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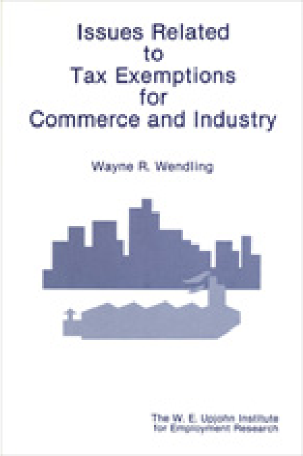
Introduction



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I. INTRODUCTION

Two apparent shifts in economic activity have dominated the discussions of public officials and researchers alike. One is the movement of new industrial and commercial investment from the Northeast and Midwest to southern and western locations. The other is the shift in investment from central cities to surrounding suburban and rural locations. Both movements appear to have impacted the older manufacturing communities most severely. Years of outmigration of industrial investment, jobs and people seemingly have impaired the capability of these old industrial regions and cities to provide public services at acceptable tax rates.

The reasons for outmigration vary. Some firms have moved to new regions to take advantage of the special resources of the region, e.g., inexpensive labor, better access to raw materials, lower energy needs, different lifestyle or a different business climate. Firms that have moved their manufacturing location within the same metropolitan area may be taking advantage of new technological developments, which require different building construction or more land, while maintaining the same labor force. Given either reason, the net result remains the same: replacement projects and new industrial and commercial investments are not taking place in the same communities and regions at the same rate as they had previously.

Officials and representatives of the impacted regions and communities naturally wish to regain the former circumstances when persistent unemployment, limited growth and a severely constrained public fisc did not dominate their agenda. In an attempt to enhance the climate for business and to encourage new industrial development, most states have enacted legislation that is designed to improve the competitive position of their communities vis-a-vis communities in other states.

There has been a virtual explosion in the number of states making tax and financial instruments available to business, either directly or through local communities, in the last two decades. Bridges (1965) reported that, in 1963, 25 states had programs permitting local industrial bond financing, but only 14 of these programs were considered active. He also noted that 15 states permitted the granting of tax concessions to newly located businesses. However, at the conclusion of 1979, 34 states had statutes providing for tax exemptions (abatements or moratoriums) either on land and capital improvements, or on equipment and machinery. In addition, 46 states provided for city and/or county revenue bond financing. Numerous other tax policies designed to assist business also were available in selected states. The *Site Selection Handbook* (1980) listed 32 general programs of state or local financial assistance or tax incentives that were available in 1979 to businesses. Additional forms of assistance also were available for specialized purposes.

The increased frequency of states offering instruments between 1966 and 1979 and also the range of financial and tax assistance available are demonstrated in Table 1. The number of states providing for accelerated depreciation on industrial equipment more than tripled and the number of states providing loans for building construction more than doubled. Similar growth was realized in many of the other instruments. The types of assistance range from exempting sales taxes on new industrial equipment to providing loans for building construction. Those listed are just a sample of

Table 1
The Frequency of States Employing Tax and Financing Instruments for Industry, 1966-1979

	1966	1970	1975	1979
Tax exemption or moratorium on equipment, machinery	15	21	27	31
Tax exemption or moratorium on land, capital improvements	11	17	21	29
Tax exemption on raw materials used in manufacturing	32	39	43	46
Inventory tax exemption on goods in transit	32	39	38	45
Corporate income tax exemption	11	21	19	25*
Personal income tax exemption	15	20	19	20**
Excise tax exemption	5	9	10	15
Sales/use tax exemption on new equipment	16	26	33	36
Accelerated depreciation on industrial equipment	9	14	21	28
State sponsored industrial development authority	25	29	30	32
State revenue and/or general obligation bond financing	10	16	21	25
State loans for building construction	11	13	15	23
State loan guarantees for building construction	11	11	14	19
State financing aid for existing plant expansion	14	26	27	31
City and/or county revenue and/or general obligation bond financing	28	43	45	46
City and/or county loans for building construction	8	5	8	11

SOURCE: Data for 1966, 1970 and 1975 are taken from Barry Bluestone and Bennett Harrison, *Capital and Communities: The Causes and Consequences of Private Disinventment* (Washington, DC: The Progressive Alliance, 1980). Data for 1979 are compiled by the author from *Site Selection Handbook,* a reference supplement to *Industrial Development* magazine, 25, 2, 1980, pp. 344-345.

*Four states, Nevada, Texas, Washington and Wyoming, do not tax corporate income. They are included in the total, however. The remaining 21 states exempt corporate income from taxation if certain conditions are met by the business.

**Seven states, Connecticut, Florida, Nevada, New Hampshire, Texas, Washington and Wyoming, do not tax personal income. They are included in the total, however. The remaining 13 states exempt personal income from taxation if certain conditions are met by the business.

the numerous instruments and incentives available. The analysis in this study, however, is limited to local incentives for business tied to the treatment of the local property tax.[1]

There is considerable public debate over the use of tax exemptions for industry and commerce. The debate has concentrated on (a) the efficacy of preferential tax treatment at inducing or retaining industrial and commercial developments and (b) the impact on other taxing units and the residential sector.[2] The opposing views range from tax exemptions being the most effective means of encouraging industrial and commercial development to being giveaways because there are other factors more important to locating industries. Because there is a divergence of opinion on local tax exemptions, there is the need to evaluate the issue being debated and other aspects that soon may gain more attention.

The purpose of this discussion is to consider the efficacy of local property tax exemptions in inducing development and also to address several related questions. The questions include: (a) What is the economic basis for attracting new industrial and commercial developments, and/or retaining existing ones? (b) What are the economic incentives in the

1. In the discussion that follows, tax exemption is used as the generic term for programs affecting the property tax liability of businesses. It includes most forms of tax relief including exemptions, abatements, credits, moratoriums, and other preferential and differential property tax treatment. The principal tax exemption legislation of the state of Michigan is the Plant Rehabilitation and Industrial Development Districts Law of 1974 (PA-198). This statute empowers local government units to establish plant rehabilitation and industrial development districts and with state approval issue certificates which exempt replacement facilities or new facilities from the general property tax for up to a 12-year period and instead subject it to an industrial facilities tax. In 1978, the creation of rehabilitation and development districts and the issuance of certificates was expanded to include commercial property as a result of Public Act 255.

2. The issue of impairment to other taxing units is addressed in the W.E. Upjohn Institute for Employment Research study, "Do Tax Abatements 'Impair' the Financing of Local Public Education." This study appeared in the January 1981 issue (Volume 23, Number 4) of *Business Conditions in the Kalamazoo Area: A Quarterly Review.*

property tax that exemptions are trying to offset or build on? (c) Can a community expect other outcomes from tax exemptions and how is it constrained in achieving them?

The basis for attracting industry and commerce is discussed initially (Section II). It is suggested that cost pressures in the provision of public services require continued growth, assuming the existence of several conditions, and that the creation of jobs from industrial and commercial investment generates increased economic activity. The principles of property taxation, and shifting and exporting concepts, are discussed in Section III. One implication of that section is that the existence of an industrial base does not imply that a lower proportion of taxes is borne locally. The issue of the effectiveness of tax exemptions at inducing investment is addressed in Section IV. One finding is that local variations in taxes do affect the location decision in some situations. Another finding is that other public programs may be more effective than tax exemptions. In Section V the relationship between the community investment goal and the method of administering the local tax program is presented. Conclusions are presented in the final section.