You Decide: Should We Pay Amazon to Come to North Carolina?

By Dr. Mike Walden. The "final 4" is over; now it's time for the "final 20." What sport is this, you say? It's for the "Amazon Cup" – the 50,000 job, multi-billion dollar investment for the cyber retail giant's second headquarters. North Carolina has a player in the competition – the Triangle region –, and now Amazon analysts are making visits to the final 20 before announcing a winner sometime this year.

The Triangle area recently received a visit from Amazon. There were no public reports on what Amazon looked at or who they talked to, but state and local officials are confident the Triangle will be in the thick of the battle to clinch the headquarters prize. Yet one of the uncomfortable questions about the quest for Amazon HQ2 is whether the winner will have to pay for winning. In other words, will North Carolina have to use financial incentives to make Amazon adopt us as their second home?

The answer is almost certainly "yes." In recent decades it has become common for states to offer financial incentives to firms – especially major ones – to locate in the state. Of course, you can't get much bigger than Amazon, so experts expect incentives in the billions of dollars will be dangled before the firm.

So does this mean the governor of the winning state will sign a check potentially in the billions for Amazon to locate there? No. Fortunately this is not how the incentives game is played. Most incentives are in the form of tax reductions for the company for a period of time. For example, let's say WALDENCO, the leading widget maker in the world with thousands of employees (hey – I can dream), is considering locating in North Carolina. Assume the typical amount of state corporate income and sales taxes paid by WALDENCO is $10 million annually. North Carolina might tell WALDENCO their tax bill will be cut in half for twenty years if the widget giant comes to the state. This would save WALDENCO $100 million over twenty years, so the incentives offer would be worth $100 million.

Firms receiving incentives do pay taxes – they just pay less than they would have without the incentives. Still, such targeted tax breaks are opposed by many people, especially when considered for such a rich company like Amazon. In fact, there have been national efforts to have incentives banned, or at least to have states agree not to use them. To date, these efforts have not succeeded.

This leaves us with two key questions about incentives. First, will big firms come to a state without them? Second, how does a state evaluate the benefits and costs of using them?vFor the first question, the existing evidence suggests states need to offer financial incentives to lure the big, potentially economy-changing, companies. Studies suggest a large company like Amazon will narrow their field of locations to two, three or four. The firm will consider each of the final locations acceptable. It's at this point the incentives package will come in to play and seal-the-deal for one of the locations. Maybe if one location had a slight advantage over the others, then its incentives package wouldn't need to be as large. But there would still need to be a package.

I have some personal experience in answering the second question – how to evaluate offering an incentives package. Almost twenty years ago I was asked to develop a set of calculations (economists call this a "model") for state leaders to use in estimating the costs and benefits of business financial incentives. The model is still used today. My model considers several possible direct and related costs of an incentives package. Obviously one is the total value of the tax reductions offered to the company. In addition, the state may offer some infrastructure investments specific to the company, such as upgraded highways. Such costs are also recognized in the calculations.

New companies – especially big ones – will usually hire out-of-state workers to fill some of their work slots. New residents and their families will create some additional public costs related to education, transportation, public safety and general government. My model factors in these considerations.

Last, there's the possibility a new company will compete with an existing company doing the same kind of work. The new company might even take-away some of the business of an existing company. While this impact won't happen in every case – it's likely low for Amazon HQ2 – users of my model are prompted to consider it.

Balanced against these costs are several potential public benefits – the remaining taxes paid by the company, the taxes paid by the company's workers, new taxes paid by in-state companies who sell to the new firm and the reduction in state unemployment and the savings in public costs – like Medicaid – associated with less joblessness.

So state leaders can look at the calculations from my model and see how an incentives package lines up in terms of costs and benefits. State decision-makers can also make the implementation of the incentives contingent on the company achieving promised payroll levels. If the levels aren't met, the financial incentives can be scaled back.

If Amazon decides to come to North Carolina, an incentives package will be part of the deal. But rather than incentives being a "yes" or "no" option, it can be a "maybe" – being based on how the estimated costs and benefits from them compare. Sound reasonable? You decide!

Walden is a William Neal Reynolds Distinguished Professor and Extension Economist in the Department of Agricultural and Resource Economics at North Carolina State University who teaches and writes on personal finance, economic outlook and public policy.

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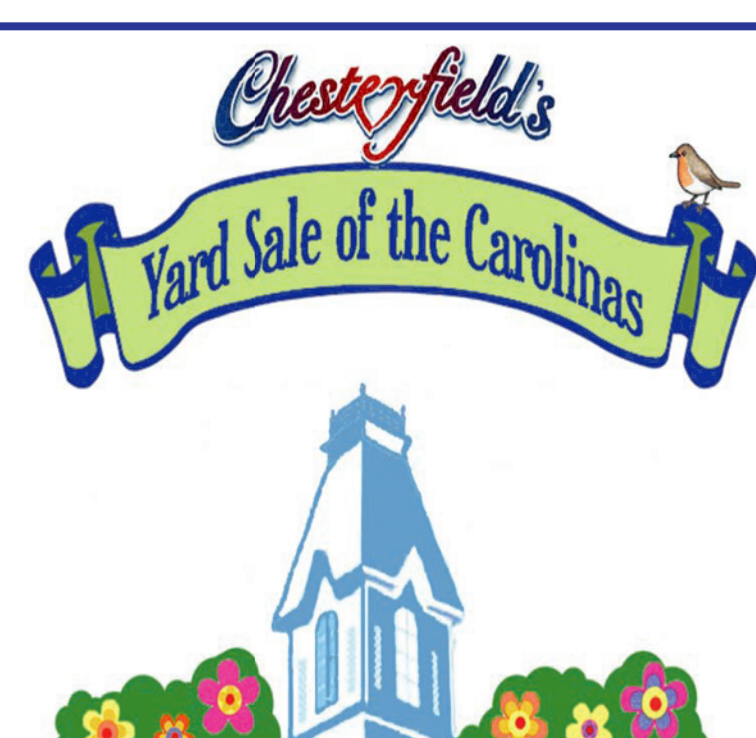

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