Disclaimer

The views expressed in this presentation are those of the presenter and do not necessarily represent the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
Roles of the Federal Reserve System

• Promote an efficient payment system
• Safeguard the banking system
• Promote economic growth and price stability
The Role of Small and Large Businesses in Economic Development

• Why Recruit Large Businesses?
• Small Businesses, Job Growth, and Innovation
• Economic Development Policy: Small Businesses vs. Large Businesses
  – Policy Effectiveness
  – Competition
Why Recruit Large Businesses? Pay.

![Bar chart showing average wages by establishment size.](chart)

Average Wage by Establishment Size:

- 1 - 49: $17.80
- 50 - 99: $19.10
- 100 - 499: $20.42
- 500+: $26.65
- All Private: $20.47

Why Recruit Large Businesses? Benefits.

![Bar chart showing the percentage of employers offering various benefits to 1-99 employees vs. 100+ employees.](chart)

- Retirement: 45% (1-99), 78% (100+)
- Health Insurance: 59% (1-99), 93% (100+)
- Life Insurance: 42% (1-99), 76% (100+)
- ST Disability: 26% (1-99), 51% (100+)
- Paid Holidays: 69% (1-99), 85% (100+)
Why Recruit Large Businesses? Stability.

Source: U.S. Census; 2006 – 2007 figures
Businesses Size and Job Creation

![Bar chart showing net employment gain by business size category from 2002 to 2007. The categories are <20 Employees, 20-99 Employees, 100-499 Employees, and 500+ Employees. The chart displays the net employment gain for each year, with 2002 having the largest negative gain and 2006 having the largest positive gain.](image-url)
Why Might Large Firms Be More Innovative?

• R&D fixed costs can only be recovered with large sales volume
• Better access to external financing for R&D
• Better access to internal financing (with higher profitability)
• Simultaneous projects means diluted risk
• Better name recognition and established marketing channels means greater opportunity to market and sale innovations
• Often compete on quality and product differentiation, meaning greater incentives to innovate
Why Might Small Firms Be More Innovative?

• Lack of entrenched bureaucracy means
  – Shorter chains of command
  – More efficient communication
  – More flexibility
  – Better managerial coordination

• Often more competitive environment, meaning more incentives to innovate

• Ownership and management more likely to be intertwined
What the Research Says

• R&D intensity increases with firm size in some industries and decreases in others
• To the extent a generalization is possible, the result is likely a moderate U-shape
Economic Development Policy

- Large firm locations are unlikely to be successful, and not cost-effective when they are.
- Local competition for firms aggravates this situation.
Unlikely Success

• Economic inefficiencies: society produces less with the resources it has available
• Budgetary implications
• A focus on a particular firm or industry is risky because sorting prospective winners and losers is difficult at best
• Industrial incentives and other large firm recruitment efforts often do not work or have limited impact
Picking Winners and Losers: United Airlines

• Touted as the “most efficient and one of the largest aircraft repair facilities ever” and opened in 1994 (construction began 1990)
• “Won” by Indianapolis with a $300 million - $450 million incentive package
• Announced employment was 7,500 ($40K - $60K per job), but actual was more like 1,500 ($200K - $300K per job)
• Closed for good in May, 2003
Picking Winners and Losers: United Airlines

• Costs for Indianapolis
  – $697,000 annual foregone rent
  – $5.2 million in 2003 and $6.1 million annually in 2004 and beyond to preserve the facility

• Oklahoma City Mayor: Losing United was the best thing that ever happened to us.
Net Impacts of Firm Locations

• Positive Spillovers
  – input-output linkages
  – agglomeration effects
    • labor pooling
    • knowledge spillovers
  – employment and income multipliers

• Negative Spillovers
  – infrastructure congestion
  – wage and rent pressure
  – reduced supply of resources
  – perception that this might occur

Net Impacts of Firm Locations

• For the *average* large firm location, a thousand new jobs yields only 285 net new jobs.
  – One study suggests that the net is closer to zero
• For the *average* large expansion of an existing firm, a thousand new jobs yields 2,000 net new jobs

Regional Competition for Economic Development

- Some Interjurisdictional Competition is Welfare-Enhancing
- Interjurisdictional Competition for Business and Industry Generally Is Not Welfare-Enhancing
- The Prisoner’s Dilemma
### The Prisoner’s Dilemma and Regional Development Competition

#### Region B

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#### Region A

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Going Forward

• While large firms offer better jobs on average and contribute significantly to job creation and innovation,
  – most net new jobs are created by small firms
  – large firm recruitment is unlikely to be successful, or successful only at great cost
  – a focus on a particular firm or industry is risky
  – large firm recruitment can breed damaging competition
Going Forward

• Expanding existing industry can be very successful, but still should weigh costs and benefits before incentivizing.

• An important strategy going forward is focusing on quality of life issues.
Going Forward

• Economy rapidly shifting towards locally-provided services and information-based production

• Biggest issues is recruiting the right workers

• Success requires building
  – Quality of life (for families also)
  – Regulatory and fiscal environment conducive to business

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