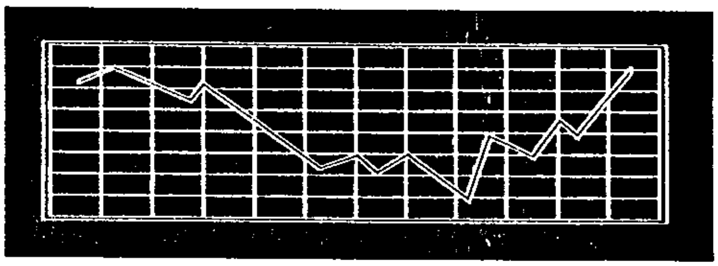
Economic Development

* *Preliminary Report* *

Tax Incentives for Economic Development



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From Al Major 3/94

THIS IS FINAL - AT THE TIME WERE PLANNING TO DO A FINAL REPORT, BUT DECIDED AGAINST

Executive Summary

Economic development experts consider Mississippi to be the first state to actively encourage industrial development and attract investment. In 1936 the state introduced its *Balance Agriculture With Industry* program, using tax incentives, industrial bonds, and promotional advertising to recruit industries to Mississippi. Other states quickly adopted this strategy—often called "smokestack chasing"—and it was the pivotal strategy for most states. For example, between 1981 and 1983, Indiana enacted a three-phase, $120 million economic development strategy. The Indiana legislature passed 53 bills concerning small business assistance, job training, resource development, infrastructure improvements, and new investment in capital. In that same period, Kansas adopted an economic development package that reorganized its economic development agency, established a venture capital agency (Kansas Venture Capital, Inc.), granted tax credits for venture capital firms and for research and development. Finally, the state created the Kansas Technology Enterprise Corporation to act as a liaison between research universities and the private market.[1]

By 1966, states offered an average of 17 economic development programs designed to attract business and industry. By 1976, the average number of programs per state had risen to 24, and to 32 by 1985.[2] However, the growth in the number of programs cannot measure the intensity of their use. Economic development policy tools and programs, once simple, have become increasingly complex and varied. Economic development now involves quantitative factors—how many new jobs—as well as qualitative factors, such as the quality of those new jobs, the impact of industrial development on the environment, and increases in real per capita personal income and in the standard of living.

An increasing number of states are rejecting the traditional approach of industrial recruitment, and tax incentives, subsidies, and exemptions. Instead, states are developing and implementing comprehensive long-run strategic programs that will enhance and complement private market decisions. Under such plans, states act as facilitators for and catalysts of economic development, and not just as service providers. These programs emphasize policies that encourage and enhance private industry productivity, innovation, and investment, and stress the state's role in creating a sound foundation for economic growth by increasing the quality and quantity of infrastructure, education, and labor force training, rather than targeting assistance to individual firms.

Conducting a detailed census of state and local government policy incentives and initiatives is an almost impossible task. Any comprehensive catalog is obsolete as soon as it is published. Furthermore, state development officials are reluctant to disclose exactly what they offer to firms. Their reluctance to share their marketing efforts, while frustrating to the researcher, is understandable. At the same time, states should not merely copy what other states are doing; what works best in one state may not work in another.

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[1] Jeffrey S. Luke, et al., *Managing Economic Development: A Guide to State and Local Leadership Strategies* (San Francisco: Jossey-Bass Publishers, 1988), pp. 195-96.

[2] Peter K. Eisenger, *The Rise of the Entrepreneurial State: State and Local Economic Development Policy in the United States* (Madison: The University of Wisconsin Press, 19), p. 14.

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Introduction and Background

The term "economic development" has recently become a political buzzword, and its application has become more of an art than a science. Economic development actually refers to the process used by state and local governments and private organizations to encourage new business investment in an area, in the hopes of directly creating or retaining jobs and enhancing and diversifying the tax base. Doing so increases an area's capacity to create and sustain wealth.[1] Recent development efforts by some states have extended beyond "smokestack chasing" to policies that emphasize the formation of new businesses, the retention and expansion of existing businesses, and taking advantage of a state's comparative advantage.[2] State policy leaders have also recognized the importance of developing telecommunications networks, building and maintaining adequate infrastructure, and providing a well-trained labor force, one that is capable of meeting tomorrow's demands.

Economic development has moved from a relatively minor item on the agenda of state and local government officials to a central issue among prevailing concerns. In some states and communities, economic development and growth are viewed as pervasive issues that directly or indirectly affect all other policy concerns. The rules for economic development have also changed, mostly because of increased global competition and a shrinking industrial base. An increasing number of states are rejecting the traditional approach of industrial recruitment and tax incentives, subsidies, and exemptions. Instead, states are developing and implementing comprehensive long-run strategic programs that will enhance and complement private market decisions. Under such plans, states act as facilitators for and catalysts of economic development, and not just as service providers. These programs emphasize policies that encourage and enhance private industry productivity, innovation, and investment, and stress the state's role in creating a sound foundation for economic growth by increasing the quality and quantity of infrastructure, education, and labor force training, rather than targeting assistance to individual firms. [3]

The enormous fiscal pressures facing states have also caused political and policy leaders to reevaluate their economic development programs. Economic development agencies' budgets were slashed during the 1990-91 recession. For example, economic development agencies' budgets in both Michigan and Illinois have been cut by over 70 percent since FY89-90. Tennessee's Department of Economic and Community

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[1] There is an important distinction between income and wealth. Income is generally defined in the context of time, such as income per hour or per year. Wealth is not defined in the context of time. Wealth generally refers to an individual's or community's net worth. The more wealth a community accumulates, the higher its standard of living, all other factors constant.

[2] Economists define comparative advantage as the ability of a state or region to produce a good or service at a smaller opportunity cost than another state or region.

[3] Richard H. Mattoon, "Economic Development Policy in the 1990s—Are State Economic Development Agencies Ready?" *Economic Perspectives*, Federal Reserve Bank of Chicago, Volume XVII, Issue 3, May/June 1993, pp. 11-13.

state will prosper from economic growth, many development programs are not reaching state residents who need them the most. The distribution of additional income is just as important as the generation of income.[7]

Third wave strategies began to emerge in the mid to late 1980s. They focus primarily on the institutions through which economic development policy is carried out. These programs are designed to ensure that policies and objectives are driven by customer demand, which in turn requires that customers—i.e., business and industry—invest time and resources in the state as well. Another goal of these programs is to provide development agencies with direct comments that allow officials to accurately measure the effectiveness of and demand for the programs. Thus, if there is no demand, the program can be eliminated.

The primary concerns of these programs include establishing an economic development base by adequately funding education and training systems; establishing stable and effective regulatory policies; providing quality infrastructure; coordinating the different levels of government; and helping set the market conditions and rules that will best enhance technological progress. Policy and political leaders in an increasing number of states are placing more emphasis on understanding a state's or region's economy and how it creates wealth and raises productivity. Under such programs, economic growth is defined as part of a turbulent process in which constant innovation and technological progress create new markets for the best firms. Firms—and states—that fail to innovate will simply not succeed. The most important aspect of government policy is to complement private sector economic changes by supporting the building blocks of growth: investment in a sound physical and social infrastructure.[8]

Third wave economic development programs emphasize that economic development is driven by decisions made in the private market. Through innovation in products, production, transportation, and entry to new markets, firms drive economic growth. Successful programs should therefore reflect the needs of private industry. State development leaders have only begun to realize that the principal element of success in any economic development strategy is government responsiveness to the needs of both investors and entrepreneurs. According to Richard Mattoon, a regional economist with The Federal Reserve Bank of Chicago, emerging economic development strategies "...go far beyond the purview of a traditional economic development department and instead cut across all services provided by all departments of state government...."[9]

Strategic Planning for Economic Development

By 1986, 25 states had written some type of strategic plan for economic development. One of the first states to do so was Rhode Island, when it released a 976-page report titled *The Greenhouse Concept* in 1984. A representative commission appointed by the Governor recommended an array of new-venture capital programs,

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[7] Ibid.
[8] Mattoon, p. 13.
[9] Ibid., p. 13.

On one hand, diversifying the state's economic base reduces its vulnerability to changes in consumer demand and business cycles. Economic growth based on only one or two industries is risky. For example, when world oil prices fell in the early 1980s, Houston, Texas lost over 100,000 jobs in 1983 alone. On the other hand, as the national and state economies shift from manufacturing- to services-based, a thorough evaluation of development strategies is necessary if states want to compete effectively for economic growth and development and to increase the standard of living in the next century.

Foundations of Economic Development

States have a major influence on seven important foundations that support the economic development process. These seven foundations are listed here:

1. A capable and motivated work force that is well-educated and -trained. This involves primary, secondary, vocational, community college, and higher education, job training, unemployment and workers' compensation insurance, income maintenance, welfare, health and human services; and labor relations policies that include right-to-work, collective bargaining, strike laws, and labor-management cooperation;
2. Sound infrastructure, including transportation, communications, energy, water supply, and waste management;
3. Well-managed and -protected natural resources;
4. Universities and research centers that are involved in the development, distribution, and application of knowledge and technology;
5. A system of regulatory policies and technical assistance that encourages entrepreneurs and new capital formation;
6. A quality of life that is attractive to employees; and
7. Fiscal stability characterized by a reasonable tax structure and prudent spending policies.[12]

Strategic Economic Development Programs in Other States

The type and complexity of state economic development efforts vary widely. Many states have only an informal plan, characterized by fragmentation, incrementalism, and executive decree. Other states have adopted an overall approach in the form of strategic planning, taking into account their influence over the seven factors listed above. These programs focus on specific, reasonable goals that maximize net benefits within a reasonable time. The main tasks involved in adopting strategic plans are analyzing and evaluating the state's economy; identifying the state's strengths and weaknesses; establishing both short-run and long-run economic goals that can be reasonably met; and determining opportunities and assets that the state can use to their best collective economic use.

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[12] Ibid., pp. 6-10.

opportunities, site reclamation, and permit processing. The overall goals of an economic development program such as Michigan's is to establish a strong foundation for economic development by working with industry to promote a sound economic base rather than by targeting the particular needs of an individual firm.[14]

Oregon

Oregon has achieved the most profound changes in development strategies. The state refocused its entire economic development strategy to serve whole sectors of the economy rather than specific firms. State political and development agency leaders developed a strategic plan for the state's economy and established specific benchmarks for a wide range of social and economic goals. Quantifiable goals are to be achieved by specific dates with the intention of providing the state with the economic base to successfully compete in the future. The overall goal of the program is that through benchmarks, Oregon will establish an economic foundation that will lead to future and sustainable economic growth by focusing government activities on necessary and appropriate activities. The plan contains two elements of third wave strategies: it is designed to strengthen the foundation of the economy more than it is designed to benefit specific companies; and all state agencies contribute to economic growth.

Oregon established a total of 155 quantifiable benchmarks. Thirty of the benchmarks are considered critical and receive special attention, and are specific. There are also intermediate and final benchmarks for the state's economy and overall quality of life. Some of the program's intermediate and final goals are listed in the tables below.

Intermediate goals:	1990	1995
Percentage of lumber and wood product employees in value added manufacturing	28.0%	39.0%
National ranking in workers' compensation costs	8	20-25
Industrial land that is suitable for development		100.0%
Taxes as a percent of the U.S. average	90.0%	90-100%
Spending for public facilities as a percent of GSP	2.1%	3.0%
High schoolers in technical education	9.0%	18.0%
Babies born to drug-free mothers	89.0%	95.0%
Teen pregnancy rate per 1,000 females	19.5%	9.8%

[14] Ibid.

aspects of the cluster rather than targeting support to just one industry in the cluster. Twelve key clusters were identified. The following table lists the clusters.

	1990 Employment (thousands)	Employment concentration (US=100)	Output Millions of 1977 $s	Projected annual growth in output 1990-2000
Agriculture and food processing	191.5	113	$20,711.8	2.0%
Business and personal travel	454.5	94	$9,252.0	3.8%
Coal mining	13.1	167	2,018.5	1.4%
Consumer appliances and electronics	16.8	188	$1,533.2	2.1%
Electrical equipment	84.0	139	$4,923.1	5.8%
Export Services	1105.5	110	40,738.8	3.3%
Health Services and biomedical products	446.2	106	$13,239.5	3.5%
Industrial machinery	142.7	187	$8,695.3	4.4%
Manufactured inputs	251.3	144	$27,627.0	2.6%
Telecommunica tions equipment	35.9	116	$3,228.7	4.4%
Transportation and distribution	205.7	121	$9,046.8	2.8%
Transportation equipment	50.9	64	$5,156.0	4.3%

these programs are characterized by improved accountability. Performance measures or benchmarks are automatically built into the program, allowing policy and government leaders to accurately and quickly evaluate the program's success or failure. Finally, successful programs allocate resources to maximize long-run net total benefits and are designed to have an impact on the entire economy rather than a particular segment. Specific policies and programs are implemented only after an overall strategic program is developed. Dabson and Schweke state that "...economic development should be much more than locational attraction and business support; it should include education, social services, and other means of engaging and mobilizing under-used human assets to achieve national and international competitiveness...."[15]

Industrial Location Decisions

The last two decades have seen a huge shift from traditional manufacturing centers such as the Northeast and Midwest to the Sunbelt. Between 1960 and 1980, capital stock (as measured by plant and equipment) grew at twice the pace in the South as it did in the North. Northern states lost approximately 800,000 manufacturing jobs while the nation gained 2.3 million. The shift in jobs from Northern to Southern states outpaced even the general shift of population in the same direction. Economists cite a favorable business climate and fewer physical barriers to new industrial development. It should be noted that capital will flow out of the Sunbelt when dictated to do so by profitability, with no regard to human social costs; any economic strategy for Tennessee should take this factor into account.

Economic theory assumes that firms are profit-maximizers. Therefore, location decisions depend ultimately on profits. Put simply, firms will locate where total income exceeds total costs by the greatest amount, or where profits are maximized or conversely where costs are minimized. Location decisions are actually the outcome of a sequence of decisions. The first decision a firm makes is whether to invest in new plant and equipment. Then the firm decides what region to locate in, and then decides on the particular state that minimizes total costs.

The site selection process is becoming more technical in nature. Every facet of a firm's operations is assigned detailed quantitative information, whether it is property requirements, construction costs, the cost of goods sold, or the extent of unionization and competition. Development experts cite several factors that influence firms' location decisions. These factors include the local labor market; utilities and infrastructure; access to customer and supplier markets; availability of development sites; transportation service and networks; education and training opportunities; quality of life; business climate; capital availability; taxes; and regulatory policies.[16]

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[15] Brian Dabson and William Schweke, "Talking Third Wave," *The Entrepreneurial Economy Review*, 10, No. 2 (Winter 1992), 5.
[16] Luke, et al., pp. 43-44.

resulting in lower unemployment, reduced poverty, and higher personal incomes. Higher personal incomes, in turn, cause an increase in demand for goods and services, which in turn results in increased private investment. Under *The Public Benefit Model*, government subsidies and assistance cause private investment to increase. Increased private investment results in an increase in taxable capital stock, jobs, and payroll. The tax base increases, causing tax revenues to increase, all other factors constant. Policy makers can either lower taxes, or use the additional revenues to increase the level of government services. Choosing the latter will cause private investment to increase. At the same time, as the level of government services increases, or the tax rates decrease, location incentives will increase, bringing more private investment, all other factors constant. [18]

Unfortunately, not all the factors remain constant. Investment is determined in part by macroeconomic factors (such as the level of private savings and national income, as well as the willingness to lend by financial institutions) that are out of the control of state and local governments. Furthermore, the increased demand for goods and services may be for products produced out-of-state, producing no new local investment. Potential investors may not be aware of the tax incentives and subsidies that a state offers. A standard finding in demographic research is that new employment opportunities tend to attract in-migrants from outside the local government's jurisdiction. If the number of jobs increases and are filled by in-migrants, there will be an increased demand for government services, absorbing the increase in revenues. In addition, the local unemployment rate may stay the same, or in some cases may increase.

Other goals of economic development include job retention (one job retained benefits a community or state as much as one new job); economic stability; reducing poverty; and increasing the tax base. Increasing the tax base takes pressure off political leaders to increase tax rates while increasing the level of government services.

Economic Development in Tennessee

The Tennessee Department of Economic and Community Development

The Department of Economic and Community Development (ECD) was established in 1972 to coordinate development services to communities, businesses, and industries in the state. The department's mission is to increase and geographically disperse quality job opportunities throughout Tennessee. The department has established three goals to achieve this mission. The first goal is to enhance community attractiveness for creating job opportunities by encouraging the development of local organizational capacity and local infrastructure and assisting with planning and technical assistance at the local and regional levels. The department's second goal is to create and promote business opportunities to entrepreneurs, existing industries, and new firms by promoting the location of new business and industry to the state, encouraging the growth of existing businesses and industries, and fostering the development of "homegrown" industries. The

[18] Eisenger, p. 36.

Exhibit One
Department of Economic and Community Development
Total Expenditures in Current and Constant Dollars
Fiscal Years 1980-81 Through Estimated 1993-94

Fiscal Year	Current Dollars	Percent Change	Constant Dollars	Percent Change
FY 80-81	$5,415,700		$5,415,700	
FY 81-82	$8,055,300	48.74%	$7,570,771	39.79%
FY 82-83	$18,768,500	133.00%	$17,203,025	127.23%
FY 83-84	$40,598,400	116.31%	$35,738,028	107.74%
FY 84-85	$49,084,400	20.90%	$41,702,974	16.69%
FY 85-86	$45,117,500	-8.08%	$37,755,230	-9.47%
FY 86-87	$41,335,000	-8.38%	$33,280,998	-11.85%
FY 87-88	$44,263,400	7.08%	$34,206,646	2.78%
FY 88-89	$44,474,800	0.48%	$32,750,221	-4.26%
FY 89-90	$58,243,600	30.96%	$40,901,404	24.89%
FY 90-91	$55,536,700	-4.65%	$37,348,151	-8.69%
FY 91-92	$49,228,000	-11.36%	$32,091,265	-14.08%
FY 92-93	$49,807,200	1.18%	$31,886,812	-0.64%
Estimated FY 93-94	$74,785,000	50.15%	Not Available	
Percent change from FY 80-81 to FY 92-93:	819.68%		488.78%	
Percent change from FY 80-81 to FY 93-94:	1280.89%		Not Available	
Percent change from FY 80-81 to FY 85-86:	733.09%		597.14%	
Percent change from FY 86-87 to FY 93-94:	80.92%		Not Available	

Source: The Department of Economic and Community Development, September 1993.

This does not mean that the Department of Economic and Community Development is not doing its job, or that it is not working to further enhance Tennessee's standard of living. Business leaders also note that there has not been a need until now to develop an overall strategy for economic development. In the past, Tennessee has been able to compete by promoting its location, low business costs, cheap labor, right-to-work laws, a strong work ethic, and quality of life. However, these comparative advantages are no longer unique to Tennessee. The state has been fortunate in attracting businesses and industry, but Tennessee is now competing with states that previously were not our competitors. Given the additional competition for scarce jobs, Tennessee must develop a comprehensive, focused, and formal economic development strategy to effectively compete for growth. The state needs to evaluate what is important, and what it needs to do not only to compete for those jobs, but to increase the standard of living and the quality of life in the state. An analogy can be made to a company with a patent. While the company has the patent, it is protected somewhat from competition. But when the patent expires, competition increases. The company cannot simply lower the price of its product and hope to maintain profits. It has to make a better product and it has to learn how to compete, not necessarily by copying what its competitors are doing, but at least by being aware of what is going on in the marketplace.

Tennessee's Corporate Taxes

Economic theory assumes that corporate taxes have negative effects on firms' decisions to invest; the higher the taxes, the lower the level of investment, all other factors held constant. The table below lists the four basic corporate taxes and the number of states that offer them:

Type of Tax	Number of States Imposing the Tax	Number of Southeastern States Employing the Tax
Corporate Income Tax	45	11
Franchise Tax	30	9
Property Tax	50	11
State Sales and Use Tax	45	11

The Excise Tax[21]

Tennessee levies a six percent excise tax on the net earnings of foreign and domestic corporations from business conducted in the state, or on state apportionment of total earnings of interstate corporations. All taxes are deductible in determining the state excise tax base, except Tennessee excise and income taxes paid to the federal government

[21] The source for all the descriptions of corporate taxes is the Department of Economic and Community Development.

item or article of tangible personal property sold at retail; cost price of each article used, consumed, or stored for use in Tennessee; lease price of tangible personal property including accounting equipment, cars, and trucks, and manufacturing equipment; hotel and motel room charges; parking lot or storage of motor vehicles; alcoholic beverages and tobacco products; telephone, telegraph, and electricity; repair and installation of personal property; and amusements and sporting events.

The Services Tax

The services tax was enacted by the Tennessee General Assembly in 1992, and is levied on services and amusements that were previously taxed under the sales and use tax laws. The state imposes a 6.75 percent tax on amusement activities, such as membership dues, sales of tickets, and charges for recreational activities, and services such as repairs and installation of tangible personal property, and intrastate communications. Items such as repairs and warranties on qualified industrial machinery and services for resale are exempted from the services tax. Under current law, the services tax is due to expire March 31, 1994.

The Utility Gross Receipts Tax

The state imposes a three percent intrastate gross receipts tax on bottlers; utilities; ferry companies; gas, water, electric power and light companies, telephone and telegraph companies; and sewage companies. Companies liable for this tax receive a credit on their franchise and excise taxes. Telephone and telegraph companies are allowed to deduct $10,000 annually from their gross receipts; water and electric companies are allowed to deduct $5,000 per year.

The Local Business Tax

The local business tax is administered by the Tennessee Department of Revenue, but is collected and imposed by local governments. The local business tax is levied as a substitute for a property tax on inventories. The owners or operators of all for-profit businesses must pay the local business tax for each place of business located in either the county or city that imposes the tax. Manufacturers that are subject to personal property taxation and professionals are exempt from paying the tax. Businesses are classified into four groups; the rate imposed upon gross sales varies from 1/60 of one percent to 1/8 of one percent. Manufacturers, employees of businesses, certain blind persons, disabled veterans, and certain professional services are exempted from paying the tax.

Tax Burdens

Many business and development leaders complain about the high level of taxes in the state, and the need to offer tax incentives to ease the corporate tax burden. Exhibit Two contains a comparison of the estimated tax burden per $100 of personal income for

State	Level of State Taxes	Rank	Level of Local Taxes	Rank	State and Local Taxes	Rank
Mississippi	$7.53	16	$2.75	44	$10.29	41
Missouri	$5.58	44	$3.53	36	$9.10	49
Montana	$7.02	25	$4.99	12	$12.00	12
Nebraska	$6.35	33	$5.17	8	$11.52	17
Nevada[4]	$7.57	15	$3.51	37	$11.08	24
New Hampshire	$2.59	50	$5.69	6	$8.28	51
New Jersey	$6.10	39	$4.98	13	$11.08	25
New Mexico	$9.55	3	$2.70	46	$12.25	9
New York	$7.28	2	$8.05	2	$15.33	3
North Carolina	$7.24	21	$3.19	41	$10.43	40
North Dakota	$7.70	13	$3.60	34	$11.30	20
Ohio	$6.06	40	$4.57	18	$10.63	36
Oklahoma	$7.96	11	$3.23	40	$11.20	22
Oregon	$6.17	37	$5.97	4	$12.14	10
Pennsylvania	$5.96	41	$4.24	29	$10.20	42
Rhode Island[5]	$6.82	29	$4.47	21	$11.29	21
South Carolina	$7.44	19	$3.13	42	$10.57	39
South Dakota	$4.69	49	$5.06	1	$9.75	45
Tennessee	$5.50	47	$3.57	35	$9.04	50
Texas	$5.51	46	$5.13	9	$10.64	35
Utah	$7.49	18	$4.30	27	$11.78	16
Vermont	$6.95	27	$4.95	14	$11.90	15
Virginia	$5.61	43	$4.44	22	$10.05	43
Washington	$8.62	6	$3.44	38	$12.07	11
West Virginia	$9.51	4	$2.48	48	$11.99	13
Wisconsin	$8.15	10	$4.53	2	$12.67	7
Wyoming	$8.26	8	$5.72	5	$13.98	5
U.S. Average	$6.65		$4.53		$11.17	

[4] Ibid.
[5] Ibid.

Exhibit Three

Tennessee's Incentives for Economic Development

Statutory exemptions:

- No state income tax.
- No state property tax.
- No property tax on goods-in process, finished goods inventories, or goods-in-transit.
- No sales tax on industrial machinery necessary and primarily for the fabrication of a product.
- No sales tax on repairs of industrial machinery.
- No sales tax on pollution control equipment.
- No sales tax on raw materials.
- No sales tax on energy fuel and water if they have direct contact with the product during the manufacturing process.
- No franchise tax on property under construction that is not being used by a corporation.
- No franchise tax on pollution control equipment.

Tax Credits and Incentives:

- Excise tax credit of up to one percent on machinery purchases, not to exceed 50 percent of tax liability for that year. Unused credit may be carried forward up to 15 years.
- Reduced sales tax (1.5 percent) on water and electricity used at the manufacturing site.
- Reduced state sales tax (1.5 percent) on gas, electricity, fuel, oil, coal, and other energy fuels sold to or used by manufacturers.
- Property rented from Industrial Development Boards may be capitalized on the corporate books.
- Franchise tax credit of $2,000 per new full-time job (or $3,000 in financially distressed counties) for eligible companies meeting specific eligibility requirements.
- Jobs tax credit of up to $2,400 per employee for the employee's first year, for hiring from targeted groups of economically disadvantaged youths and adults.
- Tax credits in enterprise zones.

- The more sophisticated the production process or industry, the more important a highly skilled labor force is for manufacturers.
- Giveaways from states do not appear to be an important factor in attracting plants. At the same time, they are becoming standard practice. Even if firms do not consider tax incentives to be important, since every state offers them to some degree, it is impossible to determine their effect on a firm's location decision.[24]

It is almost impossible to determine exactly what a state can do to attract firms; there is no answer to the question, "What works?" The ideal strategy, of course, would be "...low taxes and wages, with terrific public services—especially education—and high labor productivity, and right-to-work laws all in a wonderful environmental setting but with unintrusive environmental regulation, served by a massive and efficient transportation network—that is clearly the ticket. But great public services cost big money and hence imply high taxes. High labor productivity means high wages. A great environment has to be protected from insults, some of which are the visual and pollution side effects of highways and airports. So no one state can have it all...."[25]

Miscellaneous Issues

Regulatory Programs

Often, it is not the quality or discharge standards that firms must comply with that cause the most complaints from business and industry. Rather, the biggest complaint seems to be that no matter what state, the permit process is a labyrinth. A few development officials expressed the desire to see environmental regulations, especially the permit process, streamlined, but not necessarily relaxed. Others expressed a desire for the Tennessee Department of Environment and Conservation to provide technical assistance to companies needing aid in complying with environmental quality standards, and to inform companies of all applicable federal and state regulations. Some studies have suggested that environmental regulations are not ranked as a major location factor by industries. Instead, an efficient regulatory administration is important to firms when making location decisions.

A few states have created special offices to assist companies in the permitting process and act as a single contact for businesses for all federal and state permits and other standards. The first state to aggressively pursue environmental permitting reforms was Georgia, under former President Jimmy Carter. Georgia offers what is called a "one-stop permitting" program. The program allows a business or plant to obtain both state and

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[24] Raymond J. Kopp, "Understanding Industrial Location Decisions," in *State Economic Development Policies: What Works*, eds. Clifford S. Russell and Tari P. Hunt (Vanderbilt Institute for Public Policy Studies, 1988), p. 14-19.
[25] Clifford S. Russell and Tari P. Hunt, eds. in "Introduction to the Workshop Summary," in *State Economic Development Policies: What Works?*. (VIPPS, 1988), p. 3.

Other legislators expressed a desire to see an umbrella organization similar to the Children's Plan that would coordinate state economic development efforts across all state agencies. One or two business leaders winced at the suggestion of what they consider to be another layer of bureaucracy. However, some economists state that even though many companies complain about bureaucratic red tape, it is generally not cited as a significant factor affecting their siting decisions.[30]

Tennessee's Strengths and Weaknesses

An integral component in any strategic economic development plan is an assessment of the state's strengths and weaknesses. Staff interviewed development officials, state and local government leaders, and state legislators for their views on the state's strengths and weaknesses. This is probably the one area where most state legislators and state and local development leaders agreed. Most everyone agreed that Tennessee's number one strength is location, followed by transportation; education; fiscally conservative state finances, including the state's high bond rating; right-to-work laws; a strong work ethic; relatively low taxes; a good reputation for trainable labor and a hard-working labor force; no state income tax; desirable recreation; and quality of life. Paradoxically, those interviewed listed education as one of Tennessee's few weaknesses. One state legislator said that probably more than education itself, we suffer from having a reputation of being undereducated. A few business leaders said lack of a formal strategic economic development plan was another major weakness.

Implications for a Changing Economy

Tennessee's economy, like that of the nation, is shifting from a manufacturing to a services economy. This economic phenomenon has several repercussions for the state. Exhibit Four contains levels and growth rates for major sectors of Tennessee's economy. Exhibit Five contains wage levels and growth rates for those sectors of the state's economy. Between calendar year 1982 and 1991, employment in services increased approximately 60 percent, while total manufacturing employment fell by 89 percent. Wages in the services sector increased by 7.3 percent in that same period, while manufacturing wages increased by 4.3 percent.

Services jobs traditionally do not pay incomes equivalent to union-scale factory earnings, which can be seen in Exhibit Five. For example, 1991 real manufacturing wages were $20,804. Real wages in the services sector were $17,939, about 16 percent lower

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about their specific communities. Staff spoke with the Executive Director of the Washington County, Ohio Economic Development Office. The executive director stated that last year Ohio enacted a program entitled the First Frontier Fund, open to 29 counties in the state's Appalachian region. The program provides a matching state-to-local-dollars fund for marketing these 29 counties on national television and in national newspapers. The Ohio Department of Development distributes a list of companies and individuals who inquired about Ohio. So far, Washington County has received about 500 solid leads from the state development department.

[30] Feagin, pp. 340-341.

Exhibit Five
Tennessee Wages and Salary by Sector
1987 Constant Dollars

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Total Nonagricultural	$18,369	$18,490	$18,540	$18,598	$18,861	$18,999	$18,902	$18,424	$18,287	$18,376
Percent Change	0.67	0.66	0.27	0.32	1.41	0.73	-0.51	-2.53	-0.74	0.49
Construction	$20,425	$19,709	$19,525	$19,445	$20,274	$20,351	$20,516	$20,246	$19,840	$19,565
Percent Change	2.26	-3.51	-0.93	-0.41	4.27	0.38	0.81	-1.32	-2.00	-1.38
Manufacturing	$19,938	$20,367	$20,257	$20,480	$20,880	$20,830	$20,805	$20,468	$20,330	$20,804
Percent Change	1.64	2.15	-0.54	1.10	1.95	-0.24	-0.12	-1.62	-0.68	2.33
• Durable Goods	$19,787	$19,958	$21,312	$21,592	$22,160	$21,941	$21,766	$21,276	$21,061	$21,620
Percent Change	0.29	0.87	6.78	1.31	2.63	-0.99	-0.79	-2.27	-0.99	2.66
• Nondurable Goods	$20,058	$20,710	$19,289	$19,427	$19,660	$19,757	$19,860	$19,667	$19,608	$20,007
Percent change	2.75	3.25	-6.86	0.72	1.20	0.49	0.52	-0.97	-0.30	2.04
Trade	$14,513	$14,369	$14,463	$14,324	$14,549	$14,554	$14,457	$14,059	$13,739	$13,907
Percent Change	-0.45	-0.99	0.66	-0.96	1.57	0.03	-0.67	-2.75	-2.28	1.22
Services	$16,726	$16,946	$17,405	$17,360	$17,677	$18,143	$17,954	$17,859	$17,944	$17,939
Percent Change	2.17	1.32	2.71	-0.26	1.83	2.63	-1.04	-0.53	0.48	-0.03
FIRE[1]	$20,223	$20,883	$20,929	$21,686	$22,563	$22,740	$22,319	$21,686	$21,388	$21,336
Percent Change	4.05	3.27	0.22	3.62	4.04	0.78	-1.85	-2.83	-1.38	-0.24
TCPU[2]	$26,418	$26,769	$26,278	$26,075	$25,916	$26,024	$25,611	$24,683	$24,845	$24,914
Percent Change	0.18	1.33	-1.83	-0.77	-0.61	0.42	-1.59	-3.62	0.66	0.28
Agriculture	$7,852	$7,731	$8,095	$8,735	$6,260	$7,331	$7,206	$6,464	$6,736	$6,279
Percentage Change	16.61	-1.54	4.70	7.92	-28.33	17.10	-1.71	-10.29	4.20	-6.78

Source: University of Tennessee, Center for Business and Economic Research, *An Economic Report to the Governor, 1993.*

[1] FIRE is composed of finance, insurance, and real estate.

[2] TCPU is composed of transportation, communications, and public utilities.

After determining the area's strengths and weaknesses, the local government should then define its respective comparative advantages and disadvantages. Next, the local government should identify the area's key issues, needs, and opportunities, such as access to capital, the skill level of the local work force, and education and infrastructure requirements. Setting goals and strategies that address the key issues is the next, and probably most important step in the process. Goals and strategies need to be framed in the context of factors such as the availability and cost of current and future resources, the political climate, the likelihood of private investment, and the area's current and future capacity. It is also important to establish reasonable and measurable goals.

Finally, the local government needs to implement programs and policies to carry out its goals. The process just described here also needs to be a continuous process, reflecting changes in economic conditions and social values. The economic development process, while creating income, also redistributes it. Officials need to be aware of this fact, and must be aware of the direction of redistribution, and be able to resolve this conflict.

A Case Example: Maury County and Saturn

In July of 1985, General Motors announced plans to locate its new Saturn plant in Maury County, Tennessee.

In 1987, Timothy Bartik (then an Assistant Professor of Economics at Vanderbilt University) and others conducted a case study in an attempt to analyze the impact of tax policy on Saturn's decision to locate in Maury County. The economists created an economic model to reconstruct Saturn's location decision. They identified Terre Haute, Indiana, as the site that minimized transportation costs, considered to be the most important factor in a manufacturer's location decision. The economists then added wage costs and state and local taxes to the model. The table below illustrates the estimated cost per car among seven cities that researchers considered.[34]

Location	Average Cost to Transport the Car to Market	Local Labor Cost	State and Local Taxes	Total Estimated Cost Per Car
Nashville, TN	$426	**$159**	$118	**$703**
Lexington, KY	$423	$186	**$106**	$715
St. Louis, MO	$419	$172	$134	$725
Bloomington, IN	$417	$202	$162	$781
Kalamazoo, MI	$430	$244	$116	$790
Terre Haute, IN	**$413**	$209	$168	$790
Marysville, OH	$427	$219	$169	$815

[34] Ibid., p. 29.

its own. In addition, Saturn officials needed a tax break from the county for this project to work, and argued that what was good for Saturn was good for the county.

Jobs were not discussed until the second or third meeting. Obviously, Maury County officials were hopeful that Maury Countians would get the projected 6,000 jobs from the plant. But at one of those two meetings, Saturn officials announced that they would be bringing in their own labor force; this was non-negotiable. Saturn officials told Maury County officials that Saturn's presence would bring in suppliers, who would hire Maury Countians. Maury County officials stated that they have gotten a few jobs from suppliers, but not as many as they expected; many companies will not locate in Maury County because of Saturn. (The Tennessee Advisory Commission on Intergovernmental Relations (TACIR) report indicates that Tennessee companies provide supplies for about 20 percent of the car, with projected annual sales of $300 million at full production.[38])

Negotiations were often volatile; both sides walked out at least once. The state was involved somewhat in the negotiations, with one representative from the governor's office there. ECD officials were not actively involved. Maury County officials apparently perceived that ECD officials felt that they had finished their job by getting Saturn to locate in the state. County officials stated that they would have liked ECD to have taken a more active role, because they could have benefited from ECD's considerable expertise in negotiating favorable agreements.

Maury County officials had to negotiate four separate agreements: one with Saturn, and then one for each of the three cities. County officials had to come up with a "wish list" of government services and then assign dollar values to the estimated impact on schools, fire and police protection—basically every aspect of government service. At the same time, Saturn negotiators assigned dollar values on the county's wish list. Maury County then negotiated with the three cities using the same process.

Negotiations reached a deadlock on the length of the contract. Maury County wanted a 20-year contract, but Saturn wanted a 40-year contract; Saturn eventually prevailed. A longer contract allows Saturn to spread out total payments and to take advantage of depreciation. The contract was finally signed on November 7, 1985. Saturn agreed to make payments in lieu of taxes (PILOT) according to the following schedule:[39]

Year(s)	Amount of Annual Payment
1987-1988	$3,500,000
1989-1995	$3,000,000
1996-2005	25 percent of "Standard Tax"
2006-2010	30 percent of "Standard Tax"
2011-2015	35 percent of "Standard Tax"
2016-2025	40 percent of "Standard Tax"

[38] The Tennessee Advisory Commission on Intergovernmental Relations, *Growth and Change in Maury County: The Impact of Saturn*, 1992, p. 57.

[39] Resolution No. 1-A, *Resolution Approving Proposed In Lieu of Tax Agreement with Saturn Corporation and Recommending Approval of the Same by the Maury County Industrial Board*, signed November 7, 1985.

4. Saturn helps fund a large part of the county's capital improvements. However, county officials underestimated the impact on operational budgets. County budget staff indicate that more money should have been assigned to operations.
5. The county should have continued to keep local taxes in line with the region. Presently, Maury County taxes are about $1.70, compared to $2.50 for surrounding counties. County officials felt that with Saturn there, they did not have to raise taxes. Unfortunately, they underestimated the increase in government expenditures, especially schools, brought about or exacerbated by Saturn. County officials fear that local residents may blame Saturn if taxes are raised.
6. Negotiators should have held out for a shorter contract period, so that adjustments could be made if the county underestimates expenditures, for example.
7. Negotiators should match essentials on the front-end, and include automatic increases for education.
8. Negotiators should perform an independent benefit/cost analysis—or pay someone to do it—before negotiations begin.
9. Negotiators should consider fully and apply more weight to the social costs associated with economic growth.

County officials also made some general comments. They are listed below:

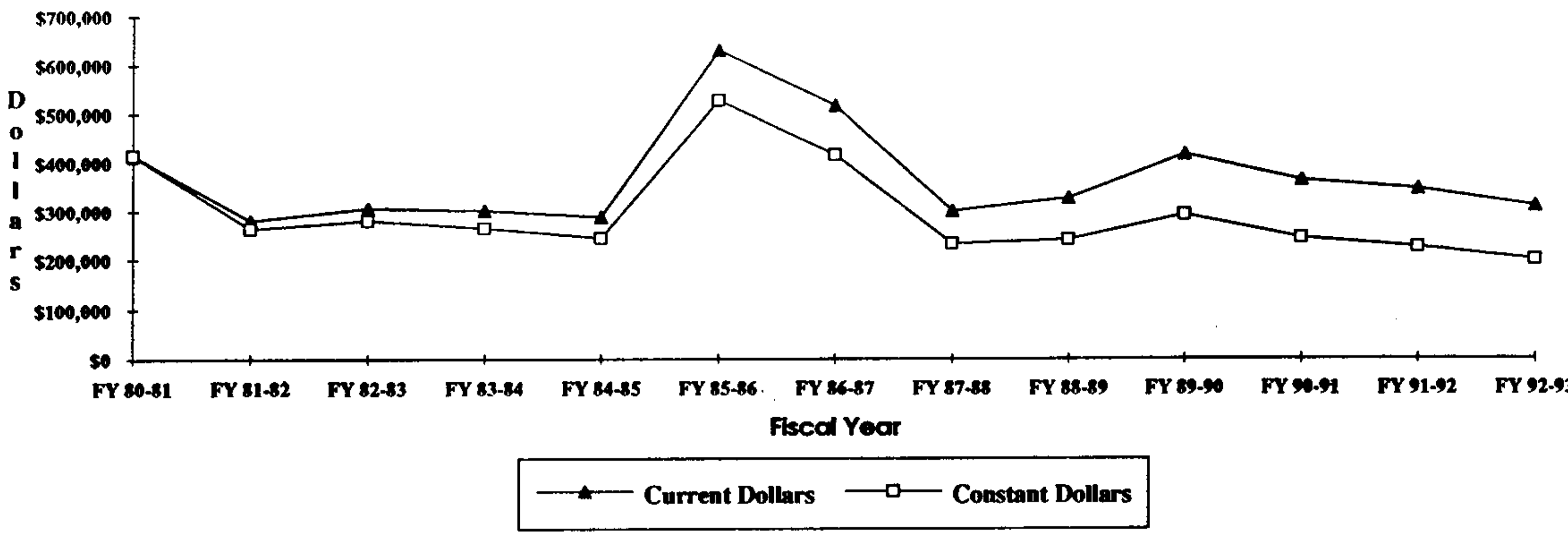
- Their local bond rating has increased since Saturn located in the county.
- The problems that the county has experienced since Saturn are bigger, but not different.
- County officials will try just as hard to land a small employer and retain existing businesses as it did with Saturn. The only difference is that they will get involved in negotiations much earlier in the process.
- Saturn has been a good neighbor. Many local retailers would have had to close if Saturn had not located in Maury County. Maury County officials also feel confident that their relationship with Saturn is strong enough that they would work with the county if it ever experienced dire financial straits.

Appendix A
Department of Economic and Community Development
Breakdown of Current and Constant Dollar Expenditures
Fiscal Years 1980-81 Through Estimated 1993-94[1]

	Industrial Training Services				Existing Industry Services				Marketing			
Fiscal Year	Current Dollars	Percent Change	Constant Dollars	Percent Change	Current Dollars	Percent Change	Constant Dollars	Percent Change	Current Dollars	Percent Change	Constant Dollars	Percent Change
FY 80-81	$1,476,200		$1,476,200		$415,000		$415,000		$669,700		$669,700	
FY 81-82	$3,241,000	119.55%	$3,046,053	106.34%	$280,900	-32.31%	$264,004	-36.38%	$756,000	12.89%	$710,526	6.10%
FY 82-83	$5,321,700	64.20%	$4,877,819	60.14%	$305,700	8.83%	$280,202	6.14%	$751,300	-0.62%	$688,634	-3.08%
FY 83-84	$1,605,700	-69.83%	$1,413,468	-71.02%	$300,900	-1.57%	$264,877	-5.47%	$828,100	10.22%	$728,961	5.86%
FY 84-85	$2,776,100	72.89%	$2,358,624	66.87%	$287,700	-4.39%	$244,435	-7.72%	$970,800	17.23%	$824,809	13.15%
FY 85-86	$2,027,700	-26.96%	$1,696,820	-28.06%	$629,600	118.84%	$526,862	115.54%	$1,266,600	30.47%	$1,059,916	28.50%
FY 86-87	$2,504,200	23.50%	$2,016,264	18.83%	$515,900	-18.06%	$415,378	-21.16%	$1,569,600	23.92%	$1,263,768	19.23%
FY 87-88	$3,883,400	55.08%	$3,001,082	48.84%	$300,300	-41.79%	$232,071	-44.13%	$1,433,500	-8.67%	$1,107,805	-12.34%
FY 88-89	$2,698,800	-30.50%	$1,987,334	-33.78%	$327,300	8.99%	$241,016	3.85%	$1,332,700	-7.03%	$981,370	-11.41%
FY 89-90	$12,328,600	356.82%	$8,657,725	335.65%	$417,200	27.47%	$292,978	21.56%	$1,442,300	8.22%	$1,012,851	3.21%
FY 90-91	$7,845,200	-36.37%	$5,275,857	-39.06%	$364,400	-12.66%	$245,057	-16.36%	$1,277,900	-11.40%	$859,381	-15.15%
FY 91-92	$5,969,000	-23.92%	$3,891,134	-26.25%	$345,600	-5.16%	$225,293	-8.06%	$1,438,600	12.58%	$937,810	9.13%
FY 92-93	$5,535,900	-7.26%	$3,544,110	-8.92%	$310,300	-10.21%	$198,656	-11.82%	$1,213,800	-15.63%	$777,081	-17.14%
Estimated FY 93-94	$5,601,800	1.19%	Not Available		$322,500	3.93%	Not Available		$1,313,700	8.23%	Not Available	

[1] Source: The Department of Economic and Community Development, September 1993.

Appendix C
Department of Economic and Community Development:
Existing Industry Services Expenditures



Appendix E
Department of Economic and Community Development
Sources of Funding in Current Dollars
Fiscal Years 1980-81 Through Estimated 1993-94[1]

Fiscal Year	Current Dollar Total Revenues	Current State Dollars	Percent of Total Revenues	Current Federal Dollars	Percent of Total Revenues	Current Other Dollars	Percent of Total Revenues
FY 80-81	$5,415,700	$4,620,400	85.31%	$426,800	7.88%	$368,500	6.80%
FY 81-82	$8,055,300	$5,307,300	65.89%	$659,800	8.19%	$2,088,200	25.92%
FY 82-83	$18,768,500	$10,141,700	54.04%	$6,342,200	33.79%	$2,284,600	12.17%
FY 83-84	$40,598,400	$6,915,300	17.03%	$32,200,000	79.31%	$1,483,100	3.65%
FY 84-85	$49,084,400	$11,814,800	24.07%	$36,546,800	74.46%	$722,800	1.47%
FY 85-86	$45,117,500	$11,488,700	25.46%	$32,919,700	72.96%	$709,100	1.57%
FY 86-87	$41,335,000	$13,294,600	32.16%	$27,295,400	66.03%	$745,000	1.80%
FY 87-88	$44,263,400	$15,185,700	34.31%	$28,310,200	63.96%	$767,500	1.73%
FY 88-89	$44,474,800	$14,383,500	32.34%	$29,341,900	65.97%	$749,400	1.68%
FY 89-90	$58,243,600	$32,590,100	55.95%	$24,638,200	42.30%	$1,015,300	1.74%
FY 90-91	$55,536,700	$26,396,500	47.53%	$27,995,500	50.41%	$1,144,700	2.06%
FY 91-92	$49,228,000	$19,145,500	38.89%	$28,783,400	58.47%	$1,299,100	2.64%
FY 92-93	$49,807,200	$19,320,200	38.79%	$29,239,900	58.71%	$1,247,100	2.50%
Estimated FY 93-94	$74,785,000	$25,046,500	33.49%	$48,618,400	65.01%	$1,120,100	1.50%

[1] Source: Department of Economic and Community Development, September 1993.

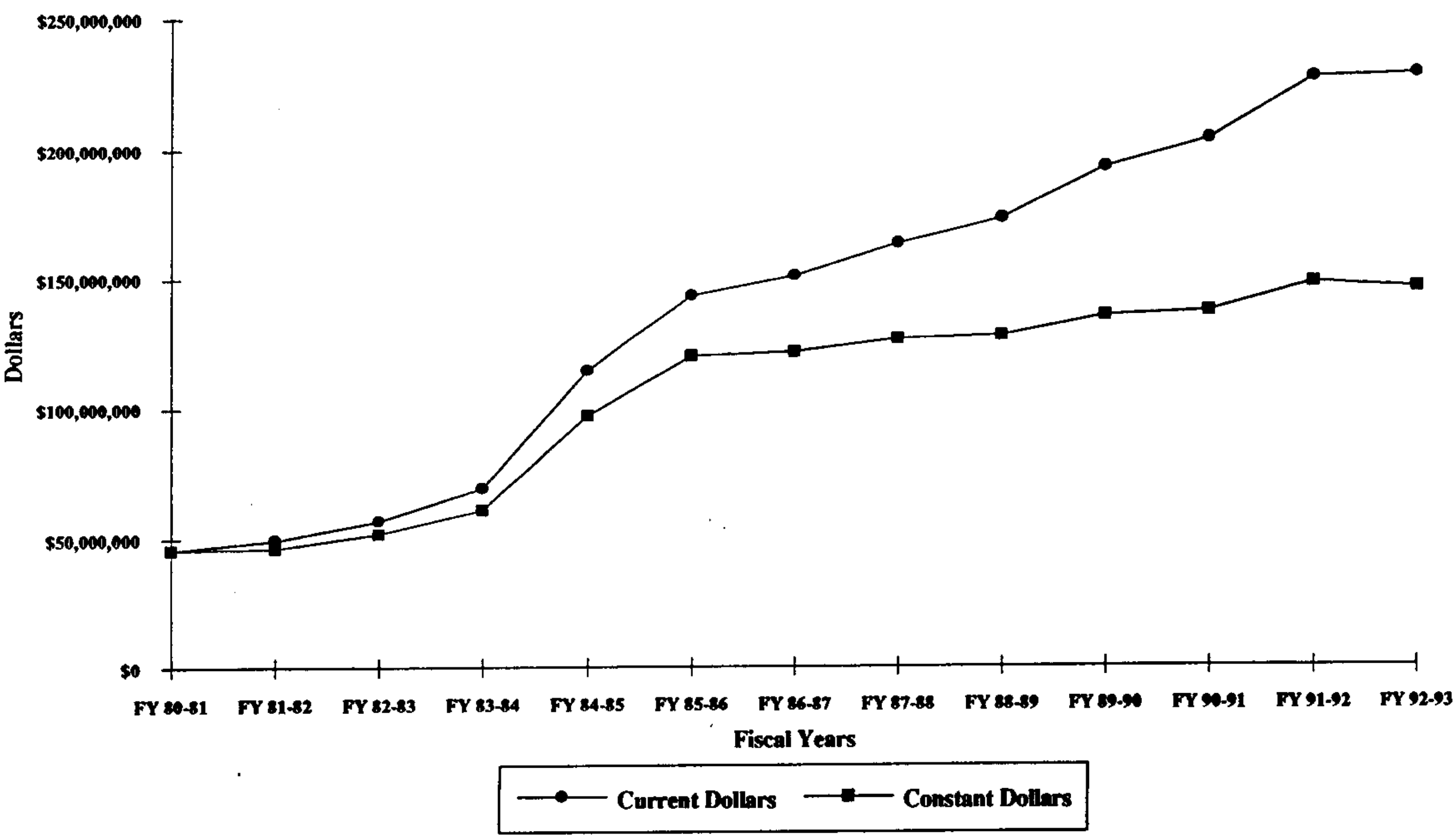
Appendix G
Comparison of Revenue Growth
Tennessee Franchise Tax and Excise Tax

Fiscal Year	Franchise Tax Current Dollars	Franchise Tax Percent Change	Franchise Tax Constant Dollars	Franchise Tax Percent Change	Excise Tax Current Dollars	Excise Tax Percent Change	Excise Tax Constant Dollars	Excise Tax Percent Change
FY 80-81	$45,704,592	13.1%	$45,704,592	0.0%	$195,064,951	-1.6%	$195,064,951	0.0%
FY 81-82	49,511,249	8.3%	46,533,129	1.8%	206,835,134	6.0%	194,393,923	-0.3%
FY 82-83	56,740,541	14.6%	52,007,829	11.8%	203,857,519	-1.4%	186,853,821	-3.9%
FY 83-84	69,482,637	22.5%	61,164,293	17.6%	226,242,061	11.0%	199,156,744	6.6%
FY84-85	114,722,321	65.1%	97,470,111	59.4%	259,197,549	14.6%	220,218,818	10.6%
FY 85-86	143,624,400	25.2%	120,187,782	23.3%	268,617,566	3.6%	224,784,574	2.1%
FY 86-87	151,213,216	5.3%	121,749,771	1.3%	298,644,360	11.2%	240,454,396	7.0%
FY 87-88	163,782,372	8.3%	126,570,612	4.0%	352,120,221	17.9%	272,117,636	13.2%
FY 88-89	173,626,287	6.0%	127,854,409	1.0%	371,545,349	5.5%	273,597,459	0.5%
FY 89-90	193,621,820	11.5%	135,970,379	6.3%	332,035,741	-10.6%	233,171,166	-14.8%
FY 90-91	204,480,153	5.6%	137,511,872	1.1%	345,541,527	4.1%	232,374,934	-0.3%
FY 91-92	227,839,383	11.4%	148,526,325	8.0%	295,266,151	-14.5%	192,481,194	-17.2%
FY 92-93*	228,978,483	0.5%	146,593,139	-1.3%	365,322,985	23.7%	233,881,552	21.5%
FY 81-84	221,439,019	52.0%	205,409,842	33.8%	831,999,665	16.0%	775,469,439	2.1%
FY 85-88	573,342,309	42.8%	465,978,277	29.9%	1,178,579,696	35.9%	957,575,424	23.6%
FY 89-92	799,567,643	31.2%	549,862,985	16.2%	1,344,388,768	-20.5%	931,624,753	-29.6%

* Unaudited tax revenue provided by the Division of State Audit, Tennessee Comptroller of the Treasury

Sources: Collections - Department of Revenue Reports
Senate and House Finance, Ways and Means Committees

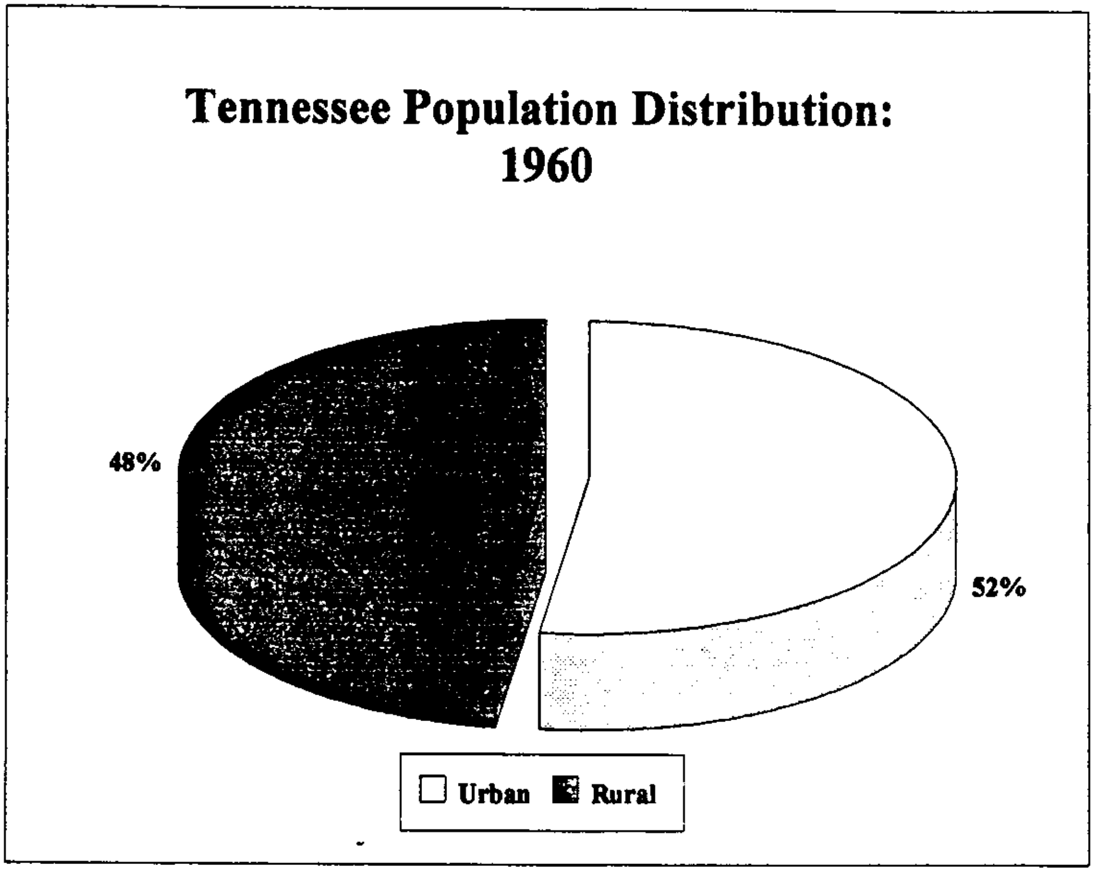
Appendix I
Growth of Tennessee's Franchise Tax



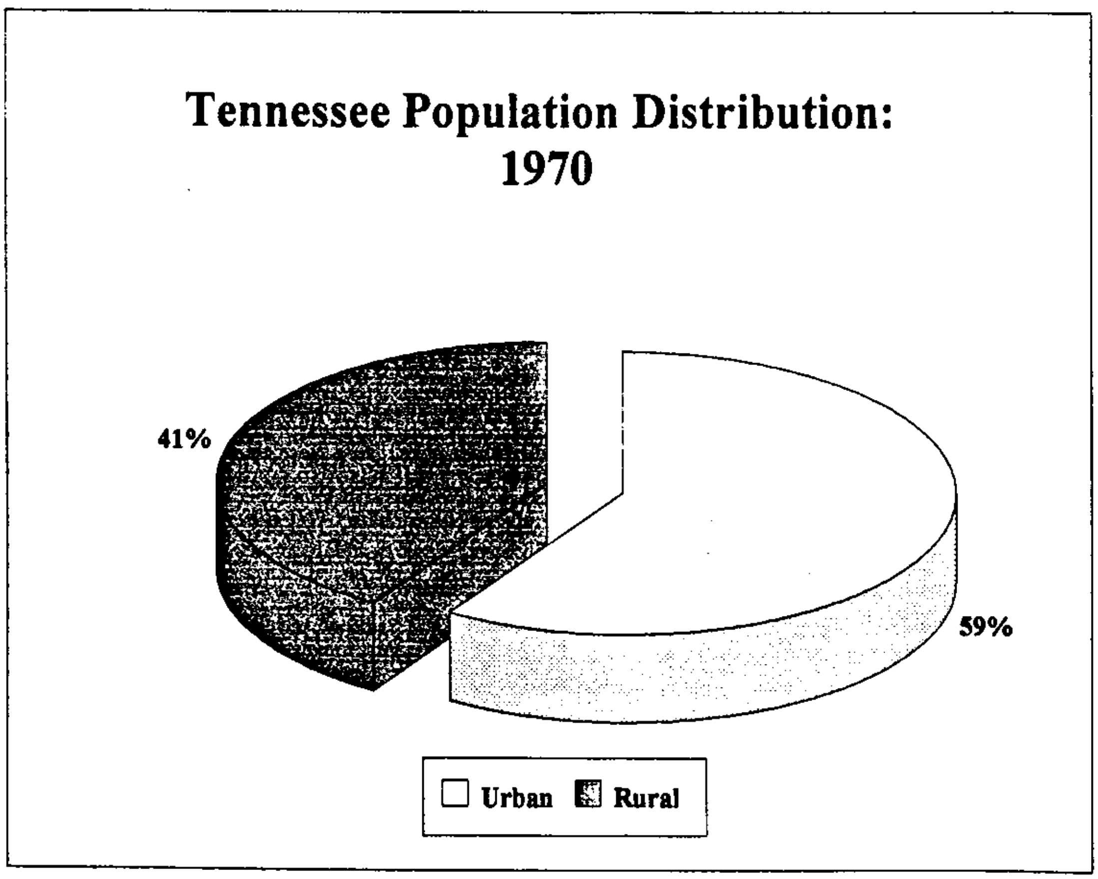
	1970	1980	1985	1986	1987	1988	1989	1990	1991
South Carolina									
Dollars	$3,004	$7,589	$10,729	$11,595	$12,314	$13,246	$13,875	$15,097	$15,467
Percent Change		152.63%	41.38%	8.07%	6.20%	7.57%	4.75%	8.81%	2.45%
Virginia									
Dollars	$3,743	$9,827	$14,468	$15,644	$16,675	$17,783	$18,955	$19,725	$20,082
Percent Change		162.54%	47.23%	8.13%	6.59%	6.64%	6.59%	4.06%	1.81%
Southeast States									
Dollars	$3,293	$8,484	$12,044	$12,994	$13,712	$14,640	$15,622	$16,507	$17,004
Percent Change		157.64%	41.96%	7.89%	5.53%	6.77%	6.71%	5.67%	3.01%
United States									
Dollars	$4,051	$9,919	$13,896	$14,910	$15,641	$16,618	$17,699	$18,639	$19,092
Percent Change		144.85%	40.09%	7.30%	4.90%	6.25%	6.50%	5.31%	2.43%
Southeast as Percent of U.S.	81.29%	85.53%	86.67%	87.15%	87.67%	88.10%	88.26%	88.56%	89.06%
Tennessee as Percent of Southeast	95.69%	94.65%	93.42%	95.94%	96.89%	96.73%	95.99%	96.20%	96.95%
Tennessee as Percent of U.S.	77.78%	80.96%	80.97%	83.62%	84.94%	85.21%	84.72%	85.20%	86.35%

Source: University of Tennessee, Knoxville, Center for Business and Economic Research, *Tennessee Statistical Abstract 1992/93*.

Appendix L



Tennessee Population Distribution:
1960
48%
52%
Urban
Rural



Tennessee Population Distribution:
1970
41%
59%
Urban
Rural

Office of Local Government Staff

Director
♦Tom Fleming

Assistant Director
♦Ethel R. Detch

Manager
Douglas Wright

Senior Legislative Analysts
Eric Wormhoudt

Associate Legislative Analysts
A. Paige Baker
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