BUSINESS BLOG: BUSINESS TIPS FROM THE LION'S DEN

Story by Dr. Howard J. Wall

ECONOMIC POLICIES typically have two types of effects: those that are seen and those that are unseen or difficult to observe. However, policies are often decided upon on the basis of their seen effects only, so they can end up worsening the problem they were intended to address. This point, which applies across a wide range of policies, can be illustrated with a policy that is particularly prominent in Missouri.

Each year, the state of Missouri hands out tens of millions of dollars in development tax credits under a variety of programs. These programs are touted by their supporters as being key to the state's economy because they are alleged to lead to the creation of jobs. The logic behind this claim is simple: Step one, tax credits are provided to a firm that promises to build a factory; step two, the factory is built; and step three, the factory employs some people. Ergo, the tax credits created more jobs.

The problem with this logic is that it takes into account only the effects that are easily seen (taxpayer money is followed by jobs at the new factory), while ignoring the effects that are unseen (the many, often small effects that ripple through the rest of the economy). There can be enough of small, unseen effects to cancel out some or all of the seen effects.

For example, in our tax credit scenario just described, where do the workers come from to fill the jobs at the new factory? It's very likely that many of the workers were already employed elsewhere in Missouri, so the new jobs do not represent a net increase in employment, only a reshuffling. And what will happen to the firms that the workers came from? Perhaps they won't be able to compete for workers any longer and, as a result, may shut down or move out of state.

It should also be noted that it is possible the factory in our example would have been built even if the firm had not been awarded the tax credits. It's certainly conceivable that the factory owners simply claimed that they needed the tax credits; but in fact, they had already made the decision to go ahead with the project before going to the state seeking financial support. In this case, the tax credits would simply be a handout of taxpayer money without any wider effects. This possibility is something that can't be seen directly, but is nevertheless an important factor in assessing the effect of the programs. Independent research that tries to account for the unseen effects of tax credits and similar programs tends to show that the tax credits do not lead to net increases in employment. In fact, in a study published recently in the Missouri Policy Journal, it was found that tax credits awarded under the Missouri Quality Jobs Program, one of the largest programs of its kind in the state, were actually associated with net reductions in employment.

Although not all economic policies have the large and unseen negative effects typical of tax credit programs, you can be assured that these effects are present for every policy. An acknowledgment of this fact might go a long way in preventing us from embracing policies that look good at first glance, but which might have unseen and unpredictable consequences. ▫