# Economic Development in the Third District: Three Approaches

*Eleanor Craig and Scott Reznick*[*]

Delaware, New Jersey and Pennsylvania aggressively compete for businesses to stimulate their economic growth and provide new jobs. Each offers an extensive array of business incentive and assistance programs. Businesses are, in a sense, the consumers of these state and local economic development programs. They shop among state and local governments for programs that will lower their costs and enhance their competitive position.

One of the most heated controversies in urban economics is the question of whether these economic development incentives make a difference in business location decisions. The divergence of feeling on the topic is suggested by the following recent statements. Vaughan, on the negative side, writes, "There is no evidence that these concessions have had any significant effect on local growth."[1] Small, however, in support of incentives, says, "Since average state and local business taxes constitute one third of profits, and local rates vary

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[1] Roger J. Vaughan, *State Taxation and Economic Development*, (Washington, DC: Council of State Planning Agencies, 1979), p. 99.

by a factor of two or more, these local variations are substantial enough to imply an important impact on locational decisions."[2]

Since all states provide locational incentives to businesses, each state must perceive beneficial results from these policies. The first state with a successful economic development program is almost certain to reap the benefits of innovation. As this program is copied, competition among states reduces these gains. Each development program is experimental in nature, and the precise employment and income gains from any individual program cannot be accurately calculated. Different programs can be compared and contrasted, however, to try to gain some rough sense of what works and what doesn't.

Each of the three Third District states has its own distinctive approach to economic development. Delaware's efforts in recent years have focused on restoring the state to fiscal stability and eliminating vestiges of poor economic management. New Jersey has centralized its economic development activities in its Department of Commerce and Economic Development. Pennsylvania has continued to decentralize its economic development programs and to target them to particular segments of the state's economy. Despite these differences in emphasis and approach, there are similarities among the three states' economic development programs. All three, for example, use industrial development bond financing and property tax abatement as tools to promote development.

## INDUSTRIAL DEVELOPMENT BONDS

Industrial Development Bonds (IDBs) offer loans to eligible businesses at interest rates below going market yields. Reduced interest charges are possible because lenders are not required to pay taxes on the interest payments they receive from IDB borrowers. Fifteen years ago IDBs were an innovative economic development tool and most states offered them. In 1982, Delaware placed more than 100 IDB loans, and the state recently created an umbrella agency to extend low interest loans to small businesses. The New Jersey Economic Development Authority helped finance more than 400 IDB projects in 1982 with average loans of $1.4 million. Many of these loans were earmarked for urban retail and commercial establishments owned by minorities. Pennsylvania's IDB program provides tax exempt mortgages as well as bonds, and the Keystone state has consistently led the nation in the volume of its tax exempt financing. In 1982, Pennsylvania placed approximately $2.2 billion in tax exempt bonds and mortgages, more than twice as much as any other state.

Recently enacted federal legislation has, however, made continued reliance on tax exempt IDB financing a highly risky proposition. The Tax Equity and Fiscal Responsibility Act of 1982 severely undercut the subsidy given to "large-issue" IDBs (over $10 million) and requires phasing out "small-issue" IDBs (under $10 million) by the end of 1986. States that stress IDBs strongly, like Pennsylvania, may find themselves at a competitive disadvantage unless they generate other financing programs to replace the interest yield subsidies provided by the IDB tax exemption.

## PROPERTY TAX ABATEMENT

The outlook for the property tax abatement programs relied upon by the three states is more certain than that of their IDB programs. Under state legislation, local governments in all three states are empowered to exempt *increments* in the assessed valuation of qualified property from real estate taxation. The programs differ, however, in their definitions of qualified property, as well as in the size of the abatement and its duration.

The City of Wilmington and New Castle County in Delaware grant property tax reductions for that portion of an increased assessment attributable to qualified new construction and improvements to existing buildings. The city provides a 100 percent credit against increased assessment for five years and extends the credit to ten years in certain targeted areas. The county exempts qualified new construction and improvements from county taxes at a rate of 100 percent for the first year, followed by 10 percent decreases each year until the full rate of taxation is reached.

Under New Jersey's tax-abatement statute, a

[2]Kenneth A. Small, "Geographically Differentiated Taxes and the Location of Firms," Working Paper from the Princeton Urban and Regional Research Center, (Princeton, NJ, 1982), pp. 4-23.

municipality may grant a property tax exemption on improvements to commercial or industrial facilities for a period of five years. Improvements may not increase the volume of a commercial or industrial building by more than 30 percent. Where a project involves construction of new facilities, or enlargement of existing facilities by more than 30 percent in total volume, a municipality may draft a written agreement allowing for payment in lieu of full property taxes for five years according to one of three possible formulae: 2 percent of the cost of the new facility, 15 percent of the annual gross revenue, or phase-in at 20 percent increments for a five year period. To qualify, a project or improvement must be located in an area "in need of rehabilitation" as determined by the Commissioner of the Department of Community Affairs or by the local governing body or planning board.

Pennsylvania's property tax-abatement programs are targeted toward deteriorated property and declining neighborhoods. These programs are available for residential as well as commercial and industrial properties, and they exempt increments in assessed valuation from property improvements through optional abatement schedules. Taxpayers may be provided with a ten-year schedule beginning with a 100 percent exemption in the first year, reduced by 10 percent per year for subsequent years, a five-year schedule permitting a 20 percent reduction per year, or a schedule of taxes stipulating the portion of improvements to be exempted in each year for a maximum of ten years.

Industrial development bond financing and property tax abatement programs are strategies for economic development that have been used over a long period of time in the three states in the Third District. In more recent years, the states have formulated other strategies with somewhat different emphases.

## DELAWARE

Delaware's financial integrity was threatened in the mid-1970s. Since 1977 the state's primary economic development focus has been to restore its fiscal health. Delaware had five deficits in its operating budget between 1971 and 1977, had enacted twenty-two tax increases in the same period, and still had one of the heaviest debt burdens in the nation. Not surprisingly, it also had the lowest bond rating of any state in the U.S. in 1977. To top things off, the bank where the state maintained its entire cash balances had come to the brink of failure. This saga of poor management, of "surprise" deficit spending, and of financial instability meant lost jobs and reduced income. The situation deteriorated to the point where Delaware officials concluded that a necessary bond issue for capital projects in 1977 could not be marketed successfully to the public. The twenty-two banks in the state bought the issue privately, following extensive negotiation and the enactment of several temporary and pledged taxes.

In the past six years, Delaware has worked hard to improve its fiscal position. Budgets have been balanced for five consecutive years, and the Governor and General Assembly worked together and tightened their belts to achieve a sixth balanced budget in fiscal 1983. A budgetary reserve fund was established and has remained fully funded (at 5 percent of budget) for the past four years. Appropriation limits have been mandated—spending plans must remain within the state's ability to finance them. A three-fifths majority voting rule for tax increases was incorporated into the constitution, on the grounds it would enhance prospects for a stable tax climate for businesses. Capital authorization limits were passed reducing the debt load on the state budget from 17 percent in 1977 to 12 percent in 1983.

Despite the recession and federal spending cutbacks, Delaware has lowered personal income tax rates by 9 percent, and is firmly committed to a second personal tax reduction. These efforts to restore fiscal health, indeed, are seen by the state as the *cornerstone* of its economic development approach. Other policies have played a role, too.

In early 1981, the Financial Center Development Act was passed; it removed usury ceilings on credit transactions and provided financial institutions a favorable tax climate with rates as low as 2.7 percent on net income in excess of $30 million.[3] Fourteen banks from Maryland, Pennsylvania, and New York have located significant operations in

[3]For further details on this act, see Jan Moulton, "Delaware Moves toward Interstate Banking: A Look at the FCDA," this *Business Review* (July/August, 1983).

Delaware, and 1,600 new jobs have been created in the state. In addition the Delaware Development Office was opened in 1981 and has been influential in attracting cyclically stable businesses. This is the first time the state has had a cabinet-level agency designed to deal exclusively with the promotion of economic development.

State government has taken an active role in fostering business expansion in Delaware. Under the Lt. Governor's direction, task forces have been developed and new legislation implemented which resulted in significant cuts in the red tape facing small business firms in the state. The state has also begun to act as a broker for firms needing skilled labor. Delaware puts new and expanding companies in contact with local community colleges and other training institutions. The state helps the training facilities and the firms gauge labor needs, then recommends certain training options in the private sector, rather than having the state provide the education and training itself.

## NEW JERSEY

New Jersey's principal economic development focus has been to centralize the administration of its economic development programs in a single state agency. The Garden State's development initiatives were scattered throughout various state and local agencies until 1981, when the state created a Department of Commerce and Economic Development to serve as a "focus" within the state government for economic and business concerns.

The New Jersey Economic Development Authority (NJEDA) is by far the most active and important of the divisional offices within the state's Department of Commerce and Economic Development. Its powers are broad: NJEDA can borrow and lend money, issue tax-exempt industrial revenue bonds, buy and sell land, buildings, and other property, and conduct research studies of the state's economic development environment. The Authority is self-supporting. The only significant limitation on its powers to promote economic development is that it cannot pledge the credit of the State.

NJEDA also administers a program to guarantee loans and bonds for the benefit of private businesses. The Authority insures repayment of portions of tax-exempt bonds and certain conventional loans, and grants limited funds when a project has failed to obtain bank financing. The Authority estimates that its volume of loan and bond guarantees averaged nearly $244 million in 1982 and helped create almost 6,000 jobs.

NJEDA operates a number of smaller programs which provide incentives to businesses contemplating opening or expanding operations in New Jersey. Under the Authority's Urban Centers Small Loan Program, loans are made directly to urban retail and commercial establishments in amounts up to $30,000 for a maximum term of ten years at below market interest rates. NJEDA also operates an urban industrial park program; it acquires parcels of land, constructs improvements and markets sites to businesses and developers in packages that contain a number of tax and low-interest financing incentives. Through 1981, this program has generated over $47 million in combined public- and private-sector investment. With four additional parks scheduled for completion in the near future, NJEDA estimates this figure will soon rise to over $134 million, creating over 34,000 jobs for New Jersey residents.

The Authority also has been empowered to subsidize trainee wages for a private sector employer. And the Office for Promotion of Technical Innovation administers a Technical Innovation Financing Fund, seeking to encourage and promote New Jersey's developing "hi-tech" business sector.

Finally, during the latter part of the 1970s, New Jersey undertook a series of revisions to its tax laws designed to create a more favorable business investment climate. For instance, the state has recently repealed its unincorporated business tax, its retail gross receipts tax, the business personal property tax, and the sales tax on production machinery and equipment, and it is phasing out the net worth component of its corporation business tax.

## PENNSYLVANIA

Pennsylvania's principal economic development focus has been to strengthen its decentralized business incentive and assistance programs by targeting its resources to small businesses, high-technology industries, and economic revitalization in distressed urban areas.

Pennsylvania encourages capital investment in new and expanding businesses through direct loans, loan guarantees, and direct grants, as well as through its IDB program. The Pennsylvania Industrial Development Authority (PIDA) provides long-term, low-interest financing to businesses and industry wanting to locate or expand in Pennsylvania. PIDA's annual appropriation from the Legislature has quadrupled in the last four years, and it has begun to target its financing activities. For example, PIDA loans to small businesses have increased 500 percent in the last two years, and over 43 percent of its loans have been placed in areas of high unemployment.

PIDA's financing activities have been supplemented for minority-owned businesses by the low-interest loans granted by the Pennsylvania Minority Business Development Authority. This Authority received $6 million in new funding in the last three years and has loans available for land, buildings, machinery and equipment, and working capital.

The Commonwealth has recently introduced a new financing program designed specifically to assist new businesses. The Pennsylvania Capital Loan Fund has $4.7 million for low-interest loans to small, young, industrial companies in need of funding for machinery and equipment, working capital and facility development. These loans have been specifically designed to fill gaps in the capital markets facing emerging businesses. A Small Businesses Action Center provides "one-stop shopping" to small businesses seeking to comply with state licensing and permit requirements, and expedites the resolution of regulatory problems. Free technical assistance is also provided through the Small Business Development Centers established at eleven Pennsylvania institutions of higher education. As in Delaware, a Small Business Task Force, under the direction of the Lt. Governor, seeks new ways of assisting small businesses in Pennsylvania.

Fostering high technology business has been the objective of an array of economic development policies in Pennsylvania, including tax incentives for research and development, low-interest loans, and programs to improve workers' skills. Recently the state established the Ben Franklin Partnership to provide $1 million in so-called Challenge Grants for the creation of Advanced Technology Centers. These Centers are consortia of academic institutions and private industry, established to carry on joint research and development activities, scientific education and technical training, and to assist in the creation and expansion of high technology businesses.

A Customized Job Training Program has also been designed to provide training to unemployed and underemployed individuals in specific skills for specific jobs. The program is both an incentive to businesses to locate in Pennsylvania, as well as a means of improving the prospects for unemployed workers to find jobs.

Pennsylvania also has employed the tax mechanism as a development tool. It has tried, for instance, to reduce the amount of paperwork facing business taxpayers. It has also enacted tax provisions, including net loss carry forward and phased-in accelerated cost recovery, to assist businesses to grow and create new jobs. Recent legislation provides employers with a tax credit of up to $3,600 over three years for hiring a welfare recipient, and has made $25 million available per year for this Employment Incentive Payment Program.

Regulatory relief has been undertaken in two ways in Pennsylvania: substantive regulatory requirements have been updated, and the regulatory process has been streamlined, not only to speed and simplify enforcement, but also to reduce the adversarial nature of regulatory determinations. For example, the state has just completed its first comprehensive review (since 1955) of its regulations promulgated under the Pennsylvania Fire and Panic Act. A Governor's Task Force on Regulatory Reform is continuing Pennsylvania's effort to modernize its regulatory system.

To enhance the economic development benefits of its diverse financing programs and tax and regulatory relief efforts, Pennsylvania recently instituted an Enterprise Development Area Program. It is geographically targeted on sites in Pennsylvania with both a significant need for revitalization and a potential for recovery. The program is designed to reduce existing financial, tax and regulatory disincentives to business efficiency, and where necessary, to provide incentives for the efficient and equitable use of limited private sector resources. Twenty-one Enterprise Development Areas will be designated in the first year of the program.

## CONCLUSIONS

Each of the Third District states—Delaware, New Jersey, and Pennsylvania—has a basic package of economic development incentives with strong similarities, but the "extras" offered by each state differ considerably, as do the degrees of emphasis. The obvious question both public and private decisionmakers might raise about the similarities and differences among the three states' economic development programs is, "How can we best judge their success?" An extensive economic literature on the subject suggests that the overall success of such programs is difficult to gauge, and a statistical comparison of the relative economic performance of these states and the nation does not give definite answers. What is certain is that policymakers and the business community must continue to make decisions.

For policymakers, these decisions involve tradeoffs among alternative courses of action in the face of budget constraints and scarce public sector resources: they try to strike a balance between expenditures on economic development programs and on general public services, given the size of state tax revenues. How much states tip the balance toward development depends on both political and economic factors. The political factors include voter preferences and policymakers' perceptions about the relative effectiveness of the trade-offs among programs, services, and taxes. The economic factors include the strengths and weaknesses of each state's service and manufacturing base, its demographic profile, and the income levels of its citizens.

The business incentive and assistance programs offered by these states stand the best chance of generating economic growth and jobs if they are responsive to the needs and strengths of each state's economy. While it is difficult to identify winners and losers among the programs, there are some broad guiding principles that seem likely to enhance the prospects for their success. For the sake of both policymakers and business, simplicity is better than complexity. Predictability and stability also are desirable, to help both make future plans that have a reasonable chance of being fulfilled. And programs which are administratively efficient, in the sense that public and private compliance costs are low, are preferable.

Economic development is a dynamic process, in which policymakers, businesses, and citizens all play a role. Policymakers weigh the relative success of programs, bolstering or even copying those that are successful, and dropping those that are unsuccessful or costly. Businesses planning to relocate, start up, or expand may thrive by taking advantage of the different programs offered by the states, and choosing the package most advantageous to them. To the citizens of Delaware, New Jersey, and Pennsylvania, the development programs now in place, and those yet to come, present an important set of policy choices and opportunities. Indeed, over the long haul, a state's citizens play a key role in selecting an economic development strategy through a simple exercise called voting. In view of the recent vigorous development activity in the three states, their citizens appear to be pleased with their prospects.

# Epilogue

*Edwin S. Mills**

The preceding papers provide instructive analyses of recent trends and public issues related to the nation's and region's economic growth. This epilogue provides some speculations about the future and some judgments about state and local government policies to encourage business and employment growth, with particular focus on the Third District and other eastern states.

It is easy to view the future with pessimism. Although recovery appears to be underway after a long and deep recession, no one knows whether it will be sustained enough to produce widespread prosperity, or whether eastern states will achieve a large share of the gains.

As Carlino showed, employment shares have shifted from central cities to suburbs, from large to small metropolitan areas, from metropolitan to non-metropolitan areas, and from eastern and north central to sunbelt and western states. These trends are likely to work against prospects in eastern states, in the large metropolitan areas that are concentrated here, and especially in metropolitan central cities that are already the sites of difficult economic conditions. It is possible that more central city fiscal crises like those discussed by Inman will occur in other eastern cities.

Yet it is also possible to be optimistic. Some of the adverse trends of the 1970s and early 1980s—such as the national reductions in living standards

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since 1979 and the metropolitan exodus of the 1970s—were themselves reversals of earlier trends. No law says they cannot be reversed again.

As Carlino argued, the geographical movements of the 1970s that have hurt eastern states, metropolitan areas, and central cities result basically from the fact that manufacturing and other industries face fewer constraints each year on where to locate their businesses. In shorthand terms, businesses are becoming increasingly footloose. One consequence of this is that during the 1970s businesses moved from high to low wage areas: from eastern and north central to southern states, from large to small metropolitan areas, and from urban to rural areas. But this trend may be reversed because regional wage and earnings differences are now much smaller than they were thirty years ago, and by now probably reflect little more than regional differences in amenities, taxes and living costs. In addition, much of the west that was easy to settle is by now relatively densely populated. Thus, regional movements of jobs and people that have hurt the eastern and north central states since 1970 may be a less important factor in the future.

It is also possible to be somewhat optimistic about slowing the movements of jobs and people from central cities to suburbs and beyond. The result of massive suburbanization for more than thirty years is that many metropolitan central cities hardly differ from their suburbs in overall densities of jobs and people and, indeed, in the industrial composition of employment. It seems unlikely that suburbs will become more thickly settled than central cities, unless central cities become especially undesirable places to live and work. Otherwise, central city population and employment should grow about in proportion to such growth, at least in their inner suburbs. In most metropolitan areas, that performance would be considerably better than during any decade since World War II.

The faster growth of population and employment in non-metropolitan areas is still somewhat new, and its causes and consequences are harder to pinpoint. If it should continue and accelerate, it would certainly reduce the chances for population and employment growth in Third District and other eastern states. Those states contain relatively few nonmetropolitan counties and even fewer that are not adjacent to metropolitan counties. Until now, however, there has been only a small reduction in the share of people living and working in metropolitan areas. We will know more about this when publication of the 1980 census is complete. Meanwhile it seems safe to assume that deconcentration will not be great enough to do substantial harm to eastern states in the 1980s.

Having set this optimistic mood, let us suppose that national economic policies produce an environment that permits steady economic growth during the remainder of the 1980s. If firms are fairly footloose, and regional wage differences are diminished, the implication is that Third District and other eastern state and local governments can do much to attract or repel businesses. But policy goals should be realistic. It is neither possible nor necessarily desirable for governments to undo the massive movements of jobs and people that have taken place during the last two or three decades. It should be possible, though, for eastern states, metropolitan areas, and central cities to capture a larger share of employment growth than they have in recent expansions.

The key to achieving this goal is for state and local governments to be aggressive in providing a favorable climate for businesses and residents. There are by now almost no businesses that lack alternatives to locations in eastern states and especially in their metropolitan central cities. These businesses will expand their employment there only if these locations are attractive places to do business and attractive areas for employees and their families.

The Craig and Reznick article documented many of the specific efforts of the Third District states to enhance their attractiveness to businesses and residents. From these specifics, we can extract some general considerations about what can help create a better business climate.

First, many regulations on businesses that impede growth could be removed or reformed and simplified at no reduction in public benefit and at savings to taxpayers. Dozens of occupations and industries require special state and local government registration, licenses and permits, most of which serve no public purpose. States permit too much discretion on the part of local governments to formulate land use controls that impede both business and residential development. Con-

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