the region for years to come, policy makers will continue to face pressure to create jobs and improve the economy. The policies available to states are limited, both in their range and their potential to create large numbers of jobs, but there are options that can help create jobs and increase economic growth.

UNEMPLOYMENT RATE FORECASTS IN NEW ENGLAND



The evidence suggests that the most effective options for creating jobs, in the short and long term, are investing in the region's infrastructure and building the skills of the current and future workforce. Tax cuts and business subsidies, on the other hand, do little to create jobs in the short run, and are not the most effective approaches to generating growth over the long term.

The value of building infrastructure

The economy of New England—the businesses and households that make up our region—depends on the roads, bridges, ports, drinking water, sanitation, and energy production and transmission built and maintained by our state and local governments. In 2007, state and local governments spent $325 billion on this regional infrastructure.

Building and repairing infrastructure projects — constructing and maintaining our bridges and roads, replacing our deteriorating water and sewage pipes, increasing the efficiency of our electricity transmission lines, etc. — are particularly effective ways for state and local governments to create jobs in the process of carrying out the necessary functions of governments. Most of these activities bring in matching funds from the federal government as well as motivating investment from the private sector. A new port, for example, is likely to attract increased shipping traffic, which in turn creates jobs at the port and in its surrounding businesses; a rapid transit line extension may allow an employer to expand into a new neighborhood. Even after accounting for the taxes needed to finance these projects, infrastructure investments are powerful job creation engines because, by necessity, they employ local workers, equipment, and materials: it's just not possible to have an underground water main in Bangor replaced in China.

The benefits of investment in infrastructure are not limited to short-term job creation: infrastructure has a lasting impact on a region's productivity. Research demonstrates that state-level infrastructure investments have a positive and significant impact on economic growth. Among the recent findings are:

- In New England, each small investment in infrastructure—installation of a culvert, extension of a bus route—leads to a small, but significant increase in demand for workers. Correspondingly, larger investments lead to larger demands for workers.

The most effective options for creating jobs are investing in the region's infrastructure and building the skills of the current and future workforce.

- Increasing the total value of the public infrastructure in a state by 10% boosts total output of that state's economy by 1.2%.
- By investing in infrastructure, states lower costs for manufacturers, which attracts manufacturing firms to the state.

Figure sources: CT, NEEP CT Economic Outlook May 2010; MA, DOR Briefing Book, FY2011 Consensus Revenue Estimate December 2009; RI, Consensus Economic Forecast by Moody's, May 2010; VT, NEEP forecast, May 2010.

- Each dollar the state spends on public infrastructure returns as much as $1.37 in benefits to businesses and households in the state.

There is an important added benefit from some of these investments: investments in mass transit systems and clean-energy production and transmission systems also reduce carbon emissions, helping to build more sustainable, less congested, and more productive urban communities.

The decline of New England's infrastructure

The infrastructure that supports New England has been allowed to deteriorate for many years, and today, some of that infrastructure is in dire condition. Our state and local governments have failed to keep up investments in infrastructure at levels which can maintain, let alone enhance, this scaffolding for our region's economy.

Between one-quarter and two-thirds of major roads in New England are in poor or mediocre condition, and 40% of bridges are structurally deficient or functionally obsolete.

As infrastructure investments have declined, the list of critical infrastructure in need of replacement and repair has grown. Between one-quarter and two-thirds of major roads in New England are in poor or mediocre condition, and 40% of bridges are structurally deficient or functionally obsolete. Our drinking water facilities—the reservoirs, water treatment plants, and pipes that bring water to homes and businesses—are long overdue for repairs and replacements throughout the region. Transit systems and schools are similarly in need of repairs, expansions, and maintenance just to maintain the current levels at which they support our communities.

Improving the education and training of the future and current workforce

New Englanders have long recognized that a highly educated workforce has powerful positive effects on the health of our regional economy. High quality education has become a requirement for accessing good jobs and developing a productive workforce. The vast majority of education and training received by workers is delivered by public schools at all levels.

For the individual, education and training mean increased skills and opportunities for higher earnings; for businesses, it means more productive workers who are able to learn quickly and adjust to changing economic conditions. A skilled New England workforce not only helps attract firms and investment, but public spending on education has been found to raise gross state product, increase employment in metropolitan areas, and raise personal income at the state level.

Additional research has documented the impacts of specific educational and training investment, including:

- The benefits of reducing elementary school class sizes from 25 to 15 students exceed the cost of doing so by nearly $66,000 per student over 20 years.
- Comprehensive high school reform efforts raise the long-term earnings of graduates by 17%, boost attendance, reading and math scores, and generate benefits that exceed program costs by nearly $150,000 per student over 20 years.
- Customized training programs, in which community colleges collaborate with employers to develop training programs for workers, have saved and created thousands of jobs in Massachusetts at a cost of less than $9,000 per job.
- Participants in community colleges' occupational and vocational training programs received increased earnings of $400 per quarter for at least four years following program completion.

Public spending on education has been found to raise gross state product, increase employment, and raise incomes in the state.

The benefits to the economy from education begin as early as preschool. Recent long-term studies of high-quality preschool programs for low-income children show that participation has substantial positive effects on high school graduation rates, college attendance,

avoiding incarceration, employment, and earnings. These evaluations suggest that adoption of universal high-quality preschool would, over the long-term, generate more than 130,000 jobs in New England.

Infrastructure and education investments are unmistakably job-creation engines, key to helping the region turn the corner toward a real economic recovery. They would create not only direct hires through government spending (such as teachers and construction workers) but also indirect jobs (machinists at the cement factory which supplies a school repair project) and induced jobs (cooks at the restaurant where school construction workers eat lunch). All told, direct, indirect and induced jobs can create between 12 and 39 jobs for each million dollars spent by state and local governments.

GROSS JOB CREATION FROM $1 MILLION INVESTMENT

	CT	ME	MA	NH	RI	VT
Education spending						
Total jobs	25.5	31.5	27.0	27.0	26.3	30.8
direct	16.2	19.8	17.2	17.1	17.0	19.2
indirect	2.0	2.7	2.1	2.2	1.8	2.8
induced	7.3	9.0	7.7	7.7	7.5	8.8
Early childhood spending						
Total Jobs	33.3	38.4	30.0	37.1	33.2	38.8
direct	21.9	24.8	19.4	24.2	21.7	24.9
indirect	1.9	2.6	2.0	2.3	2.0	2.8
induced	9.5	11.0	8.6	10.6	9.5	11.1
Infrastructure investment spending						
Total Jobs	11.6	15.3	12.0	13.4	12.0	14.8
direct	6.6	8.5	6.7	7.6	7.1	8.3
indirect	1.7	2.4	1.9	2.0	1.5	2.3
induced	3.3	4.4	3.4	3.8	3.4	4.2
with additional 20% federal match						
Total jobs	14.1	18.5	14.6	16.3	14.6	18.0

Table source: PERI and IMPLAN 2007.

Despite the overwhelming evidence that investments in education can bolster an economy, New England's current education system is inadequate to meet the region's needs. State and local governments in five of the six New England states spend less than the national average on higher education. All six states impose higher tuition than the rest of the nation, making affordability a real problem for New England students. Only four New England states have public preschool programs--and in three of those states the programs reach few students and are funded at low levels.

A $875 million annual corporate tax incentive program in New England would produce 9,000 jobs, compared to over 130,000 jobs if that money were invested in universal preschool.

Tax incentives and corporate subsidies have little impact

Despite the evidence of the impact that infrastructure and education investments can have on our region's economy, tax incentives and subsidies remain a large part of the economic development toolbox in the New England states. These subsidies reduce costs, thus increasing profits, for firms that locate, expand, or invest in a state or region. The amount of state revenue dedicated to these credits is considerable: from around $400 million annually in Maine and Vermont to $1.7 billion in Massachusetts for tax incentives alone.

Rigorous studies of these incentives and subsidies, however, suggest that their impacts are modest at best. As much as 96% of the jobs and most of the investments used to claim these tax credits would have been created without the incentives. Some studies do find an impact on economic growth, but much of that activity, is simply employment and investment that would have otherwise occurred in a neighboring city or state, making the investment a wash for the region as a whole.

Fundamentally, tax incentives cannot be expected to transform regional economies because they do little to alter the capacity of a region—they bring nothing new to the table, but rather shuffle resources from the public to the private sector, or between states.

The real harm done by corporate tax incentives and subsidies is that they deplete resources that could be

spent on real public investments. For example, one analysis finds that a long-term $875 million annual incentive program in New England would produce just 9,000 jobs, compared to over 130,000 jobs if that same amount of money was invested instead in high-quality universal preschool in the region.

Affluent households have reaped the lion's share of gains from economic growth in the last few decades, but continue to face the lowest state and local tax rates.

Financing economic development in the face of declining budgets

Realistically, in this fiscal climate, the New England states are not able to continue funding programs at current levels, let alone implement economic development initiatives. In order to sustain and expand investments in education and infrastructure, and make the most of the job-creation engines that both of these investments can be, states must look for new sources of revenues and shift priorities in their current budgets.

Most states, including all of New England, have already taken action to raise taxes during the last two budget years. There is arguably room for further tax increases targeted to affluent households, which have reaped the lion's share of gains from economic growth in the last few decades, but continue to face the lowest state and local tax rates. These households can support public spending for education and infrastructure in New England, providing the base for economic growth that these investments will create. Low interest rates and favorable bond ratings suggest there is also room for bond-financed infrastructure projects in New England.

In addition to generating new revenue, states are being forced to reassess their current budget priorities. Part of that process should be reconsideration of existing tax expenditures, which allocate tax revenues *before they are collected* through exemptions for certain groups or activities, often corporations. Total tax expenditures have grown rapidly over the last two decades in New England, and are anticipated to reach $1 billion in Vermont, $3.5 billion in Maine, $5.6 billion in Connecticut, and $23 billion in Massachusetts in the next budget year. Of these, annual tax expenditures specifically for corporate incentives and subsides are more than $400 million in the smaller New England states and are well over $1 billion in Massachusetts. Given the evidence that these tax incentives do little to create economic growth, states should consider doing away with these tax expenditures and putting the funds toward real investments in infrastructure and education.

TOTAL STATE AND LOCAL TAXES AS A SHARE OF INCOME, BY HOUSEHOLD INCOME

Income percentile		CT	ME	MA	NH	RI	VT	US average
lowest 20%		12.0%	9.5%	10.1%	8.3%	11.9%	8.2%	10.9%
second 20%		9.7%	9.2%	10.1%	6.6%	10.0%	8.0%	9.9%
middle 20%		9.9%	9.8%	9.6%	6.3%	10.1%	9.4%	9.4%
fourth 20%		9.6%	9.8%	8.8%	5.8%	9.5%	9.2%	8.5%
top 20%	next 15%	8.5%	9.5%	7.7%	4.6%	8.5%	8.2%	7.4%
	next 4%	7.6%	8.2%	7.1%	3.5%	8.1%	7.5%	6.7%
	top 1%	4.9%	6.9%	4.8%	2.0%	5.6%	7.5%	5.2%

Conclusion

State policymakers will continue to face pressure to create jobs in New England for several more years. The available evidence suggests that the most effective approaches are to improve the region's schools and infrastructure. Instead of trying to lure firms with deals and lower corporate taxes, an approach to economic development that builds the skills of the current and future workforce, improves the physical infrastructure of regions, and makes communities more attractive places for families and firms represents a more effective use of a state's scarce resources.

This brief is based on the August 2010 report Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives *by Jeffrey Thompson of the Political Economy Research Institute, University of Massachusetts, Amherst.*

The full study is available at www.peri.umass.edu

Table source: ITEP, Who Pays?, November 2009.