

ENTERPRISE ZONES AS AN ECONOMIC DEVELOPMENT TOOL: THE INDIANA EXPERIENCE

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Introduction

In the 1980s, one of the few major initiatives presented as a solution to inner city distress and lack of economic growth has been the enterprise zone (EZ). The enterprise zone concept originated in England, where zones have been in operation since 1981. The individual responsible for introducing the idea to the United States is Stuart M. Butler, an economist affiliated with the conservative Heritage Foundation in Washington, D.C. (see Butler [4, 5, 6]). To date, some 34 states have passed enterprise zone legislation of some variety. Federal legislation was proposed and backed by the Reagan administration, but has not passed because of opposition in the House of Representatives. Unlike previous programs designed to deal with poverty, inner city blight, or lack of economic development, EZ programs rely on low taxes and lack of direct government intervention. As originally envisioned, EZs were to be a more laissez faire alternative to previous governmental interventions.

The existing enterprise zones have many stated objectives. Among the objectives are employment growth, increased investment in inner cities, reduced welfare dependency, aid to new and small businesses, stabilizing depressed urban areas, improvements in the quality of life for residents, etc. By far the most important effect that is attributed to enterprise zones is the employment impact. If enterprise zones are capable of increasing employment, especially in impoverished inner cities, they will be judged effective to that extent. Therefore, this article will focus exclusively on the employment impact of Indiana's enterprise zones.

Evaluations of existing enterprise zones and theoretical discussions of the topic have been mixed. Advocates such as Butler argue that free enterprise, unleashed from stifling government regulation or excessive taxation, will make enterprise zones flourish in their job-creating capacities (see Butler [4, 5, 6]; also see *Congressional Digest* [17]). Critics argue that this is ideological supply side economic wishful thinking. They point to potential harm to the community in the form of decreased regulatory protections, inequitable tax shifts, tax losses that reduce community services, etc. (see Humberger [16]. Goldsmith [11]. Keating, Midwinter, and Taylor [19], Nissen [20], and *Congressional Digest* [17]).

Studies of the British and state zones likewise have been mixed. State officials generally have claimed great successes, but academic studies have not been so favorable (see Government Accounting Office [12], Funkhauser and Lorenz [10], and Jones [18]). England's enterprise zones have been studied a great deal; results generally show that the British enterprise zones are ineffective in creating jobs, although they do shift jobs (with both positive and negative effects for the zone and its surrounding neighborhood) (see Gunther and Leathers [14], Barnes and Preston [1], Erickson and Syms [9], Talbot [26], Bromley and Morgan [2], Bromley and Rees [3], Schwartz and Volgy [25], and O'Dowd and Rolston [22]).

Indiana claims that its enterprise zone program is one of the best in the nation. Indiana Department of Commerce officials claim that Indiana's EZ program is an almost unqualified success. In the summer of 1986, then lieutenant governor John Mutz claimed that in two and a half years the state's ten enterprise zones had created 5,682 jobs and retained 4,854 more. He stated that Indiana's program was among the five best of the 30 states that had established such programs (see Gray [13]). This result was accomplished without significant expenditures or direct outlays from the state treasury, according to official claims.

In light of these claims, Indiana's experience with EZs deserves closer scrutiny. This paper will examine and summarize both previous research and new research on Indiana's EZ program from a tax policy perspective.

Enterprise zones include a number of features that are not directly tax related. For instance, each local EZ must have a local urban enterprise association that oversees the operation of the zone. Zones also have a zone administrator who is either on the city payroll or a private individual, often someone connected with the local chamber of commerce. This evaluation of Indiana's EZs is not an overall appraisal of all aspects of the zones (except in passing). Rather, it attempts to assess the effectiveness and implications of EZ tax abatements.

Enterprise Zone Tax Incentives

Enterprise zones offer a number of tax incentives, but by far the biggest is the total exemption of property taxes on business inventories (94 percent of all EZ tax exemptions in 1986). Because all other tax abatements are small, only the inventory tax abatement will be considered here. To obtain designation, localities must meet a number of criteria, including poverty or unemployment levels, size, and population. Enterprise zone designation lasts ten years, with the tax breaks phased out during the last two years.

To date, ten enterprise zones have been created in Indiana--in Anderson, Elkhart, Evansville, Fort Wayne, Gary, Hammond, Madison, Michigan City, Richmond, and South Bend. Six zones began in January 1984 (Anderson, Evansville, Fort Wayne, Michigan City, Richmond, and South Bend), while the final four began in January 1985.

These ten sites generated \$43.2 million in inventory tax reductions from 1984 to 1987. In 1984, the first year of the EZ program, \$6.7 million was lost; by 1987 this figure had risen to \$12.8 million. The figures are given in Table 1.

Taxes thus abated are not lost; they are shifted to homeowners and other businesses outside the zone. Thus, there is no net decline in revenues because tax officials merely raise the property taxes of others to compensate for the losses. This raises equity and fairness issues, as a business on one side of a street on the zone border (inside the zone) would pay less taxes than an identical firm across the street (outside the zone). It also raises the overall property tax rates locally, as other property owners pay higher taxes to pay for the subsidy to those inside the zone.

The pattern is for these tax abatements to become larger year by year. If all EZ tax exemptions are summed annually from 1984 to 1987, there has been a 92 percent increase in taxes shifted--from \$6.7 million to \$12.8 million. The increases in tax abatements from year to year during the period 1984 to 1987 were 77 percent, .3 percent, and 8 percent, respectively. Relevant figures are shown in Table 2.

The above figures are the maximum amounts of the shift, because some capital investments may not have been made without the tax abatement. The absolute magnitude of the abatements is significant, as is the growth trend. Indiana has added two more zones for 1989, further increasing the tax abatements. The next question is whether these tax abatements are effective.

How Effective are the EZs?

The effect of state and local tax rates and tax abatement programs on job creation, business expansion, investment, and other indices of economic development is debatable. (For excellent summaries of previous research, see Corporation for Enterprise Development [8] and Wayslenko [27].) The conventional wisdom that state and local taxes are irrelevant has been challenged by some who claim that a detectable influence can be found. All agree, however, that state and local taxes are secondary to more basic market factors in business and investment decisions. Much of the argument centers on the possible symbolic effects of taxes and tax abatements. There are three basic positions: those who claim no effect of any consequence; those who claim

measurable and consequential, although secondary effects; and those who claim no rational economic effects, but possible symbolic effects. From all sides, the case that low taxes or tax abatements are important is problematic and somewhat weak. Debates over the effectiveness of enterprise zone tax abatements are a subset of this larger controversy.

EZ tax exemptions have averaged approximately \$11 million per year over the four years of the program. This means an average of \$1.1 million for each of the ten zones. These averages, however, conceal a wide variation between zones; in 1986 one zone lost slightly under \$100,000, while three zones lost between \$2 million and \$3 million.

How effective have these tax abatements been in creating new jobs? The answer is difficult to obtain. The Indiana State Enterprise Zone Board collects figures on new jobs, but they collect no figures on jobs lost. Total employment figures in most of the zones are collected, but they are imprecise. Employment figures prior to the creation of the zone are even less reliable. To compound the problem of unreliable data, many of the zones collected information in a haphazard manner for the first year or two. Only for 1986 and subsequent years can one have any confidence in the data for most of the zones, because in that year the state board required standardized responses from all EZs. Even the quality of these data may be questionable without independent verification. One example of how bad the data can be is the Fort Wayne EZ. The 1984 Fort Wayne EZ business survey indicated that EZ business employed 6,971 persons. The 1985 survey showed 3,727 employed. The 1986 survey showed 6,311. Casual knowledge of the Fort Wayne economy and businesses during these years shows that these figures cannot be accurate. No large businesses closed inside the zone in 1985, and over 3,200 jobs could not have been lost in that one year. Neither could 2,600 have been added the following year, and the 1986 survey only claims 454 new jobs (and these were not even net new jobs).

Therefore, the zones must be evaluated on a basis apart from the statewide figures. Rob Hedding, director of Indiana's enterprise zone program, was asked to rate the ten zones in terms of their job-creating effectiveness. Mr. Hedding stated that two zones were doing superbly (Evansville and Michigan City), two were doing very well (Hammond and South Bend), four were doing average (Anderson, Elkhart, Fort Wayne, and Richmond), and two were doing poorly (Gary and Madison). A check with the local leadership of four of the state's ten zones found broad agreement with these ratings. Minor changes in the exact rating sequence were given, but all listed the same four as the four best and the same two as the two worst. Hedding's ratings are illustrated in Table 3.

Four studies have been done of individual zones: Evansville, Michigan City, Hammond, and Fort Wayne. Thus, studies of the two best, a third among the four best, and one average zone have been conducted. If the tax incentives of EZs are effective, it should appear in these four studies.

The Michigan City Zone

The earliest study was conducted by the U.S. Department of Housing and Urban Development in 1986 [15]. They conducted numerous interviews with interested parties in the Michigan City zone. Their conclusion on the effectiveness of the tax incentives in creating jobs was clear:

All individuals interviewed both formally and informally--businesspersons, local officials, those managing the zone, and resident representatives--agreed that tax incentives alone would not be enough to induce location or expansion in the zone. Location and expansion decisions are based on the market conditions of each firm.

Six companies with new investment in the Michigan City zone were highlighted; the effect of the tax incentives ranged from zero, to a nice side benefit, to being a catalyst for investment that long had been planned anyway. Although the best face is put on this evidence, it is clear that tax incentives had little to do with any of the new investments. These results parallel those of an investigation into Chicago enterprise zones in neighboring Illinois by the Northeastern Illinois Planning Commission. Although the tax incentives and the specifics of Illinois' zones differ, the same conclusions resulted:

None of the zone organizations contacted felt that zone incentives played any important role in the investment decisions during FY 86 (fiscal year 1986). In a substantial proportion of cases, they felt that some or all of the incentives for which investors were eligible were unclaimed, either because the investors (and their financial advisors) were unaware of them or because the benefits were not perceived to be worth the effort of application (Northeastern Illinois Planning Commission [21]).

The Evansville EZ

A second study has been conducted of the Evansville EZ, the "crown jewel" of all Indiana zones. Margaret G. Wilder of Cornell University and Barry M. Rubin of Indiana University recently published the results of their study in the *Journal of Urban Affairs* [28]. Wilder and Rubin analyze a number of reasons for the apparent success of the

Evansville zone (43 percent increase in employment from mid-1984 to end of 1986). The reasons center largely on characteristics of the land, the local urban enterprise association, the local director, and factors outside the scope of tax incentives.

Regarding tax incentives, however, they note that the incentives seem to work best for those firms that are inventory intensive. By far the largest growth was in warehousing, wholesale trade, or redistribution. One firm, T. J. Maxx Corp. (a subsidiary of Zayre Corp.), accounted for the bulk of the zone's new jobs with a new distribution center. Zayre plans another redistribution center in the zone, probably because of the total exemption from inventory taxes. This result confirms the argument of EZ critics that EZ tax incentives are geared toward the wrong kind of economic activities: those that merely redistribute income rather than create it (such as manufacturing).

Wilder and Rubin conclude that tax incentives are not the crucial determinants of zone success:

. . . financial incentives are useful but not critical. Financial and regulatory incentives, by themselves, are very unlikely to lead to the success of the enterprise zone programs. We would even go so far as to hypothesize that rather than serving as the driving force behind enterprise zone success, the incentives really serve as the economic and political seed around which the truly necessary components for economic revitalization of distressed urban areas can germinate [28].

If tax incentives are as weak as it appears, one may question their necessity or usefulness as even a seed for the other elements that are necessary components of economic revitalization. Why not the EZ minus the tax breaks or with much less expensive ones?

Further doubt is cast by Rubin's additional research on the Evansville zone. Using the economic technique known as shift-share analysis, he and fellow Indiana University professor Kurt Zorn estimated the jobs that would have occurred in the absence of the zone. They conclude that "it does not appear the zone added any net new jobs to the Evansville region. Instead, it appears that the zone attracted jobs and businesses that would have located somewhere in the Evansville area" (see Schoch [24]). This finding parallels the research on British enterprise zones, which were found to be somewhat effective in redistributing jobs (shifting them from place to place), but not in creating them. Whether this shifting of jobs is worth the \$5.9 million in lost revenue in the Evansville zone during the three year period 1985 to 1987 (1985--\$1.7 million, 1986--\$2.1 million, 1987--\$2.1 million) is questionable.

One final finding of Rubin and Wilder is revealing [23]. In each of the three years 1985 to 1987, 36 percent of the tax breaks went to firms

with no zone employment. In other words, these were firms using the EZ as a tax shelter for warehousing, but employing no one at those warehouses within the zone. In 1987, the tax loss from this tax dodging was over \$3/4 million. Figures are provided in Table 4.

The conclusion is that although the Evansville EZ may be considered by some to be a great success, that success hardly can be attributed to tax breaks. At best jobs have been shifted, not created. Approximately \$2 million per year in taxes have been shifted, and many firms use the EZ as a tax shelter that provides zero employment.

The Hammond EZ

A third study examined the Hammond EZ in December 1987. The Calumet Project for Industrial Jobs produced a report for the Hammond City Council that included a chapter on the local enterprise zone [7]. Professor David Fasenfest, then at Loyola University in Chicago, designed and analyzed the results of a phone survey of the firms in the zone. The survey respondents were broadly representative of zone firms, and many issues were covered. The Hammond EZ is considered one of the four best in the state.

In general, the survey showed that most firms find the Hammond EZ to be relatively ineffective in providing concrete benefits. Seventy-two percent stated that they were not more competitive because of the zone; 62 percent found the zone only marginally important or not important at all to their business strength; and 48 percent could not state any known benefits from the zone. The answers to these same questions also can be classified according to types of firms: subsidiaries of larger firms (that are more likely to be footloose or prone to move), firms in Hammond prior to the zone, and firms new to Hammond. No matter how the data are categorized, the results are similar; the benefits are judged to be mostly ineffective. Results are given in Table 5.

Despite this showing that most firms find EZ benefits to be minimal or nonexistent for themselves, the Hammond EZ firms are overwhelmingly positive about the zone and believe it to be useful to others. Ninety-two percent think Hammond should keep the zone; 74 percent feel it creates a good business climate; 85 percent believe the zone is an attraction to firms looking for a site; 75 percent believe the zone would be a major component in business decisions; and 92 percent would recommend the Hammond EZ as a place to do business. Table 6 breaks down these figures in the same manner as Table 5.

The Hammond EZ clearly has been a public relations success, at least among zone firms. (The opinions of Hammond firms outside the zone may be different, however--especially among outside firms

competing in the same product markets but lacking the tax breaks). Despite this PR success, it appears that EZ tax incentives do little to help zone firms. (Any bias built into the survey would be to overstate the benefits in hopes of encouraging continued tax breaks, not to understate them and discourage public officials).

Most employment from firms new to the zone was a mere relocation of jobs (83 percent) rather than creation of new businesses and jobs. For these relocations and whatever other effects the zone may have had, the average Hammond homeowner had to pay an additional \$23.12 in 1985 payable 1986 property taxes to cover EZ tax losses. (The largest subsidy to zone businesses from the average homeowner in that year was in Michigan City: \$83.01 per homeowner.)

The Fort Wayne EZ

The same (Hammond) survey instrument was used to research the Fort Wayne enterprise zone for this study. The Fort Wayne EZ has approximately 240 businesses operating within it. Of these 240, the 1986 EZ statewide survey shows that 111 had registered with the appropriate zone agency for benefits. The survey reached 135 businesses, 16 of which refused to participate or were impossible to locate. Thus, 119 usable responses were obtained, a large and broadly representative sample. The calibre of the individuals responding (owners, presidents, and financial officers) also suggests high confidence in the results. As with the Hammond results, the Fort Wayne survey shows that EZ tax incentives are relatively ineffective. Fifty-eight percent state that they were not more competitive because of the zone; 71 percent find the zone only marginally important or not important at all to their business strength; and 49 percent are unable to list any known benefits from the zone. (Corresponding Hammond figures were 72 percent, 62 percent, and 48 percent.) Breakdowns according to subsidiary, pre-existing, or new status show similar results. Data are given in Table 7.

Again, as was the case with Hammond, Fort Wayne EZ firms believe that the zone is useful to others and have a positive attitude toward it. They are much less positive in their attitudes, however, than were Hammond firms. The majorities expressing favorable attitudes tend to be smaller, and only a minority (44 percent) believe that the EZ would be a major component in a business location decision. Clearly, the PR success of the Fort Wayne zone is not as great as that of the Hammond zone, despite the fact that Fort Wayne EZ businesses in general claimed more concrete benefits than their Hammond counterparts. This is apparently due to superb public relations for the Hammond zone through the local media and a closer and more professional manner of

administering the zone than in Fort Wayne. In Fort Wayne, the previous city administration had failed to call meetings or establish a functioning urban enterprise association to oversee the operations of the zone. Perceptions of the Fort Wayne zone are given in Table 8.

Unlike the Hammond zone, the Fort Wayne zone contained no firms that had relocated to the zone. All businesses new to the zone were also new in all other respects. Because of the unreliability of state data the effect on overall employment in the zone since its designation is unclear, but available figures show that it has remained approximately level. These meager results cost \$1.27 million in 1986 through foregone inventory tax revenue. The average inventory tax credit per firm that year was \$12,183.

The overall results for Fort Wayne confirm those of previous research: tax incentives are basically ineffective, but zone firms believe them to be more effective for other businesses. Despite the lack of perceived importance to their own individual firm, Fort Wayne EZ business leaders favor the zone, although less enthusiastically than their Hammond counterparts.

Conclusion

The conclusion to be drawn is that Indiana EZ tax incentives are not efficient in job creation, even though they are popular with those who receive them. This is not surprising, as in 1986 the average inventory tax credit was approximately \$11,000 per firm. Large firms received more than \$100,000, while small mom and pop operations received \$100 or less. An average \$11,000 gift is welcome and often will be supported politically by those receiving it. This does not establish, however, that it is an efficient route to economic development. Indiana EZs are also unfair to homeowners, businesses, and other property owners not located within the zone. Taxes are shifted to others in an inequitable manner.

There is evidence that, at least in the Evansville zone, economic activity that would have occurred anyway was diverted into the zone from other local locations. This effect may be one of the aims of the EZ program. If so, the extent to which it occurs beyond the Evansville zone needs to be investigated. Further, the characteristics that make this diversion of activity possible should be isolated. According to Rubin and Wilder's preliminary analysis, these relocations stem from local zone and leadership characteristics and have an unclear relationship with tax abatements. Also, an assessment must be made of the costs (tax losses or shifts) relative to the public benefits of this local shifting of economic activity. One discouraging aspect is that state figures show that few of the jobs inside the zone go to zone

residents. If zone firms hire mostly from more advantaged surrounding communities, the gains to an impoverished zone coming from a physical relocation of a few miles from outside the zone will be minimized, although perhaps not nullified. The effects of these zones in redistributing local economic activity need to be monitored carefully, evaluated, and controlled by local government.

On the basis of what is known, several policy recommendations can be made:

- * All firms using the zone for warehousing but providing no employment should be denied tax exemptions.

- * Abatements should be applied only to the proportion of business that has been increased beyond the level attained prior to zone designation.

- * If the name *enterprise zone* has symbolic value beyond that of rational economic calculations, the title could be retained even if tax abatements were curtailed. The many other EZ characteristics that may be vital to success (an urban enterprise association, a capable and energetic EZ director, etc.) could be retained, but without the seemingly unnecessary tax shifts.

- * The state could limit tax abatements to those investors engaged in economic activity that adds income to the community (e.g., manufacturing) rather than redistributes existing income (e.g., retail sales and commercial office buildings).

- * The state and local government should publish the estimated effect of the abatement on the tax rates of other taxpayers in the jurisdiction. In this way, open and democratic debate and decision making could determine final policy.

If these policy recommendations were implemented, Indiana could curb the inequities and apparent useless windfalls while building on any possible advantages inherent in the enterprise zone concept. A poorly conceived and designed program could be turned into a much more modest but perhaps beneficial program.

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Table 1
Enterprise Zone Tax Data, 1984-1987

Year	Number of Claims	Net Taxes Foregone
1984	928	\$6,690,320
1985	1534	\$11,826,418
1986	1516	\$11,861,471
1987	1522	\$12,847,840

Source: State Board of Tax Commissioners

Table 2
Total EZ Tax Losses, 1984-1987

Year	EZ Tax Losses	% Increase from Year Before	Cumulative % Increase from 1984
1984	\$6.7 million	--	--
1985	\$11.8 million	77%	77%
1986	\$11.9 million	.3%	77.3%
1987	\$12.8 million	8%	92%

Source: State Board of Tax Commissioners

Table 3

Rating of the Effectiveness of Indiana's Enterprise Zones

Rating	Location
Excellent	Evansville Michigan City
Good	Hammond South Bend
Average	Anderson Elkhart Fort Wayne Richmond
Poor	Gary Madison

Table 4

Inventory Tax Revenues Lost from Firms in the Evansville Enterprise Zone with No Zone Employment

Year	Inventory Tax Lost from Zero Employment Warehouses	Percentage of all Inventory Taxes Lost
1985	\$602,860	36%
1986	\$748,733	36%
1987	\$755,197	36%

Table 5
Effectiveness of the Hammond EZ, According to
Phone Survey of Zone Firms

	All Firms	Subsidiaries (27% of Total)	Firms Already In Hammond Prior to EZ (75% of Total)	Firms New to Hammond (25% of Total)
Not more competitive because of the zone	72%	77%	70%	37% (other 63% either no response or don't know)
Zone only marginally important or not important at all to business strength	62%	60%	67%	68%
Receive no known benefits from the EZ	48%	68%	65%	72%

Table 6
Impressions of Hammond EZ, according to
Phone Survey of Zone Firms

	All Firms	Subsidiaries	Firms Already in Hammond	Firms New to Hammond
Hammond should keep the EZ	92%	94%	93%	92%
EZ creates a good business climate	74%	64%	72%	81%
EZ is an attraction to firms looking for a site	85%	73%	86%	83%
EZ would be a major component in decisions to open, operate, or close a business	75%	63%	77%	67%
Would recommend Hammond EZ as a place to do business	92%	100%	91%	94%

Table 7
Effectiveness of the Fort Wayne EZ, According to
Phone Survey of Zone Firms

	All Firms	Subsidiaries	Firms Already in Fort Wayne	Firms New to Fort Wayne
Not more competitive because of the zone	58%	59%	58%	no responses
Zone only marginally important or not important at all to business strength	71%	77%	76%	39%
Receive no known benefits from EZ	49%	47%	47%	62%

Table 8
Impressions of the Fort Wayne EZ, According to the Phone
Survey of the Zone Firms

	All Firms	Subsidiaries	Firms Already in Fort Wayne	Firms New to Fort Wayne
Fort Wayne should keep the EZ	71%	65%	69%	85%
EZ creates a good business climate	56%	41%	54%	69%
EZ is an attraction to firms looking for a site	64%	53%	62%	77%
EZ would be a major component in decisions to open, operate, or close a business	44%	24%	41%	69%
Would recommend Fort Wayne EZ as a place to do business	85%	82%	83%	100%