OPLA RESEARCH REQUEST MEMO

To: Rachel Olson, Legislative Analyst, IDEA Committee
From: Kristin Brawn, Legislative Researcher
Date: March 31, 2021
RE: Other States' Programs Similar to Maine's Pine Tree Development Zones and the Effectiveness/Success of Those Programs

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Hi Rachel,

You asked me to research programs in other states similar to the Pine Tree Development Zone program and the effectiveness and/or success of those programs. Below is brief overview of each of the enterprise zone programs in Connecticut, Indiana and Maryland and reports and evaluations regarding those programs. In addition, I have also found an article regarding academic analyses and articles on the effectiveness of state enterprise zones in general, which is also summarized below.

I. Enterprise Zone Programs in Other States

According to information from the National Conference of State Legislatures (NCSL), currently 41states and the District of Columbia allow enterprise zones; however, five of these states (Arkansas, Kentucky, New Mexico, Rhode Island and Virginia) have repealed or expired previous programs. Information regarding the enterprise zone programs and their effectiveness in three of these states, Connecticut, Indiana and Maryland, is detailed below.

A. Connecticut

1. Program Overview

Connecticut was the first state to enact enterprise zones in 1981. According to a 2020 report by the Connecticut Office of Legislative Research, there are currently 18 designated enterprise zones in the state and one designation pending. There are 10 types of zone designations, including zones targeted to attract biotechnology businesses, manufacturing and businesses interested in redeveloping land around underutilized and abandoned railroad depots. Benefits to businesses that start up or improve real property in enterprise zones include:

- A five-year, 80% property tax exemption for improving or acquiring "manufacturing facilities" and acquiring machinery and equipment. The state generally reimburses the municipality for half the forgone property tax revenue, depending on available funding (CGS §12-81(59) and (60)).
- A seven-year property tax exemption (100% in first two years, 50% in third and a decrease in 10% in each of the remaining four years), with no state reimbursement, for commercial and residential real property improvements that do not qualify for the 5-year, 80% exemption (other than improvements to manufacturing facilities) (CGS §32-71).
- Corporate tax credits were also available, but legislation in 2018 ended the corporate business tax credit benefits.

2. Program Reports/Evaluations

A 2020 report by the Connecticut Office of Legislative Research states that research on the economic impact of Connecticut's enterprise zones is limited. The report cites a 1997 Program Review and Investigations (PRI) study which concluded that the enterprise zone program was meeting two of its goals (increasing private investment and expanding the local tax base), but it was unclear if it was meeting the other two goals (increasing jobs and reducing property abandonment). When PRI staff interviewed program participants, they found that people generally believed the zones were an important economic development tool and provided a "psychological boost" to businesses in the area and looking to relocate there. However, some participants said the incentives were less of a draw to the zone than other factors, such the area's manufacturing talent. PRI concluded that the program's outputs mostly outweighed their costs, in large part because the program's cost was not very high. However, they were unable to link any economic growth directly to incentives provided under the program and noted that areas that experienced growth may have done so without enterprise zone incentives.

The report also cites the state's Department of Economic and Community (DECD) 2019 annual report which includes an analysis of the enterprise zone program. The annual report states that between 2014 and 2018, the DECD certified an annual average of 41 new companies as eligible for enterprise zone benefits, and the program averaged $4,498,173 in claimed abatements for newly certified investments per year with an average associated investment value of $111,098,024 over the time period. Using a tax model for the period from October 2018 through September 2019, the DECD reported a positive economic impact for new investments in the enterprise zone program, estimated to be over $4 earned for each dollar the state contributed to the program for investments.

B. Indiana

1. Program Overview

Indiana's enterprise zone program (IC 5-28-15) was established in 1983 and allows enterprise zones to be located in municipalities or on closed military bases. There are currently 19 enterprise zones in the state. The following incentives are offered to enterprise zone businesses:

- An employment expense state tax credit equal to the lesser of 10% of the qualified increase in wages paid to employees of an enterprise zone business or $1,500 per qualified employee. A qualified employee must live in an enterprise zone and work at least 50% of the time in an enterprise zone, and 90% of the employee's services must be directly related to the enterprise zone business. (IC 6-3-3-10).
- A state tax credit for interest income earned from a loan that directly benefits an enterprise zone business, increases enterprise zone property values or is used to rehabilitate, repair or improve an enterprise zone residence. The credit is equal to 5% of the loan interest received during the year (IC 6-3.1-7).
- A state tax credit for a purchase of an ownership interest in a business located in an enterprise zone. The credit is based on a statutory percentage determined by the Indiana Economic Development Corporation multiplied by the price of the qualified investment, not to exceed 30%. (IC 6-3.1-10).
- For qualified employees of enterprise zone businesses, a deduction from the employee's gross adjusted income equal to the lesser of 50% of the adjusted gross income for the taxable year or $7,500 (IC 6-3-2-8).

2. Program Reports/Evaluations

A 2016 evaluation report of state tax incentives by the Indiana General Assembly's Office of Fiscal and Management Analysis examines the effect of the enterprise zone program tax incentives on economic development. The report finds that all firms receiving enterprise zone tax incentives tend to create jobs; however, there tends to be no employment effect for firms receiving a very high amount (above $500,000) based on statistics. The results of the analysis also suggest that employment tends to rise only for firms receiving up to $20,000, and any tax savings beyond that tends to have a negative effect on employment. The report states that this finding suggests that firms may be substituting capital for labor in the form of building renovation or capital equipment purchase, as enterprise zone businesses are required to show reinvestment of their tax savings into the business. The analysis also finds that in regard to small firms (fewer than 50 employees) small businesses tend to create jobs at tax savings below approximately $93,000, and any tax savings beyond that threshold tends to cause a decline in employment.

C. Maryland

1. Program Overview

Maryland's enterprise zone program (Md. Economic Development Code Ann. §§5-701 to 5-709) was established in 1982. As of December 2020, in the state, there are 36 enterprise zones located in 17 counties and the City of Baltimore. Businesses that move into or locate in an enterprise zone may benefit from the following incentives:

- An income tax credit for up to $3,000 of the wages paid to each qualified employee who is an economically advantaged individual or up to $1,000 of the wages paid to each qualified employee who is not an economically disadvantaged individual. The credit can be taken over a one- to three-year period. (Md. Tax-General Code Ann. §10-702).
- A 10-year property tax credit against local real property taxes. The credit is applied to the tax imposed on 80% of the eligible assessment during the first five years and decreases by 10% annually to 30% in the final year. Within a focus area that meets certain disadvantaged economic statutory criteria, a business can receive the 80% credit for the full 10-year period (Md. Tax-Property Code Ann. §9-103).

2. Program Reports/Evaluations

A January 2021 report from the Maryland General Assembly Department of Legislative Services (DLS) evaluates the state's Enterprise Zone Tax Credit Program and makes several findings and recommendations to improve the program's effectiveness. DLS finds that the design and implementation of the enterprise zone program, particularly its poorly designed criteria, prevents the program from reaching its objectives by:

- Reducing its cost effectiveness by not focusing economic activity in the most distressed areas, which are the most likely to not occur in the absence of an incentive;
- Contributing to the continual expansion of the program, which increases the program's fiscal cost; and
- Failing to provide job opportunities for community residents for whom the program is implemented and tax credits are intended to benefit.

Based on these findings, DLS makes the following recommendations in the report:

- Given the overlap of the enterprise zone program with other tax incentive, DLS recommends that the General Assembly should require the Department of Commerce and the Department of Labor to submit a report to the Assembly by December 31, 2021 on consolidating the enterprise zone program with several other state credit tax programs.
- If the General Assembly, in light of the findings from the report, decides not to consolidate the enterprise zone program, DLS makes the following recommendations to improve the effectiveness of the program:
    - Statutory changes that will improve the likelihood that residents in enterprise zones and enterprise zone communities, particularly those that are in poverty and/or chronically

unemployed, can gain employment within enterprise zones. These statutory changes should also propose methods by which other State and local programs that seek to improve job skills and educational attainment levels, such as job training programs, can be better coordinated with the enterprise zone tax credit.

- Statutory changes to the enterprise zone income tax credit that will reduce administrative burdens and help increase the employment of enterprise zone community residents.
- Statutory changes that will provide for evaluation criteria that must be considered before an enterprise zone may be expanded. These criteria should include restrictions on the size of any expansion.
- Statutory changes that establish new criteria that determine the areas of the State that can be designated as an enterprise zone. The criteria should include multiple measures and prevent areas that are not economically distressed from qualifying for program tax credits.
- Adoption of formal metrics and a framework for analyzing the cost effectiveness of each enterprise zone and the effectiveness of each zone in attracting businesses and increasing employment. The framework should identify clear outcomes and determine quantifiable measures, which could include project evaluation, employment trends, impacts on poverty and population, private-sector investment in communities, and overall community revitalization.
- Adoption of procedures to facilitate accurate collection of enterprise zone data to enable evaluation of the program.

II. Academic Articles and Reports on Enterprise Zones

Academic reviews and analyses of the effectiveness of enterprise zones over the past four decades have produced mixed results. A 2019 study by Hooton and Tyler (attached) reviewed 61 pieces of research that conducted empirical evaluations of enterprise zones or reviewed empirical research with an overall conclusion on enterprise zone effectiveness, and found that 46% of the studies reached a positive overall conclusion on the effectiveness of enterprise zones, 26% concluded enterprise zones were unsuccessful/ineffective and 28% concluded enterprise zones had mixed impacts. However, the authors noted that this breakdown was an oversimplification, as many of the individual reports examined multiple case studies and multiple outcomes. Of the studies that specifically examined employment impacts, the authors found that 58% of the studies found enterprise zone programs to be effective, while 11% found them to have negative impacts, and another 26% found them to be simply unsuccessful. The authors also state that enterprise zones "can and do work in optimal situations—ones which consider their foundational theory, strengths and weaknesses. However, zones also potentially have very real trade-offs that must be weighed by local policymakers according to local contexts."

The authors also report the results of their own analysis of enterprise zones using datasets on several federal enterprise zones. The authors state that overall, based on the evidence in previous research and their own investigation they find the impacts of enterprise zones to be generally modest. They state that the scale of their impacts does not negate their efficacy, and that an accelerated growth or decelerated decline in some outcome of about 1–5% per year across a range of potential outcomes is reasonable, potentially sustainable and a good result for many local policymakers. They state that the key is for policymakers to understand the scale of those potential gains, while working to ensure governance structures that maximize the likelihood of positive outcomes. They also state that the results show that enterprise zones can reasonably accelerate growth or mitigate decline, but not fundamentally alter an area's economic trajectory on their own and that enterprise zone performance is closely linked to the target area's characteristics and trends.