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Senator Ostalkiewicz, Chairman

THE EFFECTIVENESS OF ENTERPRISE ZONE TAX INCENTIVES: FLORIDA'S ENTERPRISE ZONE PROGRAM SINCE 1994

SUMMARY

Florida's enterprise zone program is established in ss. 290.001 - 290.016 and s. 370.28, F.S. There are 30 enterprise zones and businesses located in these zones are eligible for state tax incentives for hiring new employees and making business investments. In F.Y. 1996-97, enterprise zone businesses claimed \$4.4 million in tax credits and refunds.

Enterprise zones are administered by local governments, and each zone must have a development agency and a strategic plan for revitalizing the area, adopted by ordinance. Since the program was reenacted in 1994, most zones have shown some progress toward goals identified in these strategic plans, with urban zones generally making the most progress and net ban zones making the least.

Because of the difficulty encountered by small communities in administering their enterprise zone programs, it is recommended that state funding be provided for this function. This can be accomplished by making rural and net ban enterprise zones eligible for matching grants from the Rural Community Development Revolving Loan Fund. It is also recommended that explicit criteria for amending enterprise zone boundaries be adopted, and the Office of Tourism, Trade, and Economic Development be authorized to approve these changes, as long as the overall size of the zone does not increase, and other statutory criteria are met.

BACKGROUND

Enterprise zone incentives have been used to encourage economic development in Florida since 1980. The basic concept--tax reductions and other incentives for businesses in economically distressed areas--has remained constant, but the program has

undergone three reorganizations, in 1982, 1984, and 1994. The goal of this paper is to gather information about the enterprise zones' accomplishments since 1994 with respect to their strategic plan goals, to assess the effectiveness of tax incentives, and to identify problems that remain with the program.

The Enterprise Zone Act of 1994 changed the program to place more emphasis on development within the zones themselves and on the role of local government in administering and promoting the enterprise zone. It limited job credits to businesses located in enterprise zones that hire zone residents. (The previous program provided credits to any business that hired zone residents.) It limited the number of zones, and made enterprise zone designation a competitive process, with some exceptions. It also required local governments to create enterprise zone development agencies and adopt strategic plans for revitalizing designated zone areas. Since 1994, additional enterprise zones have been created and jobs credits have been extended to hiring WAGES and JTPA participants.

Tax incentives provided by the state for enterprise zone businesses are these:

- Building materials used in a zone for rehabilitation of real property are exempt from state sales tax by refund only. The minimum refund is \$500, and the maximum is \$5,000, or \$10,000 if at least 20 percent of full time employees are zone residents.
- Business property used in the zone is exempt from state sales tax by refund only. The minimum refund is \$100 within a 60 day period, and the maximum is \$5,000, or \$10,000 if at least 20 percent of full time employees are zone residents. If property is used outside the zone within three years it is taxable. (This provision has been modified for net ban enterprise zones to provide credit for purchases of boats, even if they are used outside the zone, as long as they meet other criteria as business equipment.)

- Electrical energy used in a zone by a qualified business is exempt from 50 percent of sales tax on electricity, or 100 percent if at least 20 percent of full time employees are zone residents, if the municipality in which the zone is located grants zone businesses an exemption from the municipal utility tax.
- Businesses located in enterprise zones which hire zone residents can receive credit against the sales tax they remit or their corporate income tax (CIT) obligation, based upon the wages paid to zone residents. The sales tax credit is 10 percent of wages for employees earning no more than \$1500 monthly, and it may be taken for up to 12 months. If at least 20 percent of full time employees are zone residents, the credit is for 15 percent of wages. The CIT credit is the same amount, and can be carried forward for 5 years. A business may use either the sales tax credit or CIT credit, but not both. (This credit has been amended to include a credit for employees earning more than \$1500 per month, and a credit for zone businesses that hire WAGES and JTPA participants.)
- Businesses in zones can receive a credit against their CIT for ad valorem taxes paid, up to \$25,000, or \$50,000 if at least 20 percent of full time employees are zone residents, for a period of 5 years.

METHODOLOGY

This report is based upon information gathered from several sources. Information about individual enterprise zones was obtained from their applications to the program and most recent annual reports, and on information gathered by a survey of the enterprise zones. In some cases, the survey was followed up with a telephone call to the zone coordinator to clarify information contained in the survey. Enterprise Zone Interagency Coordinating Council members were asked by letter to describe how their agencies support the enterprise zone program. Burt Von Hoff and Mary Helen Blakeslee of the Office of Tourism, Trade, and Economic Development provided invaluable assistance in gathering information for this project.

Information about enterprise zones in other states and analyses of the effect of enterprise zone tax incentives were obtained through a review of the literature and interviews with National Conference of State

Legislatures researchers and Kathy Shill of the Ohio Senate Finance Committee.

FINDINGS

State Support of Enterprise Zones

The enterprise zone program is supported by the activities of the Office of Tourism, Trade, and Economic Development (OTTED) and members of the Enterprise Zone Interagency Advisory Council. OTTED prepares an annual report on the accomplishments of enterprise zones. It also serves as a clearinghouse for information about enterprise zones and provides technical support for the zones. The Interagency Coordinating Council played a major role in developing enterprise zone program rules and designating zones, and members of the council provide ongoing support to the zones. The Department of Revenue plays a large role because it must approve tax credits and refunds, and prepare an annual report about utilization of these tax incentives.

Enterprise Zones in Other States and Studies of the Effectiveness of Enterprise Zone Programs and Incentives

According to a 1997 report of the U.S. Department of Housing and Urban Development, and a report by the National Conference of State Legislatures, 36 states have enterprise zone programs. There programs vary substantially in how the zones are designated and what incentives are offered. Generally, an enterprise zone is an area identified as suffering pervasive unemployment, poverty, and economic distress, but the specific criteria vary. Arkansas and South Carolina have designated the entire states as enterprise zones. Incentives offered for choosing a location in an enterprise zone generally include tax credits related to hiring new employees, sales tax credits and exemptions, and investment tax credits. Some programs also offer preferential access to services such as employee training and low-cost financing. Many states limit enterprise zone incentives to certain industries (often manufacturing) and require a minimum number of new employees or level of investment to qualify for incentives. Such criteria make it difficult to compare the experiences of state enterprise zone programs, since they are often very different programs that happen to have the same name.

A review of the economics literature concerning enterprise zones found that econometric studies have

not discovered a significant relationship between enterprise zones and economic development. Some survey-based studies have identified conditions under which enterprise zone designation seems to lead to improved economic conditions. These studies suggest, but cannot prove, that the effectiveness of enterprise zone programs is dependent upon effective marketing and availability of services and sound infrastructure in the zone.

Utilization of Enterprise Zone Tax Incentives in Florida

Enterprise zone businesses in Florida are eligible for corporate income tax credits and sales tax credits and refunds. In 1996-97, total state tax credits and refunds equaled almost \$4.5 million. Corporate income tax jobs credits comprise the largest state tax incentive, accounting for more than one-half of all state tax credits or refunds claimed. Sales tax jobs credits and sales tax refunds for business equipment purchases were each more than \$500,000. Corporate income tax credits for local property taxes paid, sales tax refunds for building materials, and sales tax exemptions for electrical energy are the remaining state tax incentives for enterprise zone businesses.

Progress Made by Florida Enterprise Zones in Attaining Strategic Plan Goals

The 1994 Enterprise Zone Act required each applicant to create a strategic plan, adopted by ordinance. This plan contained specific and detailed goals and strategies for revitalization of the area, and identified sources of funding to carry out these plans. These plans reflect the needs of individual zones, although the same goals are identified in many of the plans. Each enterprise zones was asked to complete a survey which contained questions about what goals were identified in the strategic plans and what progress had been made in accomplishing these goals.

Urban enterprise zones reported most progress toward strategic plan goals. These zones can identify progress toward 87% of the goals identified on the survey. Rural enterprise zones (including Taylor County) report progress on 66% of identified goals. Net ban zones that responded to the survey report progress on 44% of identified goals. Nearly all enterprise zones report some progress toward identified goals. The only exceptions among responding zones are two net ban zones. Detailed descriptions of the progress made by individual enterprise zones is included in the full-length report.

Conclusions About Florida's Enterprise Zone Program

One conclusion that can be drawn from enterprise zones studies and surveys and interviews of enterprise zone coordinators in Florida is that tax incentives do not, by themselves, bring about significant changes in economic conditions in enterprise zones. The economics literature indicates that lower taxes can have some positive effect on economic development, when all other things are equal, but it is a fairly small effect compared to other factors, and cannot be expected to outweigh the disadvantages present in enterprise zone areas. Tax incentives can be part of a comprehensive program to improve conditions in economically disadvantaged areas, but by themselves are insufficient to create better economic environment. The experience of Florida enterprise zones is consistent with this finding.

This review of Florida's enterprise zones since 1994 highlights strengths and weaknesses of the program. Its strengths include:

- Changes enacted in 1994 seem to have succeeded in increasing local involvement and commitment to enterprise zones. Nearly all zones can demonstrate some progress toward goals identified in their strategic plans, and many zones can point to significant local investments in zone programs, infrastructure, and administration.
- State enterprise zone incentives are tied to performance: a business must hire new employees or make certain business-related purchases to claim the credits and refunds. State resources are not used unless some new economic activity occurs in an enterprise zone.
- Unlike enterprise zone programs in many states, Florida's incentives are available to any business located in a zone, and there is no minimum number of new employees in order to be eligible for jobs credits. This is important because the needs and qualifications of each zone are unique, and investment decisions are left up to individual entrepreneurs.

Weaknesses in the program include:

- Some enterprise zones, especially in rural and net-ban affected areas, appear to lack the local resources needed to be viable. Some local

governments may be unable to provide staff that are capable of promoting and marketing an enterprise zone. Enterprise zone tax incentives are not sufficient to compensate for other liabilities which face potential businesses in these areas.

- The boundaries of enterprise zones may not be amended without statutory change. There are no criteria for ensuring that these changes are consistent with program requirements.
- While the statute allows for enterprise zone designation to be rescinded in cases of failure to make progress toward identified goals or failure to comply with the strategic plan, the statute makes no provision for a zone or part of a zone to “graduate” if conditions improve. Incentives may continue to be offered in an area where they are not necessary to induce investment. This problem was highlighted in a recent Wall Street Journal article (“South Beach Poor? Perhaps Only in the Eyes of the State” August 19, 1998) about the South Beach area in Miami Beach.
- Enterprise plan goals and strategies may not be reflected in a local government’s comprehensive plan. The law requires that strategic plans be submitted to local planning agencies which must make a written recommendation with respect to the conformity of the strategic plan with the comprehensive plan (s. 290.0057(2),F.S.), but there is no statutory requirement that the comprehensive plans be amended to include provisions relevant to the enterprise zone.

RECOMMENDATIONS

Since the enterprise zones that exist in Florida today have been in operation for only three years, significant changes to the program are inappropriate. Certain shortcomings could be addressed without fundamental changes in the program however, and other issues should be addressed if the program is reenacted after its repeal in 2005.

Two changes in the current enterprise zone program are recommended. The first recommendation is that enterprise zones in rural and net ban affected communities should receive some state assistance in program administration. This recommendation is based upon impressions received from survey results, interviews with zone coordinators and OTTED staff, and the literature concerning enterprise zones. State funding of program administration for rural and net ban enterprise zones on a matching basis would significantly improve their chances of success. Such funding could be patterned on the Regional Rural Development Grants Program (s. 288.018, F.S.) and funded out of the Rural Community Development Revolving Loan Fund.

The second recommendation is enactment of explicit policies for amending enterprise zone boundaries. Frequent amendment of these boundaries has been criticized in past studies of enterprise zones because it makes assessing the effectiveness of the program problematic, and it creates confusion for the public and local staff and officials. Explicit criteria for amending enterprise zone boundaries should be adopted, and OTTED should be able to authorize boundary changes that do not increase the overall size of an enterprise zone, as long as other statutory criteria are met.

Two other issues should be given serious consideration when the program is under consideration for reenactment. First, local governments should be required to demonstrate their support of enterprise zone goals by amending their comprehensive plans to include enterprise zone goals. Second, designation of enterprise zones should be a competitive process without special treatment of any existing zone.

COMMITTEE(S) INVOLVED IN REPORT (*Contact first committee for more information.*)

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MEMBER OVERSIGHT

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