State Economic Development Programs

CHAPTER 1

The use of business financial incentive programs has increased nationwide in the last 15 years. Minnesota has followed other states in creating a variety of programs designed to entice firms to relocate or expand in the state, as well as to help existing businesses stay in Minnesota and expand. The increased use of business incentives by states and the trend toward businesses expecting or demanding incentives has, however, raised concerns. In this chapter we address the following questions:

- **What does research show about the effectiveness of business financial incentives?**
- **What state-level programs does Minnesota use to assist business and how do they compare with those in other states?**

Some people describe the competition for businesses as "the second war between the states."

Some journalists use a battlefield metaphor to describe the competition among states for business expansions and relocations.[1] They call it the "second war between the states." In general, this chapter shows that the "war" continues and Minnesota participates in it. Minnesota's business incentive programs are comparable to those of our neighboring states, though they are far less aggressive than those of many other states. We review the business incentive programs operated by Minnesota's Department of Trade and Economic Development in detail in chapters 2 and 4.

THE HISTORY OF STATE FINANCIAL INCENTIVES

State financial incentives are not new. In 1640, Massachusetts granted the first business incentives in the U.S.[2] During the 1930s, southern states began aggressive campaigns to entice northern industrial firms to relocate, packaging tax incentives, industrial development bonds, loans, and gifts to defray moving and startup costs.

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1 See for example, "The Second War Between the States: A Bitter Struggle for Jobs, Capital, and People," *Business Week*, May 17, 1976, 92 and "War Between the States," *Newsweek*, March 30, 1988, 45.

2 Sandra Kantor, "A History of State Business Subsidies," National Tax Association, Proceedngs of the Seventieth Annual Conference on Taxation (Louisville, Ky., 1977), 147-155.

While business financial incentives are not new, their use increased markedly in the late 1970s and early 1980s. Many analysts mark 1976 as the beginning of the modern bidding war for business when New Stanton, Pennsylvania won a new Volkswagen auto assembly factory with a $71 million incentive package.[3] Other large incentive competitions include the following:

The use of financial incentives has increased markedly in the last 15 years.

- 1980 - Tennessee gave $33 million in incentives to Nissan to locate in Smyrna.
- 1984 - Mazda received $48.5 million to locate a manufacturing plant in Michigan.
- 1985 - Diamond-Star Motors received $83.3 million to locate an assembly plant in Illinois.
- 1985 - Tennessee gave $80 million in incentives to General Motors for its Saturn manufacturing plant in Spring Hill.
- 1985 - Toyota received $149.7 million to locate an assembly plant in Georgetown, Kentucky.
- 1986 - Fuji-Izuzu received $86 million in incentives to locate in Indiana.
- 1991 - United Airlines located an aircraft maintenance base in Indianapolis after receiving an incentive package estimated at $300 million.
- 1992 - BMW located an auto plant in South Carolina after receiving $150 million in incentives.
- 1994 - Mercedes Benz located an auto assembly plant in Alabama after receiving a $253 million incentive package.
- 1994 - Sears received $240 million from the State of Illinois to not relocate its corporate headquarters.

These are just a few of the many large business projects that have received financial assistance from a state government. It is important to keep in mind, however, that most economic development at the state and local levels is more modest and less visible. The use of business financial assistance programs by states is pervasive. In its most recent directory of business assistance programs, the National Association of State Development Agencies noted an increase in capital assistance for individual businesses through low-interest loans, guarantees, and interest subsidies over the years.[4]

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3 John Hood, "Ante Freeze: Stop the State Bidding Wars for Big Business," *Policy Review* (Spring 1994), 63. Volkswagen's production at the plant never met the capacity, only half the envisioned workers were hired, and the plant ultimately closed in July 1988.

4 National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition,* (Washington, D.C., 1995).

States continue to add business incentive programs.

Even in the midst of revenue shortfalls in the early 1990s, state legislatures created new business incentives and overhauled existing ones. In 1992, 40 percent of states responding to an annual survey said they had created new business development incentives.[5] In the following year, 59 percent said they had created new business development incentives, and 61 percent said they had created incentives for retention of existing businesses.[6] As state economies improved, legislatures across the country approved even more incentives for business. In 1995, 41 states reported that they offer loans for building construction, 43 reported offering loans for machinery and equipment, and 44 states reported providing financial assistance for the expansion of existing plants.[7]

Table 1.1 shows that, between 1985 and 1995, states continued to increase the number and variety of their business incentive programs. Also, more business executives are actively seeking government assistance. According to another *Site Selection* survey: "... corporate real estate executives who say they actively seek incentives jumped from twenty-eight to fifty-seven percent during 1988-1993."[8]

ARE BUSINESS FINANCIAL INCENTIVES EFFECTIVE?

There is disagreement about the effectiveness of incentives.

Many economists maintain that granting financial incentives to businesses to create jobs is a "zero-sum" game at the national level. In other words, they say that incentives do not actually create jobs, they just move them from one place to another. Art Rolnick, senior economist at the Minneapolis Federal Reserve Bank, goes further, maintaining that economic incentives are actually a "negative-sum" game because they misallocate resources. Rolnick and Federal Reserve counsel Melvyn Burstein have said that "there will be fewer public goods produced in the overall economy because, in the aggregate, states will have less revenue... In addition to this loss, the overall economy becomes less efficient because output will be lost as businesses are enticed to move from their optimal locations."[9] Rolnick advocates that the federal government intervene and use the commerce clause of the Constitution to prevent states from using financial incentives.

Some other economists argue that government interventions such as business financial incentives can be justified in cases of market failure. Advocates of this

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5 Conway Data surveys state economic development officials annually to find out about economic development activity in each state. The results are published in the magazine *Site Selection and Industrial Development.*

6 *Site Selection and Industrial Development*, Vols. 37 and 38, No. 5. Business incentives include tax incentives, direct financial assistance, and other incentives.

7 Site Selection and Industrial Development, Vol. 40, No. 5, 796.

8 *Economic Development Review* (Summer 1995), 87.

9 Melvin Burstein and Arthur Rolnick, "Congress Should End the Economic War Among the States," *1994 Annual Report* (Federal Reserve Bank of Minneapolis), 7.

Table 1.1: Trends in the Use of Economic Development Incentives, 1985 to 1995

	Number of States Offering the Incentive						
	1985	1990	1991	1992	1993	1995[a]	Change 1985-95
State sponsored industrial development authority	38	40	40	40	40	42	4
Privately sponsored development credit corporation	37	36	38	38	39	39	2
State authority or agency revenue bond financing	41	44	43	44	44	44	3
State authority or agency general obligation bond financing	13	18	19	20	20	20	7
City and/or county revenue bond financing	49	49	49	49	49	49	0
City and/or county general obligation bond financing	31	37	36	37	37	37	6
State loans for building construction	34	40	41	40	40	41	7
State loans for equipment and machinery	33	42	42	41	42	43	10
City and/or county loans for building construction	26	39	41	44	45	46	20
City and/or county loans for equipment and machinery	26	38	41	44	45	46	20
State loan guarantees for building construction	26	28	25	26	28	27	1
State loan guarantees for equipment and machinery	21	29	28	28	31	30	9
City and/or county loan guarantees for building construction	n/a	10	10	13	15	16	n/a
City and/or county loan guarantees for equipment and machinery	n/a	8	10	13	15	16	n/a
State financing aid for existing plant expansion	39	44	44	44	44	44	5
State matching funds for city and/or county industrial financing programs	15	22	22	25	26	26	11
State incentive for establishing industrial plants in areas of high unemployment	25	36	40	41	41	41	16
City and/or county incentive for establishing industrial plants in areas of high unemployment	30	32	33	35	35	35	5
Tax incentive for job creation	30	40	43	44	44	44	14

Sources: 1985-- *Site Selection and Industrial Development*, as cited in Chi, Keon S., *The States and Business Incentives: An Inventory of Tax and Financial Incentive Programs*, Council of State Governments, 1989, 5 and 10. Other years-- *Site Selection and Industrial Development*, Vols. 35, 36, 37, 38, and 40, No. 5.

n/a = Information was not available.

[a]Information for 1994 was not available.

view cite market failures in access to productivity enhancing information[10] and in access to capital for smaller firms and firms in more rural areas of the state.[11] Economist Tim Bartik notes that government financial incentives can serve social goals by targeting programs at distressed or high unemployment areas.[12]

Despite economists' doubts, it may be rational for individual states to offer incentives.

Economists' arguments aside, it may be rational for an individual state to pursue financial incentives if the incentives can entice more firms to move into or expand in the state than in competing states or countries. However, studies of industrial plant location decisions show that financial incentives from governments play a relatively small part in decision-making. Table 1.2 shows the results of a recent Deloitte-Touche survey of corporate real estate executives on the relative importance of different site selection factors. It and other studies we reviewed suggest that traditional location factors such as access to markets, raw materials, transportation, and a quality work force are the primary determinants for site selection.

Table 1.2: Location Decision Factors (In Order of Importance)

Factor	Respondents
1. Real Estate Costs	108
2. Labor Force Issues	96
3. Transportation	95
4. Real Estate Availability	92
5. Market Access	91
6. Regulatory Environment	89
7. Labor Costs	82
8. Community Image	76
9. Tax Climate	76
10. Utility Services	71
11. Utility Costs	63
12. Quality of Life	61
13. Business Services/Technical Support	53
14. Incentives	50
15. Education System/Training Infrastructure	48
16. Proximity to Suppliers/Raw Materials	45
17. University Resources	20

Source: John Mackay, "The Evolving Importance of Incentives," *Economic Development Review* (Fall 1994), 5.

10 Tim Bartik, "Is State and Local Economic Development a Zero-Sum Game?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 19-23.

11 Julia Mason Friedberg, "Improving Capital Market Efficiency Through State Programs," *Governor's 1987 Economic Report* (State of Minnesota), 128-156.

12 Bartik, "Is State and Local Economic Development a Zero-Sum Game?" See also Bartik, "Economic Development Incentive Wars," Upjohn Institute Employment Research (Spring 1995).

A 1989 review of the site selection and economic incentive literature done for the Council of State Governments concluded the following:

- **Business incentives, as defined in these studies, are not the primary or sole influence on business location decision-making;**
- **Business incentives, relative to other factors, do not have a significant or primary effect on state employment growth;**
- **Business incentives do become more effective when all other variables are equal among competing sites within a region or sub-state area; and**
- **Business incentives are important in that they are often used as a component in business climate indices.** [13]

A study by Brinton Milward and Heidi Newman, also based on a review of the literature on site selection, concluded:

> Traditionally, the overriding concerns in an industrial location decision were access to labor, transportation, markets, and raw materials. Although these business factors are still of paramount importance, research has recently highlighted the importance of state economic development programs and the fact that the location decision is a multistage process. Consideration is now given to local and state tax systems, education, the industrial climate, and labor skills.[14]

Studies conclude that state incentives can make a difference in some cases.

John Blair and Robert Premus have also noted that site selection is a multi-stage process with the earlier stages dominated by market and labor force considerations and later stages affected more by other variables such as quality of life.[15] It is at the last stage that business incentives might play a role in site selection. These findings are consistent with the Deloitte-Touche survey which found that 53 percent of the responding site selection executives said that incentives act as a tie-breaker when the decision among sites is narrowed to a few locations that are equally attractive.[16]

In spite of uncertainty about the effectiveness of financial incentives in increasing economic growth, they remain popular. There are several alternative explanations for this, but we find the "arms race" theory of Barry Rubin and C. Kurt Zorn[17]

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13 Roger Wilson, *Economic Development in the States: State Business Incentives and Economic Growth: Are They Effective? A Review of the Literature.* (Lexington, Ky.: Council of State Governments, 1989).

14 Brinton Milward and Heidi Newman, "State Incentive Packages and the Industrial Location Decision," *Economic Development Quarterly* (August 1989), 208.

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

16 John Mackay, "The Evolving Importance of Incentives," *Economic Development Quarterly* (Fall 1994), 4-6.

17 Barry M. Rubin and C. Kurt Zorn, "Sensible State and Local Economic Development," *Public Administration Review* (March/April 1985), 333-339.

and Paul Peretz[19] most convincing. Peretz notes that states are forced into the "arms race" of matching and beating incentives provided by other states because of their inability to act collectively. Rubin and Zorn explain:

> As regions, states and localities watch their neighbors attract jobs and economic activities the desire is to get a piece of the action. As more and more governmental units offer industrial location incentives to help tip business location decisions in their favor, support is lent to the belief that these incentives are necessary and that they significantly affect choices... Policymakers are afraid that if they do not participate in the economic development bidding game (e.g., business incentives), their jurisdiction will lose jobs, economic stability and the appearance of vitality and robustness.[20]

Support for the "arms race" theory was bolstered by remarks made recently by the DTED Director of Business and Community Development:

> We can't afford to unilaterally disarm ourselves. We'll jeopardize our growth and expansion in a very severe way. We simply want a tool to be able to respond in some manner when other states are putting substantial financial packages at these companies' feet.[21]

The National Governors' Association has responded to the concern about the increased use of financial incentives for business. Between 1991 and 1993 the Governors held three meetings on the issue of economic growth and incentives. The resulting policy on Economic Growth and Development Incentives was adopted by the Governors in 1993 and emphasizes partnership between state government and business.[22] The policy notes:

> States will always be in competition with one another for business investments. However, this competition should focus on how each state attempts to provide a business climate in which existing businesses can operate profitably and expand and new businesses can be established and survive. The competition should be judged on factors such as improvements in education, transportation, and telecommunications; stable fiscal conditions; tax policies; business regulation; and the provision of quality public services.[23]

MINNESOTA BUSINESS ASSISTANCE PROGRAMS

In this section we briefly review Minnesota's non-agricultural business assistance programs shown in Figure 1.1. The state Economic Recovery program is the main

19 Paul Peretz, "The Market for Incentives: Where Angels Fear to Tread?" *Policy Studies Review*, 5 (February 1986), 624-633.

20 Rubin and Zorn, 333-334.

21 Quoted in Dave Beal, "Will Depleted Development Fund be Replenished?" *St. Paul Pioneer Press* (October 30, 1995), 1B.

22 See Jay Kayne and Molly Shonka, "Rethinking State Development Policies and Programs," (Washington D.C.: National Governors' Association, 1994).

23 Ibid., 25.

Figure 1.1: State of Minnesota Business Assistance Programs by Department

Program	Department/Office and Statutory Authority	Purpose	Funding Level (not always available)
Advantage Minnesota, Inc.	Department of Trade and Economic Development 116J.693	To market the economic development potential of the state, in order to enhance the state's economic growth.	$200,000 (1995)
Minnesota Project Innovation	Department of Trade and Economic Development 116J	To help small, high technology businesses and individuals develop and market their leading technologies by securing research and development funds through the Small Business Innovation Research (SBIR) program.	$494,000 (1995)
Minnesota Technology, Inc.	Minnesota Technology, Inc. 116O.03	To "foster long-term economic growth and job creation by stimulating innovation and development of new products, services, and production processes through energy conservation, technology transfer, applied research, and financial assistance. To build on the existing education, business, and economic development infrastructure."	$5,198,000 (1995)
Agricultural Utilization Research Institute	Minnesota Technology, Inc. 116O.09	To "promote the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products."	$3,958,000 (1995)
Project Outreach	Minnesota Technology, Inc. 116O.091	To, 1) facilitate the transfer of technology and scientific advice from the University of Minnesota and other institutions to businesses in the state that may make economic use of the information; and 2) to assist small and medium-sized businesses in finding technical and financial assistance providers that meet their needs.	$947,000 (1995)
Seed Capital Fund	Minnesota Technology, Inc. 116O.122	To "implement a centrally managed seed capital fund to invest in early stage companies and small companies in Minnesota through equity or equity-type investments."	$7 million (1992)
Economic Recovery Grants	Department of Trade and Economic Development 116J.873	To provide "money to carry out specified programs, services, or activities designed to create new employment, maintain existing employment, increase the local tax base, or otherwise increase economic activity in a community."	$6,017,000 (1996)
Capital Access Program	Department of Trade and Economic Development 116J.8761	To "provide capital to businesses, particularly small and medium-sized businesses, to foster economic development."	$500,000 (1995, from the Economic Recovery Grant fund) No new money appropriated.

Figure 1.1: State of Minnesota Business Assistance Programs by Department, continued

Program	Department/Office and Statutory Authority	Purpose	Funding Level (not always available)
Small Business Development Loan Program	Agricultural Resource Loan Guaranty Program 41A.036	To create jobs and provide loans for business expansion.	No appropriated funds. Revenue bonds.
Job Skills Partnership Program	Minnesota Job Skills Partnership 116L.02	To "act as a catalyst to bring together employers with specific training needs with educational or other nonprofit institutions which can design programs to fill those needs."	$1,987,000 (1996) $1,962,000 (1997)
Urban Challenge Grants Program	Urban Initiative Board 116M.18	To "encourage private investment, provide jobs for minority persons and others in low-income areas, to create and strengthen minority business enterprises, and to promote economic development in a low-income area."	$6 million (1994) No new appropriated funds.
Challenge Grant Program	Rural Development Board 116N.08	To "encourage private investment, to provide jobs for low-income persons, and to promote economic development in the rural areas of the state."	$6 million (1994) No new appropriated funds. (Repayments)

Source: Department of Trade and Economic Development.

state-level grant and loan program and we discuss it in detail in Chapter 2. The Challenge Grant, Small Business Development Loan, and Capital Access programs are discussed in Chapter 4.

Advantage Minnesota

Advantage Minnesota, created by the 1991 Legislature, is a nonprofit corporation responsible for marketing Minnesota's strengths as a place for doing business to companies outside the state borders.[24] The corporation is a public-private partnership governed by a 43-member board of directors, consisting primarily of Minnesota business leaders. The organization has a full-time staff of five.

Advantage Minnesota's budget is made up of public appropriations and private contributions, with the public dollars available only as long as there is at least a 1-to-1 match of private contributions. Since its creation, Advantage Minnesota has requested an annual appropriation of $500,000, but the Legislature has appropriated $200,000 annually.[25] The private sector has contributed between $400,000 and $500,000 annually, exceeding the private matching requirement.

24 *Minn. Stat.* §116J.693. Advantage Minnesota, Inc. is the formal name of the organization.

25 The 1992 appropriation was reduced by $125,000 to $75,000.

Advantage Minnesota brings Minnesota to the attention of executives in targeted industries through direct mail marketing campaigns, trade shows, advertising, and newsletters.[26] The targeted industries for 1995-96 are software development/corporate data centers, composite materials/plastics, and medical/biotech/health care products. Advanced manufacturing, service, and technology growth companies in Canada are also being targeted. According to Advantage Minnesota, it follows up with executives and acts as an account representative and a single point of contact for interested businesses.

Advantage Minnesota markets the state to out-of-state businesses.

One or two economic development professionals in each region work with Advantage Minnesota. Advantage Minnesota issues monthly "Alliance Alerts" listing businesses that are interested in Minnesota and the businesses' particular needs.[27] It sends the "Alliance Alerts" to the regional contacts, who are familiar with the capacities of the communities in their regions. Communities interested in a business provide requested information to the regional contacts, who forward the information to Advantage Minnesota. Program staff present the business with a response to its inquiry by packaging the local information, along with fact sheets about Minnesota covering topics such as labor force, education, quality of life, taxes, transportation, and financial resources. By working with existing economic development experts in the regions and communities, Advantage Minnesota tries to avoid duplicating work that is already being done. According to staff, if a business shows continued interest in Minnesota, Advantage Minnesota assists the business by answering questions and coordinating site visits.

In its 1995 year-end "Alliance Alert," Advantage Minnesota reported five companies it assisted had chosen to expand into Minnesota, with three-year job creation projections of about 500 employees. None of these five companies required state financial incentives to locate in Minnesota. Fourteen companies chose not to expand in Minnesota.

Minnesota Technology

Minnesota Technology focuses on manufacturing and high technology firms.

Minnesota Technology, formerly the Greater Minnesota Corporation, is a nonprofit corporation set up to assist Minnesota businesses to remain competitive in a global economy.[28] The corporation focuses on assisting manufacturing and high technology firms with a goal of creating and developing high-skill, high-wage jobs.

The organization operates from regional offices in Moorhead, Redwood Falls, Rochester, St. Cloud, Virginia, and the Twin Cities and is guided by both local and statewide boards of directors. It administers a number of technology and innovation transfer programs to aid manufacturers and it also operates the Upper Mid-

26 The process is somewhat different for the Canadian marketing efforts. Instead of approaching companies directly and possibly being accused of trying to steal business across the border, Advantage Minnesota works with contacts in Canada and presents Minnesota as a potential state for Canadian companies hoping to expand in the United States.

27 The identities of the companies are kept confidential; the listings are numbered with a brief description of the type of work the company does.

28 *Minn. Stat.* §116O. Minnesota Technology, Inc. is the formal name of the organization.

west Manufacturing Technology Center in conjunction with the National Institute of Standards and Technology. Minnesota Technology also manages a number of programs targeted toward work force development and quality development in several different industries.

In addition, Minnesota Technology makes equity investments in "early stage companies and small companies in Minnesota" from a Seed Capital Fund. The organization had approved $1.15 million for investments in seven companies through the end of calendar year 1994. It plans to continue to invest approximately $1 million per year in four to six companies.

Job Skills Partnership

The Job Skills Partnership program works with businesses to provide job training.

The Minnesota Job Skills Partnership program was created by the 1983 Legislature as the Jobs Partnership program.[29] When created, the program was governed by a 21-member board and was staffed by the State Planning Agency. The program has been organizationally located in several state agencies, moving to the Department of Economic Security in 1985, to the Higher Education Coordinating Board in 1987, and finally to the Department of Trade and Economic Development in 1989. It is currently governed by a 12-member board. The 1995 Legislature appropriated just under $2 million for each year in the 1996-1997 biennium. An additional $500,000 was appropriated to the Job Skills Partnership Board to assist Minneapolis and St. Paul employment programs.

The Job Skills Partnership funds cooperative training programs for companies located in or intending to locate in Minnesota. Grants of up to $200,000 are awarded to educational institutions with a new or expanding business as a partner. The business must match the state grant on a one-to-one basis. The business can match state funds by providing equipment or faculty. According to the program's executive director, training (in most cases retraining) has been provided for over 23,500 workers in 300 companies since the program's inception.[30]

OTHER STATES

In this section we describe the types of economic development tools used by states to influence business expansion and location decisions. We asked:

- **What are the national trends in state economic development efforts?**

Because state and local economic development policies are more likely to be a factor in business location decisions between states in the same region, we also asked:

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29 *Minn. Laws* (1983), Ch. 334.

30 Cited in Leonard Inskip, "At St. Cloud Freezer Factory, Job Skills Partnership Scores Again," *Minneapolis Star-Tribune* (November 28, 1995), 9A.

- **What state financial assistance do states surrounding Minnesota--specifically Illinois, Iowa, Michigan, North Dakota, South Dakota, and Wisconsin--offer businesses for economic development?**

National Trends in Economic Development

According to experts, state economic development strategies have evolved through three waves.[31] Subsequent waves do not necessarily replace the previous ones, but add new programs and sometimes shift emphasis. Though there is some disagreement among economic development practitioners and academics if the wave paradigm accurately portrays how economic development programs have changed over time, it is a useful tool for discussing and classifying programs.

The first wave of economic development programs developed in the 1930s when southern states attempted to lure manufacturers from the north to their states. Sometimes referred to as "smokestack chasing," first wave programs dominated economic development activity through the 1970s. Most states engage in these types of programs to some degree.

The second wave in economic development programs emerged in the 1980s. Second wave programs emphasize job creation. Rather than luring companies from other states, these programs assist existing business expansion or new development.

Improving the overall business climate and competitiveness is an emerging economic development focus.

Both first and second wave activities have been criticized. Economists cite the fact that these activities do not necessarily create new wealth or increase productivity. In addition, states have felt hostage to demands for incentives. Also, there is growing concern that businesses are being assisted to engage in activities they would do anyway, without the assistance. Finally, businesses that do not receive assistance see their tax dollars helping other businesses.

Third wave policies emerged in the early 1990s. One component of the third wave is investments that affect the overall business climate in the state, therefore benefiting all businesses and making the state more competitive in the global economy. These activities go beyond traditional state economic development programs to include education, job training, superior infrastructure, a favorable tax and regulatory environment, and a high quality of life.[32] The second component

31 For discussions of the "wave" metaphor and "third wave" economic development policy, see "Third Wave Economic Development Strategies: What Are They? Will They Work?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 63-76; Lee W. Munnich, Jr., "Understanding Economic Development," in *Emerging Principles in Economic Development: A Benchmarking Tool* (Minneapolis: University of Minnesota, 1995), 7-11; and Peter Eisinger, "State Economic Development in the 1990s: Politics and Policy Learning," *Economic Development Quarterly* 9, no. 2 (May 1995), 146-158.

32 Dan Pilcher, economic development expert formerly at the National Conference of State Legislatures, argues that the first component activities we refer to are not really "third wave," but are investments that states already make. According to Pilcher, "third-wave" policies are more process-oriented, facilitating industries and cluster of firms working together. Phone conversation (December 19, 1995). However, others do include these broader investments as part of the "third wave." See for example, Peter Eisinger, "State Economic Development in the 1990s: Politics and Policy Learning," *Economic Development Quarterly*, 9 no. 2 (May 1995), 146-158.

emphasizes the management of economic development activities. It focuses on developing business networks and allowing business sectors, networks, and clusters of firms to identify their economic development needs, rather than the state determining what is needed. The key distinction between third wave policies and others is that third wave policies are not firm specific.
Figure 1.2 shows the characteristics of the three waves of economic development.

States are not responding to the "third-wave" movement by abandoning existing economic development strategies. As we saw in Table 1.1, states provide a variety of programs to assist with business expansions, relocations, and startups.

Figure 1.2: Three Waves in State and Local Economic Development

	First Wave 1930s-1970s	Second Wave 1980s	Proposed Industrial Services Model 1990s?
Problem	Lagging regions	Structural change	Declining competitiveness
Universality of problem	Firm specific	Episodic, firm specific	General, systemic
Goal	Attract plants	Create jobs	Improve competitiveness
Targets of policy	Relocating or new plants of large corporations	New or expanding businesses (often small businesses)	Groups or clusters of manufacturing and technology-based firms
Means	Market the area; give subsidies	Separate programs (capital, etc.)	Integrated provision of industrial services
Mode of intervention	Smokestack chasing	Respond to requests that firms define	Lead firms in new directions
Regional economic focus	Large firm anchors	Sectoral diversification	Develop agglomerations
Organization	State departments of commerce	Multiple state organizations	State funded, locally or sectorally operated organizations
Intergovernmental mode	Federally led	States as labs of democracy	State-federal-local partnership
Measures of success	Number of firms attracted	Number of jobs created/retained	Increased firm competitiveness (e.g., productivity, new products, sales)

Source: Robert Atkinson, "Third Wave Economic Development Strategies: What Are They? Will They Work?" in *Proceedings: State and Local Economic Development Strategy Summit* (Minneapolis: University of Minnesota, 1994), 67.

Neighboring States

In order to determine the economic development strategies of neighboring states, we contacted state economic development officials in Illinois, Iowa, Michigan, North Dakota, South Dakota, and Wisconsin. We found:

- **A recurring theme in the economic development strategies of the six states in the Upper Midwest region is improving their overall economic climate.**

In its 1995 report to Governor Edgar, the Illinois Economic Development Board identified key components of a strong economic foundation. They include an educated and skilled work force; access to technology; advanced infrastructure; a favorable tax and regulatory environment; and access to capital for small businesses. The report focused on key industry clusters that make up the core of exporting industries in Illinois and the businesses that support them. So far this decade, the Illinois Legislature has addressed tort reform, unemployment compensation, investments in research and development, and worker training, among other issues.

Other upper Midwest states have programs similar to Minnesota's.

In the 1992 update to its five-year Economic Development Plan, the Iowa Department of Economic Development Board emphasized the need to move from the goal of job creation to the goal of income/wealth generation. According to the update, such a focus involves continued investment in people and technology and attention to economic diversification. A focus on income/wealth generation also places a priority on the types of jobs created. Since 1990, the Iowa Legislature has created incentives to encourage the use of new technology and investments in research and development and worker training.

Michigan created the Michigan Jobs Commission, the state's new economic development agency, in 1993. A board composed of private-sector members provides guidance on economic development policy. Priorities include restricting financial assistance for businesses to public infrastructure (as opposed to other business expenses), equipping Michigan's work force with needed skills, and improving the business climate.

In 1991 the North Dakota Legislature passed legislation adopting "Growing North Dakota," an economic development strategy for the state. In addition to addressing access to capital for business, Growing North Dakota emphasizes primary sector businesses (manufacturing, food processing, and exported-service business), creation and use of technology, and community involvement. The legislature has passed workers' compensation and unemployment compensation reforms, too.

The Governor's Office of Economic Development in South Dakota emphasizes primary sector job creation, with an emphasis on rural areas and economic diversification. The legislature approved workers' compensation and unemployment insurance reform, and addressed education issues in the past several years.

Wisconsin's economic development programs address technology development, research, worker training, and financial assistance. Since 1990, the legislature has expanded the customized worker training program and reformed workers' compensation.

- **At the same time, the states have not abandoned more traditional financial incentives for business attraction, expansion, and retention.**

We also asked economic development directors and managers about their general-purpose programs that provide grants or loans to businesses.[33] We found:

- **Like Minnesota, five of the six states contacted have programs that provide financial assistance to businesses through grants or loans to fund project costs other than infrastructure.**

Through the Small Business Development Loan Program, Illinois' Department of Commerce and Community Affairs provides loans of 25 percent of project costs up to $750,000. Iowa's Community Economic Betterment Account, administered by the Iowa Department of Economic Development, provides financial assistance to new, expanding, or relocating businesses up to $1,000,000 per project. North Dakota has several loan programs through the Department of Economic Development and Finance and the Bank of North Dakota. South Dakota's Revolving Economic Development and Initiative Fund (REDI fund) provides low-interest loans (generally 3 percent) to eligible businesses to cover up to 45 percent of project costs. Wisconsin's Department of Development provides financial assistance through Major Economic Development Loans.

Michigan is eliminating financial assistance through grants and loans to or on behalf of particular businesses, except to cover public infrastructure expense. However, in 1995 Michigan created the Michigan Economic Growth Authority (MEGA), a tax incentive for relocating or expanding businesses. MEGA was created in response to similar programs in Kentucky, Ohio, and Indiana in recent years. It provides a tax credit against the state's Single Business Tax based on increased Single Business Tax liability and personal income tax withheld attributable to the project. The maximum credit is 100 percent of what is attributable to the project for 20 years, and the credit can result in a tax refund to the business. There are strict job creation, retention, and wage requirements for businesses to qualify. For more details about these and other programs, see Figures 1.3 through 1.8.

Neighboring states use a variety of revenue sources to fund economic development activities. South Dakota capitalized its REDI fund through a 1-percent sales tax imposed in 1987. The goal of $40 million was reached in 10 months, at which time the tax was discontinued. The Michigan Strategic Fund was previously funded with oil and gas fees, and is now funded by a surtax on Indian casino gambling. Through the Bank of North Dakota, programs are financed by state tax deposits, other investments, and bank profits.

33 We did not ask about venture capital programs; programs aimed at agricultural processing, technology, research, or exporting; or programs that target specific populations (such as low-income people, women, minorities, or people with disabilities).

Minnesota administers the Economic Recovery Grant program in tandem with the economic development portion of the federal Community Development Block Grant (CDBG) program. Community Development Block Grants are given to all states and can be used for a variety of purposes, including economic development. Some requirements for the use of the grants are outlined by the federal government, but states have some latitude in how funds are administered. Therefore, we asked the surrounding states how they use their economic development portion of CDBG funds. Figure 1.9 shows the different rules guiding their use in the states we contacted.

Minnesota bases its rules for the CDBG economic development set-aside on the rules for other CDBG funds. Other funds are limited to one application per local unit of government per year. This has two implications: (1) once a local unit of government has applied for $500,000, it may not request more funds, even if a very good project comes along, and (2) individual businesses can receive more than $500,000 per project by applying over several years or by applying through more than one unit of government (e.g., the city and the county). In our opinion, although grants should be distributed around the state, if there is more than one good project in a community in a particular year, state rules should not prevent funding.

- **Unlike Minnesota, the other six states in the Upper Midwest place a dollar-maximum of CDBG economic development funds on the business or project. Only one other state--Wisconsin--has a community maximum, which is twice the project maximum.**

Maximum funding ranged from $200,000 per project in South Dakota to $750,000 per project in Wisconsin. North Dakota is the only state to place the dollar maximum on the businesses. It is a $500,000 maximum at any one time; in other words, a business may receive $500,000, pay the principal down to $300,000, and then request $200,000 more.

North Dakota is the only state we contacted which allocates the CDBG economic development funds to regional councils. The revolving loan funds established with loan repayments are also administered regionally.

SUMMARY

The efficacy of state financial incentives and the influence of incentives on location decisions, job creation, and stimulating economic activity is uncertain. Yet most states offer incentives to businesses. Even if an incentive defrays only a fraction of the costs of a business location or expansion, the very fact that an incentive is or is not offered might affect the way a company perceives a state’s attitude towards business in general or the company in particular.

In Chapter 2, we discuss Minnesota's primary business financial assistance program, the Economic Recovery Grant program, and Minnesota's use of federal Community Development Block Grant funds for economic development.

The state is not the only player in public financing of economic development. We were surprised by the participation of other public entities in projects assisted by the Economic Recovery and Community Development Block Grant programs. Chapter 3 focuses on local governments' participation in economic development and their use of local revolving loan funds.

While the Economic Recovery Grant program is the state's primary business assistance program, it is not the only one. In Chapter 4 we review three other state-level economic development programs administered by the Department of Trade and Economic Development: the Capital Access program, the Challenge Grant program, and the Small Business Development Loan program.

Figure 1.3: Business Assistance Programs in Illinois

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Affordable Financing of Public Infrastructure Program (AFPIP)	Illinois Department of Commerce and Community Affairs	$13 million appropriation from revolving loan fund for FY1996 (shared with BDPIP, below).	Providing niche financing for public infrastructure projects necessary for health, safety, and economic development that are too small to make issuing of bonds or other traditional sources of infrastructure funding practical. The program provides grants or loans to local units of government up to a maximum of $100,000 per project.
Business Development Public Infrastructure Program (BDPIP)	Illinois Department of Commerce and Community Affairs	$13 million appropriation from revolving loan fund for FY1996 (shared with AFPIP, above).	Financing public infrastructure for projects by providing grants or loans to local units of government that demonstrate financial need and that the project will result in the creation/retention of private-sector jobs.
Small Business Development Loan Program	Illinois Department of Commerce and Community Affairs	Not available.	Providing financing to small businesses at market or below market interest rates in cooperation with other lenders. The program can fund up to 25 percent of total project costs or up to $750,000.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.4: Business Assistance Programs in Iowa

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Community Economic Betterment Account	Iowa Department of Economic Development	$4 million to $5 million per fiscal year for the past several years.	Increasing direct and indirect job opportunities by providing financial assistance to businesses for start-up, expansion, or relocation to Iowa. The maximum assistance through the program is $1,000,000 per project. Assistance is provided through communities; communities may apply more than once per fiscal year.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.5: Business Assistance Programs in Michigan

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Michigan Economic Growth Authority	Michigan Jobs Commission	Not applicable. Maximum credit is 100 percent of the amount attributable to the project for 20 years. (The maximum credit has been awarded once.)	Making Michigan competitive with other states for businesses considering expansion or relocation. This program is a tax credit against the Single Business Tax (SBT), the state's only business tax. The tax credit is based on increased SBT liability and/or the amount of personal income tax withholding attributable to new jobs created. There are job creation and wage requirements in order to receive the credit.
Capital Access Program (CAP)	Michigan Jobs Commission	The CAP is financed by the Michigan Strategic Fund. The balance of the fund is expected to be about $20 million in 1996. No specific amount is set aside for the CAP.	Encouraging banks to make loans to businesses that are slightly more risky than those they would usually make by contributing to a loan loss reserve pool.
Michigan Renaissance Fund (This is being proposed.)	Michigan Jobs Commission	This would be a program funded by the Michigan Strategic Fund. The balance of the fund is expected to be about $20 million in 1996.	Providing loans to communities for land assembly, site reclamation, and infrastructure or grants for infrastructure. Assistance to communities would be provided on behalf of particular businesses.

Note: Michigan does not make grants or loans to businesses. These are some of the economic development programs in Michigan.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.6: Business Assistance Programs in North Dakota

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
ND Development Fund	North Dakota Department of Economic Development and Finance	Not available.	Providing financing to businesses through loans, participation loans, subordinated debt, loan guarantees, or equity up to $300,000, but not to exceed $10,000 per job created in urban areas or $20,000 per job created in rural areas. Grants are available to Local Development Councils for construction and renovation and up to $100,000 is available for expenses incurred by businesses relocating from outside North Dakota. The latter is not to exceed $500 per job created in urban areas or $1,000 per job created in rural areas.
Small Business Loan Program	Bank of North Dakota	Not applicable.	Assisting new and existing businesses by participating in loans of up to $250,000. Maximum bank participation is $187,500 or 75 percent of the loan. There is a 15-25 percent balance sheet equity requirement for the business.
Business Development Loan Program	Bank of North Dakota	Maximum of $25 million in outstanding loans. ($6-7 million currently outstanding.)	Assisting new and existing businesses with a higher degree of risk than normally acceptable to lending institutions. The bank participates up to $500,000.
Partnership in Assisting Community Expansion (PACE)	Bank of North Dakota	Appropriation for buy down for FY1995-97 was $4.5 million, plus approximately $630,000 carried over from the previous biennium.	Creating new jobs and wealth in the state. There are two parts to this program: (1) the Bank of North Dakota participates in a loan at market interest rates and (2) the state and a local development entity fund an interest buy down up to 3 percent below NY prime or 5 percent below market. The state provides 65-85 percent of the buy down. The maximum state buy down is $250,000.
MATCH Program	Bank of North Dakota	Money for this program comes from investors such as the retirement funds. The bank gives them a certificate of deposit for the term of the loan at the US treasury note rate.	Attracting financially strong businesses to North Dakota. The bank participates in loans and charges an interest rate of the US treasury note rate plus .25 percent for borrowers with an "A" rating. The bank can participate up to about $8 million and can take up to 90 percent of the loan.

Note: Most of the state economic development programs in North Dakota are administered by the Bank of North Dakota, the only state-owned bank in the country. Its lending base is the state's tax dollars so the legislature restricts the type of lending it can do. The Bank operates like a conventional bank in administering the loans. Except for the PACE program, which is partly funded by state appropriations, there are not job creation requirements attached to loans made through the programs. The bank does not make grants and forgivable loans.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.7: Business Assistance Programs in South Dakota

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Revolving Economic Development and Initiative Fund (REDI fund)	Governor's Office of Economic Development	$24 million in cash and investments on June 30, 1995. (The $24 million includes loan commitments of $8 million to businesses and other South Dakota economic development programs.)	Assisting company expansions, relocations, and start-ups, with a focus on private sector jobs. The REDI Fund provides low-interest (3 percent) loans to businesses. The loans may finance up to 45 percent of project costs and may be used for working capital.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.8: Business Assistance Programs in Wisconsin

PROGRAM	AGENCY	FUNDING	PURPOSE/DESCRIPTION
Major Economic Development Loans	Wisconsin Department of Development	Awards for FY1993-94 reached approximately $6.6 million.	Providing financing to projects not eligible under other Wisconsin Development Fund programs. The program can be used to make grants or loans to businesses or other applicants on behalf of businesses for land, buildings, equipment, and other business operating expenses.
Rural Economic Development Program	Wisconsin Department of Development	$296,000 in FY1995.	Providing assistance for starting or expanding businesses in rural areas. The program has two parts. Part I provides grants and loans up to $30,000 for professional services. Part II provides loans of up to $25,000 for working capital or fixed assets. A business must receive professional services assistance to be eligible for a Part II loan.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.

Figure 1.9: Community Development Block Grant Economic Development Programs

STATE	PROGRAM	FUNDING	DESCRIPTION
Illinois	Community Development Assistance Program--Economic Development component	$8 million for 1995. Has varied from $4 million to $8 million the past several years. (A fixed percent is not set aside.)	Illinois provides financial assistance of $25,000 to $500,000 per project. The maximum may be waived. There are limitations on when funds may be used to assist retail. Funds may be used for working capital.
Iowa	CDBG Economic Development Set Aside and	20 percent of block grant funds, or about $6 million, is set aside for these two programs. Usually, all the money is not used.	Maximum funding through this program is $500,000 per project through loans or forgivable loans. Assistance may not exceed $10,000 per job created or retained, but has never exceeded $5,000 per job. May be used for working capital. Funding for retail is not precluded, but retail projects tend not to receive enough points in the scoring system.
	CDBG Public Facilities Set Aside		This program finances public infrastructure associated with particular business projects that will increase job opportunities by providing grants to communities up to a maximum of $500,000 per application.
Michigan	Community Development Block Grants	About 67 percent of block grant funds in 1996, or about $30 million. (A fixed percent is not set aside each year.)	Michigan provides up to $750,000 per project and government unit per year, but the maximum may be exceeded if a community has more than one good project. Funds may be used only for public infrastructure. This is a competitive program limited to industrial projects; projects resulting in higher wage jobs will be funded over projects with lower wage jobs, other things being equal.
North Dakota	Community Development Loan Fund	50 percent of block grant funds, or about $3 million annually.	North Dakota allocates CDBG funds to eight regional councils, to which local units of government apply and to which loan repayments are credited by the state. The maximum loan amount is $500,000 per business at any one time. If a business receives a $500,000 loan and repays $300,000, the business may apply for an additional $300,000. Loans for retail may be made up to $150,000. Revolving loan funds are established at the regional council level.
South Dakota	Special Projects Account	$3 million in 1995. (South Dakota sets aside a fixed dollar amount. It used to be $2 million. The state receives about $8.5 million in CDBG funds each year.)	The maximum amount of funding available through this program is $200,000 per project. Funding is also limited to $5,000 per full-time equivalent job created. Funds may not be used for retail projects or for working capital.
Wisconsin	CDBG Economic Development Program	35 percent of block grant funds in 1994, or about $11 million. (The set aside can reach 75 percent.)	The maximum amount of funding a business may receive in a calendar year is $750,000; the community maximum is $1.5 million. These funds may be used for working capital.
	CDBG Public Facilities for Economic Development Program	About $1 million in 1994 through a revolving loan fund established from previous CDBG awards	The maximum amount of funding a company may receive is $750,000; the community maximum is $1.5 million. This program provides funding to local communities on behalf of businesses to finance infrastructure improvements.

Sources: National Association of State Development Agencies, *Directory of Incentives for Business Investment and Development in the United States, Fourth Edition* (Washington, D.C., 1995); Program Evaluation Division interviews with state economic development officials; and state departments' publications.