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Why Losing Out on Amazon HQ2 Isn't So Bad for Cities.

A new study points to evidence that luring a large corporation isn't the best way to spur job growth.

After a yearlong and very public deliberation over the location of its second headquarters, Amazon this week disappointed some policymakers when it announced that it would split HQ2 into two locations, one in New York City and the other in the Washington, D.C., metro area.

In choosing New York and D.C., Amazon opted for two cities that have led the economic expansion since the end of the last recession in 2009, far outpacing the rest of the nation in job growth. The decision drew the ire of politicians at the state and federal levels, along with others who had called on the tech giant to place its second headquarters in a city where it could play a more transformative role in the economy.

Yet a new study from the Urban Institute suggests that landing such a large corporation isn't actually the best way to build a local economy and spur job growth.

Instead, the report says, cities should focus on growing existing local firms, not trying to lure out-o--town companies and poaching firms from other cities. "Most job expansion and contractions come from birth and deaths of homegrown businesses or expansion or contractions of existing home-based businesses," says Megan Randall, a research analyst with the Urban-Brookings Tax Policy Center and a co-author of the report.

When marquee companies move into a new city, they often displace existing firms, like when a big box store puts some mom-and-pop stores out of business. Creating and expanding homegrown businesses has a better track record for adding job growth to a region, the report says.

The competition to land Amazon HQ2 has spurred debate over the generous tax incentive deals cities offer up to attract big corporations. New York City offered some $3 billion incentives to Amazon, and Crystal City, Va., where the company will be located just outside Washington, put up $500 million in tax breaks. But those offers weren't the deciding factor, according to the company. The stronger draw was the highly skilled and highly educated labor force in both cities.

"One of the first things to remember when using tax incentives and any other cash rewards is that they play a relatively small role in attracting businesses," Randall says. "We see that pretty clearly in Amazon's own self-stated priority. They said they wanted to go to a place where they can recruit and hire talent."

Sometimes, tax incentives can even harm the local economy, especially in cities whose finances aren't as rosy as New York's or D.C.'s. Giving up that tax revenue can put a strain on local services, particularly schools. As New York University business professor Scott Galloway put it in an email to Barron's on Tuesday, the tax incentives from New York amount to "an elegant transfer of funds from municipal school/fire/police districts to Amazon shareholders."

Cutting into services and school budgets makes the local workforce less attractive in the long run, and the location less alluring, the Urban Institute report notes. “What is the trade-off? What are the investments that the city or the state can be making to change its long-term economic trajectory?” Randall says.

Cities would be better served, according to Randall and other economic policy analysts, by improving schools and public services, and focusing on nurturing their existing network of businesses.

When a city offers tax giveaways to lure a company, the government goes into the negotiation with a marked disadvantage because of what economists call “information asymmetry.” The city doesn’t have all the information about what the company is looking for. In some cases, a company may choose a city it would have moved to anyway, pocketing the tax incentives even though they weren’t a deciding factor.

“Firms are in a advantageous position,” Randall says. “They know cities want to attract jobs and create opportunities for their residents. They know they are in the position to leverage a public benefit from what they have to offer.”

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