Analysis of Enterprise Zone Program Options

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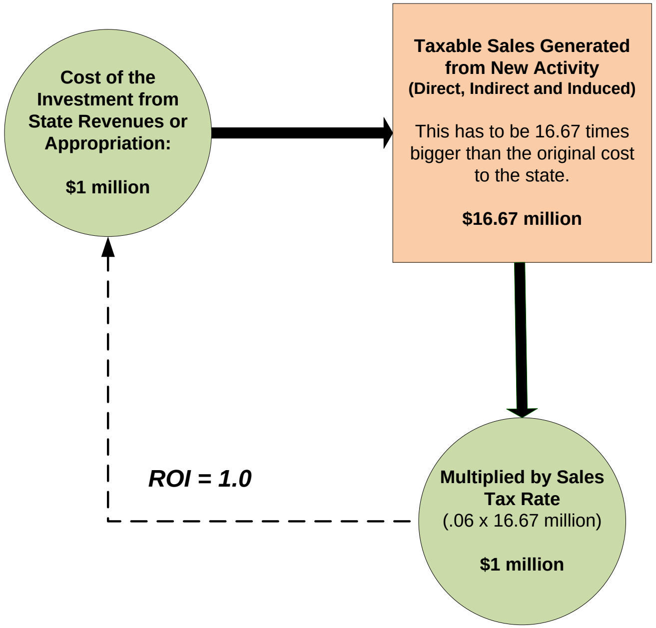
Return on Investment (ROI)...

- In EDR's analysis, the term "Return on Investment" is synonymous with the statutory term "economic benefits" which is defined in s. 288.005, Florida Statutes.

"The direct, indirect, and induced gains in state revenues as a percentage of the state's investment. The state's investment includes state grants, tax exemptions, tax refunds, tax credits, and other state incentives."

Sales Tax Example...



- "Indirect Effects" are changes in employment, income and output of local suppliers that provide goods and services to support direct economic activity.
- "Induced Effects" are the changes in spending by households whose income is affected by direct and indirect economic activity.
- The ROI does not address issues of overall effectiveness or societal benefit; instead, it focuses on tangible financial gains or losses to state revenues.

Starting Premise...

2010 Review of the Revenue Estimating Conference Methodology:

- Economic literature supported the methodology: “The REC assumes that economic activity in an enterprise zone would have occurred within the zone or somewhere else in the State absent formation of the zone. That is, businesses moving into the zone do not increase the total economic activity within the State.”

- Given this, the real research question is whether enterprise zones are effective as mechanisms to eliminate or reduce slum and blight. An economic measure of this effectiveness is changes in property tax values.

- The analysis of three zones (two urban; one rural) between 1999 and 2004 did not find consistent, direct and quantifiable impacts on property values from zone creation.

- However, the literature review suggested that a more recognizable impact may emerge over a longer period.

Return on Investment...

2014 ROI Review:

- Based on an update of the 2010 property tax analysis (longer period of time for the three zones), EDR found that there is some positive economic gain associated with property appreciation in the Enterprise Zones. However, the gain accrues to the local government.
    - The impact of local government spending on state revenues is weak because local government spending is largely not taxable. Generally only the indirect and induced spending attributable to local government spending is taxable, and these effects are small.
    - Homeowners were negatively affected by the appreciation-induced increase in property taxes. This reduces taxable consumer spending within the state.

- The conclusion was that the Enterprise Zone Program has a negative return to the state.
    - "For a number of reasons, the Enterprise Zone Program produces a negative return-on-investment to the state. Most importantly, previously taxable activity has been converted to non-taxable activity. Further, to the extent the state funds supporting the incentive could have been more productively spent elsewhere and the business activity would have occurred anyway, the state actually foregoes revenues beyond the direct cost of the incentives."
    - Many of the businesses are market or resource dependent (the customers are primarily based in Florida or the business is dependent on Florida's resources to produce its products or services). These business activities would have been undertaken somewhere in the state or local area absent the incentive.

Findings from 2015 Property Tax Analysis...

Part of the 2015 request to EDR was to expand the property value analysis from three representative zones to a statewide review, and to assess whether there are local characteristics that allow some zones (for example, urban versus rural) to have better results than others.

- Potential benefit again seen in increased property values over an extended period of time (10 years used in the analysis).
- Benefit related to the increased ad valorem tax base is realized by local governments.
- Majority of parcels within an EZ are residential parcels (82%); however, the residential parcels did not realize any detectable benefit.
- There is evidence to believe that enterprise zones benefit commercial and industrial parcels in urban enterprise zones; however, this effect is not seen in rural enterprise zones.

ROI in Context...

"Whereas most of the other programs were developed to induce business expansion or location to the state, the Enterprise Zone program has a more narrow purpose: to induce investment in designated 'severely distressed' areas within the state and provide jobs to area residents. The program primarily captures or shifts existing economic activity from other in-state locations to the zone rather than inducing new economic activity."

- The EDR property tax studies are designed to gauge improvement in blight. Some evidence exists that this occurs through commercial and industrial properties; the economic benefit largely accrues to local governments.

- The state's negative ROI may be an acceptable loss for the achievement of this purpose. This is a decision for the Legislature.

- If legislators want to reduce the loss or achieve a positive state return, there are options for improving the state's ROI. As a note of caution, these options are designed to improve the ROI, but will not necessarily cure blight or improve a severely distressed area to any greater extent than the existing program.

Options for Improving the ROI...

Specific Capital Investment Requirements

Capital investments (construction, machinery and equipment) have strong impacts. Benefits are localized, few leakages.

- Capital investment in physical space has the strongest effect (i.e. construction) due to backward linkages to local suppliers. Machinery and equipment investments have smaller effects, since many of these purchases are tax-free. Although sales tax refunds are currently allowed for businesses and individuals who purchase taxable building materials and equipment, there is no requirement to undertake this activity.

Specific New/Retained Job Requirement

New/retained jobs bring/keep additional income into an area, spending brings additional tax revenue.

- New jobs should be new to the state (not new to the area) from a new business or a business relocating to Florida. Retained jobs should pass a “but for” test indicating that the company would have left Florida. A company that could easily leave Florida would have: locations in other states, not be market or resource dependent, and not be location-bound due to prior investments in Florida.

High Wage Requirements

Higher wages linked to higher output and productivity, increase spending.

- Higher wages lead to greater consumption. However, hiring underemployed and unemployed workers, even at a lower wage, may increase the ROI as it reduces public assistance dollars. Further, those employees spend more of their wages on consumption rather than savings.

Options for Improving the ROI (continued)...

Job Training Requirement

On the Job Training (OJT) and GED assistance improve chances of an employee's retention and promotion.

- The average wage of a worker increases as his education level increases (leads to increased household spending).
- OJT and GED assistance have lasting benefits for the employee and privately funded initiatives defray state costs.

Targeting Industries with High Multipliers

Industries with high multipliers produce greater returns to the state.

- Industries with high multipliers typically have strong backward linkages to local suppliers. They also have high employment multipliers. Both result in greater indirect and induced benefits. There are few leakages to the rest of the world.
- Targeting industries with lower multipliers may be desirable in certain cases, but the trade-off is a lower ROI.
- From the perspective of the state's ROI, excluding certain retail and service-based industries generally leads to better results; however, this is part of the policy-goal decision facing the Legislature. For example, retail trade generally has lower output multipliers—but higher employment multipliers. These effects counteract each other in the overall analysis. In using the Statewide Model to calculate the state's ROI, the relationships between these multipliers, as well as differences in market dependence and product taxability, are all taken into account.

Options for Improving the ROI (continued)...

Targeting Businesses with High Export Volume or Federal Dollars

Businesses that bring in money from outside of the state grow and diversify the economy.

- Options include targeting businesses with strong export capability or requiring that a minimum percentage of the products be exported.
- The state could also target industries that receive significant funding from federal contracts (space, military), although this is less certain.

Imposing a “But For” Requirement

Businesses that would not have located in the state “but for” the incentive improve the state’s ROI.

- Businesses that would otherwise exist bring no additional dollars to the state as a result of the incentive. Essentially, the incentive is unnecessary.
- Similarly, incentives that are too small to induce new activity result in limited or no economic gain.
- Closely related to the determination of market or resource dependence.

Options for Improving the ROI (continued)...

Market or Resource Independence Requirement

Granting incentives to businesses that would have created or retained jobs regardless of incentives is a financial loss to the state.

- Businesses that are dependent on Florida's population growth or resources may be technically qualified to receive incentives from a program, but there is generally no additional state revenue attributed to these business, as they (or a competitor) would have existed regardless of the state's investment.
- From an ROI perspective, the state's investment is a pure loss if the company would have otherwise chosen Florida. In some cases, even if that particular business did not come into existence, another business competitor would have satisfied the market demand.

Limit State Investment

Limit state investment to no more than needed to accomplish goal.

- Actions that reduce the state's cost improve the ROI, assuming the outcomes stay the same.
- Some form of local participation (incentives or required matches) should be considered in lieu of state investments for incentives that produce largely local, non-taxable or property tax-related results. The size of the state incentives should be linked or calibrated to the expected gain in state revenue.
- Local contributions towards a project may have an ambiguous effect on the state's ROI due to the apportioning process. The gain must be strong enough to produce a solid ROI for the state after apportioning

Options for Improving Induced and Indirect Effects...

The literature suggests there are three ways to improve indirect and induced effects:

- By improving the direct effects on the front-end, primarily through the creation of more jobs, increased facilitation of new business establishments in targeted industries, enhanced promotion of higher salaries, or additional capital expenditures.

- By imposing a requirement for backward linkages in the selection of firms for incentives.
    - Industries with strong backward linkages generate economic activity far beyond the nominal value of their products when they spend locally on inputs instead of purchasing those intermediate goods and services from outside the state.
    - Each dollar that remains in Florida reduces leakages and continues to boost local economic activity, employment, and ultimately tax revenue.
    - All else being equal, the stronger the linkage is, the greater the impact will be on the state's economy.

- By incentivizing the creation of strong pools of local suppliers in key locations that can attract businesses who would benefit from those relationships.

Specialized Zones...

Some of these ideas would fundamentally change the nature of the program, while others could be added to the existing program as another option. A hybrid approach would make the new zones eligible for state incentives, while the existing zones would be subject to local referendum and limited to local funding.

- Cultural and Arts Districts
  - High concentration of related cultural facilities serves as the anchor of a mixed-use area.
  - The anchor encourages the development of adjacent retail and hospitality industries.
  - To increase the likelihood that these districts would draw visitors from outside the state—essential to developing a positive ROI—their number would have to be limited.

- Foreign Trade Zones
  - 20 zones already exist in Florida; businesses provide jobs to area residents.
  - Must be in an area where goods are landed, handled, manufactured or reconfigured, and re-exported.
  - However, the linkage to blighted areas would be largely lost by virtue of the requirement that an FTZ be in an area where goods can be landed. It is also unlikely that many more (if any) zones than the current 20 could be established.

- Geographically Compact Zones Tailored to a More Narrow Purpose
  - Current zone boundaries may be “too large” to effectively target policy goals, and these goals can compete against each other (blight versus jobs for area residents).

Specialized Zones (continued)...

- Industry Specific Zones
  - Zones foster clusters of specific industries (ex. healthcare, high tech, manufacturing, R&D).
  - Usually referred to in the economic literature as agglomeration, the economic concept is that related industries benefit from locating near each other through economies of scale, knowledge transfer and networking, and development of a specialized pool of labor skills.
  - Even when the firms directly compete with each other, there are advantages from attracting more customers or suppliers than any one company could on its own.
  - While industry clustering tends to occur naturally in healthy economies, it can be induced with sufficient incentives to offset the downside of being in a blighted area—so long as the general area otherwise meets the industry cluster's needs for customers, suppliers, transportation and workers. In this regard, new incentives that are more tailored to ongoing commercial or industrial development should be considered.
  - To accomplish the change, the existing zones would be eliminated and new zones authorized—each targeted to a specific industry cluster.
  - To ensure the maximum return to the state, the business clusters would need to be related to industries with high multipliers or backward linkages.

Local Funding Participation...

- Current benefits of EZ program accrue to local governments.

- Local officials have expressed support for the program, noting the economic benefits to their respective jurisdictions.

- One option is to calibrate the state's investment to the expected state benefits resulting from a revised program—essentially allocating the costs between the state and local government.

- Another alternative is to make the program a local option with the funding responsibility shifted to the benefitting jurisdictions.

- If the Legislature chooses to do this, it may also want to consider providing additional flexibility or new fiscal resources to the local governments that continue in the program.