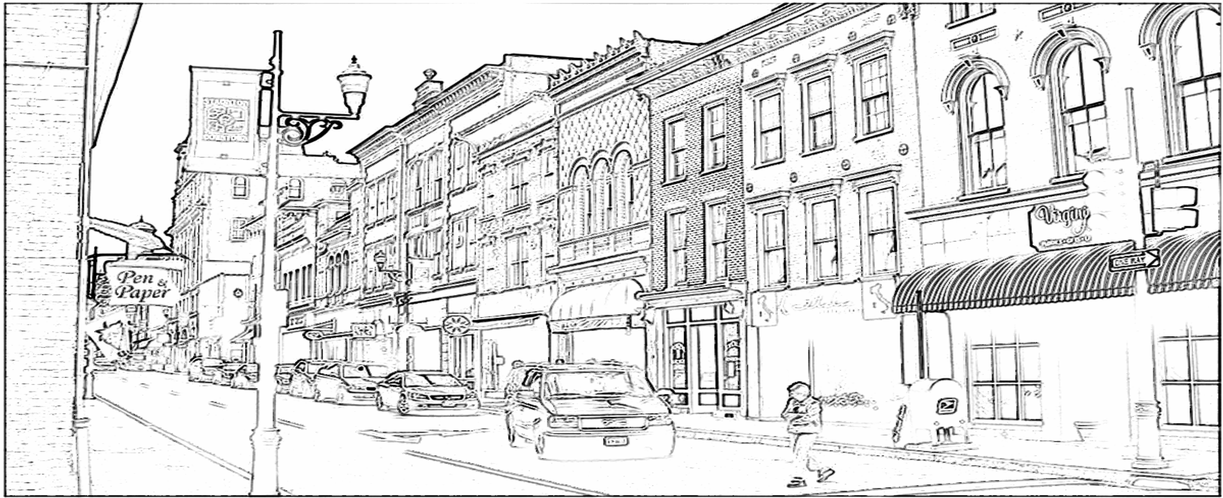

Regional Growth and Development Strategies: Business Relocation

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Executive Summary

For over 75 years one of the most popular economic growth and development strategy has been and remains the enticement of businesses to move or relocate into the community. As documented by Conroy and Deller (2014), Wisconsin was home to nearly 470,000 establishments in 2011 and just 1.1% of those establishments relocated. Of the 5,200 establishments that did move in 2011 approximately 4,000 stayed within the state and less than 1,200 moved between states. Nearly two in three establishments that did relocate within the state moved less than ten miles. Further, those firms that have moved tend to be small (fewer than five employees and less than $250K in sales). Given the modest number of firms that move and their relative size, it appears on face value that devoting limited resources to economic growth and development is ineffective.

Over the past 75 years economic development thinking has progressed over three cycles or "waves". The first focused narrowly on business recruitment with an emphasis on offering low cost alternative locations. Business climate within this context meant cheap land and labor, low taxes, and limited regulation. But beginning in the 1970s and 1980s the source of job growth shifted from large and mobile companies to smaller firms that tended to be less mobile. The role of entrepreneurship, small business development, as well as business retention and expansion came to the forefront. Notions of business climate moved away from low taxes and limited regulation to thinking about providing services aimed at helping small businesses and making the community an attractive place to live and work. During this time many economic development practitioners came to realize that they could be more effective in promoting community economic growth and development by focusing on smaller businesses already located in the community rather than on recruiting business from elsewhere.

Today business climate extends beyond taxes and regulation to the entrepreneurial culture of the community. Contemporary thinking about economic growth and development revolves around partnerships within and across communities and thinking about how these partnerships can act more entrepreneurially. Private companies come together and work with the public sector to foster a community that has an entrepreneurial spirit. Here the community, broadly defined, is willing to experiment, celebrate successes, and learn from mistakes. A supportive community culture appeals to both local entrepreneurs and business owners looking to relocate. Focusing on attitudes toward risk, experimentation, and cooperation could prove to effectively attract business.

Attempts to recruit businesses through offering low costs and tax incentives has proven to be ineffective and should be replaced by efforts to foster a more entrepreneurial attitude within the community.

Regional Growth and Development Strategies: Business Relocation

Introduction

A recent publication on business relocation in Wisconsin documents that very few businesses move each year (Conroy and Deller, 2014). The vast majority of Wisconsin businesses remain in the same location where they started and if they relocate, the distance of the move is less than ten miles. In this study, we consider business relocation in the context of regional growth and development strategies with particular emphasis on industrial recruitment. First we demonstrate the popularity of industrial recruitment and incentive programs relative to the scarcity of mobile firms. We then take a historical perspective of economic growth and development strategies as a way to better understand industrial recruitment. In the last two sections, we gain insight on firm location from recent academic literature and consider policy implications for the state of Wisconsin.

Regional Growth and Development Strategies

Industrial recruitment is perhaps the longest standing regional economic growth strategy and one of the most common. One can trace the use of tax incentives in the U.S. back to 1791 when the state of New Jersey attempted to lure Alexander Hamilton to relocate his manufacturing plant. Modern recruitment strategies have their roots in The Great Depression era Mississippi Balance Agriculture with Industry Act (BAWI), which initiated a wave of incentive-based economic development strategies that lower costs for businesses. Many communities still use these strategies to attract businesses to their area with lower tax rates, wage credits, real estate development, and other subsidies. Yet, very few businesses actually move each year and as a result a potential costly strategy is geared toward a very small set of mobile firms. Given its popularity and relevance to business relocation choices, we emphasize industrial recruitment in the following sections of this study as part of a broader consideration of business relocation in regional growth and development strategies.

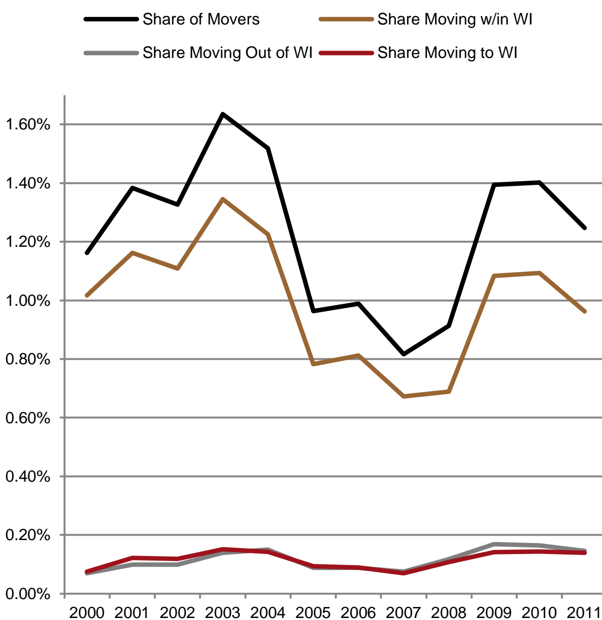
Industrial Recruitment

Many states and cities actively recruit businesses with tax abatement and other incentives likely because government and development agencies anticipate several advantages from successfully attracting new business and industry. First, residents may gain employment, income, or new products for example, from a business that moves into the region (Glaeser, 2001). Second, recruiting certain business could enhance local productivity by complementing existing industry through shared suppliers and labor pools, as well as by generating a valuable flow of information between

businesses (Ibid.). Third, state and local governments often expect large up-front incentive packages to be more than offset by future business tax revenues as well as income taxes resulting from increases in employment and wages (Ibid.). In addition, a common perception is that by recruiting businesses the expanding tax base will lower the taxes on existing residents and businesses. The political advantages of successfully attracting new business and creating jobs may also lead state and local government to continually recruit business, even when more subtle strategies could be effective (Bondonio and Greenbaum, 2007).

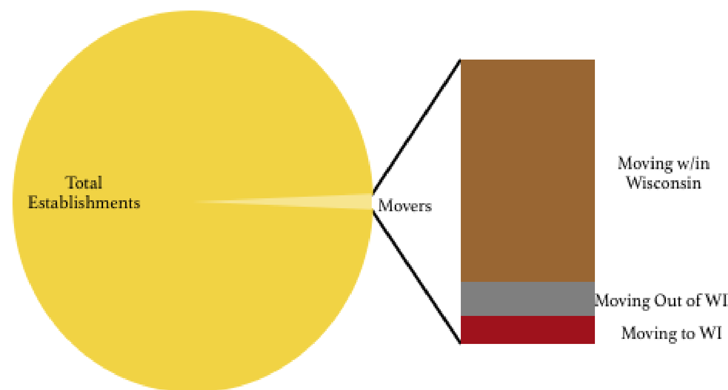
With the perception of state and local benefits from attracting new business, the extent and expense of industrial recruitment has grown dramatically since the 1970s. By the mid-1990s, over 40 states offered tax abatement (concessions or credits) to businesses for land and capital improvement, equipment and machinery, investment, and job creation (Lee, 2008). The number of states with financial incentive programs has also increased over the last 20 years. By the 1990s, the majority of states were offering subsidized loans for building construction, equipment, machinery, or plant expansion especially in areas of high unemployment (Ibid.). As an example of state-level spending, Michigan spent $530 million, three-quarters of its annual economic development resources, on location subsidies and another $50 million on business retention and recruitment in 2003 (Bartik, 2003). Peters and Fisher (2004) estimate state and local economic development spending at nearly $50 B annually. Similarly, Thomas (2000) estimates that state and local expenditures on economic development incentives at $48.8 B for 1996.

Figure 1: Establishments that Relocated as a Share of Total



Given the resources devoted to industrial recruitment, perhaps the most concerning aspect of these strategies is the limited scope. These policies often focus on incentivizing businesses to relocate yet, a very small share of all businesses move each year. Estimates of the rate of relocation vary depending on the industry and method used. In Figures 1 and 2 we demonstrate that on average just over 1% of all Wisconsin establishments relocate in any given year and most move within the state.

In 2011 Wisconsin was home to 421,000 establishments and only 1.2%, or about 5,200 firms, moved during the year. Of those movers about 4,000 remained in Wisconsin and less than 1,200 moved between states (Figure 1). Migration of establishments into Wisconsin from other states represented just 11.1% of all movers and out-migration accounted for only 11.6% of movers. The net movement in and out



of Wisconsin equals a net loss of about 29 establishments in 2011. The jobs associated with migration represent less than 0.25% of total employment in Wisconsin.

In a separate analysis, Lee (2008) finds that 3% of manufacturing plants relocate to other states in a given (Census) year. Specifically in Wisconsin, Lee finds that for the 20-year period from 1972 to 1992, 9% of manufacturing entry was from relocation, meaning that if there are one hundred new manufacturing plants in Wisconsin, only nine relocated from another state. Similarly, he finds that 7% of manufacturing firms that exit Wisconsin don't actually close, but relocate to another state. Focusing on headquarters alone, Strauss-Kahn and Vives (2009) find that nationally 5% of headquarters relocated across a 5-year period.

When one thinks about recruitment of businesses as a major economic growth and development strategy in light of the small number of Wisconsin businesses that ever relocate in a given year, and the small number of jobs that are associated with those moves, the effectiveness of the strategy comes into question. "Hunting the whale" may not be a cost effective or viable approach.

Evolution of Regional Growth and Development Strategies

Historical Perspective

Economic growth and development strategies are motivated by our understanding of communities, their economies, and how businesses function—an understanding that has evolved over time and that we continue to remodel in the face of ongoing economic change. The strategies we use are implemented in the context of changing social values, political shifts, and developments in our understanding of the economy and society. In the following section, we place economic development strategies in the context of historical events, political trends, and analytic advancements that changed our economic understanding. We outline the "waves" of economic development policies at the state and local levels, from the Great

Depression Era polices that brought on state and local competition for businesses, to the emphasis on entrepreneurship, all leading up to the modern strategies that focus on cooperation within and across communities.

First Wave Strategies

Prior to World War II there was little economic development policy or practice. The first policies were born out of The Great Depression and few followed until the late 1940s. Disillusionment with the free market and desperate economic conditions, alongside the apparent success of relatively centralized systems such the Soviet Union, pre-war Japan, and Germany created conducive circumstances for a larger role for government in general. Informed by new Keynesian economic theories that outlined how the government could facilitate needed economic growth, The New Deal advanced government activity in the economy.

Early development strategies that took shape in the 1930s were based on traditional neoclassical firm location approaches (maximize profits by driving costs down as low as possible), characterized by incentives that reduce costs for businesses. These supply-side strategies were intended to stimulate the local economy by improving the "business climate" with lower taxes, cheap labor, and limited regulations. Under the authority of the Mississippi Balance Agriculture with Industry Act (BAWI), Mississippi implemented the first of this type of strategy by appealing to northeastern manufacturers as a low-cost location choice. Perhaps most importantly, the BAWI marked the beginning of using lower taxes as an incentive for business (re)location. The evolution of state and local economic development strategies can be described in waves and the industry recruitment or "smokestack chasing" exemplified by the Mississippi BAWI characterize the first wave (Deller and Goetz, 2009).

Following World War II, economic development policy and practice became much more consistent and a field of study of its own. In the wake of reconstruction and rebuilding after the war, the U.S. initiated several development policies and related agencies. As an example, several provisions in Titles I and II of the 1949 Housing Act were targeted at urban renewal and implemented to encourage small business. The Small Business Administration was established in 1953 followed by the Economic Development Administration in 1965, both of which continue to influence local economic outcomes.

Second Wave Strategies

The second wave of economic development strategies resulted from a changing economy and political sphere wherein prior strategies were challenged. Politically, the Reagan Administration in the U.S. and Thatcher Administration in the UK imposed limitations on government and favored deregulation. The decline of the Soviet Union and its centralized system also aligned with sentiments in favor of smaller government. New developments in economic research emphasized innovation (Romer 1986), small business (Birch 1979, 1987), and the importance of competition between businesses for entrepreneurship, efficiency, and ultimately, for economic

growth. Applications of the "behavioral approach" to business location acknowledged that (re)location decisions are often the result of a complex process that incorporates far more factors, many internal to the firm, than a pure cost-based approach. More intangible attributes like the quality of life for the business owner and management come to the forefront. Industrial recruitment strategies can seem relatively ineffective in the face of less objective, more intricate decisions that involve factors beyond the influence of policy makers and practitioners.

This fundamental shift in thinking caused policy makers and practitioners to reevaluate industrial recruitment and reconsider the role of small businesses in a local economy. Many development agencies found that they could be more efficient and effective by directing their efforts at small- and medium-sized businesses already operating in their communities. The second wave of strategies prioritized homegrown businesses by focusing on entrepreneurship, expansion, and retention. These strategies tend to feature investment in local businesses, start-up incubators, and technical assistance for local firms.

Third Wave Strategies

Over time the mix and implementations of first and second wave strategies led to a fragmented and disjointed system of delivering economic development strategies. The third wave of strategies integrates different programs into a cohesive approach that considers a broad set of factors and stakeholders. Strategies focus not just on businesses—their location, production, and expansion—but the social, political, and cultural context in which this business behavior is embedded. Many business decisions involve negotiations with other businesses, landowners, labor unions, and local government. The "institutional approach" that motivates third wave strategies focuses on the laws, expectations, and social norms that set the parameters for businesses and other stakeholders as they navigate contract law, negotiate, and reach agreements. The most common way we can see this at the community level are through private-public partnerships. Business, government and other non-governmental organization (NGOs, such as development corporations) are in continuous conversations about how to improve the local economy.

In practice, government agencies and economic development organizations using third wave strategies tend to attract new business with local strengths and tailored strategies that partner business interests with community goals, instead of incentive packages that lower business costs. Third wave strategies that result from a holistic evaluation of local communities tend to be difficult to exactly replicate elsewhere, giving business a reason to stay long term. These strategies curb tax and incentive based competition that can be expensive for local government. Instead, the third wave focuses on fostering knowledge networks, developing the skills and education of the workforce, influencing regulation, and facilitating clusters of connected businesses that both cooperate and compete with one another. Ultimately, the goal is to improve the overall business climate or social capital that defines the ability of public and private sector to work

together.

In essence, how we think about the business climate of the community or region has undergone a fundamental change. In the paradigm of the first wave of economic growth and development a positive business climate was equated with reducing the cost of doing business: cheap labor and land, low taxes and limited regulation. Today the notion of a positive business climate is more focused on the entrepreneurial spirit of the community. Is the community, broadly speaking in terms of both the public and private sectors working together, willing to try new ideas, accept and learn from mistakes, have open dialogue and depersonalize decision-making? Is the community willing to tax itself to make necessary investments in infrastructure and public services? Is the community taking a regional and cooperative view of the local economy? In the simplest sense, is the community thinking and acting proactively in a collaborative approach? The few firms that are thinking about relocation are likely to find a community promoting a contemporary view of business climate more attractive than a community promoting a business climate purely through the lens of first wave thinking.

Effectiveness of Industrial Recruitment[*]

A location decision for a business concerns several factors including those affected by incentive packages, but many factors go beyond the influence of local government and economic development agencies. Each analytic approach to location decisions indicates certain factors that are most relevant to the choice. The "neoclassical approach" emphasizes factors that affect production and costs. The "institutional approach" draws attention to the role of government and fiscal policy as well as the market power of large firms. Indeed, certain neoclassical and institutional factors produce consistent results across several studies of industrial location. The "behavioral approach" also suggests several key factors, though more difficult to quantify, such as quality of life.

The neoclassical approach has established some of the fundamental factors to business location decisions, particularly for large firms that utilize objective decision-making processes such as profit maximization. In general, businesses consider the most profitable locations. Hence, factors that affect costs and revenues are important to location choice. Studies testing the neoclassical approach consistently find that locations with skilled labor are more desirable to firms, but those with high wages are less appealing (Arauzo-Carod et al. 2010). Much of the production process involves moving inputs and outputs, thus transportation infrastructure is an important aspect of the location choice though it varies across industries (Ibid.). Relatedly, businesses also value market access/size in trying to most

[*] *The scope of the literature review is approximately narrowed to industrial recruitment strategies in relation to **re**location decisions in the U.S., published in the 15 years.*

efficiently reach customers (Ibid.; Deller et al., 2006).

Yet location is often not a decisive factor for profit or loss (Pellengard et al. 2002) and in many cases the decision process is far less objective than the neoclassical model predicts (Berg 2014). There may be many profitable location choices and it seems that businesses only consider a very narrow subset of them (Berg 2014). In many cases businesses choose between just three alternatives and in some cases consider just one location (Ibid.). There is only limited information available about each location and rather than invest potentially limitless time and resources collecting information, many business owners and entrepreneurs simply choose to locate in the same location that other businesses chose (i.e., "follow the leader") (Ibid.).

In short, information is costly to collect and process. One strategy that communities can pursue is to have detailed information about the local/regional economy available for any business that might be interested in locating within the community. This includes information about potential sites and actions needed to bring those sites into acceptable condition. A strong signal that can be sent to the prospective business about the positive business climate of the community is if site information in neighboring communities is also shared.

Businesses do tend to cluster together because there are many advantages of co-locating. In "agglomerated economies" or "cluster economies" businesses that are physically near each other benefit from shared labor pools and supplier networks, and valuable flows of information that can spur innovation. Economies that feature a productive industrial mix, or urbanization, generally draw more new businesses than do highly specialized economies (Arauzo-Carod et al. 2010). As evidence of this, Lee (2008) finds that manufacturing plants tend to leave places that are concentrated in same-industry activity and relocate to new centers of industry. Headquarters, though, seem to relocate to metropolitan areas with same industry specialization and an agglomeration or clustering of other headquarters (Strauss-Kahn and Vives, 2009).

Whereas the cost of labor, access to markets, and patterns of industry concentration are largely beyond the influence of policy makers and economic development practitioners, they can alter tax rates and spending on public services. Many do just that but the effect of taxes on location is ambiguous (Arauzo-Carod, 2010). Operating outside the conventional profit-maximization model, there is evidence that entrepreneurs largely ignore tax incentives. Berg (2014, p 1700) writes, "…when asked directly about how tax incentives would (or do) influence location choice, the modal reaction was to ignore government's nudges to invest in regions of the city targeted by policies seeking to stimulate local economic growth in particular locations." Certain industries, such as manufacturing, may be sensitive to changes in particular tax rates but the effect is still small (Billings 2009, Lee 2008). Businesses do however seem to consider taxation and public good provision together, preferring a high tax-high public service location to one featuring low taxes and fewer public services. (Gabe and Bell, 2004).

In a study of small (less than 100 employees) rural manufacturing firms in Wisconsin, Maine, New Hampshire and Vermont Halstead and Deller (1997) found that only 25% of respondents picked their current location because of cost advantages while 61% stated that its current location is because that is where the owner of the business lives. One respondant wrote "[f]ind an area that you want to live, then start your business." When asked to evaluate the importance of 16 location characteristics, the top two were quality of life/amenities and access to local business services. Labor costs and property taxes were ranked third and fourth respectively. No business identified a business incentive as a driver of their location decision.

Even if state and local governments do manage to attract new business with incentive packages the changes in employment and incomes are likely to be small. Neumark et al. (2006, p. 93) write, "...the negligible role of business relocation suggests that a policy focus on such relocation is badly misdirected, and unlikely—even if successful at attracting new businesses and retaining old ones—to contribute visibly to job growth…" Local start-ups and the expansion of existing business have a much larger effect on employment dynamics, (Ibid., Eisenger, 1995). If employment growth is indeed the goal, it may be strategic to focus on fostering a dynamic economy with high rates of start-up and failure (Bunten et al., 2015).

As a special type of industrial recruitment, Enterprise Zones (EZs) have proved successful in some cases as measured by employment growth and wage increases (Busso et al. 2013, Okeefe 2004). In other studies the impact of Empowerment Zones is insignificant or negative (Parker and Fisher 2002, Neumark and Kolko 2010). The specific features and incentives of these programs vary dramatically across the country, however, making them difficult to assess. Likely the success of EZs is a function of the particular attributes of the incentive program, the surrounding community, and the implementation process. There is also evidence that EZs have a different affect across business dynamics (Bondonio and Greenbaum, 2007). New establishments tend to benefit the most from EZs and by a wide margin in terms of employment, shipments, and capital expenditures (Ibid., Billings, 2009). Existing establishments exhibit small, positive effects, but the gains are offset by losses from business closures and exits. Taken together across each type of dynamic, the net effect of EZs is small (Bondonio and Greenbaum 2007).

Policy Implications

Many communities engage in industrial recruitment as an economic development and growth strategy, often targeting businesses from elsewhere with incentive packages for relocating to their region. Though estimates of how many businesses relocate do vary, they are generally quite small ranging from one to five percent. In Wisconsin specifically, the share of establishments that move each year is consistently between 1% and 1.5%, and the share that makes an intrastate move is well below 0.5%.

Dedicating a large share of resources to recruitment may be inefficient considering

how few businesses actually relocate and that incentives seem to have little effect on location decisions. Trying to compete for businesses by lowering their costs, as exemplified by incentive package used for industrial recruitment, leads to a narrow and temporary advantage that is relevant to only a few businesses. Even those businesses that are considering a new location do not seem to be strongly swayed by tax rates or other incentives. Location decisions are often the result of a multifaceted and, in many cases, not purely objective decision process where incentive programs play a limited role. In the simplest case, businesses are located where the owner resides or would like to reside (Halstead and Delller, 1997). Indeed, behavioral studies show that entrepreneurs prefer a home-field advantage (Arauzo-Carod, 2010). In which case, developing generally attractive communities where people want to live may be the key to business location.

The quality of the relationship between the public and private sector will play a large part in appealing to business. The "business climate," for which there nearly as many definitions as there are studies and ways to measure it, does generally describe the tax and regulatory environment of a place if not the broader role of the public sector in economic growth and development. Ideally, businesses take on their social responsibilities and government supports legitimate business needs (Deller and Goetz, 2009). To this end, there may be much to gain from strategies geared toward viable institutions and partnerships within a community. A strong relationship between the public and private sectors goes beyond fostering community to enhancing the business climate.

More broadly, the business climate extends beyond taxes and regulation to the community culture. A supportive community culture appeals to both local entrepreneurs and business owners looking to relocate. Focusing on attitudes toward risk, experimentation, and cooperation could prove to effectively attract business. The force of community expectations largely determines the way business will interact with economic growth and development strategies. For example, some communities are more amenable to failure and innovation than others, making them more inviting places for entrepreneurs. These informal rules and expectations, combined together with the regulations and laws define the business climate and local ability to create and take advantage of economic opportunities.

Proponents of recruitment efforts often point to the number of businesses that demand and accept incentive packages. From the "institutional approach", large firms will attempt to exert market powers and extract what economists call "monopoly rents" by demanding exception for certain taxes. Firms will also "play communities against each other" in an attempt to maximize those monopoly rents. We see this with professional sports teams demanding public resources to improve or build a stadium. In addition, most firms that are offered an incentive will tend to accept the incentive, but this does not show that the incentive changed the decision of the firm.

Ultimately, the resources and effort devoted to recruitment may be better

invested in local communities and their businesses. Few businesses relocate each year but those that do will likely be drawn to communities with a strong business climate. Places that focus on the community culture, cooperation between the public and private sectors, as well as developing their local strengths in the workforce or industry clusters for example, may be more likely to attract new ventures than places offering the best "deal." Those communities that are better prepared to partner with new business and leverage their community ties will be well positioned to attract new business.

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