THE HAMILTON PROJECT

Advancing Opportunity, Prosperity, and Growth

How Federal Policy Can Target Job Creation for Economically Distressed Areas

In 2006, well before the recession began, the U.S. unemployment rate was 4.6 percent. At the same time, fifty metropolitan areas had unemployment rates of 6 percent or higher, and eleven had unemployment rates of 8 percent or higher. The recession exacerbated these differences but did not

Bringing Jobs to People

POLICY BRIEF | OCTOBER 2010

create them. Disparities in employment and economic growth have long been a challenge for the country. Even as the economy grew rapidly during the 1990s, many areas were left behind. These economically distressed areas challenge the idea that economic growth alone will create opportunities for all. Some communities may need an extra push even in good times, let alone in the current economic climate.

Author Timothy Bartik of the W. E. Upjohn Institute for Employment Research lays out a suite of proposals to increase employment, raise wages, and enhance the competiveness of businesses in economically distressed communities. Proposed investments include job training driven by employer demand, subsidized business consulting for small- and medium-sized enterprises (SMEs), and the creation of revitalized Empowerment Zones that will bring together grants for expanded public services and tax cuts for businesses to foster business growth in the most economically distressed areas. By targeting areas in the most need, each dollar spent will have a higher impact than would dollars diffused across more-advantaged areas. Together, these three policies have the potential to put currently economically distressed areas on a faster path to recovery and to increase national productivity.

The Challenge

Economic growth and prosperity have not been equally shared across the United States. During good times, some areas have lagged behind. During bad times, as in the recent recession, some localities have suffered disproportionately. Over the period 2006 to 2008, the United States poverty rate was 13.2 percent, but 154 metropolitan areas had poverty rates of 20 percent or higher and twenty-two areas in nine different states had poverty rates of 30 percent or higher. Given the experience of past recessions, these inequalities are likely to persist long after the wider economy recovers.

In communities experiencing severe economic hardship, the disappearance of good jobs is often the start of a painful process of adjustment in which wages fall as workers compete for scarce jobs, and the unemployed or underemployed pursue better opportunities elsewhere and move away, putting downward pressure on local housing prices. Left unchecked, this process may continue for many years until wages and land prices have fallen enough to retain and attract businesses.

One approach to stop this cycle is to provide incentives for businesses to invest and expand in distressed areas. But incentives alone do not address the challenges businesses face when starting up or expanding in economically distressed areas—workers may not have the mix of skills or the training required, business owners may not have the strategic and managerial tools to expand and compete, and local infrastructure and government services may not meet the needs of business. Policies that address these needs directly by investing in local government services and infrastructure, customized training for workers, and consulting advice for management can boost the productivity of those workers and businesses, raising wages and making businesses more profitable and competitive.

Such investments may be particularly effective because SMEs tend to invest less in training than other businesses do, despite evidence that suggests training improves the productivity of workers and the profitability of firms. This may be because SMEs face borrowing or cash constraints that make up-front investments difficult, or because they fear losing their training investments to other businesses if workers change jobs after being trained. In the 1990s, the Clinton administration attempted to address this problem of localized distress through a series of investment incentives known as Empowerment Zones. Empowerment Zones received tax breaks for businesses to locate and expand in economically distressed areas as well as block grants to expand public services such as infrastructure and housing, workforce development, social programs, and public safety.

By reducing business costs and establishing zones with high levels of public-service support, these original Empowerment Zones appear to have succeeded in their goals of attracting jobs to targeted areas. Despite these promising results, the original program was short lived and limited in scope—only eleven Empowerment Zones received the full block grants provided under the original design.

The Empowerment Zone program and a similar Renewal Communities program still exist, but both have changed to focus almost entirely on tax breaks for businesses. However, research has found that tax breaks alone may be more costly and less efficient than the original Empowerment Zone design. Although tax incentives may be one part of the solution, alone they do not address the wider problems facing businesses in economically distressed areas.

A New Approach

Programs to Expand Businesses and Increase Worker Productivity

Taking these challenges into account, Bartik proposes to augment current tax-focused policies with a broader economic development strategy that includes human capital investments and public services. This proposal would expand on the successes of existing programs with a track record of increasing economic activity in targeted areas while raising productivity. By focusing on productivity-increasing investments, this strategy has the promise to increase wages and profitability, raising national living standards.

Customized training: Bartik would provide matching grants for state-customized training programs that target SMEs. Customized training is organized in part by states and by workforce development agencies and may involve partnerships with community colleges. Unlike traditional job training, customized training provides employer-specific training requested by businesses, and employers select which employees or potential employees receive the training. Businesses work with state partners to develop a training program that meets their needs, and share in the costs of the training. Research suggests that this type of training is more effective than general training at increasing earnings and productivity.

Targeting training to SMEs would make it less likely that publicly funded training would replace privately funded training because SMEs very commonly invest less in training compared with large businesses. Bartik also would ensure that the training is valuable to the employer by requiring employers to share the costs of training fifty-fifty with state partners.

Manufacturing Extension Partnership: The Manufacturing Extension Partnership (MEP) program provides business advice to small- and medium-sized manufacturers. One can think of this as a federally subsidized consulting service that helps businesses improve their productivity and efficiency and build their market base. Evidence suggests that businesses receiving assistance from MEP centers experience improvements in productivity.

The MEP is currently a small program, providing support to only 5 percent of small- and medium-sized manufacturers. Building on a proposal developed by a consultant to the National Institute of Standards and Technology, Bartik suggests expanding the MEP program to cover about 20 percent of all small- and medium-sized manufacturers and reducing the current cost-sharing requirement so that state, local, or private entities would need to provide only 25 percent of total spending.

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Empowerment Zones: Bartik proposes to reestablish Empowerment Zones in their original form, including block grants for public services. The program would be expanded significantly with the creation of sixty to eighty Zones across the country. Businesses located in the Zones would receive tax credits for employing residents of Zones, and these incentives would be combined with public service block grants to improve the economic climate. If the program operated similarly to the original Empowerment Zones, each Zone would receive about $125 per resident in public service grants and about $3,000 in tax credits for each newly hired worker. Bartik suggests funding these new Zones in part by eliminating inefficient tax breaks in less–economically distressed areas.

TABLE 1

Annual Federal Costs and Services Provided by These Three Distressed Area Job-Creation Programs, When Operated at Full Scale

Program	Annual Federal Costs	Services provided
Federal matching grants for customized job training	$750 million	1.5 million annual trainees
Expanded and targeted MEP	$371 million	23,000 additional manufacturers served annually
Restarted and restored Empowerment Zones	$820 million (net cost after phasing out current Empowerment Zones and Renewal Communities)	Sixty to eighty Zones, with a population of about 6 million people.

Targeting Economically Distressed Areas

Each of these reforms would be targeted to economically distressed areas to ensure that government funds are spent on areas with the greatest need.

Customized training grants would be targeted in two principal ways. First, states would only receive federal matching funds for training in areas that exceed certain objective measures of economic distress, such as unemployment rates or income growth. To ensure that the benefits of the program are concentrated in distressed areas, areas would have to be defined in such a way that no more than 30 percent of the population of each state lived in these areas. States with a higher degree of economic distress would have economically distressed areas that encompassed a larger percent of the population, but even states faring relatively well could identify as much as 10 percent of their population as qualifying. Second, the federal match on customized training programs would be higher in harder-hit states—ranging from a 25 percent match in less-distressed states to 75 percent in the most-distressed states.

The MEP program expansion would be targeted by offering a higher federal subsidy in economically distressed areas. Bartik proposes a subsidy of 75 percent in these targeted areas and 50 percent for businesses located elsewhere, instead of the current federal share of only 33 percent. The definition of economically distressed areas could be the same as the definition used for allocating customized training program funding, but also could include indicators to identify areas that are losing manufacturing jobs.

Empowerment Zones would be the most heavily targeted of the three programs. Zones would have to meet minimum criteria based on measures such as poverty rates, employment rates, and unemployment rates. In addition, state and local governments would have to apply for the funding through a competitive process, presenting a compelling plan for how the combination of tax breaks, business support, and public service grants would be used to develop the area. Compared with the other policies, Zones would be more narrowly defined to sublabor market areas with populations between 50,000 and 200,000. This is important because criteria related to a larger labor market may lead to resources going to the most advantaged part of the labor market rather than the least advantaged areas where the impact per dollar spent is likely to be highest. On the other hand, the customized training and MEP program expansion are also needed, because distressed neighborhoods will fare better if the overall metropolitan area improves.

Each of these three efforts to target distressed areas would likely have wider agglomeration effects. Offering these incentives could encourage businesses to invest in areas if they believe other businesses would do so at the same time. If many businesses locate in an area, local demand expands, which will help make the area more attractive to other businesses in the future.

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Evaluating Outcomes

Bartik proposes expanding these programs significantly, based on existing evidence of their positive returns. To ensure that these programs continue to be effective and to identify best practices among state programs, these programs should be implemented along with provisions to rigorously evaluate the performance and economic returns of each intervention. Evaluating these expansions will provide evidence on the aspects of these programs that are most effective in increasing key outcomes such as employment, business productivity, and economic output. The structure of these programs allows for such evaluation through the comparison of businesses and communities that receive support to similar areas with businesses and communities that do not.

Costs and Benefits

The table below describes some key expected features, costs, and benefits of the program proposals, based on research.

Questions and Concerns

To what extent is the proposal just moving jobs from more-advantaged to less-advantaged areas? To what extent will it result in net job creation?

Some jobs will be created in economically distressed areas that would otherwise have been created or located in nondistressed areas. However, net growth in economic activity will result from the boosts to productivity described above. Additionally, Bartik argues that moving job creation to high-unemployment areas may have positive economic and social impacts for the country as a whole.

First, scholars have pointed to concentrated joblessness as a potential cause of social problems like crime and teen pregnancy; reducing severe unemployment could help reduce the prevalence of those problems.

In addition, persistent joblessness has been shown to result in the deterioration of job skills; longer spells of unemployment lead to lower subsequent earnings on reemployment. Bringing

TABLE 2

Estimates of Costs and Benefits

	Percentage effects on productivity	Ratio of productivity benefits to government costs	Government cost per new or relocated job
Federal matching grants for customized job training	0.5 percent	1.8	$25,000
Expanded and targeted MEP	0.8 percent	2.1	$8,500
Restarted and restored Empowerment Zones	3 percent	2.1	$18,000

Key Highlights

Proposals would create jobs in distressed areas at a low cost and increase workers' productivity.

The Proposal

Bartik's three-pronged approach, aimed at SMEs, seeks to revitalize distressed areas by attracting capital and businesses. Features include the following:

Customized training: Businesses would work with state partners to help overcome barriers and provide on-the-job training.

Expanding the MEP: The MEP would provide federally subsidized consulting services to help businesses improve their productivity and efficiency and build their market base.

Empowerment Zones: Businesses located in the Zones would receive tax credits for employing residents of Zones, and these incentives would be combined with public service block grants that would improve the economic climate in the Zones.

Benefits

The proposal would train 1.5 million workers every year, provide an additional 23,000 manufacturers with extension services annually, and bring jobs to and improve the environment of 6 million people who live in Empowerment Zones.

Productivity: Research suggests that each of these proposals would boost productivity at assisted businesses and in Empowerment Zones by 0.5 percent or more.

Cost effective: Net annual costs of all three proposals are less than $2 billion. Productivity benefits are estimated to be 1.8 to 2.1 times the cost of implementing each of the three policies.

Success moving forward: The program design allows for rigorous evaluation and accountability and continuous program improvement.

jobs to persistently distressed areas could help reduce long-term unemployment and limit the depreciation of job skills.

Finally, providing incentives for job growth in high-unemployment areas would help attract businesses, workers, and their families to areas with preexisting capacity for local transportation and other government-provided infrastructure and away from areas whose infrastructure is strained or congested. Encouraging growth in these areas reduces the need to build expensive new infrastructure and to utilize and preserve existing infrastructure.

In sum, the proposed suite of programs increases net economic activity through productivity improvements and by encouraging economic activity in distressed communities where the economic and social benefits of that renewed activity may be greatest.

Why is it important to focus on productivity-enhancing investments?

Unlike tax incentives to locate in one area instead of another, productivity-enhancing investments have the ability to do more than just redistribute economic activity. Investments that increase productivity increase living standards by raising wages, lowering consumer prices, and increasing business profits.

In local communities, investments that raise business and worker productivity help provide a more sustainable basis for an area's economic prosperity by making the business more competitive. From a taxpayer perspective, a dollar spent on investments that increase productivity return more than a dollar of economic activity, and therefore magnify the impact of those funds.

Could these policies be effective when implemented by state or local governments?

There is no reason why most of these policies cannot be pursued at the state or local level. Many state governments already operate customized training programs and MEPs, and those programs could be expanded and enhanced, and targeted more efficiently to maximize the economic return. State governments also could revitalize state-run Enterprise Zone programs to put greater emphasis on public services. Even at the local level, distressed areas could devote resources to support certain programs—localities already set aside considerable resources for economic development programs, mostly in the form of costly tax breaks. Diverting some of these funds to more-effective programs could provide increased local economic returns.

Conclusion

Even as the wider economy recovers, some states, cities, and communities will continue to suffer from the scarring impacts of the recent recession, a recession that has only exacerbated long-term disparities. As demand picks up and the economy recovers, the overall level of distress will fall; nevertheless, economic challenges may persist for some communities unless policies directly focus attention on addressing those disparities.

As the programs funded by the Recovery Act begin to expire, new policies may be needed to aid distressed areas. Bartik provides a three-pronged plan that policymakers can use to direct key government programs—job training, business consulting, tax breaks, and expanded public services—to the areas that continue to struggle as the wider economy recovers. These programs will increase business activity and jobs in the hardest-hit areas. In addition, these programs benefit the national economy as a whole by improving business productivity and human capital. Amidst real concerns about widening economic disparities, Bartik's plan could dramatically change the course for our nation's most economically distressed areas.

Learn More About This Proposal

This policy brief is based on The Hamilton Project discussion paper, Bringing Jobs to People: How Federal Policy Can Target Job Creation for Economically Distressed Areas, which was authored by:

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Additional Hamilton Project Proposals

The Mobility Bank: Increasing Residential Mobility to Boost Economic Mobility

This paper proposes the creation of a "mobility bank" at a government cost of less than $1 billion per year to help finance the residential moves of U.S. workers relocating either to take offered jobs or to search for work, and to help them learn more about the employment options available in other parts of the country. Whereas those with college degrees and savings are much more likely to move in response to job loss and to improve their job market outcomes, those with less skills and no savings may have difficulty financing such transitions. The government should target mobility bank loans toward displaced, unemployed, and underemployed people in depressed areas of the country and should help to insure people against job-outcome uncertainty by making repayment terms contingent on the borrower's postmove employment and income. This proposal extends government support for work-related moves that already are included in the U.S. tax code but that primarily benefit higherincome households. The author's calculations suggest that the benefits compare favorably with the costs from alternative federal efforts. Perhaps more importantly, this proposal helps address a persistent market failure that limits the ability of low-income families to borrow against future earnings to "invest" in job-promoting residential moves.

Retraining Displaced Workers

Displaced workers can experience significant permanent earnings losses. For these workers, the challenge is finding another job that pays as well their previous job. Schooling or vocational training can function as a relatively efficient way to compensate some workers for these losses. Six interconnected proposals would expand and improve the quality of training. They include (i) a new displaced worker Pell Grant program that subsidizes retraining even if they take new jobs; (ii) a mechanism to fund community colleges during economic hard times; (iii) adjusting community college funding to direct funds to higher return training; (iv) targeting training-ready displaced workers; (v) linking financial aid to performance; and (vi) a commission that fosters, disseminates, and evaluates standardized courses for displaced workers.

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by making economic growth broad-based, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments. Our strategy—strikingly different from the theories driving economic policy in recent years—calls for fiscal discipline and for increased public investment in key growth-enhancing areas. The Project will put forward innovative policy ideas from leading economic thinkers throughout the United States—ideas based on experience and evidence, not ideology and doctrine—to introduce new, sometimes controversial, policy options into the national debate with the goal of improving our country's economic policy.

The Project is named after Alexander Hamilton, the nation's first treasury secretary, who laid the foundation for the modern American economy. Consistent with the guiding principles of the Project, Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces.

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