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How States Can Avoid Costly Pitfalls While Rebuilding Their Economies.

3 ways to increase the effectiveness of economic development incentives and control spending

In 2010, Michigan's economy was reeling. The Great Recession had hit the state hard and U.S. automakers were struggling to survive. Seeking to ease the pain, state officials authorized tax credits under the Michigan Economic Growth Authority (MEGA) program as part of long-term deals with distressed automakers. But the program did not include fiscal protections to control the state's costs. This would prove to be a damaging misstep years later when Michigan had to close a multi-million dollar budget gap with spending cuts after automakers began claiming credits in larger amounts than expected.

How did this happen? When developing the agreements, the state relied on unrealistic estimates of the number of jobs the companies would create and the salaries they would pay. The companies hired more workers at higher than anticipated salaries, qualifying for more tax credits and driving costs higher than expected. Fortunately, such situations can be avoided.

An unexpected decrease in revenue is one of the most challenging budget situations that state governments can face, as recent experiences grappling with the impact of the pandemic show. Policymakers are also feeling pressure to get their economies back on track. If economic development incentives are part of a state's recovery strategy, leaders should take three steps to increase predictability and effectiveness:

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