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A PRIMER ON ENTERPRISE ZONES AND PROPOSED LEGISLATION IN PENNSYLVANIA

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Allegheny Institute Report #98-09
September 1998

Note: Nothing written here is to be construed as an attempt to aid or hinder the passage of any bill before the Pennsylvania General Assembly.

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KEY FINDINGS

- Enterprise zones have been utilized as an economic revitalization tool for approximately two decades. The concept entails the removal of governmental barriers, such as excessive taxes and regulation, in order to spur investment in blighted areas. Enterprise zones were inspired by the impact of such policies of the then-British colony Hong Kong, which has demonstrated the fastest and proportionally greatest economic growth in the world. Great Britain implemented more enterprise zones under Margaret Thatcher.
- In the United States, enterprise zones did not develop quickly at the federal level. The current federal Empowerment Zone and Enterprise Community program emphasizes the leveraging of federal grants which are controlled by a community board. This stands in sharp contrast to the free-market principles underlying the enterprise zones. By the early 1990s, nearly three-fourths of the states had adopted variations of the program. The common thread between these state programs was the inclusion of tax and financial incentives, along with some regulatory relief.
- Most successful state enterprise zone programs offer substantial capital investment, labor and finance incentives. In particular, Michigan has attracted a good deal of attention because it provides a full exemption for most state and local taxes within its "Renaissance Zones."
- The experiences of the various states suggest that an ideal enterprise zone would have the following characteristics: incentives for new capital investment, incentives for existing firms to remain and expand their operations, a long-term commitment to those incentives, and the ability of marketing, technical assistance, and job placement and training programs to create and maintain a pool of local workers.
- Pennsylvania's Keystone Opportunity Zones (KOZs) are designed to entice businesses to depressed communities through numerous tax incentives or abatements. To qualify, a zone must meet at least two of twelve pre-determined criteria assessing its economic condition, and must be evaluated further based upon other factors which may be relevant.
- Specific incentives offered to residents located in Opportunity Zones include tax exemptions for: personal income earned as a KOZ resident; interest, rent and dividends earned in the KOZ, and business net income earned in a KOZ. An individual must reside in a KOZ for 184 consecutive days in order to take advantage of these incentives. Businesses in KOZs will (with some limitations) be exempt from the retail sales tax, income tax, capital stock and franchise tax, real property tax, local earned income, net profit and business privilege taxes, mercantile license taxes, and local sales and use taxes. Businesses moving into a KOZ must meet certain employment and capital investment targets in order to take advantage of the incentives.
- The proposed Pennsylvania KOZ program is designed to be very similar to the Michigan program. However, the State of Michigan reimburses or compensates all zone localities (dollar per dollar) for all abated local property tax revenue for schools and libraries. In contrast, the Pennsylvania proposed program does not reimburse or compensate the zone localities for abated property tax revenue for schools and libraries. Although it has many strong components, Pennsylvania's proposed zone program will experience problems at the local level unless the legislature corrects this flaw. The first and easiest solution to this problem is to duplicate and add the Michigan reimbursement or compensation (state to local transfer of revenue) component for abated property tax revenues for schools and libraries. The second and better solution is to provide property tax abatements on capital improvements only, such as renovation and new construction.

INTRODUCTION

The proposed Pennsylvania "Keystone Opportunity Zone" bill (Session of 1998) is a dynamic piece of legislation designed to help create and expand jobs and businesses in low-income areas. Keystone Opportunity Zones are, in essence, "enterprise zones." This new bill proposes many important elements for implementing twelve geographically defined enterprise zones to be designated for a period of up to twelve years. These essential elements have proved to be highly successful in other state enterprise zones in increasing jobs, businesses, and economic development in low-income areas. Some of these vital elements are:

- A strong, combined package of state and local incentives for zone businesses and/or zone residents, such as income, capital, property, sales, and miscellaneous tax and financial incentives;
- A mandated strategic "opportunity plan" to be formulated by the locally governed applicants of a zone;
- Designated criteria outlining the economic "distress", plus additional criteria focusing on vital local measures to reduce "crime," to improve "job training and educational opportunities," to reduce "regulatory burdens," to utilize "existing resources," and to actively "market" the zone program.

Of course, there are many other important aspects of the proposed legislation, which all add up to significant supplemental support for the program.

KEYSTONE OPPORTUNITY ZONES ARE, IN ESSENCE, "ENTERPRISE ZONES." THIS NEW BILL...PROPOSES MANY IMPORTANT ELEMENTS FOR IMPLEMENTING TWELVE GEOGRAPHICALLY DEFINED ENTERPRISE ZONES TO BE DESIGNATED FOR A PERIOD OF UP TO TWELVE YEARS. THESE ESSENTIAL ELEMENTS HAVE PROVED TO BE HIGHLY SUCCESSFUL IN OTHER STATE ENTERPRISE ZONES IN INCREASING JOBS, BUSINESSES, AND ECONOMIC DEVELOPMENT IN LOW-INCOME AREAS.

In other state zone programs, capital incentives in the form of local property tax abatements on improvements, income tax credits, and capital investment tax credits have been shown to be highly effective tools in reducing the excessively high costs of creating and expanding business activities in blighted areas. This is especially true for *existing* businesses with community roots, which have been in operation for many years. These *existing* businesses become *expanding* businesses that "create many more jobs" than start-up and relocating businesses in most successful zones throughout the nation. Across the nation, it is a blighted area's legitimate and *existing* businesses, which are the *stronghold* for the community in *hiring* local residents, in *expanding* economic opportunity in the area, and in *providing* wholesome community leadership (through the business owners, who are often local residents) for civic outreach programs to youth, the aged, and throughout the community.

The proposed Pennsylvania zones program is designed to be very similar to the Michigan "Renaissance Zones" program, which is a strong state zone program. However, there is one major problem (along with a few other problems) with the proposed Pennsylvania legislation. First of all, the Michigan zones are tax-free with the exceptions of state sales taxes and local special bond levies. More importantly, the State of Michigan reimburses or compensates all zone localities, dollar per dollar, for all *abated* local property tax revenue for schools and libraries. Thus, there is *no* revenue shortage for schools and libraries. In contrast, the Pennsylvania proposed program also provides for implementing tax free zones (that is, tax free to a large degree), but the State of Pennsylvania does *not* reimburse or compensate the zone localities for *abated* local property tax revenue for schools and libraries. In spite of many strong components, *Pennsylvania's proposed zone program might experience problems at the local level unless the legislature corrects this significant flaw.*

...THE STATE OF MICHIGAN REIMBURSES OR COMPENSATES ALL ZONE LOCALITIES, DOLLAR PER DOLLAR, FOR ALL ABATED LOCAL PROPERTY TAX REVENUE FOR SCHOOLS AND LIBRARIES...IN CONTRAST, THE PENNSYLVANIA PROPOSED PROGRAM ALSO PROVIDES FOR IMPLEMENTING TAX FREE ZONES... BUT...DOES NOT REIMBURSE OR COMPENSATE THE ZONE LOCALITIES FOR ABATED LOCAL PROPERTY TAX REVENUE FOR SCHOOLS AND LIBRARIES... PENNSYLVANIA'S... PROGRAM MAY EXPERIENCE PROBLEMS AT THE LOCAL LEVEL UNLESS THE LEGISLATURE CORRECTS THIS SIGNIFICANT FLAW.

The following report will contain a detailed analysis of the items mentioned above, along with other significant aspects of the proposed "Keystone Opportunity Zones" legislation. However, to help the reader (and policy-maker) gain a better understanding of and greater insights into enterprise zones, this report will describe the evolution of enterprise zones, their major successes and failures, their ideal or preferred components or characteristics, and exactly how Pennsylvania's proposed plan measures up against the ideal zone program.

EVOLUTION OF ENTERPRISE ZONES

The enterprise zone is an innovative, public-private cooperative policy tool with an emphasis on *free market principles* for targeting economic development *incentives* into specific geographical areas suffering from economic distress or depression. Blighted areas usually suffer due in large part to onerous costs to business, such as excessively high taxes and burdensome regulations that tend to be much higher than outlying areas. Therefore, job creation and retention are primary goals of a zone program, along with greater entrepreneurship opportunities for zone residents. Other onerous costs to business are high crime rates, dilapidated infrastructures, deteriorated public services, and an overall declining community standard of living. Therefore, other goals include community improvements (such as redeveloping neighborhoods, housing, and business districts) and improving the infrastructure and quality of life in the safety, education, health, and welfare of zone residents.

Enterprise zones were officially conceptualized as formidable public policy, instead of mere academic theory, in a 1978 speech delivered in London's depressed dockland district by Sir Geoffrey Howe, member of Great Britain's House of Commons, who later became Chancellor of the Exchequer (equivalent to a Cabinet Treasury Secretary) and then Foreign Secretary in Margaret Thatcher's Conservative government. Howe had taken the framework for enterprise zones from academician Peter Hall's analysis on the economic growth of the then-British-governed city-state of Hong Kong. Hong Kong had no natural resources other than a port and it was once an extremely blighted area, but it demonstrated the fastest and proportionally greatest economic growth in the world by eliminating governmental barriers. The standard of living of both rich and poor has increased dramatically, and the middle class has grown and flourished.

There may be other societal causes than deleterious governmental policies that contribute to blight, but government can elect to remove any unnecessary barriers, such as heavy tax burdens, that it has contributed to causing poverty, unemployment, and the urban *flight* of both businesses and working-taxpaying residents. Hall was a British urban planning expert from Reading University and former chairman of the socialist Fabian Society. Ironically, Hall saw government as the root cause for much of the blight, and in addition to contributing to enterprise zones, he wrote a distinguished book entitled *Great Planning Disasters*, which includes some of American government's most renowned boondoggles. Thus, the enterprise zone concept in the industrialized West was to "create mini-Hong Kongs" within blighted inner cities.

THERE MAY BE OTHER SOCIETAL CAUSES THAN DELETERIOUS GOVERNMENTAL POLICIES THAT CONTRIBUTE TO BLIGHT, BUT GOVERNMENT CAN ELECT TO REMOVE ANY UNNECESSARY BARRIERS, SUCH AS HEAVY TAX BURDENS, THAT IT HAS CONTRIBUTED TO CAUSING POVERTY, UNEMPLOYMENT, AND THE URBAN FLIGHT OF BOTH BUSINESSES AND WORKING-TAXPAYING RESIDENTS.

In Britain, Howe's elaboration of the concept came directly after Sir Keith Joseph, another leading Conservative politician, announced at a conference arranged by the Adam Smith Institute that when elected the next Conservative government would *experimentally* adopt and adapt Hong Kong's successful economic model to selected urban industrial (non-residential) parks and port areas, and establish "demonstration zones." Eventually, this policy came to fruition under Prime Minister's Margaret Thatcher's strong leadership.

In America, the concept expanded into targeting both blighted "urban and rural" areas, plus "business districts and residential neighborhoods." This vision was developed by Republican Jack Kemp, then a U.S. Representative from Buffalo, New York. Kemp was simultaneously formulating a policy at the federal level through his study of the U.S. income tax incentive program for Puerto Rico's industries, as Puerto Rico (once a dirt-poor island) developed into the economic powerhouse of the Caribbean, (relative to the other island-nations). For instance, Puerto Rico easily surpassed Fidel Castro's Cuba, which implemented Marxism and destroyed its capital incentives. Cuba developed a highly educated Marxist-socialist workforce, but in contrast to Puerto Rico, Cuban citizens had no jobs and Cuban businesses had no investment, due to the anti-capitalistic government, subsidized by the old communist Soviet Union. Also, Kemp reviewed and endorsed an insightful position paper in 1979 on "Enterprise zones" authored by Stuart Butler of the Heritage Foundation. Butler had emigrated from Great Britain and had connections with the British intellectual and political climate. He brilliantly summarized Howe's proposal and expounded upon a new initiative for stimulating economic development in America's blighted areas.

Energized and armed by recent events and his own innovative vision, Kemp introduced a bill in 1981 that was co-sponsored first by House Democrats Robert Garcia of the South Bronx and then by Charles Rangel of Harlem, New York, both of whom were concerned about worsening slums in their districts, which needed attention and innovative policies. Most policy-makers in both Great Britain and the United States were disappointed in the poor results of similar versions of Urban Renewal and Model Cities programs that *displaced* many of the poor. Instead these programs, intentionally or unintentionally, supported gentrification and redevelopment of downtown locations for the primary benefit of the middle and upper classes. Thus, enterprise zones gained support from both conservatives and liberals, but new significant legislation at the federal level was stalled throughout the 1980s at the federal level, although President Ronald Reagan did get a symbolic bill to pass in 1987 to keep the momentum going after his tax reform policy of stimulating economic growth (with a revenue-neutral tax package) had passed in 1986.

In contrast to the stalled legislation at the federal level in the 1980s and early 1990s, legislation *exploded* in the states and nearly three-fourths of the states adopted various enterprise zone programs and experimental initiatives. No two states duplicated the same or exact package of incentives, due to the unique differences between states. However, the *common thread between state programs was tax and financial incentives, along with some regulatory relief.* Some programs had various strong incentives and others had various weak incentives. Some programs were broad in scope and others were narrow in scope. Yet, all states adopted various strategies, goals, and objectives centered on revitalizing blighted areas.

IN CONTRAST TO THE STALLED LEGISLATION AT THE FEDERAL LEVEL IN THE 1980S AND EARLY 1990S, LEGISLATION EXPLODED IN THE STATES AND NEARLY THREE-FOURTHS OF THE STATES ADOPTED VARIOUS ENTERPRISE ZONE PROGRAMS AND EXPERIMENTAL INITIATIVES. NO TWO STATES DUPLICATED THE SAME OR EXACT PACKAGE OF INCENTIVES, DUE TO THE UNIQUE DIFFERENCES BETWEEN STATES. HOWEVER, THE COMMON THREAD BETWEEN STATE PROGRAMS WAS TAX AND FINANCIAL INCENTIVES, ALONG WITH SOME REGULATORY RELIEF.

In the 1990s, state programs have continued with nearly three-fourths of the states. Some states have allowed their programs to sunset and expire, some states have renewed previous legislation, and some states have implemented brand new programs. Ironically, Pennsylvania is proposing new legislation, yet its previous targeting of economic development initiatives in the 1980s and 1990s was considered by some policy analysts to be similar to enterprise zones. Therefore, some researchers included it while others did not when categorizing different states into those that did or did not have specific enterprise zone programs. The states that adopted enterprise zones most quickly were in the East, Midwest, and North regions of the United States, and these states tended to have the strongest programs. States in the South followed suit by implementing Enterprise Zone programs, but until recently, they had rather weak programs. States in the West have been the last to implement programs, and most Western states have not yet done so. The states that were the most serious about Enterprise zones tended to have Republican Governors as leaders, along with leading Democrats in the legislatures who were minorities representing impoverished districts and who were willing to risk supporting new initiatives on improving blighted communities.

Currently, the federal government has implemented a new Empowerment Zone and Enterprise Community program. The Clinton Administration was able to pass legislation and gain budget approval for the first round (Round I) of zones and communities. Across the nation, 106 zones and communities were activated about December 1994-January 1995. Nine full Empowerment zones were designated, including a combined Philadelphia/Camden zone (the only cross-border zone, or two zones in one) in Pennsylvania and New Jersey. Six were urban zones and three were rural zones. Two "supplemental" zones were added for urban areas, but these had lesser incentives than the designated urban zones. Recently, one of these supplemental zones became a full Empowerment Zone. Out of all Enterprise Community designations, 65 were urban communities, including Pittsburgh and Harrisburg in Pennsylvania, and 30 were rural communities, including Lock Haven in Pennsylvania. There will be another round (Round II) of 20 new full zone designations in with increased incentives. Existing Empowerment Zones are to receive *future* additional support, and existing Enterprise Communities will be allowed to compete, along with all localities and regions in an open application process, for the new full zone designation. Also, grant support for the cleaning up of environmental "brownfields," while creating "greenfields" or restoring business development, is an additional priority for the Empowerment Zone program.

IN A NUTSHELL, THE FEDERAL EMPOWERMENT ZONES PRIMARILY EMPHASIZE THE LEVERAGING OF FEDERAL GRANTS WITH A LOCAL COMMUNITY BOARD AT THE CENTER OF ECONOMIC DECISION-MAKING. CONVERSELY, IN A PURE SENSE, ENTERPRISE ZONES PRIMARILY EMPHASIZE REMOVING GOVERNMENTAL BARRIERS AND PROVIDING ECONOMIC INCENTIVES FOR CAPITAL FORMATION AND INVESTMENT, WHICH INCREASE JOB AND BUSINESS GROWTH.

In a nutshell, the federal Empowerment Zones primarily emphasize the leveraging of federal grants with a local community board at the center of economic decision-making. Conversely, in a pure sense, enterprise zones primarily emphasize removing governmental barriers and providing economic incentives for capital formation and investment, which increase job and business growth. This can best be illustrated by understanding the distinction between "Empowerment," which emphasizes the public sector, and "Enterprise," which emphasizes the private sector. Some states that call their programs "Enterprise" zones instead resemble an "Empowerment" zone approach. This shows the difference of emphasis in the public-private initiatives depending upon the legislation. Democrats tend to emphasize the "public empowerment" concept, and Republicans tend to emphasize the "private enterprise" concept.

The public empowerment approach is designed for local governmental entities to actively initiate deals with selected businesses to meet perceived community needs. Contrarily, the private enterprise approach is designed for government to implement strong economic incentives that produce substantial investments for all participating businesses in a potential market-based, growth-oriented community. The public empowerment approach puts more weight on strategic public planners, while the private enterprise approach puts more weight on dynamic economic forces. The public empowerment approach seeks to reinvent government as the steering wheel of targeted economic development, while the private enterprise approach seeks to unleash capital investment as the engine of powerful economic growth. The public empowerment approach places government in an "activist" role. The private enterprise approach places government in a "structural" role. The former makes government the "star player," while the latter makes government the "authoritative referee." Again, the current federal program is a mix of public and private incentives with *public grant subsidies in a heavily dominant role.* By definition and practical application, no program can be 50-50, as one approach must dominate the other. One approach *strengthens government's hand* in "cutting deals" with selected industries, while the other *lessens government's fist* of bureaucratic involvement and costly taxes in favor of "freeing up latent economic growth and innovation in a high risk depressed market." However, this does not discount a holistic approach to community development.

THE PUBLIC EMPOWERMENT APPROACH SEEKS TO REINVENT GOVERNMENT AS THE STEERING WHEEL OF TARGETED ECONOMIC DEVELOPMENT, WHILE THE PRIVATE ENTERPRISE APPROACH SEEKS TO UNLEASH CAPITAL INVESTMENT AS THE ENGINE OF POWERFUL ECONOMIC GROWTH...THE FORMER MAKES GOVERNMENT THE "STAR PLAYER," WHILE THE LATTER MAKES GOVERNMENT THE "AUTHORITATIVE REFEREE."

Recently, an impressive bipartisan federal bill on enterprise zones has been proposed by J. C. Watts (R-OK), James Talent (R-MO), and Danny Davis (D-IL) in the U.S. House of Representatives, along with companion bipartisan legislation by Spencer Abraham (R-MI) and Joseph Lieberman (D-CT) in the U.S. Senate. Republican Senator Rick Santorum of Pennsylvania has also been a staunch supporter of the Senate bill. These companion bills have similarities to Jack Kemp's original initiative, which is to stimulate community revitalization through *substantial* economic incentives, such as capital gains tax exemptions, to federally designated enterprise zones, whereas the existing Empowerment Zone program has rather *meager* economic incentives. Other incentives proposed in this legislation or splinter legislation have been: educational scholarships for school choice, increased charitable tax deductions, and support for drug treatment and counseling programs (including faith-based programs, which tend to be the ones that successfully change people's lives). Finally, in 1997 new federal legislation for the District of Columbia provided a special Washington Enterprise Zone with capital gains tax exemptions to increase capital investment, jobs, businesses, and economic development. This legislation has helped to pave the way for potential passage of the Watts-Talent and Abraham-Lieberman bills sometime in the near future, especially under the scenario of a federal budget surplus. This D.C. policy is separate and distinct from the current Empowerment Zone program.

SUCCESSES AND FAILURES OF ZONE PROGRAMS

The record is mixed on enterprise zone and empowerment zone programs. However, there are zones that clearly show success and others that clearly show failure. To review these diverse programs, it would be best to look at the best examples of zone programs that have conclusive results.

On the international level, Hong Kong is the *model* enterprise zone, with its unexpiring capital gains tax exemptions, (optional) flat income tax rate of 15%, and full expensing (income tax credits) of all capital equipment. Also, it has established a long-standing stable currency, which promotes minimal inflation and strong capital investment. Currently, Hong Kong has the "second highest *per capita* income in the world" (second only to the United States). During the first decade of the 21st Century, Hong Kong was estimated to rise above the United States and take over first place for *per capita* income, before it was taken over by the People's Republic of China in July 1997. Hong Kong is the *greatest* Enterprise Zone in the world, and the crowded islands became so without any major natural resources other than a port. The public policy of Hong Kong maximized free market principles in its democratic system of government. Unfortunately, China's governance could possibly harm this distinct entrepreneurial society. It is the unequaled, high value, capital incentives that has made Hong Kong the "greatest and most successful enterprise zone" in the world. In an attempt to turn Washington, D. C. into another Hong Kong, several capital incentives have been proposed, such as the 15% flat income tax rate, which did not pass. However, the capital gains exemptions have been implemented beginning 1998, so the special Washington, D. C. zone will be the most important of all federal zones in evaluating and influencing federal legislation.

ON THE INTERNATIONAL LEVEL, HONG KONG IS THE MODEL ENTERPRISE ZONE, WITH ITS UNEXPIRING CAPITAL GAINS TAX EXEMPTIONS, (OPTIONAL) FLAT INCOME TAX RATE OF 15%, AND FULL EXPENSING (INCOME TAX CREDITS) OF ALL CAPITAL EQUIPMENT. ALSO, IT HAS ESTABLISHED A LONG-STANDING STABLE CURRENCY, WHICH PROMOTES MINIMAL INFLATION AND STRONG CAPITAL INVESTMENT.

On the federal level, the chief difficulty has been having no empirical studies and only anecdotal results on the Empowerment Zone program. Another problem with the federal program is that it was intended to be combined with the state programs. However, the federal and state programs are essentially separate and uncoordinated with different boundaries and different participants. This has been a major failure, since the federal economic incentives are not substantial and the zones are primarily grant programs from the federal level to the local level. Therefore, the state zone programs could provide much needed capital incentives for business development and increased employment, yet there is essentially no coordination of the federal and state programs.

With anecdotal data, the Detroit Empowerment Zone is considered to be the model zone by the U. S. Department of Housing and Urban Development, yet it has mixed results. The success in Detroit is largely due to active local leadership by Mayor Dennis Archer and local city incentives combined with massive investment (about a billion dollars) by the Big Three auto makers and their corporate suppliers. Thus, Detroit is a unique federal zone, which could be successful with or without the federal program. Success stories in Baltimore seem be similar to, but less than that of Detroit's, as local leadership, local entities, and local incentives have created thousands of jobs in new industrial parks. At best, the two strongest federal programs, Detroit and Baltimore, seem to have only a small part of the success due to federal incentives, and the combined federal and state effort seems to be no part of the success. Finally, the federal program in Houston is a disaster, as no businesses participated during its first two years of existence. This is largely due to the minimal incentives for federal Enhanced Enterprise Communities. There is no coordination between the Houston federal and state zones, neither is there coordination with the federal Empowerment and Foreign Trade Zones. Houston is the number one city in the nation for the *per capita* creation of new businesses, yet the federal zone essentially does *not* participate in this economic success.

ON THE STATE LEVEL, MANY OF THE SUCCESSFUL ZONE PROGRAMS IN THE 1980S AND 1990S HAVE BEEN IN ILLINOIS, INDIANA, MISSOURI, NEW JERSEY, AND NEW YORK. THESE STATES ALL HAVE SUBSTANTIAL CAPITAL INVESTMENT, LABOR, AND FINANCE INCENTIVES. OVERALL, STATES WITH SUBSTANTIAL INCENTIVES HAVE TENDED TO SUCCEED, WHILE STATES WITH MODEST INCENTIVES HAVE TENDED TO FAIL.

On the state level, many of the successful zone programs in the 1980s and 1990s have been in Illinois, Indiana, Missouri, New Jersey, and New York. These states all have substantial capital investment, labor, and finance incentives. Overall, states with substantial incentives have tended to succeed, while states with modest incentives have tended to fail. Evansville, Indiana has been considered to be a model zone with its successful impact on increasing employment and business development. (In fact, Evansville had a drop of ten percentage points in unemployment over a five and a half-year period of time in the 1980s.) St. Louis, Missouri, and Harlem in New York City have undergone significant increases in employment and business development. Harlem has also emphasized reducing crime through 24-hour community policing, which has also been a substantial incentive in creating a positive business climate. Even though Illinois has had success in many cities and counties throughout the state, ironically, Chicago's three state zones have not had significant impacts, since only about 15% of the new hires are zone residents. New Jersey's program requires reinvestment of tax revenues into the infrastructure of the zones, and a cost-benefit analysis shows that the benefits are comparatively substantial.

Louisiana and Michigan have newer zone programs in the 1990s, which also have substantial incentives. National consultants Glick and Glick, Inc., recommend Louisiana as the best state enterprise zone program. However, Louisiana does not quite match Michigan's experimental and brand new "Renaissance Zones" program, which has full exemptions for most (but not all) state and local taxes. This is already stimulating major capital investment in a very short period of time. Over the next few years, Louisiana's and Michigan's experimental zones will stand out as two of the leading state programs for evaluation.

Oregon and Texas are two good examples of states with active but very modest programs. However, Portland, Oregon has had 67% of new hires from zone residents due to its formal and structured job placement and training network made up of over 200 private organizations and companies, and less than a dozen public agencies. Additionally, newly created Portland zone jobs pay $10 per hour on average with full benefits (retirement, health care, vacation, and sick leave). Texas has had limited success since it restricts the number of participating businesses (or projects) in the zones to three, with additional projects made available to localities that produce quality applications. Thus, the Texas zone program is too similar to a state grant program. On a limited positive note, a cost-benefit analysis in Texas shows that the benefits are relatively high compared to the costs. In the past, Texas has also experienced some abuses of its program, so it has never let it grow into a full incentive program.

OREGON AND TEXAS ARE TWO GOOD EXAMPLES OF STATES WITH ACTIVE BUT VERY MODEST PROGRAMS. HOWEVER, PORTLAND, OREGON HAS HAD 67% OF NEW HIRES FROM ZONE RESIDENTS DUE TO ITS FORMAL AND STRUCTURED JOB PLACEMENT AND TRAINING NETWORK MADE UP OF OVER 200 PRIVATE ORGANIZATIONS AND COMPANIES, AND LESS THAN A DOZEN PUBLIC AGENCIES...TEXAS HAS HAD LIMITED SUCCESS SINCE IT RESTRICTS THE NUMBER OF PARTICIPATING BUSINESSES (OR PROJECTS) IN THE ZONES TO THREE...

California is a state with two different zone programs, and both are modest programs. Ironically, South Central Los Angeles has a state zone located exactly where the 1992 riots (due to the acquittal of police officers in the Rodney King case) took place. Thus, this indicates a rather modest state program, since local (non-Asian) minority residents felt economically disenfranchised in the community.

Finally, a thorough scholarly review of successful and failed programs can be gained by studying the most impressive published research works on enterprise zones. These three publications provide, describe, and reference all of the numerous landmark studies. These recommended publications are: (1) a book entitled *Enterprise Zones: New Directions in Economic Development*, edited by Roy E. Green and published by Sage Publications, 1991; (2) a book entitled *The Impact of Enterprise Zones on Employment* by Terry Wm. Van Allen, published by Austin and Winfield Publishers, 1995; and (3) an article entitled "Tax and Spending Incentives and Enterprise zones," by Peter S. Fisher and Alan H. Peters, published by the *New England Economic Review*, March/April 1997. Another landmark book that does not provide data analysis, but provides the intellectual foundation of enterprise zones is entitled *Enterprise Zones: Greenlining the Inner Cities* by Stuart Butler published by Universe Books, 1981.

The first work edited by Green provides an individual chapter for each landmark study written by the author(s) of the research work. The chapters are essentially written by many of the intellectual giants at the time, including Stuart Butler who wrote the fourth book listed above. The second work by Van Allen provides a national study, plus a case study, showing the statistically significant successes and failures throughout the nation. Van Allen's work either reviews or references all major studies up to the early 1990s, plus his work provides the intellectual underpinnings for future research work. (Researchers at Carnegie Mellon University in Pittsburgh, Pennsylvania have stated that Van Allen's work is the most important to date, even if future studies will and should become the leading works with more and better data becoming available.) The third work by Fisher and Peters exclusively focuses on manufacturing, which is a major flaw for any broad-based evaluation; but more importantly, it reviews and references many of the most important scholarly studies in comparing its findings. This work does have some conflicts in conclusions with other major studies, but it was funded by the W. E. Upjohn Institute for Employment Research, which shows the seriousness of the research work.

THERE IS A HIGH CORRELATION BETWEEN CAPITAL INCENTIVES AND THE POSITIVE OUTCOMES OF INCREASED EMPLOYMENT AND BUSINESS DEVELOPMENT. STATES WITH LOCAL PROPERTY AND/OR STATE INCOME TAX INCENTIVES FOR BUSINESS TEND TO HAVE FAR GREATER SUCCESS THAN THOSE THAT DO NOT.

IDEAL ZONE CHARACTERISTICS

What are the *ideal* or preferred components or characteristics of an enterprise zone? There are several major or strong variables that determine success (and the lack thereof determine failure) for zone programs. The following sections will first discuss three items as major factors, and then a fourth item will review supplemental factors that contribute to success in various zone programs. These successful variables and factors constitute the *ideal* zone program:

1. CAPITAL INCENTIVES: There is a high correlation between *capital incentives* and the positive outcomes of increased employment and business development. States with local property and/or state income tax incentives for business tend to have far greater success than those that do not. This seems to be true, because property tax abatements and income tax exemptions/credits tend to have much higher capital values for business than all other incentives. *Capital is the life-blood of any dynamic economic renewal*, so these capital-based incentives have the greatest positive impact on enterprise zones, which, by definition, are *capital-starved* or *capital-deprived*, low-income areas. Again, capital is highly correlated to job growth, job income levels, business investment, and business development. This positive correlation between capital and economic development is true in every zone and non-zone (poor and wealthy) community in the nation.

Other capital incentives, such as sales tax reductions and low-interest loan guarantees, have a positive impact on economic development, but only when included in a *large package or combination of state and local incentives.* A large package or combination of incentives highly correlates to increased economic development. This is due to the fact that a large package or combination of incentives tends to have a high capital value for business.

It is also important to note that incentives *directly* for business will create jobs and stimulate business development. It takes business capital to create and retain jobs, and *good-paying* jobs. Contrariwise, incentives *directly for residents* may be important for social reasons, but unfortunately these incentives do not automatically create a high volume of jobs. However, these incentives do help the unemployed to compete better for jobs and help local residents overcome welfare dependency—as the most highly taxed individuals in America are the "working poor," who strive to overcome welfare dependency and improve their economic well-being for themselves and their families. The working poor often lose welfare and health benefits; yet they must pay social security, Medicare, and other taxes with low wages.

2. EXISTING AND EXPANDING FIRMS: There is a high correlation between the *expansion of existing* firms and the *creation of start-up* firms with the positive outcomes of job creation and business development. Between 55-66% of all job creation and business development is by *existing* firms that *expand* by utilizing the zone incentives. Between 21-31% of all job creation and business development is by start-up firms. Between 7-16% of all job creation and business development is by *relocating* firms. The least amount of zone activity is by *relocation*, yet large corporations are sought relentlessly by localities.

One of the biggest misnomers from advocates of historic and bureaucratic economic development programs is that localities should target a large corporation from the outside and lure them into the zone. Too much energy is wasted on going for a large corporation where one community gains while the other community loses in a zero-sum game. Too many zone programs fail due to the mesmerizing attraction of playing for the corporate home run or touchdown, when these large-scale corporate location opportunities are few and far between. If a large corporation shows an interest in *relocating* into a zone, then every effort should be made to assist the possible move.

ONE OF THE BIGGEST MISNOMERS FROM ADVOCATES OF HISTORIC AND BUREAUCRATIC ECONOMIC DEVELOPMENT PROGRAMS IS THAT LOCALITIES SHOULD TARGET A LARGE CORPORATION FROM THE OUTSIDE AND LURE THEM INTO THE ZONE. TOO MUCH ENERGY IS WASTED ON GOING FOR A LARGE CORPORATION WHERE ONE COMMUNITY GAINS WHILE THE OTHER COMMUNITY LOSES IN A ZERO-SUM GAME. TOO MANY ZONE PROGRAMS FAIL DUE TO THE MESMERIZING ATTRACTION OF PLAYING FOR THE CORPORATE HOME RUN OR TOUCHDOWN...

In reality, most large corporations make location decisions based on many market and non-market characteristics not possessed (with few exceptions) by most zones. However, the economic incentives by zone programs do make a major difference to *small and medium-sized firms*, especially start-up firms and those existing firms with the latent capacity to expand. Again, capital incentives help to unleash the *latent* abilities and existing resources within a zone. In priority order, the zone programs should focus on *existing* firms, then *start-up* firms, and lastly, *relocating* firms. The focus should also be on small to medium firms, unless large corporations *already exist* in the zone. This is true for *both* urban and rural areas.

3. TIME AND LONG-TERM COMMITMENT: There is a high correlation between the *time* or *duration* of the available incentives with the positive outcomes of job creation and business development. It takes time for jobs to be created and for business activities to develop, so a *long-term commitment* of available incentives is essential to success. Some zone programs have an immediate impact within months, but most zone programs take years to have a significant impact. On average, it takes about three years for a zone to a have a significant impact in a community. A statistical model designed with full strength incentives showed that a zone would need 12 years to equal the low unemployment rate in surrounding higher income areas. However, this was strictly a linear model, so it could take even longer if other factors influenced the zones and surrounding areas, such as when the percentage drop of unemployment becomes more difficult to achieve as the rates are narrowed. For instance, it would be easier for an unemployment rate to drop from a ratio of 15% to 14%, than it would be for an unemployment rate to drop from a ratio of 7% to 6%, since there are more people already working at the lower unemployment rates. In sum, over a significant period of time, substantial incentives do work ever so explosively or incrementally when utilized by zone programs to increase employment and business development.

OTHER POSITIVE FACTORS THAT INFLUENCE ZONE SUCCESS ARE MARKETING, TECHNICAL ASSISTANCE, AND JOB PLACEMENT AND TRAINING PROGRAMS. MARKETING IS MOST EFFECTIVE WHEN IT IS A PRIORITY OF A STRATEGIC PLAN FOR THE ZONE.

4. MISCELLANEOUS FACTORS: Other positive factors that influence zone success are *marketing*, *technical assistance*, and *job placement and training* programs. Marketing is most effective when it is a priority of a strategic plan for the zone. Many successful zone programs use all marketing tools as a top priority in a strategic plan, such as disseminating information through public meetings, brochures spelling out zone incentives and opportunities, and an information internet Web-site. Technical assistance is most effective when there is a prioritized *commitment of leadership* by the local mayor and entities involved within the zone. Many successful zone programs provide technical assistance to businesses seeking participation, as well as to public and private entities involved with activities in the zone. Job placement and training programs are most effective when private organizations, agencies, and companies are affiliated in a *formalized* or *structured* information network within the zone. Many successful zone programs have community colleges, which are crucial to providing technical skills training to local residents, plus "first source" hiring agreements with participating businesses, which are sometimes utilized to give greater opportunities to job applicants, who are local residents and clients in the affiliated network of job placement and training agencies.

Existing business owners who have not participated in zone programs, but are already located in the zones, cite several major reasons for their lack of participation. These major reasons are:

(A) they found that the incentives were *not* strong enough or attractive;
(B) they did *not* know about the incentives;
(C) they felt that the red tape was *too* difficult and costly in meeting application and reporting requirements; and
(D) they felt that incentives for hiring local residents were unattractive and did not offset the high personnel costs for training unskilled new hires, who also have high rates of absenteeism.

However, successful zone programs address most of these concerns in their state's legislation and administrative procedures, as is provided in the above listed *ideal* variables determining success:

(i) businesses do find substantial capital incentives and a large package or combination of state and local incentives to be strong and attractive, especially if they extend over a long period of time;
(ii) businesses are made aware of meetings;
(iii) businesses are given technical assistance for the application process and regulatory reporting, to reduce administrative paper work and accounting compliance costs; and
(iv) businesses are able to find local hires who have entry level or technical job skills, including life skills, through zone affiliated job placement and training programs.

...THE THREE STRONGEST... FACTORS THAT DETERMINE SUCCESS: (A) CAPITAL INCENTIVES FOR BUSINESS, (B) A LARGE PACKAGE OR COMBINATION OF STATE AND LOCAL INCENTIVES WITH HIGH CAPITAL VALUE, AND (C) A COMMITMENT OF AVAILABLE INCENTIVES EXTENDING OVER A SUBSTANTIAL PERIOD OF TIME.

Part "i" is by far the most important, as it includes the three strongest of the ideal variables or factors that determine success: (a) capital incentives for business, (b) a large package or combination of state and local incentives with high capital value, and (c) a commitment of available incentives extending over a substantial period of time. Parts "ii, iii, and iv" are important supplements in so far as part "i" is in place as the cornerstone and foundation of the zone program.

KEYSTONE OPPORTUNITY ZONES: PROGRAM OVERVIEW

When the Pennsylvania General Assembly reconvenes on September 28, the House will vote on HB 2328, the Keystone Opportunity Zones Act. This legislation will mandate the creation of twelve Keystone Opportunity Zones throughout Pennsylvania. Communities that wish to submit applications to become a Keystone Opportunity Zone (KOZ) must do so by December 31, 1998. The administrator of this initiative, the Pennsylvania Department of

Community and Economic Development (DCED), will designate all twelve zones by February 28, 1999. All tax incentives and abatements will be retroactive to January 1, 1999. Each zone will be comprised of no more than twelve sub-zones and the total aggregate of all twelve sub-zones can not exceed 5,000 acres. Each sub-zone must contain a minimum of twenty acres in an urban area and ten acres in a rural area.[1] The sub-zones may or may not be contiguous to each other. However, all of the land within a subzone must be contiguous, and an entire KOZ may not be contiguous to another Zone. In addition, a KOZ may not contain an entire political subdivision, i.e. county, municipality, or school district.

PENNSYLVANIA'S KEYSTONE OPPORTUNITY ZONES ARE DESIGNED AS THE NEXT GENERATION OF ENTERPRISE ZONES, WITH THE INTENDED PURPOSE OF REBUILDING AND REVITALIZING SOME OF THE COMMONWEALTH'S MOST DISTRESSED AND DILAPIDATED COMMUNITIES... FOR THOSE BUSINESSES WILLING TO RELOCATE TO A COMMUNITY THAT IS EXPERIENCING NO GROWTH, THE STATE AND LOCAL GOVERNMENTS WILL PROVIDE A VIRTUALLY TAX FREE ENVIRONMENT.

Pennsylvania's Keystone Opportunity Zones are designed as the next generation of enterprise zones, with the intended purpose of rebuilding and revitalizing some of the Commonwealth's most distressed and dilapidated communities. These twelve zones are intended to entice businesses and new residents into communities through numerous tax incentives or abatements. For those businesses willing to relocate to a community that is experiencing no growth, the state and local governments will provide a virtually tax free environment.

CRITERIA FOR KEYSTONE OPPORTUNITY ZONE APPLICATION

There are twelve main criteria that the Department of Community and Economic Development will use for evaluation of the KOZ applications. A proposed zone must meet at least two of the following criteria to qualify:

1. At least 20% of the population is below poverty level
2. The unemployment rate is 1.25 times the statewide average.
3. At least 20% of all real property within a five-mile radius of the proposed KOZ or sub-zone in a non-urban area is underutilized or deteriorated.
4. At least 20% of all real property within a one-mile radius of the proposed KOZ or sub-zone in an urban area is underutilized or deteriorated.
5. At least 20% of all occupied housing within a two-mile radius in a non-urban area is deteriorated.
6. At least 20% of all occupied housing within a one-mile radius in an urban area is deteriorated.
7. Urban area: The median family income is 80% or less of the median family income for that metropolitan statistical area.

[1] The legislation gives DCED the permission to wave the twenty-acre requirement for rural (non-urban) areas. The DCED application guidelines have established that all rural areas must have a minimum of ten acres in each of their subzones.

8. Non-urban area: The median family income is 80% or less of the non-MSA statewide median family income.
9. Population loss exceeds 10% in an area that includes the proposed zone and its surrounding area.
10. The area has experienced a severe job loss.
11. At least 33% of the real property (in a non-urban area) would remain underdeveloped or non-performing due to physical characteristics of the real property.
12. The area has substantial real property with adequate infrastructure and energy to support new or expanded development.

In addition to meeting two of the previous twelve criteria, other factors to be considered include:

1. Evidence of distress (including, but not limited to, unemployment, percentage of population below 80% of the State median income, poverty rate, deteriorated property and adverse economic and socioeconomic conditions).
2. Strength and viability of proposed goals, objectives and strategies included in the opportunity plan.
3. Creativity and innovation of the opportunity plan, compared to other application.
4. Local public and private commitment to the development of the zone and cooperation of surrounding communities.
5. Existing resources available.
6. How the KOZ and economic redevelopment relate to other current economic and community development projects and regional initiatives or programs.
7. How the local regulatory burden will be alleviated.
8. Proposals for educational opportunities and improvement.
9. Crime statistics and proposals for crime reduction.
10. Proposals for linking job creation and training.
11. All political subdivisions participating in the application process must pass an ordinance or resolution (effective on or before January 1, 1999) that exempts or provides deductions, abatements or credits to qualified persons and businesses from local taxes. If the political subdivision is designated as part of a KOZ, the resolution/ordinance will be binding and non-revocable for the duration of the opportunity plan.
12. The Department of Economic and Community Development shall define "urban area" for the purposes of receiving applications and designation of KOZ.

ALL POLITICAL SUBDIVISIONS PARTICIPATING IN THE APPLICATION PROCESS MUST PASS AN ORDINANCE OR RESOLUTION (EFFECTIVE ON OR BEFORE JANUARY 1, 1999) THAT EXEMPTS OR PROVIDES DEDUCTIONS, ABATEMENTS OR CREDITS TO QUALIFIED PERSONS AND BUSINESSES FROM LOCAL TAXES. IF THE POLITICAL SUBDIVISION IS DESIGNATED AS PART OF A KOZ, THE RESOLUTION/ORDINANCE WILL BE BINDING AND NON-REVOCABLE FOR THE DURATION OF THE OPPORTUNITY PLAN.

Included in the application process is a report on youth at risk including health, welfare and education issues. The application will also state the proposed duration of the zone, as well as binding ordinances or resolutions from every political subdivision located within the proposed zone describing the exemptions, deductions, abatements or credits that will be provided. The application must also include a comprehensive opportunity plan, which will include:

THE APPLICATION WILL ALSO STATE THE PROPOSED DURATION OF THE ZONE, AS WELL AS BINDING ORDINANCES OR RESOLUTIONS FROM EVERY POLITICAL SUBDIVISION LOCATED WITHIN THE PROPOSED ZONE DESCRIBING THE EXEMPTIONS, DEDUCTIONS, ABATEMENTS OR CREDITS THAT WILL BE PROVIDED.

1. A detailed map of proposed opportunity zone which includes:
   - all sub-zones
   - geographic boundaries
   - total area
   - current conditions and use of land and structures
2. Evidence of support from:
   - local government
   - school districts
   - educational institutions
   - business groups
   - community organizations
   - the general public
3. A detailed proposal stating the purpose of the designation as a KOZ which includes:
   - an increase in economic opportunity
   - reduction of crime
   - improvements to education
   - infrastructure improvements
   - reduction of regulations
   - identification of potential jobs and training opportunities
   - a statement describing if zone is located in area which has tax revenue dedicated to payment of debt
4. Description of current social, economic and demographic characteristics and examination of the anticipated improvements in:
   - education
   - health
   - human services
   - public safety
   - employment
5. Description of anticipated activity in the zone to include:
   - industrial site reuse
   - industrial use
   - commercial or retail use
   - residential use
6. Evidence of potential public and private investment

7. Role of proposed zone in regional economic and community development
8. Plans for utilizing existing resources in the administration of the KOZ

INCENTIVES OFFERED BY KEYSTONE OPPORTUNITY ZONES

It is anticipated that by offering an enticing package of tax incentives to residents and businesses within a KOZ, these new residents and businesses will economically revitalize the community. The act provides significant tax relief for both businesses and residents of the opportunity zone. Residents of the zone will be exempt from state income taxes. A resident of a KOZ will be allowed exemptions for:

IT IS ANTICIPATED THAT BY OFFERING AN ENTICING PACKAGE OF TAX INCENTIVES TO RESIDENTS AND BUSINESSES WITHIN A KOZ, THESE NEW RESIDENTS AND BUSINESSES WILL ECONOMICALLY REVITALIZE THE COMMUNITY. THE ACT PROVIDES SIGNIFICANT TAX RELIEF FOR BOTH BUSINESSES AND RESIDENTS OF THE OPPORTUNITY ZONE.

1) Compensation received during the time period when the person was a resident of the KOZ.
2) Net income from the operation of qualified business received by a resident or a nonresident of the KOZ. If that net income is attributable to business activity conducted within a KOZ.
3) Net gains or income (less net losses) on the sale, exchange or disposition of real or tangible property located in the KOZ.
4) Net gains (less net losses) realized by a resident of KOZ from the sale, exchange or disposition of intangible personal property or obligations issued after February 1, 1994 by: the Commonwealth, a public authority , commission, board or other Commonwealth agency, political subdivision or authority created by a political subdivision or by the Federal Government.
5) Net gains or income derived from or in the form of rents received by a resident or nonresident of a KOZ, to the extent that income or loss from the rental of real or tangible property is allocable to a KOZ.
6) Dividends received during the time a person was a resident of a KOZ.
7) Interest received during the time a person was a resident of a KOZ.
8) Net gains or income derived from estates or trusts by a resident of a KOZ.

Businesses located within a KOZ will receive tax incentives as well. These incentives will come from the local and state levels. The incentives include:

1) **Retail Sales Tax**
Exemption from retail sales tax for services and tangible property (other than motor vehicles). The property/services must be bought by a qualified business for their exclusive use, consumption, and utilization at its facility located within a KOZ.

Limitation: Goods that are sold by a business in the zone are not exempt from sales tax. Goods bought by businesses for use or consumption outside of the zone are not exempt from sales tax.

BUSINESSES LOCATED WITHIN A KOZ WILL RECEIVE TAX INCENTIVES AS WELL. THESE INCENTIVES WILL COME FROM THE LOCAL AND STATE LEVELS.

2) **Income Taxes**
All corporate net income taxes are waved for the duration of the zone.

3) **Capital Stock Franchise Tax**
All capital stock franchise taxes are waved for the duration of the zone.

Limitation: Any portion of income that is attributable to the operation of a railroad, truck, bus or airline company, pipeline or natural gas company or a water transportation company.

4) **Real Property Tax**
All local property taxes are abated for the duration of the zone. (There are many restrictions and formulas involved with this exemption that are too numerous to discuss at this time.)

5) **Local earned income, net profit and business privilege taxes**
Businesses operating in KOZs are exempt from all local income taxes, net profit taxes and business privilege taxes.

6) **Mercantile License Tax**
Any and all mercantile taxes are waved.

7) **Local Sales and Use Tax**
Local sales and use taxes are exempt in the same manner as the state sales and use taxes. However, the exemption applies to the sale of building machinery or equipment to a qualified business or to a construction contractor for use within a KOZ.

RESIDENCY REQUIREMENTS

In order for a business or resident to take advantage of the tax abatements within a KOZ, certain residency requirements must be met. In order for a resident to qualify for any tax exemptions, deductions, abatements or credits, a person must reside in the KOZ for 184 consecutive days. This period may begin on a date determined by the DCED, or on the date the person first resides within the zone.

There are similar, yet more extensive, requirements for businesses:

IN ORDER FOR A BUSINESS OR RESIDENT TO TAKE ADVANTAGE OF THE TAX ABATEMENTS WITHIN A KOZ, CERTAIN RESIDENCY REQUIREMENTS MUST BE MET. IN ORDER FOR A RESIDENT TO QUALIFY FOR ANY TAX EXEMPTIONS, DEDUCTIONS, ABATEMENTS OR CREDITS, A PERSON MUST RESIDE IN THE KOZ FOR 184 CONSECUTIVE DAYS.

1) In order to qualify for a tax deduction, exemption, abatement or credit, a business must own or lease real property in the zone. From this property, the business must actively conduct a trade, profession or business.
2) The qualified business must receive certification from the Department of Economic and Community Development. The department will certify that the business is located, and is in the active conduct of trade, profession or business, within the zone.
3) The business will have to receive annual renewal of their certification.
4) Any business that relocates from outside a KOZ into a KOZ will not receive any of the exemptions, deductions, abatements or credits unless:
    a) The business increases full-time employment by at least 20% in the first full year of operation within the KOZ.

OR

    b) The business makes a capital investment in the property located within the KOZ equivalent to 10% of the gross revenues of that business in the immediately preceding calendar or fiscal year.

PENNSYLVANIA'S PROPOSED ZONES: MAJOR IMPACT INCENTIVES

As noted in the introduction of this report, the proposed state "Keystone Opportunity Zones" program is a dynamic piece of legislation. There are several components of the bill that are close to ideal in formulating an economic revitalization program in low-income areas. First of all, the capital incentives necessary to significantly increase employment and business development are very strong. Incentives available to qualified zone businesses are substantial state corporate net income tax credits, state capital stock franchise tax credits, state and local sales and use tax exemptions, and local mercantile license tax and fee waivers. Substantial local property tax abatements could be a vital incentive for the qualified zone businesses, if the serious design flaw in the property tax abatement is improved. A large combination of state and local incentives is available in this package. The exclusions in any of these incentives, (such as sales taxes on motor vehicles and corporate taxes for transportation and utility companies cannot be exempted), are relatively minor in comparison to the overall capital incentives. An additional capital finance incentive is the low-interest loan guarantee program. Thus, the program provides many of the essential and substantial capital incentives to business, and this makes the "Keystone Opportunity Zones" bill one of the strongest in the nation, especially if the serious design flaw in the property tax abatement (a major incentive) is improved.

...THE PENNSYLVANIA PROPOSED PROGRAM IS SIMILAR TO MICHIGAN'S IN PROVIDING LARGELY TAX FREE ZONES... BUT THE STATE OF PENNSYLVANIA DOES NOT REIMBURSE OR COMPENSATE THE ZONE LOCALITIES FOR ABATED PROPERTY TAX REVENUE FOR SCHOOLS AND LIBRARIES. ALTHOUGH IT HAS MANY STRONG COMPONENTS, PENNSYLVANIA'S PROPOSED ZONE PROGRAM WILL EXPERIENCE PROBLEMS AT THE LOCAL LEVEL UNLESS THE LEGISLATURE CORRECTS THIS FLAW.

PROPERTY TAX ABATEMENT

Although the bill's language is somewhat unclear on property tax abatements for specific "deteriorated" (or dilapidated) properties versus general deteriorated areas and *all* properties in a zone, there is a "much more serious flaw" with the design of the property tax abatement. The proposed Pennsylvania "Keystone Opportunity Zones" program is designed to be very similar to the Michigan "Renaissance Zones" program, which is a strong state zone program. The Michigan zones are largely tax free (with the exceptions of state sales taxes and local bond levies), however, the State of Michigan reimburses or compensates all zone localities (dollar per dollar) for all *abated* local property tax revenue for schools and libraries. This is essential to the success of the zone program, since there is *no* revenue shortage for schools and libraries at the local level. In contrast, the Pennsylvania proposed program is similar to Michigan's in providing largely tax free zones (and includes sales tax exemptions, which the Michigan program does not provide), but the State of Pennsylvania does *not* reimburse or compensate the zone localities for *abated* property tax revenue for schools and libraries. Although it has many strong components, *Pennsylvania's proposed zone program will experience problems at the local level unless the legislature corrects this flaw.*

In essence, there are two ways to deal with the design flaw. The first and easiest solution is to duplicate and add the Michigan *reimbursement* or *compensation* (state to local transfer of revenue) component for abated property tax revenues for schools and libraries. The second and better solution is to provide property tax abatements on capital *improvements* only, such as renovation and new construction.

The first solution of compensating localities for property tax abatements has the disadvantage of compelling localities to design very restrictive zone boundaries to very small areas of deteriorated and dilapidated and unutilized properties.

This is due to the fact that it is politically difficult to give a full property tax abatement to one existing business, while across the street or down the road other existing businesses do not receive the large tax incentive. It is also due to the fact that the state legislature will not want to make large transfers of (grant-like) revenue to compensate localities for uncollected revenues from existing businesses, whereas dilapidated properties already have little tax revenue to abate, thereby causing little need for compensation in a state to local transfer of revenue. The result is likely to be the restrictive targeting of outside large firms with the design of attracting them to relocate to deteriorated properties, thereby excluding many existing businesses in low-income areas where *most of the jobs are created through business expansion* in zone programs throughout the nation.

However, Pennsylvania's zone program is designed to stimulate the growth of a community through an influx of new residents and businesses. The legislation should address the impact that the non-taxpaying residents and businesses will have on a community's tax base, due to the fact that these new residents and businesses will be consuming public services past their current levels and may even require additional services. Pennsylvania's zones must be prepared to handle the increase in public utilities and transportation services in order to ensure that the program runs as efficiently and effectively as originally proposed.

...THE LEGISLATION SHOULD ADDRESS THE IMPACT THAT THE NON-TAXPAYING RESIDENTS AND BUSINESSES WILL HAVE ON A COMMUNITY'S TAX BASE, DUE TO THE FACT THAT THESE NEW RESIDENTS AND BUSINESSES WILL BE CONSUMING PUBLIC SERVICES PAST THEIR CURRENT LEVELS AND MAY EVEN REQUIRE ADDITIONAL SERVICES.

The second solution of abating property taxes for capital *improvements* enables localities to target not only severely deteriorated properties and a wide range of existing businesses, but will also limit the impact that the residents and businesses within a zone will have on public services. Except for Michigan, all of the other states that provide property tax incentives for zones have designed their programs in this manner. In other states, these property tax abatements on capital improvements are decrementally phased out over a period of time. Therefore, the participating, existing, and expanding businesses will provide substantial property tax revenues on the existing property values, plus substantial and incremental future tax revenues on capital improvements, and no transfer of revenue from the state to the localities is required. It is important to note that it is the existing businesses that provide the only substantial property tax revenues in low-income areas, so this is a good base for building upon existing resources. Another important note is that incentives for capital improvements have the advantage of stimulating not only existing businesses, but small and medium-size start-up firms to develop in *non-dilapidated* properties that require only smaller-scale renovations or expansions. A third important note is, ideally, the Pennsylvania zone program should decrementally abate property taxes on capital improvements over twelve years with the first three years abated at 100% and then reduced 10% each year. This enables businesses with major capital needs to receive strong incentives for improvements, especially at the beginning or first few years of the investment.

Portland, Oregon provides a good example for preferring the approach of providing property tax abatements on capital improvements. The North/Northeast Portland Enterprise Zone was designated to include many strong existing businesses, such as Nabisco and Blue Bell, in its low-income area. Both companies invested in, renovated, and expanded their existing facilities and operations thereby creating hundreds of new jobs for local residents due to the property tax incentives. Both companies were existing strongholds in the low-income area. Both companies already provided significant property tax revenues for the community, and will provide increased tax revenues in the future. Both companies have substantially added to the economic well being of local residents. In sum, both companies are successful zone activities.

The most important point is that a zone should provide strong economic incentives and be designed to promote the successful *expansion* of as many *existing* businesses as possible, especially those businesses that have operated for many years in *undeteriorated* properties while operating in low-income areas. It is the *existing* businesses that become *expanding* businesses, which create many more jobs than start-up and relocating businesses in state zone programs throughout the nation. It is these legitimate and existing businesses with community roots that are often a blighted community's greatest "existing resource," and these existing businesses are the stronghold for the community in hiring local residents, in expanding economic opportunity, and in providing wholesome community leadership (through the business owners, who are often local residents) for civic outreach programs to youth, the aged, and throughout the community.

THE MOST IMPORTANT POINT IS THAT A ZONE SHOULD PROVIDE STRONG ECONOMIC INCENTIVES AND BE DESIGNED TO PROMOTE THE SUCCESSFUL EXPANSION OF AS MANY EXISTING BUSINESSES AS POSSIBLE, ESPECIALLY THOSE BUSINESSES THAT HAVE OPERATED FOR MANY YEARS IN UNDETERIORATED PROPERTIES…IN LOW-INCOME AREAS. IT IS THE EXISTING BUSINESSES THAT BECOME EXPANDING BUSINESSES, WHICH CREATE MANY MORE JOBS THAN START-UP AND RELOCATING BUSINESSES IN STATE ZONE PROGRAMS THROUGHOUT THE NATION.

ADDITIONAL COMPONENTS

There are many other significantly strong points in the bill. There are personal income tax exemptions (as well as personal property, rental property, interest, and dividend exemptions), for all zone residents. The personal income tax exemptions have strong benefits in improving the economic well being of zone residents and their families, and in assisting zone residents to rise above welfare dependency and poverty. Designations and incentives are available for up to 12 years, and provide a long-term commitment of time to produce positive results. A strategic opportunity plan with a map for targeted boundaries is required of and formulated by locally governed applicants in a coordinated agreement of binding ordinances and resolutions. This is crucial to designing a zone that includes as much existing low-income demographics (businesses and residential areas) as possible. The designation criteria requires the specific targeting of poverty and economic distress. Important additional criteria focuses on vital local measures, such as reducing crime, improving job training and educational opportunities, reducing regulatory burdens, utilizing existing resources, and actively marketing the zone along with a technical assistance program for all private and public organizations associated with the zone. All of these factors are important building blocks that comprise an ideal zone program.

Other supplemental points that strengthen the bill are the criteria for businesses relocating inside and outside of the zone, the withholding tax provisions and reporting mandates, and a one-time initial grant to activate each opportunity plan. Requiring qualified businesses that relocate into the zone to increase full time employment by 20% or to increase capital investment by 10% helps to limit the focus of large companies only on a few possible relocating firms, while the zone program primarily keeps the focus on existing and start-up firms, especially small to medium firms, which comprise the greatest potential increases of employment and business development. Requirements on employers and employees for tax withholding notification provisions and reporting mandates are something that few state zone programs proscribe or prescribe. This data is extremely useful in evaluating the outcomes of the zones on residents and businesses. The grants provide more of a bureaucratic empowerment approach by subsidy, but a one-time initial supplement for managing, marketing, technical assistance, and assisting with all zone activities could be useful, since the local management of zones is seriously neglected and unfunded in most state programs. Only providing 12 zones (plus subzones) for a large state such as Pennsylvania is a flaw or limitation of the bill. However, it is better to concentrate on and be serious about 12 zones with strong incentives and provisions, than to provide a meager or modest program with dozens of weak zones scattered throughout the state.

OTHER SUPPLEMENTAL POINTS THAT STRENGTHEN THE BILL ARE THE CRITERIA FOR BUSINESSES RELOCATING INSIDE AND OUTSIDE OF THE ZONE, THE WITHHOLDING TAX PROVISIONS AND REPORTING MANDATES, AND A ONE-TIME INITIAL GRANT TO ACTIVATE EACH OPPORTUNITY PLAN.

Another point is that there is no mention in the proposed legislation of coordinating efforts with the federal Empowerment Zone and Enterprise Community designations, four of which are located in Pennsylvania. This is probably unnecessary to include in the bill since no preferences for named locations should attempt to be legislated, as this may cause conflicts between legislators representing different districts. It is also better to have a competitive and open application process. The political subdivisions of the zones should already be involved with the federal programs in coordinating efforts to revitalize blighted areas where applicable. However, since most localities in most states do not coordinate federal and state zone efforts where possible, it is worth noting this particular need in this report.

CONCLUSION

In sum, the "Keystone Opportunity Zones" concept is generally sound, but it will have a better chance of success if *the property tax abatement is redesigned in a positive way*. The bill should also require that the State reimburse the local zone entities for all abated property tax revenues for schools and libraries, such as in the experimental Michigan "Renaissance Zones" program, or (preferably) it should provide property tax abatements on "capital improvements only," such as is *successfully* done in many states across the nation. If the specific legislative language is modified in such a manner that will address these potential problems, it will help to avert any missteps with the implementation of the zone program, and strengthen the zone program's potential for revitalizing blighted areas in Pennsylvania.

...THE "KEYSTONE OPPORTUNITY ZONES" CONCEPT IS GENERALLY SOUND, BUT IT WILL HAVE A BETTER CHANCE OF SUCCESS IF THE PROPERTY TAX ABATEMENT IS REDESIGNED IN A POSITIVE WAY.