Economic Development: State Financial Incentives

BACKGROUND

Recent economic data illustrate the current improvement in Michigan's business climate.

- *Unemployment* In 1992 the Michigan unemployment rate was 8.8 percent, above the national rate of 7.4 percent; by 1997 the state rate not only was down to 4.2 percent, it also was below the national rate of 4.9 percent. In fact, the Michigan unemployment rate has been below the national average since 1994, which was the first time since 1966.
- *Employment* From 1992 to 1997 Michigan wage and salary employment increased 13.2 percent, exceeding the U.S. increase of 12.6 percent, and ranking 24th nationally (in contrast to 40th from 1980 to 1990).

Many factors affect a state's level of economic development, including proximity to markets and materials, quality of its economic infrastructure (e.g., roads, airports), quality of public services (e.g., education, police and fire protection), labor availability, labor cost, labor relations, government-controlled business costs, and the condition of national and international economies. All but the last are viewed as aspects of a state's business climate.

Studies and Rankings

Until recent years, Michigan's business climate had been ranked near the bottom among the 50 states. In 1990 a study by Grant Thornton Company of state manufacturing climates found that Michigan ranked last among the 29 "high manufacturing intensity" states (the study gave great weight to production costs). In 1992 a study by Public Sector Consultants of U.S. state-local tax systems ranked Michigan 47th among the 50 states in business climate (the ranking focused on factors directly influenced by state government policy—overall tax burden, marginal income tax rates, public-service expenditures, workers' disability compensation rates, and unemployment insurance costs).

More recently, the news has been much better. *Site Selection* magazine, which for 30 years has ranked states' ability to attract business, selected Michigan as the winner of its "1997 Governors Cup" for leading the nation in economic development with 1,285 new plants and expansions announced. In 1996 Michigan had ranked sixth, with 400 new plant and expansion announcements; in 1991 there had been only 46.

GLOSSARY

Michigan Economic Growth Authority (MEGA)
A state body that grants single business tax credits to firms creating a given number of new jobs.

Renaissance zones
Eleven designated areas in the state that are virtually tax free for a specified number of years for businesses and residents currently located in or moving into them.

According to *Site Selection*, in 1997 Michigan also led the nation in the total number of new manufacturing facilities announced: 278.

Michigan's business tax burden is higher than the national average but competitive with many states. A 1995 study by the Policy Economics Group of KPMG Peat Marwick compared North Carolina's business tax structure to that of 20 other states, including Michigan, Illinois, Indiana, and Ohio. Using its "business tax competitiveness model," Peat Marwick ranked the states on the combined effective business tax rate on investment. The average was 8.60 percent, and Michigan's 9.74 percent ranked it 9th; the rates in Illinois, Ohio, and Indiana were 6.80, 10.78 and 10.97 percent, respectively.

Programs and Tools

The Michigan Jobs Commission offers several programs to encourage and assist economic development. In recent years several new programs have been instituted by law; the Michigan Economic Growth Authority (MEGA) and renaissance zones offer the principal and most visible financial incentives.

Other financial assistance mechanisms include industrial development revenue bonds, state and local property-tax abatements, and tax-increment financing. Michigan also has one of the largest venture capital funds in the Midwest: $170 million. The Michigan Jobs Commission also offers a wide array of services to business, among them export assistance, site development and infrastructure improvement, Electronic Site Location Network, job training and retraining, regulatory/government ombudsman, Michigan industry round tables, workers' compensation cost management, and recycling/waste-reduction.

Michigan Economic Growth Authority

One of Michigan's most important economic development tools is the MEGA, a unique program established in 1995 for the purpose of reducing taxes for firms wishing to locate or expand facilities in the state. The legislation allows the Michigan Jobs Commission, with assistance from an eight-person board appointed by the governor, to grant single business tax (SBT) credits based on the number of new jobs created. Michigan-based and out-of-state firms must create and maintain at least 75 and 150 new jobs, respectively, to receive SBT credits. Businesses may be awarded credits for up to 20 years, and the number of firms authorized to receive credits is limited to 25 per year. In some ways the MEGA is the state counterpoint to the industrial tax-abatement program, which allows local governments to reduce or eliminate property taxes for firms that locate or expand in their jurisdiction. Proposal A (1994) reduced the value of the local tax-abatement program by reducing property taxes and placing new restrictions on the program.

Renaissance Zones

Michigan's renaissance zones are 11 regions of the state designated as virtually tax free for any business or resident currently located in or moving into them; there are six urban zones, three rural zones, and former military bases comprise two additional zones (see the exhibit). The zones are designed to provide selected communities with the market incentive of no taxes in order to spur new jobs and investment. To give businesses more loca-

Michigan Renaissance Zones, 1998

Zone Location	*Size (acres)*	*Duration (years)*	*Number of Sub Zones*
Benton Harbor, St. Joseph, and Benton Township	120	10	5
Detroit	1,345	12	6
Flint	836	15	5
Gogebic, Ontonagon, and Houghton counties	2,917	15	6
Grand Rapids	536	15	6
Lansing	110	12	2
Manistee County	556	15	2
Montcalm and Gratiot counties	1,870	15	6
Saginaw	743	12	5
Warren Tank Arsenal (former)	153	15	1
Wurtsmith Air Force Base (former)	2,202	15	1

SOURCE: Michigan Jobs Commission.

tion options, each renaissance zone may comprise up to six smaller zones located throughout the community. All renaissance zones began on January 1, 1997, and will last 10–15 years (the local government decides the length), with taxes phased back in during the last three. One aspect that sets Michigan's renaissance zones apart from such zones in other states is that in Michigan, individuals living in the zone are exempt from the personal income tax, regardless of where they earn the income.

DISCUSSION

How effective are state economic development policies? Numerous studies may be found on both sides of the issue. In reviewing the literature, Robert Lynch, in *State Tax Notes* (1996), concludes:

> State and local tax incentives do not work well. They do not stimulate economic activity and create jobs in a cost-effective manner. On the contrary, by forcing reductions in public services, tax cuts and incentives may retard economic and employment growth.

On the other hand, many recent econometrics studies find that state and local tax incentives may have some positive effect on economic growth. In the most thorough review of recent research on the effects of state and local taxes on economic development, Timothy Bartik, in *Who Benefits from State and Local Economic Development Policies?* (W.E. Upjohn Institute for Employment Research, 1991), summarizes the results of 75 studies conducted from 1979 to 1994. He concludes:

> Most recent business location studies have found some evidence of statistically significant negative effects of state and local taxes on regional business growth.

There is considerable debate about the wisdom of state competition for jobs and investment. Burstein and Rolnick, in *State Tax Notes* (1996), argue that unfettered competition among private businesses generally has proved to be a very successful economic system and that competition among governments based on their general spending and tax policies leads to a better outcome for the overall economy. However, they say, when competition takes the form of preferential financial treatment for specific companies the economy suffers as a result of the misallocation of resources, in particular too few public goods. Graham Toft, also in *State Tax Notes* (1996), argues, however, that states should be free to compete according to their economic strengths. He says that incentives are a cost of business, and they can and should be maximized in a strategic and disciplined way that will upgrade the local and regional economy while ensuring acceptable rates of return to taxpayers.

In recent years the question has arisen about whether government should help finance construction of private sports stadiums. Supporters argue that government subsidies often are needed to make a stadium financially viable, and without the stadium, the professional sports team would move to another community, taking its prestige and economic benefits with it. Supporters also contend that sports teams generate substantial economic activity and create a considerable number of jobs. Opponents argue that state government should not subsidize a private, for-profit business that benefits a limited number of people in only one community. They also contend that the economic benefits of having sports teams and stadiums usually are overstated: Money spent on professional sports tickets simply is transferred from other entertainment expenditures, such as movie tickets, and creates no or little new economic activity. Baade, in *State Tax Notes* (1997), makes the point that a way is needed to adequately measure the economic effect of sports teams and stadiums.

> Given the cost to a city of building or refurbishing a stadium or attracting or retaining a team, the economic impact of professional sports requires empirical examination. To supplement and to facilitate evaluation of sports impact studies, a method of providing after-the-fact audits of the contributions of professional sports to metropolitan economies would provide a filter through which team and stadium impact studies can be run.

Michigan Economic Growth Authority

The MEGA program has been criticized as being too narrowly targeted, too expensive, and unnecessary. Opponents argue that (1) the MEGA will provide a large benefit to a few firms, while not assuring that those firms will locate in the areas that most need the jobs, and (2) the 20-year eligibility period is more generous than any other existing state program and will cost millions in forgone tax revenue. These critics contend that the state should concentrate on broad-based improvements to the business climate, such as reducing personal property taxes, which would benefit all the large manufacturing firms targeted by the MEGA as well as many other small and medium-sized firms.

Supporters of the MEGA point to early evidence that the program is working well, contending that Michigan has attracted or saved many jobs that, according to University of Michigan estimates, will generate more tax revenue than is forgone. Supporters argue that the MEGA gives state government (1) leverage to attract the most promising commercial and industrial projects and (2) a critical tool in convincing businesses to locate and expand in Michigan. Moreover, they say, the MEGA provides sufficient safeguards to ensure that the businesses uphold their agreement to provide jobs and invest in the state; this is an improvement over the local tax-abatement program, which offered no such assurance. Some tax policy experts argue that the MEGA is a better approach than local tax abatements because it allows tighter control and does not pit one community against another. Supporters also point out that 44 states, including Ohio and Indiana, have implemented similar programs, and Michigan must be able to compete with these states.

Renaissance Zones

Critics of renaissance zones argue that much of the new business locating in the zone likely will come from surrounding communities, creating new pockets of depressed activity and adding no new economic activity in the state. Supporters contend that many of the businesses will be attracted from out of state or will be new startups that would not have occurred without the no-tax incentive. Supporters also maintain that communities with stagnant or declining economic activity need this tax advantage to place them on a competitive footing with communities with a stronger economy.

Summary

The jury is still out on the value of state financial incentives for promoting economic growth. However, the Michigan business climate clearly has improved. All the factors contributing to this improvement are not known, but general tax reductions, less regulation, a more pro-business attitude, the diminishing strength of labor unions, a strong economy (success breeds success), and aggressive economic development policies likely all have played a part in Michigan's emergence as a good place to do business.

See also Air Quality; Business Taxes; Community Colleges; Job Training; Personal Property Tax; Road Funding; Sales and Use Taxes; Urban Revitalization; Water Quality.

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