LUSK RESEARCH BRIEF

MARSHALL SCHOOL OF BUSINESS • SCHOOL OF POLICY, PLANNING, AND DEVELOPMENT

LUSK CENTER FOR REAL ESTATE

# PRELIMINARY

## RESULTS ON THE EFFECTIVENESS OF STATE ENTERPRISE ZONES

In an effort to stimulate jobs and activity in economically depressed regions, many states designate them Enterprise Zones (EZs) and offer lucrative tax benefits for firms that locate in them. The six studies to date of the effectiveness of EZs (cited in Bandonio and Engberg 1990[should this be 1999, as in references?), however, have yielded disappointing results, finding only a slight increase in economic activity in the EZs as a result of the programs.

These studies are not conclusive, however, because they suffer from two severe limitations. First, they define EZs in terms of Zip codes; since EZs are actually defined in terms of census tracts (areas that are smaller than, and different from, Zip code areas), the studies suffer from measurement problems. Second, each study examines only a few states; in fact, all studies combined examined only 10 states. Thus, the body of research may not be generalizable and may reflect problems of selectivity.

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## A MORE COMPREHENSIVE ANALYSIS

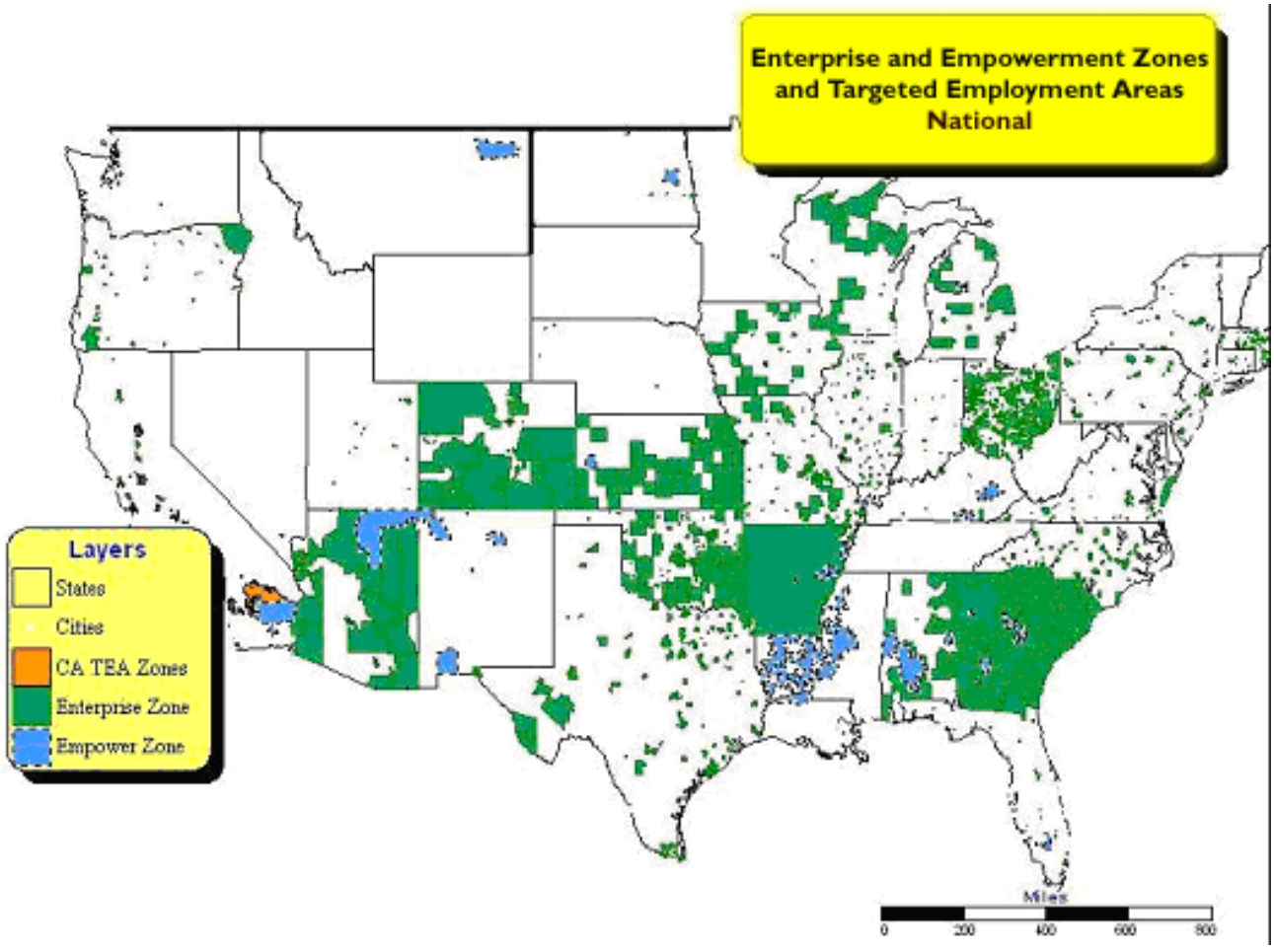
To address these two methodological issues, I have begun a study that examines EZs for all 42 states offering them and that carefully defines the EZ areas in terms of their exact census tract areas. The first step in the study was to gather data on the zone locations and to plot them using GIS software. The results appear in Figure 1.

In addition to EZs (shown in green), the map shows areas eligible for Targeted Employment Areas (eligible for hiring credits, shown in orange), and Federal Empowerment Zones (eligible for federal hiring credits, shown in blue); the latter two programs are similar to EZs.

## *A SCENARIO COMPARISON OF THE BENEFITS OF EZs*

EZ tax benefits vary widely by state. Typically, benefits include income tax credits for hiring, income tax credits for machinery and equipment (m&e) [purchases?], sales tax exemptions, or combinations of all three.

To show these differences across states, I constructed scenarios for each state comparing the outcomes when a firm with a given set of characteristics takes advantage of locating in an EZ. The firm is a transportation equipment manufacturer with land, building, and m&e investments of $20m, $100m, and $20m, respectively; payroll is $20m for 1,000 employees; sales and pre-tax net income are $100m and $8m, respectively. I then compute the taxes the company would pay if not located in an EZ, the taxes it would pay if located in an EZ,



and the number of new jobs created by locating in an EZ, all over a six year investment horizon. The results appear in Table 1.

The column *Taxes company will pay* includes all property taxes and income taxes after normal credits (including business expansion credits not requiring location in an EZ). The column *Taxes company will pay if located in an EZ* include property taxes and income taxes after all EZ benefits. The results in the column showing jobs generated as a result of the new business are computed based on Type II multiplier effects on the economy. The mutipliers were obtained from the U.S. Department of Commerce's Bureau of Economic Analysis and are for individual states and industries. The multiplier effects reported in the table assume that any jobs created in that particular state are new jobs, i.e., not replacing existing ones. In that sense, they may overstate the employment impact of a new company on a state.

## Conclusion and policy implications

My calculations of substantial possible benefits from EZs appear to be at odds with the results of previous research indicating their limited success. Still, there are at least two reasons that further research may accord with the previous research, finding that EZs may not be effective, even if the methodological issues are resolved. First (as noted in Bandonio and Engberg, 1999), EZs are usually located in economically distressed areas with little new business development and decaying public works; this poor general infrastructure for any new business may suffice to dominate any tax incentives. Second, as noted in Lohrman and Wilson (2002), which surveys all state EZ administrators, the programs often do not have enough funding to promote the programs vigorously. Whether these two reasons suffice to negate the benefits at stake will be empirically addressed in the next phase of my research. If EZs are still found to be ineffective, states should consider whether to increase their spending on promotion or to abandon the programs. If EZs are found to be effective, then their continued existence—and even possible expansion in number—may be warranted.

## References


Bandonio, Daniel, and John Engberg. 1999. "Enterprise Zones and Local Employment: Evidence from the States' Programs". Working paper, Heinz School of Public Policy and Management, Carnegie Mellon University.

Lohrman, Janette, and Rachel Wilson. 2002. "State Enterprise Zone Programs: A Survey of the Benefits." *Journal of Multistate Taxation and Incentives* Vol. 12, No. 2 (June).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## Table One • The totals shown below are over a six-year investment horizon

| Rank | Location | Taxes Company will pay | Taxes Company will pay if located in an enterprise zone | Jobs Created in local economy |
|---|---|---|---|---|
| 1 | Alabama | $4,886,400 | $2,486,400 | 2,210 |
| 2 | Alaska | $6,264,800 | $6,264,800 | 1,637 |
| 3 | Arizona | $5,624,640 | $2,124,640 | 2,121 |
| 4 | Arkansas | $4,170,000 | $1,050,000 | 2,438 |
| 5 | California | $5,923,200 | $1,680,000 | 1,964 |
| 6 | Colorado | $5,084,200 | $4,383,900 | 1,937 |
| 7 | Connecticut | $7,886,800 | $7,885,000 | 1,573 |
| 8 | Delaware | $4,236,000 | $3,736,000 | 2,166 |
| 9 | DC | $10,160,000 | $8,660,000 | 2,402 |
| 10 | Florida | $4,966,800 | $2,326,800 | 2,075 |
| 11 | Georgia | $5,411,200 | $5,409,760 | 1,996 |
| 12 | Hawaii | $4,188,000 | $2,652,000 | 2,137 |
| 13 | Idaho | $6,220,000 | $5,720,000 | 1,780 |
| 14 | Illinois | $7,120,800 | $6,620,200 | 2,018 |
| 15 | Indiana | $9,543,200 | $8,043,200 | 2,282 |
| 16 | Iowa | $10,119,600 | $10,118,400 | 1,869 |
| 17 | Kansas | $7,686,000 | $7,684,236 | 2,096 |
| 18 | Kentucky | $5,098,000 | $3,598,000 | 1,922 |
| 19 | Louisiana | $6,542,000 | $4,042,000 | 2,420 |
| 20 | Maine | $7,506,400 | $7,506,400 | 2,446 |
| **Rank** | **Location** | **Taxes Company will pay** | **Taxes Company will pay if located in an enterprise zone** | **Jobs Created in local economy** |
| 21 | Maryland | $5,206,800 | $3,706,800 | 1,746 |
| 22 | Massachusetts | $8,335,800 | $8,334,800 | 1,654 |
| 23 | Michigan | $9,688,000 | $3,388,000 | 1,859 |
| 24 | Minnesota | $9,813,600 | $5,109,600 | 1,761 |
| 25 | Mississippi | $4,025,400 | $4,024,200 | 2,578 |
| 26 | Missouri | $5,657,400 | $2,657,400 | 1,648 |
| 27 | Montana | $4,836,000 | $4,836,000 | 1,602 |
| 28 | Nebraska | $6,467,600 | $2,718,800 | 1,936 |
| 29 | Nevada | $1,626,800 | $1,626,800 | 1,766 |
| 30 | New Hampshire | $6,423,600 | $6,423,600 | 1,702 |
| 31 | New Jersey | $8,590,000 | $8,587,840 | 1,625 |
| 32 | New Mexico | $5,311,200 | $1,663,200 | 2,013 |
| 33 | New York | $8,304,000 | $4,464,000 | 1,339 |
| 34 | North Carolina | $4,735,800 | $4,734,144 | 2,281 |
| 35 | North Dakota | $8,540,000 | $8,540,000 | 2,388 |
| 36 | Ohio | $5,971,400 | $4,971,400 | 2,173 |
| 37 | Oklahama | $5,353,400 | $3,353,400 | 2,051 |
| 38 | Oregon | $4,693,800 | $4,693,800 | 1,979 |
| 39 | Pennsylvania | $6,979,200 | $2,184,000 | 1,877 |
| 40 | Rhode Island | $9,080,000 | $4,760,000 | 1,840 |
| 41 | South Carolina | $4,899,200 | $4,892,200 | 2,354 |
| 42 | South Dakota | $2,868,000 | $2,868,000 | 1,774 |
| 43 | Tennessee | $5,581,200 | $5,581,200 | 2,484 |
| 44 | Texas | $5,497,600 | $5,463,600 | 2,303 |
| 45 | Utah | $4,136,000 | $2,486,000 | 2,336 |
| 46 | Vermont | $7,779,600 | $7,779,600 | 1,962 |
| 47 | Virginia | $5,043,200 | $3,891,200 | 2,172 |
| 48 | Washington | $4,903,600 | $4,903,600 | 1,798 |
| 49 | West Virginia | $6,376,600 | $6,316,600 | 1,575 |
| 50 | Wisconsin | $7,675,600 | $3,883,600 | 2,054 |
| 51 | Wyoming | $658,000 | $658,000 | 1,934 |