REPORT OF THE
SECRETARY OF COMMERCE AND TRADE ON

# The Feasibility of Various State and Local Governmental Incentives to Encourage Economic Development

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

## HOUSE DOCUMENT NO. 59

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# COMMONWEALTH *of* VIRGINIA

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TO: The Honorable Lawrence Douglas Wilder
Members of the General Assembly of Virginia

House Joint Resolution 579, agreed to by the General Assembly in 1993, requests the Secretary of Commerce and Trade to "examine the feasibility of various state and local governmental incentives to encourage economic development."

As directed by this joint resolution, I hereby submit the attached report which includes the findings of the study that was conducted in response to HJR 579.

I wish to express my sincere appreciation to the many individuals who assisted my office in carrying out the request of the General Assembly for this important study.

Respectfully submitted,

Cathleen A. Magennis
Secretary of Commerce and Trade

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## EXECUTIVE SUMMARY

The debate about whether or not states should provide economic incentives to prospective employers has escalated significantly over the past ten years. Unfortunately, much of the debate has been based on theory and perceptions, not on fact. Even more importantly, the debate has yet to define what is, and is not, an incentive. Accordingly, public policy makers may be well served to clearly analyze the evolution of incentives, define the programs, and review a comparative analysis of alternative means for expending public funds.

The following report outlines the differing denotations for the expenditure of public funds. All funding in the name of economic development is not, as connotated, an incentive. Once the distinctions have been made, it is easier for policy makers to identify the benefits and costs associated with attracting new, and/or retaining old businesses. Ultimately, with this analysis, policy makers are provided a vehicle to determine the worthiness of funding programs based upon the ultimate benefit to the citizens, the businesses, and the communities of the Commonwealth of Virginia.

House Joint Resolution No. 579, passed by the 1993 Session of the General Assembly, requested the Secretary of Economic Development (Secretary of Commerce and Trade) to examine the feasibility of various state and local governmental incentives to encourage economic development.

### Highlights of Findings

- On the whole, national research is <u>not very supportive of incentives</u>. From a macroeconomic point of view, incentives produce nothing of value and do not increase national wealth. They <u>merely transfer resources from the public to the private sector</u>. Traditional economic development programs, such as introducing new firms to the export market, actually increase U.S. wealth.

- <u>Until public policy makers and the business community establish principles of conduct</u>, there will continue to be competition among states for new domestic investment, and foreign firms have significantly increased their demand for state funded subsidies.

- Given that the use of incentives by states is not simply going to go away, it is imperative that public policy be directed to ensure that funds expended <u>to influence private development support public goals</u>.

- The General Assembly's objective is to create economic growth for the citizens, the communities, and the industries of Virginia. <u>The distinction must be made between reinvestment programs which expend public funds for the public benefit and company specific incentive packages which expend public funds for the benefit of one particular company</u>.

- Nationwide, economic development incentives and programs are suffering from the lack of quantitative and qualitative assessment. Unaccountability of public funds expended is the norm, not the exception. The recent Mercedes-Benz offer demonstrates the spectrum of contrasting public policies. Where Alabama has pledged Mercedes-Benz $253 million to potentially create 1500 jobs; a cost of over $169,000 per job, Virginia has expended $6.8 million from the Governor's Economic Opportunity Fund to benefit 21 different companies and create 6,128 jobs; a cost of only $1,100 per job. The fund helped create jobs within our current businesses, and it help offset the extraordinary costs associated with new business locating in Virginia.

- Virginia's most effective economic reinvestment programs, workforce training, industrial road and rail access, revolving loan fund, and the Governor's Economic Opportunity, largely emanate from a long-standing strategy designed to bring manufacturing jobs to rural areas. These programs should be revised to ensure their applicability to all areas of the Commonwealth, with special emphasis on emerging high technology companies.

- Virginia's business tax liabilities are among the lowest of the states examined. Whereas other states often use tax incentives to offset their higher tax rates, Virginia does not have to offer tax breaks since its rates are already lower than competing states.

- Several trends are emerging among economic development programs in neighboring states that target white-collar jobs and entrepreneurial activity.

**Summary of Recommendations**

- Virginia should adopt a set of principles to guide interstate competition, particularly pertaining to the use of extraordinary financial incentives. One recommended model is the National Governor's Association, August 1993, Incentives: Interstate Cooperation agreement.

- Virginia should pursue its strategic plan (HJR 389) to continuously improve the business climate which allows business to achieve economic success and provide jobs through a rational tax policy and regulatory and legal environment (i.e. workman's compensation, efficient and effective government) by reducing regulatory barriers.

- The General Assembly should support economic development and should engage in traditional and entrepreneurial economic development policies and programs that support Virginia's existing business base. These policies and programs should be subject to a periodic evaluation to measure quantitative and qualitative results from the public funds expended. Among these program recommendations are increasing funding for workforce training and a continuation of the Governor's Economic Opportunity Fund and the Industrial Access Road program.

- Legislation creating local industrial development authorities should be reviewed to increase flexibility. In addition, the results of the enterprise zone program should be reviewed and consideration given to modifying it to improve its ability to help encourage job creation and investment in Virginia.

- Virginia should adopt a sustained investment strategy that supports human resources (education, job training) and infrastructure development (transportation, energy, telecommunications) and environmental stewardship.

- All states should discourage the offering of customized firm specific incentive programs which pit state against state in bidding wars.

## SOURCES OF INFORMATION AND REFERENCES

This report reflects the consensus reached by the National Governor's Association as reflected in their publication: Investing in America's Economic Future: States and Industrial Incentives.

This report also draws upon the following reports and studies:


- State Economic Development Promotions and Incentives: A Comparison of State Efforts and Strategies: Ted Bradshaw, Nancy Nishikawa, and Edward Blakely, The Institute of Urban and Regional Development, the University of California at Berkeley, June 1992.

- Memorandum, KJDA/KIRA Legislation: Mac Unger, Executive Administrator, Department of Finance and Budget, City of Louisville, April 26, 1993.

- The Costs and Benefits of Business Subsidies: Wim Wiewel, Joseph Persky, and Daniel Felsenstein, June, 1993.

- Strategic Targeting of Economic Development Incentives By Utilities: Glen Weisbrod, Cambridge Systematics, Inc., October, 1993.

- Memorandum, Industrial Development Policy: Michael F. Brown, City Manager, City of Tucson, October 11, 1993.

- Memorandum, State Business Incentives: Elisabeth Kersten, Director, California Senate Office of Research, October 18, 1993.

- "States' Bidding War Over Mercedes Plant Made for Costly Chase." Wall Street Journal. November 24, 1993, page 1.

- Council on Urban Economic Development Incentives Task Force Work Plan and Background Material: 1993.

- Information Packet on Incentives offered by the Kentucky Jobs Development Authority, Kentucky Cabinet for Economic Development, Division of Research and Planning.

- Information Packet on Incentives offered by the Kentucky Industrial Development Authority, Kentucky Cabinet for Economic Development, Division of Research and Planning.

- Information Packet on Incentives offered by the Kentucky Rural Economic Development Authority, Kentucky Cabinet for Economic Development, Division of Research.

- Interstate Meat Markets: The High Price of Buying Jobs: John E. Petersen, President, Government Finance Group, GOVERNING, October 1993.

- Incentives: Not the Only Way to Win: Ticknor and Associates, November 1993.

- The Incentives and Obstacles Facing Business When Making Location Decisions in Virginia: House Document Number 5, 1992.

- The Measures Necessary to Assure Virginia's Economic Recovery: House Document Number 37, 1992.

- Review of Economic Development in Virginia: House Document Number 39, 1991.

- Toward A New Dominion: Choices for Virginians: Report of the Governor's Commission on Future, December, 1984.

- Virginia's Economic Development Strategies for the Future: Establishing a New Standard of Leadership in and Evolving Technological Age: March 1983.

Additionally, this report reflects interviews with colleagues in Maryland, South Carolina, North Carolina, Florida, Georgia, and Kentucky. Further interviews have been held with executives from the Virginia Chamber of Commerce, the Virginia Economic Developers Association, and a series of interviews have been held with city and county officials throughout Virginia.

An Examination of the Feasibility of Virginia State
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## HISTORY OF FEDERAL AND STATE ECONOMIC INCENTIVES

So long as commerce has existed in America, governments have offered entrepreneurs economic incentives to succeed. The founding of Jamestown by the Virginia Companie was driven by pure, unadulterated, economic incentive. The Crown had granted the Companie significant land holdings, and privileges to the ultimate inhabitants, including control over mineral, forest, and soil resources. The right was exclusive, and it was meant to be exercised by the Companie and the Crown as sole proprietors. As the control exercised by the monarchy was changed into a constitutional democracy, much public policy has been written to ensure ongoing economic growth and stability. Whether it was the granting of land to those who would build railroads, or the expenditure of public funds in the name of public works, the implementation of legislated policy have played an important role in our country's economic development. From 1945-1966, three significant federal decisions have had a direct impact upon the U.S. economy. The passing of the G.I. Bill provided significant funds to re-educate our workforce. The funding of the interstate highway system likewise channeled significant public revenues into newly created economic marketplaces, and the passing of the Bretton Woods agreement effectively opened global marketplaces by creating an entirely new monetary system.

As noted by John E. Petersen, President of Government Finance Group based in Arlington, Virginia, the federal government historically has financed state economic development programs. Federal grant and loan programs, particularly the reliance by states and localities on Industrial Revenue Bonds (IRB's) has fueled economic growth. Indeed, during the 1970s and 1980s, IRB's were the tool, or if you will, the incentive, financing up to 90% of local economic development activity.

After the Tax Reform Act of 1986, the Industrial Development Bonds, along with other significant federally funded development-related programs, were all but eliminated. Accordingly, states and local economic development organizations reacted by creating their own inducements. Hence, the significant escalation in the use of state subsidized incentives.

Many observers believe that incentive strategies and philosophies developed in three waves since the late 1940s. The first wave began when Mississippi started offering business tax breaks to encourage northern manufacturers to move to the state. This strategy was adopted by states throughout the South and became the centerpiece of most business attraction programs by the 1960s. A second wave sought to assist small and medium sized businesses with a variety of complicated issues such as financing and export development. However, the programs that were created to deal with these issues, when spread among a number of state agencies, led to further confusion among businesses. The emerging third wave, one that promotes public-private partnerships to share the burden of relocation between the state and a company, may be a trend that will benefit Virginia. By employing agreements between the state and the company, both of their interests can be protected.

In this historical context, we can better examine the burden of responsibility which has shifted from the federal budget onto states' budgets. States and localities responded, under the extraordinary economic and competitive pressures occasioned by recessions, by creating a litany of economic incentives. Most states have done so without a strategic plan. Most states have done so without a cost-benefit analysis. Accordingly, in the race to stave off further economic decline in the short term, some states have chosen to pursue dubious long term obligations.

To chart a course towards sustained economic growth for the Commonwealth, Virginia is well served to pursue economic development programs which meet the specific needs of our unique strengths and vulnerabilities. Within the framework of the Statewide Economic Development Strategic Plan (HJR 389), the General Assembly is provided such a course. By defining alternative means to expend public funds, the General Assembly is given the ability to draw the distinction between those programs which reinvest tax revenues for continued economic growth, and those programs which gamble the public funds on potential short term gains. The following section outlines this distinction.

## DEFINING ECONOMIC INCENTIVES

- *Public Resources should be used to encourage and foster development that otherwise would not occur, not merely to influence the location of private investment.*

- *Public Subsidies should benefit and be available to all businesses - large and small, new and existing, of domestic and foreign ownership - based on an individual state's objectives, identified criteria and calculated rate of return.*

- *Public Subsidies should be investments in people to develop a better educated and skilled workforce and in communities to develop the physical and social infrastructure needed for healthy economic development. Improvement in the workforce and community should not be wholly dependent on the fortunes of a single company but be viewed as assets for other businesses that locate in the community.*

- *The Business community should be obligated to deliver promised benefits (investments, jobs, payroll, etc.) in return for state development subsidies. States are to ensure that all development agreements include provisions for recouping subsidies when businesses fail to meet this obligation.*

The above principles, issued by the National Governor's Association in August 1993, set forth a basis upon which the General Assembly and the Executive Branch may determine the merit of alternative economic development programs.

Defining Economic Incentives

As all previous studies have clearly established, the General Assembly's objective is to create economic growth for the citizens, the communities, and the industries of Virginia.

Good government and good government policies, equitably achieve this goal. The distinction, therefore, must be drawn between:

A. Reinvestment programs: expending public funds for the public benefit, and

B. Company specific incentive packages: expending public funds for the singular private benefit of a company.

Reinvestment Programs

"A" is the reinvestment of citizen and corporate tax dollars in residual, viable resources which benefit each citizen. Such expenditures are a reinvestment of taxpayer funds for the ultimate benefit of the taxpayer. When the Commonwealth expends these public funds, the investment benefits remain, whether or not a particular company does.

Examples of Virginia's current programs which fit this criteria include:

**Financing Programs**

- Community Development Block Grants
- Industrial Development Bonds
- Small Business Financing Authority
- Virginia Business Modernization Loans and Grants
- Tax Increment Financing
- Virginia Coalfield Economic Development Authority
- VEDCORP
- Virginia Economic Development Revolving Loan Fund

**Infrastructure Programs**

- Industrial Access Road Program
- Rail Industrial Access Program
- Shell Building Initiative

**Tax Programs**

- Taxes
  - Corporate Income Tax Credits
  - Sales and Use Tax Exemptions
  - Real Estate Tax Exemptions
  - Tangible Personal Property Tax Exemptions

- Enterprise Zones
  - Income Tax Credits
  - Sales & Use Tax Refund

- Foreign Trade Zones

- Targeted Jobs Tax Credit

- Solar Photovoltaic Manufacturing

**Training Programs**

- Workforce Services Training Program

- Job Training Partnership Act Programs

**Management and Technical Support Programs**

- Center for Innovative Technology
- International Market Planning Program
- Small Business Development Center Program
- Rural Economic Development Fund
- Center on Rural Development Grants

**Special Ports Programs**

- Virginia International Terminals/Norfolk Southern Savings Plan
- Virginia International Terminals

Company Specific Incentive Programs

In contrast to programs which reinvest public funds for the public benefit, "B" accrues to the benefit of a single, private-sector company. These are publically funded incentives designed to attract one specific company by effectively subsidizing the company's cost of doing business. Examples of these types of expenditures include:

- Site acquisition
- Corporate facility construction
- Company specific tax abatements\credits
- Payment of employee relocation costs and payroll

As written recently in the Wall Street Journal: "*States today are vying more desperately than ever to lure new industrial jobs and hold on to those they have. They give away millions of dollars in free land as a starter - after which come fatter and fatter aid checks for site clearance, training, even employee salaries. And big companies - foreign and domestic - are finding ingenious ways to cash in.*

*'There's some question whether states can play this secretive game with taxpayers' money - but they do,' says Douglas Woodward, associate professor of economics at the University of South Carolina. 'There seems to be very little accountability over it. Nobody does any follow-up, and nobody does any cost benefit analysis.'" (Wall Street Journal, November 24, 1993, page 1)*

In the increasingly competitive environment to create and retain jobs, several states have aggressively pursued programs which are intentionally designed to attract major companies. Hence, the rapid escalation of incentive packages created only to attract, and benefit, a specific company.

The following chart contains examples which demonstrate the escalating trend in state sponsored incentive packages. The reader will note the public funds expended, per potential job created by the recipient company, has increased from $43,636/job to $169,000/job.

| *YEAR* | ***PROJECT*** | *Gross $ (mill)* | *Direct Jobs* | ***Cost/Job*** |
|---|---|---|---|---|
| *1993* | ***Mercedes*** | *$253* | *1,500* | ***$169,000*** |
| *1992* | ***Dofasco Steel*** | *$140* | *400* | ***$350,000*** |
| *1992* | ***BMW*** | *$135* | *1,900* | ***$71,000*** |
| *1990* | ***United Airlines*** | *$300* | *6,000* | ***$50,000*** |
| *1989* | ***Sears*** | *$240* | *5,500* | ***$43,636*** |

All incentive packages are gross dollars, without discounting for the time value of money.

The Mercedes incentive is still being formulated in its final terms. It includes tax abatement of $42.6 million under the newly enacted Legislative Act 93-851, which allows a company to finance land, buildings, and equipment by applying abated future corporate income taxes and "Job Development Fees" of up to 5% of gross wages from new employees. Each employee will then receive a state tax credit against personal income taxes for the amount of Job Development Fees withheld. Other annual operating subsidies may increase the total package.

Mercedes and United Airlines actively considered Virginia before choosing Vance, Alabama and Indianapolis respectively.

The Dofasco Steel package is so generous because Kentucky has a program which was the precursor of the Alabama Job Development Fee system.

The Sears Merchandise Group was ultimately a business retention project for Illinois. After considering many outside locations, Sears relocated this function from downtown Chicago to suburban Hoffman Estates.

Source: Ticknor and Associates

A recent study conducted by the National Council for Urban Economic Development has determined the majority of states involved in bidding for company specific projects have had neither a strategic plan to justify the extraordinary public expenditures, nor have they obtained legal assurance from the recipient companies that they will perform in accordance with the proposed projections.

For example, after receiving special tax abatements from Ypsilanti Township in Michigan, the General Motors Corporation nonetheless decided to shift production from that plant to a plant in Arlington, Texas. In response, the township of Ypsilanti brought a suit against General Motors which remains in contention.

Similarly, when Sears threatened to relocate its headquarters from Illinois, the state "successfully" outbid other states. After all the bids were in, Illinois had anted up $240 million to keep what it had.

Cost/Benefit Analysis

As Don Haider, Professor of Economics at Northwestern University in Chicago, stated to the National Governor's Association on February 2, 1992:

> *"I'm not going to tell you that incentives do not work. Our whole economic system is based on competition and incentives. However, there is nothing in the literature that says they invariably work, from the macro picture. Also, there is no evidence that they work over time. In fact, there is considerable evidence that if everyone gives them, and they are basically the same, you are in a zero-sum game."*

Nationwide, economic development incentives and programs are suffering from the lack of quantitative and qualitative assessment. Unaccountability of public funds expended is the norm, not the exception.

Because the practice of using extraordinary incentives to attract or retain companies is relatively new, little empirical evidence exists to support a benefit analysis.

The recent Mercedes-Benz offer demonstrates the spectrum of contrasting public policies. Where Alabama has pledged Mercedes-Benz $253 million to potentially create approximately 1,500 manufacturing jobs, within Virginia we have expended $6.8 million from the Governor's Economic Opportunity Fund on infrastructure at the expressed request of our communities for the benefit of some 21 different projects creating cumulatively 6,128 jobs. As a return on investment, Alabama has spent approximately $169,000 for each manufacturing job created. By contrast, Virginia spent approximately $1,100 for each job -- often in higher skilled and higher valued jobs. As importantly, those jobs are created within our current businesses to help them grow and expand, as well as to offset extraordinary costs associated with new businesses locating in Virginia.

The following chart summarizes the cost and benefits of ongoing economic redevelopment programs:

# DIRECT ASSISTANCE TO BUSINESSES IN THE COMMONWEALTH

Mission: to provide to existing businesses in the Commonwealth specific services, such as training, export assistance, financing, and ombudsman assistance. To establish communication links with Virginia's business community and to closely monitor Virginia's business climate.

| Performance Measures[1] | 1993 | 1992 | 1991 |
|---|---|---|---|
| ■ Workforce Services | | | |
| * Project | 220 | 202 | 183 |
| * Employees trained | 12,500 | 9,365 | 6,062 |
| * Average payback | n.a. | 11.5 mo. | n.a. |
| ■ Business Services | | | |
| * On-site visits to industry | 274[2] | 603 | 538 |
| * Requests for assistance | 512 | 1,150 | 941 |
| ■ Small Business Development Centers | | | |
| * Jobs created or saved | 1,427[3] | 2,211 | 1,852 |
| * Private investment | $21M | $42M | $22M |
| ■ Small Business Financing Authority | | | |
| * Financing | $3.8M | $3.8M | $1.9M |
| * Jobs created through various programs | 125 | 254 | 287 |
| ■ Small Business Services | | | |
| * Direct client inquiry responses | 973 | 2,313 | 1,674 |
| ■ Export Development | | | |
| * Trade leads from shows and missions | 871[4] | 810 | 952 |
| * Virginia firms represented at | 92 | 45 | 37 |
| * IMPs | 35 | 25 | 28 |
| * Export InfoCenter responses | 897 | 1,300 | 650[5] |
| * Exporting seminars/audience | 14/787 | 20/95 | 8/496 |
| ■ Retention/Emergency response visits | n.a. | 9 | n.a. |

[1]Performance measure data is for calendar year 1992 except for Workforce Services, which is for the 1992 fiscal year.

[2]Visits through October, 1993.

[3]Jobs created or saved through September, 1993

[4]Trade leads through September, 1993

[5]Estimate based on doubling July-December data.

# VIRGINIA'S APPROACH TO ECONOMIC DEVELOPMENT PROGRAMS AND USE OF INCENTIVES

The Constitution of Virginia defines the structure, responsibilities, and powers of government in serving the citizens of the Commonwealth. The definition places limits on what government can and cannot do while embodying a philosophy of governance that has come to represent "the Virginia way." Among other things, the Constitution requires the state to maintain a balanced budget and details which powers are delegated to local governments. The resulting fiscal responsibility, tax climate, and predictability that have long characterized Virginia represent an environment that has been attractive to business since the founding of Jamestown by the Virginia Companie in 1607.

To promote development, Virginia, along with many other southern states, embraced the concept that state government serves a public purpose by encouraging companies to create jobs and make investments in its communities. The Department of Economic Development has operated under a legislated mandate to carry out this mission for more than 30 years. Likewise, the Commonwealth created the Virginia Port Authority and the Department of Agriculture to further economic opportunity for Virginian commerce.

The Commonwealth traditionally has emphasized our business climate marked by strategic location, quality workforce, competitive wages, equitable tax structure, right-to-work law, and pro-business government to successfully attract new jobs and investment. The program has been anchored by a commitment to provide accurate up-to-date information, timely service, and suitable locations that effectively satisfy stated needs, with an expectation that Virginia will be inherently cost competitive. The Commonwealth, largely restricted from offering public dollars to enhance the financial or operational success of private companies, has adhered to a policy of treating new business and existing business alike. The only long-standing exceptions to not offering publicly funded "incentives" have been the state's support of training Virginians to fill jobs created by new or expanding companies and providing funds to help build roads and, more recently, rail access to inaccessible industrial sites.

## Constitutional Provisions

The Constitution of Virginia restricts the ways government can participate in private business ventures. Article X, Section 10 of the Constitution, known as the "credit clause," prohibits the use of public funds and credit to foster and encourage the construction and operation of private enterprise. State government cannot directly participate in reducing the cost of establishing or operating a new or expanded business. Public funds, however, can be directed through various authorities created to serve broadly defined economic development purposes. Local industrial development authorities, the Small Business Financing Authority and the Virginia Coalfield Economic Development Authority represent mechanisms through which incentives are offered to private companies.

The Constitution restricts the use of tax abatements or deferrals. Article X, Section I, states that all property shall be taxed, levied, and collected under general laws that shall be uniform upon the same class of subjects within the territorial limits of the taxing authority. Although selected tax incentives are employed to encourage certain types of investments; i.e., recycling and pollution control equipment, or targeted in selected locations (enterprise zones); the Constitution, for the most part, prohibits the abatement or deferral of local property taxes.

Although the Constitution restricts the manner in which Virginia can offer business incentives or alter tax liabilities as an incentive, the state has been able to implement such programs through the creation of special authorities at the state and local levels, the establishment of single purpose non-profit public corporations, or other such mechanisms. In addition, payback programs such as the photovoltaic grant program, workforce services training, and any potential job credit approach are made possible through legislation and funding that agrees to "reimburse" or "credit" companies for pre-approved expenditures or performance. Even tax differentials and "abatements" are possible by creating special zones, such as the enterprise zone program, or for selected activities or purchases, i.e., recycling equipment.

Major Reinvestment Programs

Virginia's traditional focus on rural industrial development resulted in the creation of an industrial training program. The program, now known as Workforce Services, has been modified over time to include training for a wide variety of both manufacturing and non-manufacturing jobs. The industrial access road program reinforced Virginia's original strategy by making essentially undeveloped agricultural land selected for a new manufacturing operation accessible by a road meeting established state standards. The program was expanded to include rail access as well as non-industrial projects that create "basic" jobs, but its roots go back to helping bring manufacturing operations to rural Virginia. Both of these "incentives" have long been part of an industrial development initiative that was established and supported by the General Assembly and a long series of Governors.

The Virginia Economic Development Revolving Loan Fund, initially established to augment the financing of small to medium size projects, was essentially designed to help small companies in rural areas. The primary intent of the program is to help finance land, buildings, and equipment for companies creating basic jobs in localities not eligible to receive funds (Community Development Block Grants - CDBG) directly from the federal government. An annual loan pool is maintained to ensure money will be available to those companies not sufficiently capitalized to acquire cost competitive financing from the private sector. The program is consistent with Virginia's traditional approach to economic development (small awards directed toward small projects in rural jurisdictions).

The recently created Governor's Economic Opportunity Fund was largely designed to augment local efforts to address development-related requirements associated with "closing the deal" for a new location or an existing company expansion. The program has been effectively utilized, with its application being primarily limited to offsetting the cost of infrastructure/site improvements. In many ways, the program has helped shift some of the responsibility for supporting project development by requiring local matching funds; and, by so doing, broadened the state's ability to be a participant while adding to the total pool of resources available for economic development.

These four widely used reinvestment programs support the implied goal of helping create jobs and encouraging investment throughout the Commonwealth. Each was conceived to address an identified deficiency in the state's ability to implement a long-standing strategy of bringing jobs to rural Virginia. The subsequent modification and/or inherent flexibility of these programs has enabled them to be creatively applied to a wide variety of projects.

Recent initiatives such as optional tax incentives for recyclers, photovoltaic grants, enterprise zones, business modernization and other similar programs were designed to accomplish more narrowly defined strategic purposes.

Eligibility Requirements and Funding Levels

Incentive programs that have the greatest impact on companies' decisions to create jobs and make investments are those with broadly defined parameters, administrative flexibility, and adequate funding. The most widely used Virginia program workforce training, is available to all firms, new or existing, who create 15 or more basic, non-exempt and wage jobs and invest at least $500,000 in capital improvements. There are no program limitations as to where the jobs exist, who is hired or the size of the company creating the jobs. Workforce training is designed to be flexible to meet a company's needs and is available to all firms who meet the job and investment requirements. Limited funding in recent years has raised questions about whether or not eligibility restrictions should be placed on this program. At $3.2 million in FY 1994, Virginia funds its programs at a level lower than any of the five competing states included in the study.

The industrial road and rail access programs are applicable anywhere in Virginia. Any company investing at least $3 million is eligible for the maximum non-matched state contribution of $300,000 for road construction, while up to $100,000 is available to support a rail served project. (Rail projects are evaluated using different criteria.) An additional $150,000 for road construction (requiring an additional $3 million investment) and $50,000 for rail construction is available on a one-to-one matching basis. Total allocations for FY 1994 were $4 million for the road program and $500,000 for the rail program. Both of these incentives are largely "fringe" incentives that are frequently used to create a development package for a project that often includes funds from other sources, i.e., local, federal, private. The eligibility requirements allow broad participation, but narrowly defined purposes and limited funding minimize the "incentive" effect of these two programs.

The Virginia Economic Development Revolving Loan Fund is essentially limited to providing gap financing to smaller companies through rural industrial development authorities. Administrative flexibility has permitted the program to be effectively applied to help bring many small projects to all areas of Virginia. Limited to the maximum loan amount of $700,000, the revolving loan fund has primarily been used to assist projects under $4 million.

The Governor's Economic Opportunity Fund is the newest and most flexible state program offered to both new and existing industry. A total of $7.5 million has been appropriated for fiscal years 1993 and 1994. To date, funding for 21 projects has been approved, the largest of which was $750,000. Eligibility is based on private investment, local participation, number of jobs created and local economic conditions. These and other factors are used to "score" applications for funding. Administrative flexibility has allowed widespread use of the program for economic development purposes.

This program has proven, empirically, that fewer dollars can create more jobs. For example, where Alabama is spending $253 million to create 1,500 Mercedes-Benz factory jobs, the Governor's Economic Opportunity Fund has created 6,128 highly diversified jobs by reinvesting $6.8 million to assist 21 separate projects located throughout the state. A simple cost analysis alone demonstrates the cost savings realized by the more equitable reinvestment program in the Governor's Economic Opportunity Fund. Alabama will expend $169,000 for each factory job created, Virginia will reinvest $1,100 for each job. Moreover, in Virginia, the funds benefit our existing companies as well as new companies.

Workforce training, the road and rail access programs, the Virginia Economic Development Revolving Loan Fund, and Governor's Economic Opportunity Fund are the state's most widely used incentive programs for creating new jobs and encouraging investment. All four have broad eligibility requirements and administrative flexibility. Workforce services training, offered by all 50 states, is now considered a "given" by all companies seeking to establish a new operation. (If Virginia were to limit or restrict this program, it would become a competitive disadvantage for attracting jobs and investment.) The Industrial Road Access Program, as well as the Governor's Economic Opportunity Fund, are largely "infrastructure" incentives that companies now tend to view as a public sector responsibility. Rail access is not a public sector responsibility, but the number of projects requiring rail are small, (less than 30 percent of the companies that make inquiries to the Department of Economic Development) thereby minimizing the impact these projects have on job and investment objectives. The broader purposes of the Governor's Economic Opportunity Fund makes it the most effective state program at this time.

Virginia's remaining programs, such as enterprise zones, photovoltaic grants and tax concessions for various purposes such as recycling are more limited in eligibility but have proven very successful in creating jobs in their targeted markets.

<u>Responsible Agencies</u>

There are many examples of interagency cooperation and an overall commitment to help bring jobs and investment to the Commonwealth. As an example, economic development incentives are now being made available through:

Local industrial development authorities
Virginia Small Business Financing Authority
Virginia Department of Housing and Community Development
Virginia Department of Economic Development
Virginia Department of Transportation
Virginia Coalfield Economic Development Authority
Center for Innovative Technology
Virginia Economic Development Corporation (VEDCORP)
Virginia Port Authority

It should be noted, at times, it is difficult to effectively bring all existing programs to bear on a specific project, or apply programs in a manner that is most responsive to different company needs.

# COMPARATIVE ANALYSIS

## VIRGINIA AND REGIONAL COMPETITION

Many factors go into the decisions associated with creating jobs and making new investments. The broad spectrum of a state's overall business climate includes both quantifiable and non-quantifiable elements that affect a company's choice as to where to locate a project. Experience, perception and emotion join with an extensive number of quantifiable cost and operational issues that vary from company to company to form the basis of a site location decision.

In the competition for attracting jobs and investment, Virginia is most frequently compared to North Carolina and to a lesser extent with South Carolina, Tennessee, Maryland and Kentucky. Virginia competes well with the states in the mid-Atlantic/Southeastern Region. In most areas, Virginia holds an advantage, particularly in location, diversity and overall tax structure for business. The areas often sited as a disadvantage for Virginia are wage rates and commercial air service.

### Factors Affecting Competitive Advantage

Incentives are designed to provide a state, portions of a state, localities or portions of a locality with a competitive edge to encourage economic development. Although incentives can act as a stimulus for making a desired location decision, the many other factors that constitute the climate in which a particular business must choose to operate remain the major determinants in the economic development process.

The competitive problem that Virginia now faces is largely caused by the aggressive manner in which neighboring states have developed incentives to offset some of Virginia's inherent advantages. In many cases these incentives are promoted and used to attract the attention of businesses as they begin consideration of where to locate a project. Since a final location decision consists of weighing a wide array of different elements, the ultimate choice depends on attracting attention early, being responsive throughout the evaluation process and, finally, creating the confidence that a planned operation can be established and operated more efficiently and less expensively than in any competing location. Well conceived and promoted incentive programs often give states and localities an edge in attracting initial attention, as well as in demonstrating how public participation will allow a planned operation to be established and/or operated at a lower cost.

After conducting an evaluation of incentives in the selected states and the affect they have on Virginia's competitive advantage, the following observations can be made.

- Virginia's business tax liabilities are among the lowest of the states examined. In particular, sales and use tax, average cost of workers compensation and average cost of unemployment insurance are among the lowest in the nation. This gives Virginia a baseline competitive advantage over most neighboring states.

- States often use tax incentives to offset their relative disadvantage when they have higher tax rates than a neighboring state. South Carolina, with the highest property tax rates in the region, offers front-end tax abatements or fees in lieu of taxes to be competitive. North Carolina, Kentucky, and Tennessee can effectively use income tax credits to offset their high corporate income tax rates or additional franchise taxes on corporations.

- Incentives to attract new manufacturing facilities continue to dominate the mix of incentive programs in all of the states; however, an emerging shift to more incentives for nonmanufacturing is evident. Maryland, Kentucky, and South Carolina appear to lead in this area with specific programs targeted at attracting white collar jobs.

- Another emerging trend is emphasis on instate business growth and entrepreneurial activity. North Carolina's tax credits for small, growing businesses; Tennessee's financing assistance for small business start-up and growth; and Virginia's Business Modernization Program are examples of some of these new targeted incentives.

- While all of the states now offer some level of state subsidized financing, Kentucky and Maryland lead in this assistance. South Carolina relies upon two private economic development credit corporations to provide financing; and Tennessee has long relied upon TVA assistance in the eastern part of the state.

## Comparison of Incentive Programs

During the last two years, most of the six states that were examined have enacted new discretionary incentive programs to meet the increased level of regional competition for jobs and investment. Kentucky, North Carolina, and Tennessee have undertaken very aggressive business development incentive programs, marking a major shift from the traditional practice among southern states of offering few incentives. Maryland has enhanced its incentives for R&D and biotechnology. South Carolina, having established a number of new incentives several years ago, turned its attention to business climate improvements--chiefly, streamlining state government from 139 state agencies to 39. Virginia has also enacted three new incentive programs: The Governor's Opportunity Fund for Economic Development, the Solar Photovoltaic Manufacturing Grant Program, and the pilot Business Modernization Program. Some noteworthy new or expanded incentive initiatives among Virginia's competitors are:

**Kentucky**

- Direct incentives for white collar jobs.
- Use of employee income taxes as an incentive to business.
- Incentive to prevent manufacturing plant closure.
- Major emphasis on subsidized business financing options.

**Maryland**

- Construction of a $22 million BioCenter for biotechnology development.
- Expanded tax concessions for research and development.

**North Carolina**

- Flexible, discretionary "deal closing" fund, similar to Virginia's.
- Substantial broadening of jobs tax credit and industrial renovation program.

**South Carolina**

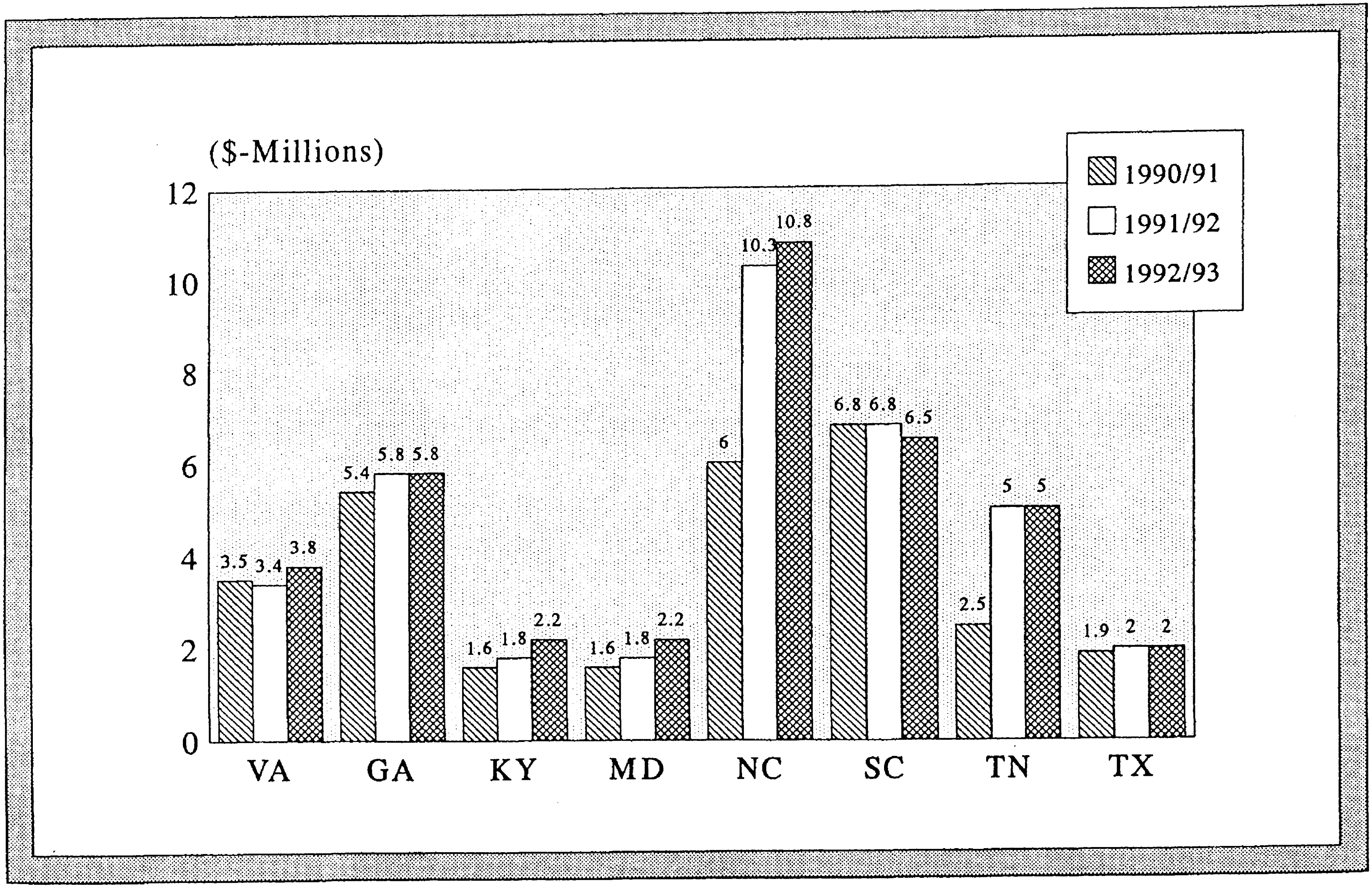
- Income tax credits for headquarters and R&D activity.

**Tennessee**

- Substantial Franchise Tax credit for new job creation.
- State subsidized financing for small business start-up and growth.

A narrative summary of major incentive programs in Virginia and the five competing states included in the study can be found in the Appendix.

# A COMPARISON OF INDUSTRIAL TRAINING BUDGETS



# COMPARISON OF BUSINESS TAXES

| | TAX RATES | | PROPERTY TAX EMEMPTIONS: YES = Taxed, NO = Not Taxed. | | | | | STATE COST RANKINGS | |
|---|---|---|---|---|---|---|---|---|---|
| STATES | CORPORATE INCOME TAX | STATE & LOCAL SALES & USE TAX | REAL ESTATE | INTANGIBLE | MACHINERY & TOOLS | MFG. INVENTORY | WHOLESALER INVENTORY | UNEMPLOYMENT INSURANCE (2) | WORKER'S COMPENSATION TAX (3) |
| VIRGINIA | 6% | 4.5% | yes | no | yes | no | Local option (1) | 3 | 1 |
| KENTUCKY | 4 - 8.25% (L) | 6% | yes (abatements) | yes | Minimal state tax | Partially taxed | yes | 21 | 27 |
| MARYLAND | 7% | 5% | yes (with tax credits) | no | Generally exempt | Generally exempt | Generally exempt | 38 | 4 |
| NORTH CAROLINA | 7.75% + surtax | 6% | yes (abatements) | yes | yes | no | no | 9 | 6 |
| SOUTH CAROLINA | 5% | 5% | yes | no | yes | no | no | 11 | 3 |
| TENNESSEE | 6% | 8.25% | yes | yes | yes | no | yes | 14 | 10 |

(L) Cities also impose municipal corporate income tax.
(1) Local option to tax a merchant's capital or to impose a business license tax on distributors or wholesalers.
(2) Ranked on basis of 1992 average tax per employee; 1 = Lowest.
(3) Ranked on basis of 1992 average manufacturing net insurance cost; 1 = Lowest.

Table II

# A COMPARISON OF MAJOR TAX INCENTIVES FOR INDUSTRY

| | CORPORATE INCOME TAX INCENTIVES | PROPERTY TAX EXEMPTIONS | SALES & USE TAX EXEMPTIONS* |
|---|---|---|---|
| VIRGINIA | 10% Recycling Investment credit.<br>Enterprise Zone job creation credits. | Mfg. inventory, furniture, fixtures, aircraft.<br>Rehabilitated industrial property.<br>Recycling & pollution control equipment at local option. | Mfg. inputs & machinery.<br>R&D inputs & equipment. |
| KENTUCKY | 100% credits & job assessment fees for:<br>-Annual debt service on new mfg. facilities financed by state industrial revenue bonds.<br>-50% service-sector business start-up & lease costs.<br>-50% of investment to prevent mfg. facility closure.<br>$100 credit per unemployed worker hired. | NOTE: KY has state & local property taxes.<br>Mfg. machinery & tools (local tax).<br>Facilities financed by state IRBs.<br>New mfg. real property in cities (5 years). | New mfg. facility machinery.<br>Some mfg. inputs.<br>Pollution control equipment.<br>Recycling equipment. |
| MARYLAND | Enterprise Zone job creation credits. | All business inventory (most localities).<br>Mfg. machinery & tools (most localities).<br>New or expanding Mfg. real property (local option).<br>Enterprise Zone real property tax credits, 10 years.<br>Business personal property (local option). | Mfg. inputs & machinery.<br>R&D inputs & equipment.<br>Pollution control equipment. |
| NORTH CAROLINA | $2,800 job creation credit (50 counties).<br>Alternative energy/recycling credits.<br>25% small business growth investment credits.<br>Export income deferral. | Mfg. & wholesaler inventory.<br>Pollution control & recycling facilities/machinery. | Mfg. raw materials.<br>Mfg. machinery, fuels taxed at 1%.<br>All utilities taxed at 3%. |
| SOUTH CAROLINA | $300 - 1,000 job creation credit.<br>20% corporate hdqtrs. investment credits.<br>Export income deferral. | New & expanding facilities, real property (5 years).<br>Fee-in-Lieu of tax option for real property.<br>All business inventory & intangibles.<br>Pollution control equipment. | Mfg. inputs & machinery.<br>Pollution control equipment.<br>Film production. |
| TENNESSEE | $2,000 - 3,000 job creation credit.<br>1% Mfg. investment credit.<br>Multiple Enterprise Zone credits. | All business inventory.<br>Pollution control equipment. | Mfg. raw matls. & machinery.<br>Pollution control equipment.<br>Mfg. fuels & water taxed at 1.5%. |

* Full exemption granted where not otherwise noted.

# A COMPARISON OF MAJOR FINANCIAL INCENTIVES FOR INDUSTRY

| STATE | CUSTOMIZED INDUSTRIAL TRAINING | STATE GRANTS FOR INFRASTRUCTURE IMPROVEMENT | DIRECT STATE FINANCING | LOCAL/REGIONAL DIRECT LOANS/GRANTS |
|---|---|---|---|---|
| VIRGINIA | $3.2 MM budget FY 1994. | Road and rail access funds - $4.5 MM FY 1994<br><br>Governor's Opportunity Fund - $3.0 MM FY 1994 | VA Economic Development Revolving Loan Fund - $3.9 MM FY 1994.<br>Business Modernization Fund $0.5 MM FY 1994.<br>Solar Mfg. Grants - $22.5 MM FY 1996 - 2000. | Coalfield Economic Development Authority - $6.8MM available.<br><br>Financing also available in some other localities. |
| KENTUCKY | $3.5 MM budget FY 1994. | No known program. | State IRB financing as needed.<br>Fixed asset loans (gap financing) at or below market rates.<br>Venture capital loans/investment. | Loans for local business start-ups and expansions with owner equity and/or other conventional financing -- fund levels vary. |
| MARYLAND | Subsidizes 50% of training costs. | Industrial & Commercial Redevelopment Fund and Industrial Land Act - $175 MM funding from state general obligation bonds. | Maryland provides a broad range of state bond funded financing programs to large and small businesses--mainly loan insurance and guarantees. | No major programs known. |
| NORTH CAROLINA | $6.4 MM budget FY 1994. | Access road funds - as needed.<br><br>New "deal closing" fund - not limited to infrastructure uses - $5.0 MM FY 1994. | See also new "deal closing" fund in under Infrastructure Improvement.<br><br>Industrial Bldg. Renovation Loan Fund - $1.0 MM FY 1994. | New local IRB/Tax Increment Financing option for infrastructure improvements- as needed. |
| SOUTH CAROLINA | $6.5 MM budget FY 1994. | Access road funds - $10 MM annually.<br><br>Utility infrastructure funds. | Jobs Economic Development Authority low interest loans and loan guarantees to small/medium sized firms of up to $500,000 or 40% of project cost. | No major programs known. |
| TENNESSEE | $5.0 MM budget FY 1994. | Industrial Infrastructure Grant Program - $40 MM state bond funding in 1980s. | Tennessee Growth Fund for start-up and growing small business gap financing -$5.0 MM. | Local obligation bond financing available, but used little in recent past.<br>TVA financing - $2,000 - 6,000 per job, up to 50% of project costs. |

## Funding for Incentives

States use various combinations of nonfederal funding sources to "pay" for incentive programs. These include: local government sources, anticipated future tax revenues from new or expanding facilities, general fund appropriations, state obligation bond financing, and private sources. The mix of these sources and degree to which they are used by a given state can have a direct impact on the speed and flexibility of the response given to a company, as well as on the ability to plan and carry out strategic marketing initiatives through times of abundent and limited state fiscal resources. The funding of a state's incentive program helps determine how some states are able to quickly and efficiently offer attractive, customized incentive proposals.

Local government participation spreads the incentive funding burden, and assists in allocating more state resources to needy areas that have fewer local resources.

Tax credits or abatements represent the use of future revenue streams, automatically adjust to the size of the project, are tied to actual company investment or employment performance, and use only revenues that would not be available without the new investment.

State general fund appropriations offer a "pay as you go" discipline, and allow close monitoring of programs; however, underfunding tends to occur in limited budget years, and supplemental appropriations may be required when business development activity exceeds expected levels.

State bond financing uses the debt carrying capacity of the state to fund programs and can enable the state to provide more resources for future use than it may be able to provide in any one budget year. Such a dedicated source is similar to a "rainy day fund" and can provide a greater degree of flexibility, discretion, and stability to economic development strategies over time.

Private source funds are generally available in the form of financing programs such as venture capital funds, loan subsidization funds, or direct grants from utilities, railroads or other private parties directly involved in economic development. Besides spreading the funding burden, these sources can often accept a greater degree of risk than can a government entity.

A general assessment of competitor funding sources:

| | |
|---|---|
| **Virginia** | Mainly uses state appropriation with some local source funding. Incentive programs are often insufficiently funded and response flexibility constrained. |
| **Kentucky** | Predominantly state bond financing and future corporate and individual income tax revenues. One of highest levels of funding and flexibility of the states examined. |

| | |
|---|---|
| **Maryland** | Predominantly state bond financing and state and local future tax revenues. One of highest levels of funding and flexibility of states examined. |
| **North Carolina** | Mix of state appropriation, future state income tax revenues, and local bond financing. New 1993 legislation greatly improved flexibility as well as funding levels; localities now share funding burden. |
| **South Carolina** | Future tax revenues and special state appropriations. Private sources add considerable back-up resources. Appears to have great degree of discretion in offering incentives. |
| **Tennessee** | Mix of state appropriation, state bond financing, and future tax revenue. TVA funds also heavily relied upon. Funding levels appear to be adequate and available as needed. |

## RECOMMENDATIONS

An examination of various state and local governmental incentive programs and their ability to encourage economic development suggest that the Governor and the General Assembly consider the following recommendations to help ensure that Virginia will remain competitive in attracting jobs and investment into the 21st century.

Incentives are only one aspect of an overall business climate that is the major determinant of how Virginia will grow. Therefore, it is most important that government acts to guard and enhance, whenever possible, a tax structure and regulatory process that will help maintain Virginia's inherent ability to attract and encourage new job creating investment. The manner in which government treats all businesses, how they are taxed, and the quality of services they, in turn receive from those taxes, will have the greatest impact on the future of the state's economy. Any established competitive advantages that the Commonwealth possesses in this area should be aggressively promoted to encourage economic growth.

- Increase Funding for Workforce Training

A number of Virginia's programs, particularly workforce training, industrial road and rail access, and the Governor's Opportunity Fund, have proven effective in helping to encourage companies to undertake projects in Virginia by extending accepted responsibilities of government in education and infrastructure development. A strong commitment to these programs is important to Virginia's future economic development success. Funding for workforce services, in particular, should be increased and sustained at a minimum of $5 million a year. (North Carolina and South Carolina funded their training programs at $10.8 and $6.5 million respectively in FY '93). In addition, the broader issue of preparing Virginia's workforce for the jobs of the 90's and beyond through the combined application of new and existing education/training programs should be continued.

- Continue and Strengthen the Industrial Access Road Program and the Governor's Economic Opportunity Fund

The Industrial Access Road Program and the Governor's Economic Opportunity Fund should be maintained at current funding levels. Based on past experience, the combined funding for these programs should be approximately $10 million a year. In recent years, the rail access program experienced reductions in funding that has diminished its effectiveness. This particular program should be funded at a minimum for $1 million a year to adequately respond to eligible requests for assistance.

- Revise Local Industrial Development Authority Legislation

The legislation creating local industrial development authorities should be reviewed and consideration given to broadening types of activities that may receive assistance to include such things as resorts, hotels, and other selected recreational/travel activities. In addition, the types of assistance that can be offered by all local authorities should be extended to such things as grants and loans to private businesses. Local industrial development authorities are the key mechanism for county/city participation in providing economic development incentives. They should, therefore, be structured to allow a community as much flexibility as possible to consider how it can best accomplish its development objectives.

- <u>Quantify and Analyze the Benefits of the Enterprise Zone Program</u>

The enterprise zone program should be reviewed and, based on past experience, consideration should be given to making modifications that will improve their ability to help encourage job creation and investment in Virginia. Attention should always be given to maintaining and improving Virginia's overall business climate while ensuring that existing incentive programs are adequately funded and structured to maximize their ability to influence job creating investment.

The broader questions associated with incentives and how they relate to the future of economic development in Virginia and across the United States are being considered by a number of organizations including the Virginia Chamber of Commerce, the Virginia Economic Developers Association, ant the National Governor's Association among others. These efforts reflect a number of common themes that should be considered as Virginia sets a course for economic development into the 21st century.

- incentives should encourage and foster development in accordance with an established strategic plan

- incentives should be beneficial and available to all qualified businesses based on established economic development objectives

- to the extent possible, incentives should support mutual (private and public) development objectives and be joint ventures between government and businesses

- recipients of incentives should be held accountable for performing as promised, with mechanisms for recouping public funds when agreed to obligations are not satisfied

- incentives should be provided under a policy structure that can establish appropriate guidelines and procedures to direct the use of public resources at both the state and local levels

- distinctions should be made between single project incentives, so called "bidding wars," and incentives that are conceived according to established guidelines to help achieve selected economic development objectives

To ensure that Virginia remains competitive in economic development and to appropriately address the consideration of additional new incentives, it is recommended that the General Assembly and the Governor pursue the Statewide Strategic Economic Development Plan, a strategic plan for job creation and investment that includes:

- types of jobs to be created
- types of investment to be encouraged
- where jobs are to be located
- where investments are to be made
- types of companies that will create the desired jobs
- types of companies that will make the desired investments
- Virginia's competitive position in each case
- what incentives, if any, will enhance Virginia's competitive position in each case

In addition, the plan must be annually reviewed, revised, and updated with the resulting strategies and objectives; identification of sources of funding to sustain selective programs must be presented; and an econometric model must be developed to provide an annual cost/benefit analysis of all funds expended in the name of economic development.

Implementation of the plan and supporting elements should be carried out with the input and participation by both local government and the private sector. It should also include an assessment of what constraints, if any, the Constitution places on establishing a truly competitive program for economic development in Virginia. By presenting a clearly articulated and widely disseminated vision of Virginia's economy, decisions related to the state's business climate, incentives, and a wide variety of other programs affecting economic development can be made more effective.

# APPENDIX

# SUMMARY OF MAJOR ECONOMIC DEVELOPMENT INCENTIVES*

## VIRGINIA

**Governor's Opportunity Fund**
Grants are made to localities to support industrial development projects that create new jobs and investment and could possibly locate outside of Virginia. Eligibility is based on minimum job creation and investment levels, depending on the population of the community. The program is administered by the Department of Economic Development with grants awarded at the discretion of the Governor.

**Customized Industrial Training**
Workforce Services, administered by the Department of Economic Development, provides customized training and pre-employment services directly to new and expanding industrial clients in Virginia. Firms must invest a minimum of $500,000 and create 15 new jobs in a one-year period to be eligible. FY 1993/94 state funding is $3.2 million.

**Industrial Road and Rail Access Grants**
State transportation funds are allocated to localities to construct access roads and rail lines for new or substantially expanded industrial facilities. Annual funding is approximately $4.5 million with some matching funds required from non-state sources.

**Virginia Economic Development Revolving Loan Fund**
Secondary fixed asset financing is provided for manufacturing and other basic employment industries in rural areas which will create or retain jobs. Loans up to a maximum of $700,000 may be awarded and private-sector matching funds are required.

**Virginia Coalfield Economic Development Authority**
Financing is targeted to seven counties and one city in Southwest Virginia for basic sector job creation. Funding is derived from dedicated local taxes and may be lent to eligible projects creating at least 25 new jobs within a one-year period, up to an amount of $10,000 per job. (Targeted to a region.)

**Virginia Business Modernization Program**
Grants and loans are available to small and medium-sized businesses to make improvements in quality, competitiveness, and operational performance. (Targeted to a function.)

**Solar Photovoltaic Manufacturing Grants**
Manufacturers who sell solar photovoltaic panels, manufactured in Virginia, are entitled to receive an annual grant based on the rated capacity of panels sold. Grants are available for sales in a five-year period, beginning January 1, 1995 and extending through December 31, 1999. (Targeted to an industry.)

**Recycling Income Tax Credit** 10% of manufacturers' recycling machinery and equipment cost.

* Levels of overall funding or revenue caps for each program were not available for all of the states.

# KENTUCKY

## Manufacturing Recruitment Financing and Income Tax Credit Package

Kentucky offers state bond financing for new and expanding manufacturers. Companies may be offered long-term financing for land, building, and fixtures (up to 25 years maximum in distressed counties) and allowed to recoup annual debt service cost on the bonds from company and employee income tax obligations. Recoupment works as follows: companies take 100% income tax credits and supplemental "job assessment fees" to equal the total annual debt service. Job assessment fees are employee income tax payroll witholdings equal to up to 6% of total employee wages; employees then receive full tax credits for the "fees" used by the company.

## Service Sector Recruitment Income Tax Credits

Basic service sector businesses may be allowed to recoup up to 50% of their relocation, start-up, and first ten years rental costs when they locate new or expanded services or technology intensive projects in Kentucky. Costs are recouped with 100% corporate income tax credits and up to 5% of employee wages through the job assessment fee mechanism. Qualifying businesses may include headquarters, regional offices, R&D, telecommunications, sales and marketing offices, distribution centers, customer service, and other back office operations.

## Manufacturing Facility Closure Prevention Income Tax Credits

Kentucky manufacturing facilities are allowed income tax credits for up to 50% of the cost of upgrading plant and equipment to prevent the imminent closure of outdated facilities. The company may also use job assessment fees of up to 6% of total employee wages, with approval of employees, to supplement tax credits that do not reach allowable amounts. Employees receive only a partial tax credit for their contribution, thereby contributing to saving their jobs.

## Other Tax Credits and Abatements

Companies may take a $100 income tax credit for each **new hire** previously unemployed more than 60 days. Cities may offer new manufacturing facilities five-year abatements from local income tax. Kentucky also allows cities to offer five-year real estate tax abatements to new manufacturers. Local governments may offer property tax exemptions to all businesses in enterprise zones.

## Financing Programs

Kentucky offers a broad range of state-funded industrial financing programs including: an array of direct loans, loan guarantees, venture capital, export lines of credit, and bridge grants for innovative research. In addition, a number of local and private financing programs are available.

Customized Industrial Training is provided by an independent, quasi-public corporation which awards grants up to $200,000 to educational institutions for skills training. Companies are required to make equal or greater matching grants. FY 1993/94 funding is $3.5 million.

# MARYLAND

## Direct Business Financing and Infrastructure Financing

Maryland is known for its broad range of direct business financing programs generously funded by state obligation bonds. Many of the programs provide assistance in the form of insurance or guarantees of commercial loans. Conventional loan insurance of up to $1 million is available to new and expanding basic industries, as well as secured, below market rate loans for seafood and aquaculture businesses, contract financing, and surety bond guaranty programs. Two equity participation investment programs are also available for small or minority business or franchise ownership. The Enterprise Incentive Deposit Fund provides three percent interest rate subsidies for real estate and equipment financing to businesses in certain rural, high unemployment areas of the state. Limited funds are available for this program.

Maryland has two additional funds that make direct grants and/or loans to localities for industrial infrastructure improvements, site development, and supplemental "gap" financing assistance to facilitate industrial and commercial development. Since 1980, Maryland has put over $175 million in these two programs from the proceeds of state-issued bonds.

## Property Tax Exemptions and Credits

Maryland's offers generous property tax incentives to business. Most counties do not tax manufacturers' machinery, tools, or inventories and have the discretionary authority to grant tax credits to nonmanufacturing businesses against their personal property taxes. Counties may grant real property tax credits to new and expanding manufacturers.

## Customized Industrial Training

Maryland underwrites up to 50% of the costs of customized training for eligible state businesses. The program is administered by the state economic development agency.

# NORTH CAROLINA

## Industrial Recruitment Competitive Fund

A new fund of $5 million in FY 1993/94 is provided for the Governor to finalize deals. Funds may be used for equipment; building renovation; and water, sewer, gas, and electric utility lines.

Customized Industrial Training is funded and administered by the state community college system. FY 1993/94 funding is $6.4 million.

## Income Tax Credits

**Job Creation**--Credits are available to companies creating 20 or more full time jobs in the 50 most distressed counties. A credit of $2,800, taken in equal installments over four years, is available for each new hire. Credits may not exceed 50% of the annual tax liability, after all other tax credits are taken.

**Small Business Growth**--Small, growing businesses receive a credit equal to 25% of investment with a maximum of $50,000 per year for individuals and $750,000 for corporations. The credit has a statewide annual cap of $12 million.

**Alternative Energy**--Various credits are targeted at producers and users of alternative energy sources, including solar photovoltaic equipment.

Industrial Access Road Funds are available from the State Department of Transportation.

## Industrial Development Fund

Subsidies for industrial building renovation are available in 50 of the state's most economically distressed counties. Companies receive funds based on job creation--$2,400 per job, up to a maximum of $250,000 or the cost of the renovation, whichever is less. The types of businesses eligible have recently been expanded.

## Economic Development Bond Financing

This new 1993 program uses the mechanism of "tax increment financing" which allows local governments to earmark future additional property taxes generated by a new company to finance public facilities used by that company. Bonds issued by local governments will be used only for infrastructure projects, not buildings; the company must pay competitive local wages. The use of tax increment financing will require an amendment to the N.C. Constitution.

# SOUTH CAROLINA

## Corporate Income Tax Credits

**New Job Creation**--basic sector companies receive five years of credits for each new full-time job ranging from $300 to $1,000, depending on which county the facility is located in. When jobs are created in industrial parks jointly developed by two or more counties, an additional $500 credit is available for each job. Credits are limited to 50% of annual income tax liability, and excess credits may be carried over for 10 years. **Corporate Headquarters**--a credit of 20% of qualifying real property costs is allowed against corporate income tax or corporate license fees when a minimum of 75 new jobs are created at a U.S. headquarters in the state; when 150 new jobs are created in headquarters **and/or** R&D functions, companies also receive a credit equal to 20% of their tangible personal property.

**Industrial Training** Customized training is fully funded by the state and is delivered through 16 technical colleges. FY 1993/94 budgeted funding is $6.5 million.

## Property Tax Abatements and Exemptions

South Carolina does not tax intangibles or business inventories and offers a broad range of tax abatements: five-year county "ordinary" property tax abatements are available statewide for all new and expanding manufacturing, distribution, headquarters, office, and R&D facilities; and cities have the option to grant 5-year abatements of municipal property taxes for new and expanding manufacturing facilities. In addition, a county negotiated "fee-in-lieu" of property taxes is available when facility capital investment equals $85 million and is financed by taxable IRBs.

## Infrastructure Funding

South Carolina annually sets aside $10 million in highway funds to be used exclusively for the construction of new or improved roads for new and expanding businesses. Funding mechanisms are also available to localities for the utility infrastructure needs of new or expanding industrial projects.

## Financing Programs

The state funded **Jobs Economic Development Authority** provides direct loans and guarantees equal to $10,000 per job up to a maximum of $500,000 for basic sector industrial development projects. South Carolina also depends on several privately-sponsored financing sources: The **Carolina Capital Investment Corp.** provides gap financing for growth-oriented, existing businesses up to $200,000. The **Business Development Corporation of South Carolina** provides direct financing for businesses unable to secure loans from conventional sources. The **Palmetto Seed Capital Fund,** a for-profit venture capital fund, invests in new start-up South Carolina-based companies.

# TENNESSEE

## Customized Industrial Training

Training is fully funded and administered through the state department of economic and community development and is provided to new and expanding industries through state vocational-technical schools and mobile training classrooms on-site. FY 1993/94 funding is $5 million.

## Jobs Tax Credit

A new 1993 program gives basic sector businesses a $2,000 tax credit per job against the increase in its state franchise tax liability if the business creates at least 25 new full-time jobs and increases its capital investment by $500,000. The credit increases to $3,000 if the business is located in an economically distressed county, as defined by the state.

## Manufacturing Investment Tax Credit

Corporations purchasing industrial machinery are allowed to take one percent of the purchase price as a credit against corporate excise tax (income tax). The total credit cannot exceed 50% of the tax liability in any one year, but excess credit may be carried forward for 15 years.

## Tennessee Industrial Infrastructure Program

A $40 million grant program assists local governments in providing infrastructure to support locating and expanding basic sector industries in the state. The state grants to localities may be used to provide water, wastewater, transportation, and utility systems, as well as site improvements and other physical infrastructure improvements. This funding was primarily instituted to assist with the development of the Saturn and Nissan assembly plants.

## Tennessee Growth Fund

The $5 million Tennessee Growth Fund, administered by the state economic development agency, assists new firms having difficulty obtaining assistance from traditional lending sources. The funds are matched from private sources and may be used for industry start-ups and expansions that create new and needed jobs.

## Tennessee Valley Authority Financing

TVA funding is available to support industrial development in the 50 poorest counties of the Tennessee Valley. Financing can range from $2,000 to $6,000 per job created, depending on the wage and skill level of the jobs and is limited to 50% of a project's total cost.

# GENERAL ASSEMBLY OF VIRGINIA--1993 SESSION

## HOUSE JOINT RESOLUTION NO. 578

*Requesting the Secretary of Economic Development to examine the feasibility of various state and local governmental incentives to encourage economic development.*

Agreed to by the House of Delegates, February 9, 1993
Agreed to by the Senate, February 16, 1993

WHEREAS, one of the keys to economic growth is the ability to attract new business and industries; and

WHEREAS, one of the components which enhances a state's attractiveness as a location is its state and local tax structure; and

WHEREAS, the suspension or freezing of an economic development prospect's tax liability is an incentive offered by various other states; and

WHEREAS, the suspension or freezing of property taxes would violate Article X, Section 1 of the Constitution of Virginia; and

WHEREAS, as a taxpayer's local tax liability often exceeds its state tax liability in Virginia, the inability to freeze or suspend certain taxes may constitute an impediment and disincentive for businesses to locate in Virginia; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Secretary of Economic Development be requested to examine the feasibility of adopting new state and local governmental incentive programs to encourage economic development in Virginia and that such examination include a consideration of amending the Constitution of Virginia to permit property tax concessions at the local level. Among the incentives to be considered are the following: tax depreciation schedules, tax deferrals, direct contributions to new entrants, specific infrastructure improvements (whether built as a preexisting inducement or tailored to the prospect after agreement to relocate has been reached), and loan guarantee programs. In her considerations, the Secretary shall examine the programs and techniques utilized by localities in other states.

All agencies of the Commonwealth shall, upon request, assist the Secretary in her conduct of the study.

The Secretary of Economic Development shall complete her work in time to submit her findings and recommendations, if any, to the Governor and the 1994 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.