



An AI Innovation Toolbox for Governors

DR. MICHAEL MANDEL

PROGRESSIVE POLICY INSTITUTE

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INTRODUCTION

Should state governors act now to capture their share of the tech/AI investment boom? The answer is unequivocally yes. By many measures, the economic heft of the software and related industries now matches or exceeds that of the motor vehicle industry, a traditional target of state economic development efforts. In 2024, U.S. businesses invested \$700 billion in software, about equal to consumer spending on motor vehicles. In the first half of calendar year 2025, Amazon, Alphabet, Microsoft, Meta, Oracle and Apple laid out a stunning \$180 billion in total capital expenditures, primarily in AI-related structures and equipment.¹

To put these numbers in perspective, this tech and AI investment surge dramatically overshadows domestic investment from major manufacturing industries. The motor vehicle industry invested just \$29 billion in structures and equipment across all states in 2023, while the primary metals industry, including steel and aluminum, invested only \$15 billion.

Governors who attracted high-wage auto assembly and parts plants to their states in the 1980s and 1990s were hailed as economic heroes. They used economic development tools like tax incentives and worker training subsidies to lower the cost and riskiness of making such large investments. At the same time, smaller businesses were supported through manufacturing and agricultural extension programs, which helped them keep up with new developments. The economic literature suggests that the benefits of these policies, on average, substantially exceed the costs.²

Today, governors are putting together a new “AI innovation toolbox,” analogous to the economic development tools of the past. Tax incentives, employed wisely, can be used to attract AI startups and data processing centers to boost state economies. Smart energy policy, including faster approval of new grid investments, demand side management and long-term capacity commitments, can better match electricity

generation and transmission upgrades to AI, industrial and transportation demand, and minimize the impact on retail rates. Governors can leverage their state's public and private universities to develop and attract AI-focused businesses. Worker training subsidies and AI-focused career technical education can ensure that existing

workers are not left behind. AI "extension programs" can accelerate the adoption of AI by small businesses, making state industries such as manufacturing, agriculture, and construction more competitive, and creating more demand for AI-enabled workers.

TABLE 1: OPENING THE GOVERNOR'S AI INNOVATION TOOLBOX

TAX INCENTIVES	Used to attract AI startups and data centers
GOVERNMENT-UNIVERSITY PARTNERSHIPS	Governors can leverage their state's public and private universities to develop and attract AI-focused businesses
SMART ENERGY POLICY	Governors can encourage regulators and utilities to use new tools to better match electricity supply and demand, and reduce the risk of high prices
WORKER TRAINING SUBSIDIES AND AI-FOCUSED CAREER TECHNICAL EDUCATION	Ensure that workers are not left behind by technological changes
STATE-SPONSORED AI "EXTENSION PROGRAMS"	Accelerate the adoption of AI by small businesses, making industries such as manufacturing, agriculture, and construction more competitive

REGULATION VS INNOVATION AND INVESTMENT

So far, state AI policy has generally focused on efforts to regulate the development and deployment of artificial intelligence applications. In 2024, there were more than 600 AI-related bills introduced at the state level, almost all designed to restrict or monitor the use or development of AI.³ About the same number have been introduced in the first half of 2025 alone.

Obviously, some form of regulation of AI is needed, though it's still an open question whether regulatory oversight is more appropriate at the

federal or state level. But states that lean too heavily on regulating AI run the risk of missing the potential productivity and growth benefits that developing and using AI can bring.

What about jobs? Everyone is aware of the possibility that AI will eliminate a swathe of existing jobs.⁴ Our perspective is that AI will accelerate the development of new products and services, especially in "physical" industries like manufacturing, construction, and agriculture. New products and services create new demand and require new job skills.

It's important to note that previous forecasts of technology-driven job collapses have turned out to be premature, often signaling future job gains instead. It doesn't make sense to just focus on job destruction from innovation without considering job creation as well.

For example, the big ecommerce innovation was supposed to lead to a "retail apocalypse," or a "retail meltdown," eliminating millions of retail sales jobs and replacing them with fully automated websites.⁵

In fact, retail turned out to be fundamentally a logistics business, and having a good website was only the beginning of the e-commerce transformation. As PPI showed in a prophetic 2017 paper, getting fulfillment and delivery right was much more difficult and important, requiring more investment and more people.⁶ So while the number of poorly-paid retail sales positions declined by 15-20%, better-paid jobs doing ecommerce fulfillment increased even faster. Employment in the consumer distribution sector — including brick-and-mortar retail, fulfillment, and local delivery — actually rose by 1 million jobs from 2017 to 2024.

Moreover, the adoption of AI in business operations is likely to be costly and slow: Applications of AI to the existing workflow of a business will cut some costs by speeding up one step, while exposing other bottlenecks. It typically takes years to adopt a new technology across an entire business, and AI won't be different.

In a pharma company, for example, speeding up the creation of marketing presentations using AI will do nothing to cut the cost and time of clinical trials. AI can help there as well — but it's a much slower and painstaking process.⁷ Indeed, even if AI helps move us towards new treatments for conditions such as cancer and Alzheimer's, the necessary lab research and clinical trials to validate the insights will themselves become job producers.

Third, and related, what Americans complain about the most is the cost of necessities, such as housing, food, transportation, child care, and elder care. High tariffs may also increase the emphasis on domestic manufacturing. AI has a powerful opportunity to modernize these sectors, boosting capacity and creating a new wave of AI-complementary jobs, including for workers without a college education.

Fourth, the educated employment market has been fed in recent years by a wave of immigrants. Since 2019, fully one-third of the net new jobs for workers with a college degree or better have gone to foreign-born individuals. (That's according to the published data from the BLS. However, adjusting for under-measurement of immigration in the post-pandemic period gives roughly the same percentage.) If that flow is choked off by Trump's actions against foreign students and educated adult immigrants, we are more likely to end up with skilled labor shortages than surpluses.

TAX INCENTIVES TO FOSTER AI DEVELOPMENT EFFORTS IN THE STATE

What tools can governors use to attract their share of growth? Tax incentives — targeted reductions in state and local income, sales, and property taxes — are key tools for encouraging businesses to locate or expand in a state. The consensus is that "economic development tax incentives can pay off if properly designed and in the right local circumstances."⁸

Many states already offer tax breaks for data centers. In 2024, new laws in Kentucky and Louisiana implemented sales and use tax exemptions/rebates for new data center equipment as long as companies made sufficient investments and created a minimum number of jobs.⁹

Indeed, data center construction is providing a much-needed boost to state economies. Consider

Virginia, one of the leading locations for data centers. The 2024 report on “Data Centers in Virginia,” from the state’s Joint Legislative Audit and Review Commission, found that “the data center industry provides approximately 74,000 jobs, \$5.5 billion in labor income, and \$9.1 billion in Virginia GDP overall to the state economy annually.”¹⁰ That estimate was based on average spending by the industry between FY21 and FY23, prior to the AI boom.

The Virginia report noted that data center revenue has allowed localities to lower real estate tax rates, construct new schools, and establish revenue stabilization or reserve funds. Moreover, “data centers are an attractive industry because they impose minimal direct costs on the provision of government services,” including local roads and school systems. Of course, data centers do require large amounts of energy, and the resulting investment in new power generation and transmission facilities needs to be considered as well.

In recognition of the economic benefits of data centers, most states offer an exemption from sales tax for the equipment going into data centers. That’s analogous to the sales tax exemption most states offer for the purchase of manufacturing machinery to go into a factory.¹¹ Texas, for example, exempts “certain items necessary to the operation of qualifying large data centers,” while also exempting “several types of items used in manufacturing products for sale, including materials that become part of the manufactured product” and equipment “necessary or essential” to the manufacturing operation if it causes a physical or chemical change in the product being manufactured.¹²

In New Jersey, Governor Phil Murphy has pioneered the “Next New Jersey Program,” which is more focused on AI. The program will award tax credits to eligible businesses that are engaged in

artificial intelligence work or large-scale artificial intelligence data centers. A business must commit to creating at least 100 new full-time jobs and meet a minimum capital investment of \$100 million to be eligible for tax credits, which are tied to capital investment and the number of new full-time jobs. In New Jersey, Governor Phil Murphy has pioneered the “Next New Jersey Program,” which is more focused on AI. The program will award tax credits to eligible businesses that are engaged in artificial intelligence work or large-scale artificial intelligence data centers. A business must commit to creating at least 100 new full-time jobs and meet a minimum capital investment of \$100 million to be eligible for tax credits, which are tied to capital investment and the number of new full-time jobs.¹³

To summarize: A state sales tax exemption for data center equipment, like the one for manufacturing machinery, is designed to boost investment and jobs. Without the exemption, the investment in the state — and the contribution to the state economy — would be lower.

CREATING A BETTER GRID

When tackling the issue of energy demand from data centers, it’s essential to realize that on a national level, utility electricity generation has barely risen over the past two decades. This is an industry that has gotten used to slow growth. From 2004 to 2024, net utility-scale electric generation rose by only 8%, according to data from the Energy Information Administration.¹⁴ By comparison, over the same period, the size of the economy, as measured by real GDP, increased by some 50%. In other words, utilities have been generating, and selling, fewer megawatt-hours of electricity per unit of real GDP.

One way or another, this rather odd trend of slow growth is coming to an end. Even without new data centers, the ongoing electrification of transportation, homes, and manufacturing

means that more generating capacity needs to be added, and the transmission system needs to be modernized. Prices may rise in the short run, but as one leading energy economist wrote recently, there's "extensive evidence that supply will respond (if the government doesn't block it and grid operators avoid delaying interconnections) and eventually drive prices down again."¹⁵

Viewed in this context, governors have a key role in facilitating the transition of the electricity industry from a no-growth to a pro-growth mode. First, this means being willing to make the case for generation and transmission upgrade projects to lower prices. What's needed is an "all of the above" energy strategy, embracing renewables, natural gas, and nuclear.¹⁶

In Ohio, for example, Governor DeWine signed House Bill 15, which, among other things, creates an accelerated review process for major utility facilities. It also provides incentives for solar development on brownfields—such as former industrial sites, by providing property tax exemptions for five years. In addition, the legislation encourages utilities to consider advanced transmission technologies.

Governors also have an important role in encouraging regulators and utilities to engage in collaborative planning with potential sources of demand. For example, peak power requirements at some data centers can possibly be adjusted to avoid system demand peaks.

According to one analysis, demand-side management can handle 10% of the U.S. load in 2030.¹⁷ A recent Duke University report "found nearly 100 gigawatts of existing capacity on U.S. grids for data centers" that can commit to curtailing loads at times of peak demand.¹⁸

Not all data centers are suited to demand-side management. Nevertheless, Google has already

started making agreements with Indiana Michigan Power (I&M) and Tennessee Valley Authority (TVA) that deliver "data center demand response by targeting machine learning (ML) workloads."¹⁹

Governors can also help owners of transmission and power generation facilities decide how much to invest in expensive grid infrastructure upgrades. One danger is underinvestment. But the other danger is overinvestment—if the anticipated demand does not materialize, consumers will be stuck paying for unnecessary capacity. This is an especially big problem for the AI boom, where it's not clear how many planned data centers will actually get built. It means that utilities move more cautiously than they otherwise would, so paradoxically, the threat of overinvestment leads to underinvestment and higher prices.

What's needed is a "capacity commitment framework" which shifts much of the risk from utilities and retail customers to large customers. For example, in February 2025, the Indiana Utility Regulatory Commission approved an agreement between the Indiana Michigan Power Company and Amazon, Google, and Microsoft, which called for large customers to commit to buy capacity for many years, with collateral or the equivalent required, significant minimum charges, and transparent fees for modification.²⁰ In addition, the terms apply consistently to all new large loads above a certain peak demand threshold.

Similar frameworks for capacity commitment have been implemented in Georgia, Utah, and West Virginia, and are under consideration in other states. The result is a win-win outcome—less risk for retail customers and utilities, and more investment for growth.

UNIVERSITY PARTNERSHIPS FOR AI RESEARCH

Governors can leverage their state's public and private universities to develop and attract AI-focused businesses. In New Jersey, the NJEDA,

as part of its AI-focused economic development effort, has partnered with Princeton University and Microsoft, among others, to open an AI Hub, focusing on research and development; commercialization and accelerating innovation; and strengthening AI education and workforce development.²¹

In New York, Governor Kathy Hochul has spearheaded the Empire Artificial Intelligence (AI) Partnership, a research consortium aimed at advancing AI innovation, including a state-of-the-art artificial intelligence computing center, housed at SUNY's University at Buffalo. The state originally made a 10-year \$275 million investment in its 2025 fiscal year budget, and then added an additional \$90 million in FY 2026.²²

TRAINING WORKERS IN AI-RELATED SKILLS

Predicting the workforce needs of companies in an era of AI is difficult. Still, governors have a key role to play in developing an AI-ready workforce in their state. Investments in K-12 education have a high payoff, and smoothing the school-to-work transition is essential.

High schools in California, Florida, Georgia, and Maryland have started to design and implement AI-specific career technical education (CTE) programs that prepare students to enter the emerging technical workforce.²³

One leader is Florida, which has developed a statewide AI CTE pathway that focuses on technical skill proficiency and competency-based applied learning of AI.²⁴ This pathway includes four classes:

(1) AI in the World, where students explore the role of data and ethics in AI applications and how AI agents make decisions; (2) Applications of AI, designed to deepen understanding of AI applications and how to build AI models; (3) Procedural

Programming, which continues the study of computer programming concepts with a focus on the creation of software applications; and (4) Foundations of Machine Learning, designed to provide students with core foundational knowledge to deepen understanding of machine learning (ML) practices and applications.²⁵

Individuals already in the workforce need a different sort of AI-related training. In the Macon (GA) area — which still has some 15,000 manufacturing jobs — the Georgia Veterans Education Career Transition Resource Center (VECTR), a branch of state-funded Central Georgia Technical College, offers a technical certificate in “AI Enhanced Robotic Manufacturing.” The program

...Allows students to enhance their automated manufacturing skills by learning robotic programming, fundamentals of cyber-physical systems, artificial intelligence in the manufacturing environment, programmable logic controllers, and machine vision technology.²⁶

This comes against the backdrop of attempts to develop “apprenticeship degree” programs, to offer an alternative pathway to good-paying jobs, combining on-the-job training with related academic work.²⁷

Some states have been training public sector workers in AI skills. For example, partnering with nonprofit InnovateUS, Pennsylvania and Oregon are both providing state employees with AI training.^{28, 29}

ADOPTION AND DEPLOYMENT OF AI APPLICATIONS

Governors also have an important role to play in accelerating the adoption and deployment of AI applications, especially among the small and medium-sized businesses that make up so much

of state economies. These small- and medium-sized businesses traditionally have underinvested in information technology, driving up costs and hampering state competitiveness.

Small and medium businesses don't have the resources to keep up with the latest AI tools in their industry, putting them at a disadvantage. That's where state governments can come in. In Connecticut, Governor Ned Lamont has introduced a bill (CT SB 1249) that takes an economic development approach to AI.³⁰ Among other steps, the bill would create an AI regulatory sandbox program, "which would allow an applicant to temporarily test an innovative product or service on a limited basis under reduced licensure, regulatory, or other legal requirements than may otherwise be required under the laws of the state."³¹

Another possibility: Setting up an "AI extension" program to help small and medium businesses learn how to use AI, analogous to manufacturing and agricultural extension programs. According to a 2024 estimate, manufacturing extension programs saved manufacturers \$2.6 billion,

generated \$5 billion in manufacturing investments and created or retained 108,000 manufacturing jobs.³² AI extension programs, if done right, could have a similar positive impact.

For example, one key area where AI could make an enormous difference is the long and difficult process of developing and testing new products and services.³³ Large companies such as Pepsico and Toyota are already using AI to accelerate product development.³⁴ Food and beverage companies can identify combinations of ingredients that appeal to new markets.³⁵ Manufacturers can use AI to reduce reliance on physical prototypes and speed up the design cycle.³⁶

AI extension programs can be targeted toward key sectors where productivity growth has lagged, including construction, agriculture, and manufacturing (Table 2). These sectors form an important part of the economic base of many states, and without faster productivity growth, state wages and profits will stagnate, and so will the state and local tax revenues.

TABLE 2. INDUSTRIES WHERE AI CAN HELP STATE PRODUCTIVITY AND INCOME GROWTH

	AVERAGE LABOR PRODUCTIVITY GROWTH		
	1993-2003	2003-2013	2013-2023
CONSTRUCTION	0.4%	-1.3%	-0.2%
CROP AND ANIMAL PRODUCTION	2.7%	1.8%	-1.1%
MANUFACTURING	4.6%	2.2%	-0.6%

Data: BLS

Indeed, it may take time, but one important measure of the success of a state AI innovation policy will be the revival of productivity and income growth in these industries.

CONCLUSION

As shown in this policy brief, governors have a special role to play in fostering AI-related growth in their state. That includes taking steps to attract AI-related investments; adopting smart energy policy, develop government-university partnerships for AI research; subsidize AI-related education and training; and support AI application use by small- and medium-sized local businesses.

Using these policy levers, capturing their share of the AI boom may have long-term positive impacts. The window of opportunity is now.

ABOUT THE AUTHOR

Dr. Michael Mandel is Chief Economist and Vice President at PPI.

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PROGRESSIVE POLICY INSTITUTE
1919 M Street NW,
Suite 300,
Washington, DC 20036

Tel 202.525.3926
Fax 202.525.3941

info@ppionline.org
progressivepolicy.org
