PROMOTING ECONOMIC DEVELOPMENT
THROUGH FINANCIAL INCENTIVES FOR BUSINESS:
AN ANNOTATED BIBLIOGRAPHY

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By

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This bibliography discusses findings of research into the effects of business incentives on regional economic development. Annotated beneath each listing are the major findings or policy implications of the study. Publications are listed chronologically to demonstrate how the literature has developed. The material is organized as shown below, though the reader will find topics frequently overlap.

A. STATE AND LOCAL BUSINESS INCENTIVE STUDIES

1. Overviews

Bridges, Benjamin Jr. (1965) "State and Local Inducements for Industry: Part I." National Tax Journal 18 (March): 1-15.

The first in a two part analysis (see below), this paper describes 1965 industrial development programs. Five types are examined: state industrial finance authorities, local industrial bonding, and tax concessions - all publicly financed, plus statewide and local development credit (or business development) corporations which are financed privately. State and regional use of these programs is reported and discussed.

Bridges, Benjamin Jr. (1965) "State and Local Inducements for Industry: Part II." National Tax Journal 19 (June): 175-93.

The second part of this analysis (see above) evaluates the effect of inducements on industrial development. The attitudes of business executives and the impacts of inducements on firm costs are examined. Bridges concludes that inducements are more important to location decisions within a region than between regions, and even then their impact is probably of secondary importance. Program benefits were thought to exceed costs for local revenue bonds, well-established state loan guarantees, and statewide development corporations. Credit gaps and wage-rate inflexibility arguments justify (from a national viewpoint) the use of development programs.

Cornia, Gary C., William A. Testa, and Frederick D. Stocker. (1978) State-Local Fiscal Incentives and Economic Development. Urban and Regional Development Series No. 4. Columbus, Ohio: Academy for Contemporary Problems.

Four types of fiscal incentives are commonly used to attract industrial development; the general "tax climate", tax incentives, industrial revenue bonds, and infrastructure amenities. Cornia, et al., examine factors influencing plant location decisions and evaluate (through a review of the empirical literature) these four incentives accordingly. State and local officials, they conclude, should recognize the limited effectiveness of these development tools, and realize that nonfiscal factors nearly always dominate business location decisions.

Wasylenko, Michael. (1981) "The Location of Firms: The Role of Taxes and Fiscal Incentives," in Urban Government Finance: Emerging Issues. Urban Affairs Annual Review 20: 155-90. Edited by R. Bahl. Beverly Hills, CA: Sage Publications.

Tax and fiscal incentives play no role in plant location decisions among regions, but evidence is less conclusive about intra-regional effects. Fiscal policies vary less among regions than do production costs and market availability. Therefore, firms as profit maximizers will be influenced by (regional) tax policies only when they are the deciding or marginal factor. Firms, generally, may be viewed like "Saturday shoppers," differing in their demands and willingness to pay for public services. They will not always avoid high-tax jurisdictions, provided the "right mix" of services exist. This paper bases its conclusions on an extensive and concisely described review of the economic literature.

Advisory Commission on Intergovernmental Relations (1983) The States and Distressed Communities: State Programs To Aid Distressed Communities. ACIR Information Report, Catalog of State Programs. Washington, D.C.

State programs to aid distressed communities are cataloged in this publication. Information gathered on twenty assistance program areas is divided into two groups. The first group includes targeted programs: housing subsidies, economic development incentives, and community development programs. The second group are nontargeted efforts: state-local fiscal relations and programs designed to increase local government 'self-help' capacities. In conclusion, recommendations are made for improving state aid to distressed communities.

Louisiana Department of Commerce. (1983) Recommendations for a Cost-Effective Business Incentive Program For Louisiana. State of Louisiana.

Eleven Louisiana State business development programs are analyzed and an equal number of recommendations for action are made. Among these: IRBs should be used selectively; the state should be allowed to issue IRBs; establish an umbrella bond program to aid smaller firms; establish a targeted loan guarantee program; provide land "write-downs"; institute a program of principle reduction payments complementary to loan guarantees; and use these programs to leverage private sector investments. These conclusions are made after investigators applied the development programs to (baseline) financial statements of simulated companies. The paper includes an overview of each program, and details of the analysis.

Stohr, Walter, and Franz Todtling. (1984) "Quantitative, Qualitative, and Structural Variables in the Evaluation of Regional Development Policies in Western Europe," in Regional Development: Problems and Policies in Eastern and Western Europe. edited by G. Demko, 157-73. New York: St. Martin's Press.

Policy evaluation methods have focused largely on quantitative variables for modeling regional impacts, thus ignore important qualitative and structural information. While acknowledging these latter variables are difficult to quantify or make operational, the authors argue their inclusion is a necessity in the increasingly complex policy environment. Numerous examples of qualitative and structural variables are tabled, and methodological problems are discussed.

Wassall, Gregory H., and Daryl A. Hellman. (1985) "Financial Incentives to Industry and Urban Economic Development." Policy Studies Review 4 (May): 626-40.

Financial incentives aimed at improving urban income and employment problems could be made more effective if the lessons from past policy evaluations were incorporated into current programs. Many studies report common failures or insights with important urban development implications. Employment gains do not allows accrue to local residents. Urban areas in the greatest need often participate the least in development activities. Short-term unemployment relief and long-term economic growth may be competing goals with different solutions. Targeting aid allows resources to be devoted to areas with the largest problems.

Blair, John P., and Robert Premus. (1987) "Major Factors in Industrial Location: A Review." Economic Development Quarterly 1 (February): 72-85.

Traditional economic factors (access to markets, labor, transportation, and raw materials) continue to be the most significant determinants in plant location decisions. Non-traditional location factors (taxes, education, community attitude, labor productivity, and infrastructure), however, are becoming increasingly important - especially, the authors speculate, as the nation's high-tech economy grows. Based on a review of industrial relocation surveys and econometric studies, this article is current, easy reading, and insightful.

2. Industrial Revenue Bonds

Apilado, Vincent P. (1971) "Corporate-Government Interplay: The Era of Industrial Aid Finance." Urban Affairs Quarterly 7 (December): 219-41.

Surveys and in-depth interviews of corporate and public officials show that industrial bonds are not a significant factor in plant location decisions. A majority of business users of industrial bonds indicated a willingness to locate without inducement. Thus, Apilado maintains, business savvy allows them to use threat or innuendo of selecting an alternative site to elicit community financial concessions. Municipal leaders, on the other hand, lack business and financial expertise, and as a result, little or no project cost-benefit analysis is done at the local government level.

Dewar, Margaret E. (1981) "The Usefulness of Industrial Revenue Bond Programs for State Economic Development: Some Evidence from Massachusetts." New England Journal of Business and Economics 7 (Spring): 23-34.

A survey of Massachusetts firms shows that industrial revenue bonds have little influence on firm location or expansion decisions. Respondents cited inefficient or undersized plants and poor work environments as primary reasons for relocation-expansions; bonds are never mentioned. Other interview responses reinforce the lack of regional or intra-regional influence from bond incentives on plant-siting decisions.

Pascarella, Thomas A., and Richard D. Raymond. (1982) "Buying Bonds For Business; An Evaluation of the Industrial Revenue Bond Program." Urban Affairs Quarterly 18 (September): 73-89.

The social costs of industrial revenue bonds (IRBs) outweigh their benefits, thus their use should be restricted, if not eliminated altogether. Pascarella-Raymond make this recommendation based on their analysis of IRB use in Ohio. The costs of IRBs (including lost federal tax revenues, over-investment in capital, bond market distortions, and administrative costs) are a poor solution for stimulating investment (in general or among economically distressed areas) or for reallocating capital toward small, risky firms. Their study finds no evidence of a correlation between IRB issues and a reduction in area unemployment. They instead argue that locational (IRB) subsidies shift production to high-cost areas at the expense of existing non-subsidized firm.

Joint Legislative Committee on Trade and Economic Development (1985) "Industrial Revenue Bond Program Evaluation: Summary Report." Oregon State Legislature.

Industrial revenue bonds failed to produce promised job creation over a 10 year period of use in Oregon. Only 27 percent of the jobs promised were created. Employment objectives were met by 16 percent of the firms that received bonds; 40 percent reduced their employment levels. A survey of firms that received bonding authority yet were unable to sell bonds demonstrates comparable employment results. Most firms that received bonds reported that they would have undertaken the investment even if bonds had not been available.

Stutzer, Michael J. (1985) "The Statewide Economic Impact of Small-Issue Industrial Revenue Bonds." Quarterly Review 9 (Spring): 2-12.

Stutzer argues that small-issue revenue bonds (SIRB) fail to create either their promised statewide employment gains, or any significant expansion of the aggregate (Minnesota) local property tax base. Three factors contribute to this failure: intrastate competition, interstate competition, and capital-labor substitution. The adverse effects on in-state competitors may largely offset gains of SIRB-firms when barriers to entry do not exist. On a national basis the use of SIRBs is widely thought to be a zero-sum game. Finally, capital subsidies can increase the property tax base, but labor cost reductions (such as job training or neutral cash grants) may more efficiently increase total statewide employment.

Legislative Budget and Finance Committee (1986) A Sunset Performance Audit of the Pennsylvania Industrial Development Authority, Joint Committee of the Pennsylvania General Assembly.

The Pennsylvania Industrial Development Authority (PIDA), which provides low-interest loans to industrial development projects, is important to the promotion of public welfare in Pennsylvania. This endorsement is made despite recognition of the programs' failure to get funds to the high unemployment counties it was designed to help. Recommendations for improvement are included. Rules and regulations concerning the programs' authority and management should be developed. Improvements should be made to the programs' performance-objectives measurement system. Provisions are needed to improve or assure Authority Board members qualifications and meeting attendance.

Legislative Audit Bureau (1986) *A Review of Small Enterprise Economic Development Program*. State of Wisconsin.

The Small Enterprise Economic Development (SEED) program in Wisconsin has been successful in meeting some of its economic development goals. New jobs anticipated by businesses receiving SEED low-interest (IRB) loans have been realized. However, these jobs may well have been created anyway. Poor performance indicators include the lack of statewide aid distribution, very few loans to women-owned firms, no loans to minority-owned companies.

Marlin, Matthew R. (1986) "Reevaluating The Benefits And Costs Of Industrial Revenue Bonds." *Urban Affairs Quarterly* 21 (March): 435-41.

Based on his analysis of industrial revenue bond (IRB) data from the Norfolk-Virginia Beach area, Marlin argues against the findings of Pascarella-Raymond (see above). IRB-financed projects are not induced by subsidy to locate at high-cost sites, as Pascarella-Raymond contend. Marlin faults their assessment of costs and benefits. Administrative costs are real, he agrees, but the diversion of resources from the public to private sector can as easily be classified as a benefit as it can a cost. If increasing overall investment is a goal, lower (IRB) interest rates achieve this by facilitating private capital formation.

Pascarella, Thomas A., and Richard D. Raymond. (1986) "Rejoinder to Matthew R. Marlin's Reevaluating the Benefits and Costs of Industrial Revenue Bonds." *Urban Affairs Quarterly* 21 (March): 443-47.

Pascarella-Raymond reiterate their belief that IRBs are inefficient and should be eliminated (see above), and criticize Marlin's study showing IRB's are an effective and beneficial capital formation mechanism. Alternative tax and fiscal policies would increase capital formation more efficiently, but Congress lacks the political will to replace the popular and established IRB.

3. Tax Exemption Programs

Ross, William D. (1953) "Tax Exemption in Louisiana as a Device for Encouraging Industrial Development." Southwestern Social Science Quarterly 34 (June): 14-22.

The Louisiana property tax exemption program is costly and ineffective. Ross asked managers how the program had affected their plant location or expansion decisions, and found that the state would have lost new investments worth much less than the exemptions cost. The form of the survey questions may have made the results of the program appear more favorable than they were.

Morgan, William E., and Merlin M. Hackbart. (1974) "An Analysis of State and Local Industrial Tax Exemption Programs." Southern Economic Journal (October): 200-05.

This study measures the costs and benefits of industrial property tax exemption programs in seven states. The authors conclude that for tax exemption policies to be efficient, costs (other than taxes) must be approximately equal between alternative plant location sites. Naturally, as more state and local governments use tax exemption programs to promote industrial development their effectiveness will diminish.

Kieschnick, Michael. (1981) Taxes and Growth: Business Incentives and Economic Development. Vol. 11, Studies in Development Policy. Washington, D.C.: Council of State Planning Agencies

Policymakers are wise to recognize the ineffectiveness of most tax incentive programs, and adopt one of two strategies. The "cheap" strategy involves making a token effort. According to Kieschnick, the appearance of a concern for business development may provide an advantage over the state or region offering nothing at all. The alternative, he argues, is to provide "serious" tax incentives to influence business location decisions. Such a strategy would go beyond a criteria-based targeting program, and provide discretionary funding on a case-by-case basis. These recommendations follow a lengthy development of how tax incentives work, a review of the empirical literature, and the analysis of survey data collected by Kieschnick.

Coffin, Donald A. (1982) "Property Tax Abatement and Economic Development in Indianapolis." Growth and Change 13 (April): 18-23.

Data from the Indianapolis area suggest property tax abatement does not affect either intra- or inter-regional business location decisions. Coffin tests the hypothesis that tax abatement increases the investment attractiveness of building improvements by calculating the present values of program benefits as a percentage of total building investment. No positive effects on economic development due to property tax incentives were evident, leading to the conclusion by Coffin, that a reversal in the decline of Center Township (the focus of his study), was in fact only relative to happenings in other areas of Indianapolis.

Wolkoff, Michael J. (1985) "Chasing a Dream: The Use of Tax Abatements to Spur Urban Economic Development." Urban Studies 22 (August): 305-15.

Full and indiscriminate tax abatement is an ineffective and costly economic development tool. The performance of property tax abatement can be improved, however, according to Wolkoff. Two important policymaking considerations are the effects of tax abatement on the firm's decision to invest, and the impact of that investment on the community. Wolkoff argues for the use of variable abatement awards, since they allow for a greater recognition of project costs and benefits, while acknowledging that different firms respond differently to tax incentives. More generous awards should be given where infrastructure costs are smaller, or where development is highly desirable. Awards might also be used more efficiently if annual limits were placed on the portion of the tax base eligible.

4. Loans, Loan Guarantees, and Grants

Gold, Ronald B. (1966) "Subsidies to Industries in Pennsylvania." National Tax Journal 19 (September): 286-97.

This study reports significant employment gains by communities providing plant development subsidies to private industry. Subsidies to small and medium (net worth) firms brought "definite employment gains," while subsidies to large firms were a wasted effort. This early attempt at identifying employment growth determinants, however, suffers data and methodological shortcomings. The author notes that the estimation procedures make "the figures presented subject to, perhaps substantial error."

Sazama, Gerald W. (1970) "State Industrial Development Loans: A General Analysis." Land Economics (May): 171-81.

State industrial loans and loan guarantee programs may be merited, depending on state fiscal and employment conditions. Business survey data is examined, and state finance options (to tax or borrow) are considered. Sazama recommends adopting an industrial loan program only: (1) if a state's (social) discount rate is lower than the private sector's, then a tax financed program will reduce current (private) consumption and increase investment. (2) In situations of chronic unemployment, a program can be financed by borrowing or taxes to create (lower-wage, labor-intense) jobs. Borrowing implies a redistribution of wealth (into the state from outside); tax financing is an intra-state redistribution. (3) At times of full employment, state loans financed by borrowing should only be given to high-wage firms. To encourage low-wage, labor-intensive employment will induce in-migration and lower state per capita income.

Sazama, Gerald W. (1970) "A Benefit-Cost Analysis of a Regional Development Incentive: State Loans." Journal of Regional Sciences 10 (December): 385-96.

Sazama constructs a cost-benefit framework for analyzing state industrial loan programs, that is applicable to other incentive programs as well. A model is derived, specifying opportunity costs (forgone consumption and investment) and benefit measures (induced labor and capital incomes). It is then applied to selected state data. Sazama notes the importance of assumptions in cost-benefit models and discusses some of their implications.

Wiltshaw, Desmond G. (1985) "Jobs and Local Authority Subsidies." Urban Studies 22 (June): 433-37.

A direct labor subsidy to a small competitive industry can never destroy jobs (absolutely), but that may not be the case with an indirect subsidy for a particular type of input or property. Using a simplified econometric model, Wiltshaw looks at the demand for labor given changes in the price of other inputs - what economists refer to as "cross-price elasticities." Wiltshaw concludes that policy results would be improved if local authorities better understand product demand, cost structures, and input relationships before attempting to promote jobs with input or property subsidies.

5. Studies with Combined Program Results

McMillan, T. E. Jr. (1965) "Why Manufacturers Choose Plant Locations vs. Determinants of Plant Locations." Land Economics 41 (August): 239-46.

Communities should focus on those development factors over which they have the greatest control: good tax policy, maintenance of community facilities, and a positive community development attitude. Surveys and case studies demonstrate the importance firms attach to exceptional education, recreation, and cultural facilities. The author notes, however, that these facilities go unappreciated without site visits, and that firms routinely make preliminary selection decisions without such inspections. Communities are advised to pay primary attention to those factors that the largest number of firms rate important. Firms with large property holdings are particularly concerned about their tax liability; therefore, community officials need to articulate a tangible, understandable tax policy.

Williamson, Robert B. (1968) "Some Evidence in Support of State Industrial Financing Programs: The Southwestern Case." Land Economics 44 (November): 388-93.

State-sponsored industrial finance programs (revenue bonding, direct loans, and tax concessions) can be an effective, competitive tool in promotion of a state's economic development, according to the evidence gathered by Williamson. Personal income, industrial sector growth, and manufacturer survey data are used to support the thesis that a lack of industrial finance programs in Texas leads to its economic decline relative to four neighboring states. Causation, however, is weakly linked to effect. Williamson draws his conclusions from simple comparisons of percent change in state personal income and industrial sector growth over two 10-year time periods. Leading questions and poor sampling bias the survey results.

Deaton, Brady J. and Dan Gunter. (1974) "The Influence of Community Characteristics on Industrial Plant Location and Expansion: A Preliminary View." Tennessee Farm and Home Science 91 (July, August, September): 34-6.

Industrial bonding is rated of average or minimal importance, while tax incentives are considered a significant location determinant by firms locating in rural areas. Fire protection is the most important community attribute, followed by police protection, industrial water supplies, sewage treatment, and solid waste disposal. Important, though outside the direct influence of local communities, is access to a major highway, a pool of trained workers, and airport services. Deaton-Gunter make these conclusions after analyzing the U.S. Department of Commerce, Survey of Industrial Location Determinants (1971-75).