An Analysis of the Impact of Michigan Economic Incentive Legislation

Plan B Paper

Submitted by Roberta L. Cook
to the
Department of Agricultural Economics
Michigan State University

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Introduction

In the appendix to this paper an overview of Michigan economic incentive legislation is presented (MSU Ag Econ Staff paper No.79-79). This describes Michigan's economic incentive program without conducting an analysis of the consequences of the program. The purpose of the following discussion is to analyze the impact of economic incentives, providing some insights into the incidence of benefits and costs resulting from Michigan's economic development program.

This discussion is comprised of four parts:

1) The relationship between tax levels, industrial revenue bond financing, and economic growth.

2) A description of industrial revenue bond use on a national level, Michigan's program placed into perspective.

3) Summary and discussion of the results of "The Plant Location Survey" and other Office of Economic Development (OED) publications analyzing the impact of Act 198.

4) Policy alternatives and conclusions.

THE RELATIONSHIP BETWEEN TAX LEVELS, INDUSTRIAL REVENUE BOND FINANCING, AND ECONOMIC GROWTH

Gary C. Cornia et al conducted a thorough review of the literature on state-local fiscal incentives [Cornia, 1978]. Some of the important findings of their study will be summarized below.

Studies on economic development have generally attempted to examine the relationship between the level of taxes or industrial revenue bond (IRB) financing and the rate of manufacturing growth. Three types of studies have been used to analyze this relationship: case studies, questionnaire studies and statistical studies.

Case Studies

Case studies usually involve the construction of hypothetical businesses which represent various growth rates, sizes, levels of capital usage and profits. Tax levels for the specified business types are then compared among states or communities, with inter-state comparisons predominating. Case studies have noted regional similarities in overall tax levels, indicating that states are fairly competitive within regions.

A 1967 report by the Advisory Commission on Intergovernmental Relations compared the industrial growth rate of high and low tax states in eight regions of the United States. The study found: "Because the tax differentials are so small, it is possible to draw the negative conclusion that there is no clear cut relationship between the level of business taxes and manufacturing employment growth rates for states within the same region." [Cornia, p. 11) The report attributed the lack of a relationship to the similarity in tax policies, not to a belief that the local tax factor represents an insignificant cost.

However, these studies don't analyze the effect of other factors on industrial growth rates. Factors such as differences in public service levels may greatly outweigh the tax differences. Therefore, in order to obtain more meaningful results, communities with different tax rates should be compared with communities with similar public service levels, plant sites, labor forces, etc. Controlling these other variables would help to isolate the effect of taxes on growth. Another weakness of case studies is that the comparison focuses on artificial businesses which don't necessarily represent the type of firms seeking relocation.

Questionnaire Studies

Most questionnaires ask businesses to identify and rank the factors that influence their location decisions. The results vary widely depending on whether it is asked directly how taxes influence a location decision. With the more direct approach, businesses tend to place substantial weight on the role of taxes in the industrial location decision. When the question is asked in a less direct manner, they tend to report little or no tax influence.

Most questionnaire studies indicate that labor costs, labor availability, convenience to markets, access to raw materials, community environment and industrial climate are more important factors than taxes in influencing location decisions.

One of the more sophisticated approaches combines cost-benefit analysis with a questionnaire. The questionnaire attempts to determine what part of business investment is actually induced by subsidies. The cost benefit follow-up seeks to measure the value of additional business investment to the community. The results of this type of approach vary greatly from study to study. Many fallacious assumptions are made, therefore, it is difficult to make any kind of a conclusive statement on the findings of these studies. Even when benefit-cost ratios are estimated to be greater than one this does not show that an incentive is the best use of state funds. Neither does it show that a particular incentive is the least costly way of attracting industrial activity. In addition, the jurisdictional boundaries of a cost-benefit study are important in influencing the results. Much of the benefit to one community may be offset by a loss to another. While pursuit of pecuniary benefits may make sense from a local perspective, from a societal viewpoint we should examine whether and under what circumstances mere redistribution of income should be considered a benefit. It is important to distinguish between redistribution and distribution of income. Redistribution occurs when there's no net income change, a net benefit to society doesn't occur in this case.

Some studies point out a need for exploring how taxes affect particular industries. Minor changes in the tax laws might have a major impact on certain industries and no impact on others.

In 1969 Stober and Falk constructed an analytical model to calculate the effect of financial incentives on industry costs. They found that revenue bond financing was the most effective inducement to industrial location. Another conclusion was that financial incentives have the greatest impact on capital-intensive industry and not on mobile labor-intensive industry. Another study by Falk, Hellman, Loeb and Wassall showed that financial incentive programs provide a less costly inducement to industry than property tax exemptions.

Hellman, Wassall and Eskowitz investigated how well Massachusetts' loan and revenue bond programs were targeted to remedy local unemployment. They found a definite trade-off between the ability of new investment to curb local unemployment and the industry's growth potential. Companies attracted by fiscal incentives tended to employ low-skill labor and as a result had a substantial and rapid impact on unemployment. However, this type of firm was frequently found to be in nationally declining industries. This raises concern over possible long-run unemployment problems. High growth industries were generally high-wage and employed highly skilled labor, thus, their impact on blue-collar unemployment was minimal. This points out the need for communities to identify the type of industry that they are seeking to attract, a type that will be compatible with the human resources they have to offer. Where this does not occur, labor with the appropriate skills will merely be imported, with no direct impact on unemployment in the community offering the incentive.

A study was conducted in 1971 in Michigan by Vincent Apilado regarding the use of Act 62, Industrial Development Revenue bonds. It must be recognized that this was conducted before the introduction of most of Michigan's current economic incentive programs. Apilado looked at both the government units offering IRBs and the companies taking advantage of them during a five year period. Apilado attempted to determine whether the companies would have located or expanded in Michigan without the aid of the IRBs. He concluded that almost without exception the firms would have made the same type of investments without IRBs as they made with them. Apilado noted that many businesses were able to induce communities to compete with one another, with the company locating in the community which made the best offer.

A National Tax Association Survey carried out in 1967 investigated the relationships between property taxation and interstate competition for industry. They concluded that, "property tax differentials or exemptions have little, if any, regional attraction for industrial locations; it is only when the selection process has been narrowed to a few communities within an area that property taxes may make a difference for some firms." [Cornia, p. 15]

The National Tax Association Survey emphasized several nontax factors which can be very important in influencing location decisions of firms. These include the attitude of government officials, the educational facilities, water and sewage facilities and police and fire protection services available in the community under consideration. This study concludes that the combination of these factors and a "balanced" tax structure will improve a state's competitive position more than tax exemptions will.

Statistical Studies

Statistical techniques have been used to isolate the elements that affect industrial growth. These techniques are designed to determine whether a distinguishable relation exists between some measure of economic developments and variables such as tax levels and wage levels.

Leonard F. Wheat wrote in 1973 that "the tax hypothesis is perhaps the most tested of all hypotheses. And the results of prior testing do not encourage further tests." [Cornia, p. 15] In contrast, efforts to determine the effect of IRBs on economic growth have generally shown a positive relationship.

In summary, all three types of studies are consistent in their conclusions that the relationship between economic growth and IRBs is much more significant than between economic growth and tax rates. However, this does not demonstrate that IRBs are the best approach to promoting economic development.

A DESCRIPTION OF IRB USE ON A NATIONAL LEVEL, MICHIGAN'S PROGRAM PLACED INTO PERSPECTIVE

Any state's economic incentive program will be viewed by investors in the context of the general economic climate of the state, labor costs and labor availability according to level of skill, access to raw materials and markets, and many other factors already mentioned. However, another important consideration for firms is the design, and therefore advantages and disadvantages, of a state's program relative to economic development programs offered by other states. In order to compare the competitive position of Michigan's program relative to other states the extent that economic incentives are available and used on a national level should be reviewed.

The Congressional Budget Office has carried out a study on small issue industrial revenue bonds [Congressional Budget Office, April 1981]. This provides information on the historical development of revenue bonds on a national basis, and current and projected levels of use. The study also estimates the cost to the federal government of IRB use. The findings of this study will be summarized in the following section.

Small Issue Industrial Revenue Bonds - A CBO Study

To begin with the term "small issue" IRB must be defined. Prior to 1968 industrial revenue bonds were free of any dollar limitations on size of the bond issue. Congress became concerned over the use of IRBs by large corporations and passed the Revenue Expenditure and Control Act in 1968. This withdrew the tax exemption for IRBs except for "small issues" and for those projects financing quasi-public facilities or services. This act prohibited a state or locality to float a small issue IRB for more than $5 million. For bonds of $1 million or less no capital expenditure limit exists. For bonds exceeding $1 million, total capital expenditures on all of the borrowing firm's facilities within the same county or city were not to exceed $5 million for the three years before and the three years following issuance of the bond. In 1979 the Revenue and Expenditure Control Act was amended to raise the limits on permissible capital expenditures and on the size of bonds from $5 to $10 million. The $1 million limit free of capital expenditure restrictions is still intact.

History of IRB Use on a National Level

Tax-exempt IRBs originated in the south in the 1930's to promote industry in predominantly rural areas. The volume of IRBs issued was low until the 1960's when northern states began to use IRBs to compete with the sunbelt. By

1968 forty states were issuing IRBs and large corporations were using IRBs to finance major capital expansion. The annual volume of IRBs issued jumped from $100 million in 1960 to $1.8 billion in 1968.

This was the reason for Congress' concern (noted earlier) and the resulting passage of the Revenue Expenditure and Control Act in 1968, which withdrew the tax exemption for IRBs except for small issues and for those projects financing quasi-public facilities or services. Due to this limitation, for the past decade the chief use of IRBs has been to finance the expansion of small and medium-sized firms. A CBO random sample of nearly 800 IRBs issued in 1978 and 1979 indicated that 61 percent of the total number of issues in the sample were for less than $1 million, while only 12 percent were for more than $2.5 million. In terms of dollar volume 24 percent of all sales were for issues of less than $1 million, 44 percent of sales were for issues of more than $2.5 million.

The dollar volume of small issue IRB sales was six times greater in 1980 than in 1975. This is in part due to the amendment to the Revenue and Expenditure Control Act in 1979 which raised the limits on permissible capital expenditures and on the size of bonds from $5 to $10 million. The most important effect of this was to reduce constraints on future investments, thereby making IRBs attractive to a much larger number of firms.

Another important factor contributing to increased use of small issue IRBs in 1978 and 1979 was the increase in interest rates on conventional loans to record rates. This widened the differential between loan rates and interest rates on IRBs, significantly increasing savings to IRB users.

The CBO study indicates that forty seven states permit small issue IRB financing and that Pennsylvania is by far the largest user with $1639.1 million worth of small issue IRBs in 1980. Michigan is in about ninth place with $279.4 million worth of IRB bonds issued in 1980 according to a CBO projection. In 1980 a total of $8.4 billion worth of IRBs were issued on a national level.

Today more than half of the states issuing IRBs put no restrictions on the use of the proceeds. However, up until 1970 most states permitted IRBs to be used almost only for manufacturing purposes. Restrictions were imposed at the state level to this effect even though federal law permits small issue IRB financing to be used for any type of enterprise. By the mid-1970's state legislatures recognized that they were not taking full advantage of the potential uses of IRBs. State legislatures responded by relaxing or completely removing restrictions limiting IRB use. Michigan participated in this movement and extended IRB financing to commercial enterprises with the passage of Act 338 in 1974.

Today small issues are used throughout the country to finance a broad range of activities, including commercial real estate development, retail stores, recreational and tourist facilities, and health facilities.

Michigan has used IRBs for all of the above purposes. Michigan's Act 338 is designed to permit relatively simple and quick implementation at the local level, with only a minimum of state involvement and supervision. When placing Michigan's program for IRB use in a national perspective, it becomes evident that Michigan's program is competitive with other states, but probably gives Michigan no special advantages or disadvantages.

The Effect on Federal Revenues of IRB Use

Most small issue IRBs are exempt from state and local income taxes, in addition to being exempt from federal income taxes. Clearly, the effect on federal revenues of tax exempt bonds is by far the greatest cost created by their use. Since the federal government bears the burden of the interest subsidy this makes IRBs particularly attractive to state and local governments as an economic development tool.

The cost to the federal government of providing tax exemption depends on several factors, including: the volume of bonds being issued, prevailing interest rates, and the marginal tax bracket of investors in tax-exempt securities. The CBO study summarizes these results as follows: "As of the end of 1979, the value of outstanding small issue IRBs amounted to $24.9 billion. In fiscal year 1980, federal revenue losses amounted to more than $700 million. Assuming current law remains in effect and growth in sales is modest, the volume of IRBs outstanding would increase from $33.1 billion in calendar year 1980 to $101.7 billion in calendar year 1986, resulting in fiscal year revenue losses that rise from nearly $1 billion in 1981 to $2.9 billion in 1986." [p. 39]

These revenue loss estimates measure the cost to the federal government of continuing the exemption for small issue IRBs. If the exemption for small issue IRBs were ended, the net revenue gain to the federal government would be less than the budgetary cost, due to the offsetting reflow or feedback effects. The purpose of small issue IRBs is to stimulate increases in the overall level of investment, this in turn may increase taxable incomes. Given higher taxable incomes more federal tax revenues will be collected. This in part offsets the revenue losses caused by tax-exempt financing. In addition there are "multiplier effects: the portion of increased wages and profits that is spent on goods and services represents new income for other workers and firms," this further increases the level of income taxes paid. [p. 44] CBO estimates that about 60 percent of the gross revenue loss up until 1986 would be offset by reflow effects. After 1986 only 40 percent of gross revenue gains could be expected to be offset.

SUMMARY AND DISCUSSION OF THE RESULTS OF "THE PLANT LOCATION SURVEY" AND OTHER OED PUBLICATIONS

In 1979 the Research and Marketing Division of the Office of Economic Development, Michigan Department of Commerce, prepared a report on companies using the Plant Rehabilitation and Industrial Development Districts Law. This report is entitled "The Plant Location Survey." In addition, recently the Legislature began to require the above division to evaluate the use of PA 198 in three communities every year. In 1978 a report was prepared on Grand Rapids, Menominee, and Ypsilanti Township. In 1979 an evaluation of Sturgis, Port Huron, and Detroit was conducted. In 1980 Lansing, Sault Ste. Marie, and Berrien County were evaluated. The results of these reports will be summarized and interpreted.

The Plant Location Survey is a questionnaire study which was mailed to 469 companies which are PA198 users in 1979. A 54% response rate was obtained. Some of the important results of The Plant Location Survey are as follows: over half of all PA 198 users employ less than 100 employees, over three-fourths of all users employ less than 250 employees; the average company using PA 198 increased its employment nearly 56% from the pre-project level, and as of December 1978 a total of 62,147 new jobs were created and 70,794 jobs were retained since the enactment of Act 198 in 1974; over three-fourths of the total number of projects were new projects rather than rehabilitation projects, and new projects tend to have a greater impact on job creation; over four-fifths of the companies receiving tax abatement have been in business in Michigan for about ten years, although PA198 has been assisting an increasing number of new businesses since 1976; and two-thirds of the companies only considered their present site for expansion, but of the one-third that considered another location more companies considered another state than another Michigan location. Firms were also asked to respond to the following question: "If two or more sites for a new plant were equal in regard to basic location factors such as market access, material suppliers, skilled labor, transportation, etc., how would each of the following factors encourage you to build your plant in a Michigan location rather than some other state?" (Plant Location Survey, p. 13) Firms were asked to indicate whether each of seven factors would primarily, somewhat, or not encourage location there. The factor that was the principal incentive was special property tax exemption, second was if energy utilities have a record of uninterrupted supply to industrial customers, third was if industrial land is available at relatively low cost, fourth in importance was if site improvements are offered by the community, fifth was tax-free IRBs. The least important factor was if a site is located in a certified industrial park.

When asked what state government should do to encourage business expansion and location, the number one response was to reform workers' compensation laws, and thirdly to keep PA 198/provide tax incentives. But while 63% thought number 1 was the most important, only 10.8% thought that number 3 was the most important policy. Last on a list of 10 factors was revenue bond financing.

Some of the problems which can be found with the OED report will now be discussed. First of all, when evaluating results from questionnaire studies in general, it is important to remember that there is a tendency for respondents to consider the source of the question and to respond in a way that reflects their own self-interest. In this case the respondents knew that the Office of Economic Development was investigating the impacts of Act 198. Thus, it would logically be perceived in their interest to give heavy weight to the importance of Act 198. They did so when asked to respond to the importance of various incentives if all other factors regarding a location were equal. Yet when asked a more open-ended question regarding what government should do to encourage business expansion and location, they overwhelmingly named reform of workers' compensation laws and unemployment insurance laws as the most important factors. This tends to indicate that tax abatement is important in inducing investment mainly when firms are considering relocation, and not as much so for the majority of firms who are considering expansion in their present location.

In all instances survey respondents indicated that IRB financing was one of the least important factors influencing location and expansion, yet the studies previously cited gave much more weight to IRBs than to tax levels. One wonders whether if this was a survey conducted among IRB users if IRBs might be rated as much more important.

The Michigan Commerce Department quantifies benefits flowing from Michigan economic incentives only in terms of benefits to the state of Michigan. The impact of the implementation of Michigan incentives on the nation is not examined. Furthermore, industrial or commercial expansion in a locality is assumed to be beneficial to the state as a whole. Little attention is paid to possible losses in other areas of the state due to transfers of industries and employment from one community to another.

In addition, most of the state's attempts at quantifying the impacts of incentives does not extend to the offering of incentives. Thus, benefit information must be recognized as being gross benefit rather than net benefit. For example, The Plant Location

Survey doesn't record total taxes foregone although it reports total investment of PA 198 users. For IRBs the state has conducted very little analysis, nothing similar to The Plant Location Survey has been carried out. The state reports total investment of IRB users and jobs created and retained, but does not report federal, state, and local income tax revenues foregone. The Office of Economic Development also fails to consider the "with and without" situation in most of its announcements of the benefits of incentives. It is implicitly assumed that investment generated and jobs created and retained by users of Michigan's incentives would not have occurred in the without incentive situation.

The OED does attempt to measure the with and without situation to some extent in The Plant Location Survey, however, by asking firms whether they would consider constructing a new plant or expanding facilities in Michigan without Act 198. 20% responded that they would cancel plans, 56% said that they would reconsider building, and 15% said that they would build on schedule anyway. Again, the two factors that most affected decisions to build were workers' compensation costs and unemployment insurance costs. This gives us somewhat of an indication of the with and without situation but it is not very helpful because such a large portion of firms responded in the would reconsider building category. This type of response does not carry very much information with it.

IRBs are primarily used by smaller firms, while Acts 198 and 255 can be taken advantage of by all sizes of firms. This has led some to argue that PA 198 is most used by large firms who least need it. This is not supported by the figures noted earlier in the summary of the Plant Location Survey results.

Since the survey showed that the overwhelming majority of firms had been in business in Michigan for ten years and two-thirds of the Act 198 users only considered their present location, this implies that a large amount of relocation and competition between communities both in and out-state is not occurring.

In making location decisions firms consider states with healthy economies and the necessary access to markets, materials and skilled labor. Firms will not make relocation decisions only on the basis of economic incentives being offered. The literature cited by Cornia and the Plant Location Survey all indicate that incentives mainly influence location decisions when all other factors are equal. Therefore, the assertion that economic incentives are causing non-optimal allocation of resources is somewhat questionable. Also, it must be recalled that similar incentives are now available nationwide, and that tax levels tend to be fairly uniform within regions, thus, very few areas have distinct advantages or disadvantages over others in the incentives they offer. In the 1960s and early 1970s this may have been less the case, however, due to a wider discrepancy in the incentive programs existing in different states, as state's moved at different paces in enacting economic development legislation.

Even if incentives are not causing misallocation of resources on a large scale, this does not mean that incentives don't foster unnecessary competition among communities in some instances. Particularly in border areas among states, as the Berrien County case study indicated, competition may be quite severe. Companies usually have narrowed their location decisions to more or less equal sites within the Midwest, and then may play off one community against another in order to obtain maximum available economic incentives.

It was mentioned in the first section that in quantifying benefits the previous employment situation of those affected by an incentive must be considered. The OED does not consider the prior employment status of those workers in the new job creation category of firms which are recipients of incentives. Since the opportunity cost of workers is not included this implies on over-estimation of benefits.

In the three evaluation studies conducted by OED examining a total of nine communities, tax savings to firms (revenues foregone to communities)are compared to the costs to the municipalities of providing services to those companies, and the total investment generated by Act 198 users. The results of all three evaluations reinforced one another, these include the following general conclusions:1)"PA 198 has influenced companies to expand and locate in Michigan; 2) granting tax exemptions to industry under PA198 did not impair the fiscal strength or stability of the communities studied; 3) in cities where income taxes are levied, foregone property tax revenue is offset by increased income tax revenue that's generated by new jobs; and 4) most school districts are largely compensated by state school aid for potential revenue that is foregone by granting tas exemptions to industry." (An Evaluation of Its Use and Economic Impact on Three Communities in Michigan: Sturgis, Port Huron, Detroit," 1979)

All three studies showed that, even at one-half the tax rate, industrial property returned more in tax revenue than it received in services from the community. Therefore, business continued to subsidize residents in terms of local property tax millage. Local officials interviewed felt that PA 198 benefited their communities by influencing business expansion and job creation.

Currently tax abatement can be granted to firms that have already begun construction on projects for which they're requesting PA 198 assistance. In the 1980 evaluation study done on Act 198 use in three communities, CED suggests that the law should be amended to require that firms request the establishment of an industrial development or plant rehabilitation district before the project has been completed. This would eliminate exemptions for projects which have already been built without the inducement of the act and which would have to be removed from the existing tax rolls. (p.v)

POLICY ALTERNATIVES AND CONCLUSIONS

At this point it is appropriate to summarize the prior information in a way that will highlight the incidence of costs and benefits of economic incentives. A taxonomy of participants will be outlined in order to further this process.

Participants affected by the use of economic incentives in Michigan include the following groups:

1. State, local and federal government
2. Residents of Michigan, as taxpayers
3. Firms not receiving incentives
4. Firms receiving economic incentives
5. The rest of the nation
6. Employees of firms receiving incentives

Conceptualization of benefits and costs must be undertaken with care. For example, taxes represent distributional impacts at different jurisdictional levels. A loss to one area isn't necessarily a net loss to state or federal governments. Taxes are a non-Pareto optimal transfer of resources within the economy, not a net gain or loss to society.

In the area of benefit measurement it has already been mentioned that the previous employment status of employees impacted on by economic incentive programs must be considered. Where resources were unemployed (underemployed) the opportunity cost of employing those resources is zero (low). If resources were employed the opportunity cost is their value in that alternative use. The relevant opportunity costs must be subtracted from gross benefits. The previous employment situation of affected employees must also be considered in order to calculate indirect benefits and costs. Where there is unemployment indirect impacts may be included, but they are hard to identify and measure. If unemployment and idle capacity are chronic and long run, then net indirect impacts could be significant for certain areas.

Impact of Incentives on State, Local, and Federal Government

State, local and federal government revenues and costs are impacted on by economic incentives. The distribution of costs and benefits between the different levels of government varies depending on several factors, including the following: the type of incentive, the previous employment situation of those hired by firms receiving incentives, and whether new employees reside in the communities where they work. In some instances one unit of government may bear a disproportionate share of the costs or receive a disproportionate share of the benefits.

Government at all levels advances two broad policy goals as the justification for economic development programs, these are expanded employment opportunities and expansion of the tax base. These two goals will allegedly be fulfilled by increased industrial and commercial activity. Increased economic activity is also said to yield decreased governmental expenditures due to a reduction in benefits paid to the unemployed, and decreased tax burdens to communities.

Let's look at some examples of how incentives can affect the costs and revenues of the different levels of government. A tax abatement involves a reduction in local property taxes paid by private firms and is therefore a cost borne primarily at the local level. However, since revenue foregone to school districts under PA198 and PA255 is compensated by state school aid, state government also bears a portion of this cost. IRBs in contrast, reflect costs largely borne by the federal government.

If a locality grants tax abatement to a new firm but employees of the firm reside outside the community, then the local government not only foregoes the property tax revenue, but continues to provide social services for the unemployed residing in the community. This can occur where the labor structure of a town is not properly matched with the needs of a company. If the new employees were previously unemployed, then the federal and state governments benefit from a reduction in the cost of unemployment benefits to the respective workers. A city income tax with a reduced rate for nonresidents could be instituted to permit the city to capture some of the benefits.

When a firm locates or expands in an area and employment increases, the demand for city services will increase. The company may require additional water and sewage services, police and fire protection, etc., and if in-migration occurs, additional public school services will also be required. The impact on the costs of a municipality will depend on the degree of excess capacity present in the various service areas. Some local services may exhibit collective good characteristics, thus, the marginal cost of serving additional users may be low within a given range. Where this is the case and excess capacity exists, a municipality may be able to serve another firm with relatively low costs. Where excess capacity nor collective good characteristics are present, the local government entity might have to incur significant fixed costs to expand capacity. The local government should attempt to measure whether the costs of providing services to a firm will be more than offset by the expected revenues generated by the firm, particularly where tax abatement is also being granted.

In the nine communities examined by the OED it has been noted, in the last section, that the OED shows a net benefit to communities granting tax abatement. To analyze the fiscal impact of abatements the standardized fiscal impact model known as the Proportional Valuation Method was used in conjunction with refinement coefficients. [Sturgis, Port Huron, Detroit, p. 28] The methodology appears to be appropriate and it was complemented by discussions with township administrators and officials of the fire, sheriff, and garbage collection departments. "Examination of the service activities of these departments revealed that most of the township's resources were used to service the area's residents and that industry placed very little demand on local government facilities." [Grand Rapids, Menominee, Ypsilanti Township, 1978, p. 31]

However, if all communities are competing by offering incentives then any long term advantages are largely eliminated. The net result might be that some towns might end up with less productive and equitable tax structures in the attempt to encourage business expansion.

The use of IRBs does not change the local tax structure, but does have an effect on the federal tax structure. The impact of IRBs on the federal tax structure is to make it less progressive. [Congressional Budget Office, p. 47] This is because purchasers of tax-exempt bonds are in relatively high marginal tax brackets. The higher the marginal tax bracket, the greater the tax savings from purchasing tax-exempt bonds. As sales to high-income purchasers increases there is an overall decrease in their tax liabilities. The tax payments of lower-income people remain unchanged since they don't purchase tax-exempt bonds and receive no benefit. Thus, as the volume of tax-exempt issues grows, high income taxpayers can shield increased amounts of their income from taxation, undermining the progressive features of the tax system.

Impacts of Incentives on Michigan Taxpayers

As was just mentioned, the effect of IRBs is to make the federal tax structure less progressive. This also applies to the state tax structure, although this effect is much less pronounced, since the majority of taxes exempted from taxation under IRBs are federal taxes. The effect on taxpayers residing in Michigan is first, to reduce the state and federal taxes of purchasers of IRBs, Secondly, if a constant expenditure level is to be maintained, then concessions to some taxpayers necessitate higher payments from others. In this case, there would be a shifting of tax burdens to non-IRB purchasers, with no net decrease in taxes collected. The degree to which the burden is shifted will depend on the extent to which investment generated by IRBs increases incomes and stimulates reflow and feedback effects. As noted in Section II, the CBO study estimates a 60 percent reflow effect currently on IRBs.

Regarding tax abatement, it is also true that a shifting of the tax burden will result, from firms receiving abatements, to local property taxpayers not receiving property tax relief. Yet it must be recalled that industrial and commercial property already subsidizes services to residential property, and usually continue to do so even with tax abatements. Therefore, the effect is to reduce the transfer from businesses to residents. The net effect that this will have on property taxpayers will depend on the impact of business expansion and employment creation on land and home values in the area, and the extent to which expanded services and profits of existing businesses increase as a result of secondary effects.

Impacts on Firms not Receiving Incentives

All firms competing in conventional capital markets for funds are impacted on by IRB borrowing. This is because the larger the supply of

IRBs, the more the financing costs of other firms rise. [CBO, p. 45] To induce investors to buy additional IRBs, interest rates on IRBs (and other tax-exempt securities) must increase relative to the interest rates on alternative, taxable securities. Concurrently, as investment shifts from taxable securities to IRBs, the yield on the former must rise to restore their attractiveness. As the yield on taxable securities rises the costs of funds to businesses operating in this market will increase. This will cause a reduction in the investment spending of these firms, somewhat offsetting the net investment stimulus from IRBs.

In the area of tax abatement the impacts on firms not receiving reductions in their property taxes under Acts 198 and 255 vary depending on whether business expansion would have occurred without Acts 198 and 255. Given maintenance of a constant expenditure level, where tax abatement was granted unnecessarily the cost of the foregone taxes will be shared by other businesses. But where investment would not have taken place without the property tax abatement, the net effect is to reduce the tax burdens of others.

Both IRBs and tax abatement also impact on firms not receiving these incentives in another way. The costs of doing business are reduced for firms that receive incentives and this may give them a definite cost advantage compared to their competitors not benefiting from incentives.

This type of cost disadvantage might be most greatly felt by a small, struggling firm who had yet to achieve economies of scale. Both in the case of IRB use and tax abatement, very small firms or firms with poor credit ratings are underrepresented. Thus, cost advantages induced by incentives and the effect of IRBs on interest rates could contribute to increased exit of very small firms from the market.

Impacts on Firms Receiving Incentives

From the standpoint of the individual firm, some projects might be impossible without IRB financing or tax abatement. Likewise, other expansion plans would be unaffected by the use of incentives.

The presence of small issue IRBs affects the cost of capital and in turn the amount and timing of investment. As interest rates increase cash flow problems presented by loans become quite significant for many businesses. It is therefore hypothesized that interest rate sensitivity may vary with interest rate levels. [CBO Study, p. 51] Recently, the effect of IRB subsidies on investment may have become much greater as a result of record breaking interest rates.

IRB financing is designed such that smaller firms are the main beneficiaries of its use. An argument has been advanced by many that IRBs may be needed to help fill the credit gap in the capital market for smaller businesses. Some small firms have always experienced difficulties in gaining access to capital. This situation may have worsened in the 1970's when inflation rates became chronically high. State usury laws preventing lenders from charging high nominal interest rates probably made it even harder for small businesses to borrow in the private capital market. [Cornia, p. 16] When the real return to lenders declines they will attempt to decrease transaction costs as much as possible, this implies lending to large companies rather than small firms who are often higher-risk borrowers.

It is frequently pointed out by business leaders and government officials that the impact of incentives goes beyond cost reductions to recipient firms. Robert M. Ady of The Fantus Company stated that Michigan's tax exemption program "presents a very positive picture of Michigan's business climate and the willingness and desire of the state legislature to create job opportunities in the private sector." This in turn may influence the ability of Michigan to attract new industry and retain existing businesses. Through multiplier effects this impacts on all companies, regardless of whether they are recipients of economic incentives.

Impacts on the Rest of the Nation and on Employees of Firms Receiving Incentives

In this impact category the problem of the nation versus the state or region is evident. Many contradictions and conflicting goals may arise between regional and national policy. For example, from a national viewpoint, it is difficult to justify expanded employment for a particular state if workers would move to more remunerative employment opportunities in other parts of the country. On the other hand, if workers would otherwise remain unemployed, an expansion of even relatively low-income employment opportunities can be justified for a particular state or region on national grounds. [National Growth and Economic Change in the Upper Midwest, 1965, p. 34]

Currently Michigan is experiencing out-migration of unemployed workers to the sunbelt who are seeking job opportunities unavailable in Michigan. To the extent that they are successful in finding more remunerative employment, the nation will be better off. To the extent that their skills do not adapt well to the type of opportunities in the south (as sometimes appears to be the case), the nation would be better off if employment expansion were stimulated in Michigan.

If economic incentives do have an impact on the decisions of Michigan businessmen to expand in Michigan rather than to leave Michigan, then the state of Michigan will receive a net benefit. Some studies have indicated that differences in economic growth rates reflect not so much variations in rates of new business immigration, as they do differences in the survival and expansion of existing businesses and in the birthrate of new firms.

Since economic incentives affect the costs of firms and the general business climate, they can affect the ability of businesses to survive and expand.

Policy Alternatives

Current economic incentive programs represent one approach to stimulating economic development. The potential alternative policy approaches are numerous. Alternative policy approaches could range from no economic incentives, to maintaining the status quo, to substantially increasing economic incentives and changing their design.

The Congressional Budget Office study examines some possible impacts of changes in the design of small issue IRBs. The CBO study states that there is no evidence to indicate that small issue IRBs are any more or less effective in stimulating investment than other kinds of reductions in business taxes. "The aggregate economic effects of eliminating small issue IRBs could thus be offset by a general business tax cut of the same size." [CBO Study, p. 44] Therefore, if the aim of the government is to stimulate investment then an alternative would be a general business tax cut rather than IRB financing which is implemented on a selective basis. Small issue IRBs discriminate against very small firms and large firms, a general business tax cut would not do so.

Another alternative would be to remove all limits on IRBs. CBO estimates that if this were done the supply of tax-exempt securities would increase enough to cause an eventual elimination of the interest rate differential between tax-exempt and taxable securities.

Another alternative would be to target IRBs to distressed areas. Currently, IRBs have little if any effect on location decisions because the bonds are almost universally available. However, if they were available only in distressed areas, then investment might be induced in the most needy areas. For this to function IRBs would need to be used in conjunction with other local, state, and federal programs. On the other hand, the criteria at the federal level for defining distressed areas would probably significantly increase the transaction costs of using IRBs. At present, the higher capital expenditure limits for IRBs that apply to projects with UDAG funding could be diverting some investment into distressed areas that would otherwise take place elsewhere.

A fourth alternative would be for Congress to prohibit the use of all small issue IRBs. "Since small issue IRBs make more capital available to small and medium-sized firms and to companies that are extremely sensitive to interest rates, it follows that these would be most affected by the elimination of tax exemption." [CBO Study, p. 66] Therefore, the primary effect of a ban would most likely be on the allocation of capital, rather than on the overall level of investment. In other words, some investments would proceed without IRBs and others would not, but the amount and timing of investment would change.

A fifth alternative would be to maintain current law, but to require reporting of IRB sales. Currently, no mechanism exists for reporting IRB sales to any federal agency. Annual reporting would permit the Congress to become more informed about IRB use and the costs of maintaining their tax-exempt status.

In the area of policy alternatives to property tax abatement little analysis has been carried out. However, it was mentioned in Section I that many studies reviewed by Cornia have noted that property tax abatement is not the most efficient means to stimulate investment. Property tax abatement may cause an inequitable municipal tax structure since it is applied on a selective basis. Some studies have indicated that fear of crime is a major cause of business flight from urban centers such as Detroit. This might point to investment in crime prevention as a more efficient use of local revenues.

"The Plant Location Survey" reported workers' compensation and unemployment insurance costs to be the main concerns of businessmen. Michigan has recently modified both these programs in response to these concerns. The impact of these changes is yet to be determined.

Conclusions

Whenever economic incentives are utilized by private sector firms, ipso facto, there are costs associated with these incentives in the form of revenue lost to governmental entities. In addition, losses may occur in other sectors of the economy or among competing firms which are not recipients of subsidies. The question of key economic import then becomes whether the net effect of the incentives is positive, or in otherwords, whether the benefits exceed the costs.

Obviously the benefit-cost ratios forthcoming from any given investment project depend on how the analysis is bounded, or in otherwords, whose costs and benefits are included. The results of the studies previously cited indicate that in most instances economic development incentives do not play a major role in investment analysis decisions. While they may be instrumental in attracting an industry to locate in a particular state or city in some cases, influencing a decision at the margin, the existence of similar incentives throughout the country precludes any major influence in general.

The question of the use of economic incentives as a competitive tool by states or local governmental entities imposes a state (local) boundary on the analysis and excludes corresponding costs incurred by other areas. The broader question of the net impact on society as a whole will be summarized below.

When viewed on a societal level economic incentives frequently have the effect of redistributing income among parties without affecting total output. Let us assume that full employment levels prevail in the economy and that a constant public sector expenditure level is to be maintained. In this situation investment subsidies imply a net shift from consumption to investment because income is taxed at a higher rate to make up for the tax loss associated with tax exempt bonds. Under full employment resources are merely shifted among sectors and gains in the sectors receiving subsidies are offset by losses in sectors where subsidies are not granted.

When can economic incentives produce a net gain from society's perspective? To find a net gain we must look at the case where previously unemployed resources are brought into production by a subsidized investment. Here the opportunity cost of labor was zero and the government was expending resources via unemployment and welfare benefits to these individuals. The resources which were being used in the form of welfare payments to subsidize consumption are now being used to subsidize production. Hence, if consumption levels are maintained a net gain is obtained in the form of increased output. As long as the returns to capital and labor generated by the investment project are greater than the opportunity cost of the total capital employed in the project, then a net increase in output has been realized.

Nevertheless, it is still necessary to account for any losses in employment that may take place in other firms as a result of subsidies since they lower the cost of production selectively among firms. This places other firms at a disadvantage and potentially decreases their output and employment levels.

It becomes clear that it is unlikely that economic incentives are yielding a net gain to society as a whole in a majority of instances. The employment created by subsidized investment frequently does not impact previously unemployed labor, therefore the opportunity cost of labor will negate any gains. Furthermore, even where the opportunity cost of labor employed in the project is zero and savings are obtained in the form of lower welfare costs, any net gains generated directly by an investment must be compared to losses ocurring elsewhere to those not benefiting from investment subsidies.

It appears that one important reason that economic incentives have been so popular is because the accounting methods used do not bound the problem on a national level but rather locally or on a state-wide basis. In the case of industrial revenue bonds the costs are largely borne by the federal government, thus explaining their popularity among state legislatures. However, for either property tax abatement or IRBs, the rationale for offering selective reductions in tax levels must be seriously questioned. If a different level of investment is desired in the economy then an across-the-board change in tax incentives to invest may offer more effective results.

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Appendix

Agricultural Economics

Staff Paper No. 79-79

NOVEMBER 1979

AN OVERVIEW OF MICHIGAN ECONOMIC INCENTIVE LEGISLATION

Roberta Cook Villarreal
Graduate Assistant
and
Dr. Al House
Professor
Department of Agricultural Economics
Michigan State University

Table of Content

Introduction

Many communities are plagued by chronic unemployment problems, an eroding tax base, a lack of commercial services, and are failing to attract new enterprises or to retain old ones. As a result, the government has seen a need for public support of economic development in an attempt to foster cooperation between public and private interests towards the mutually advantageous goal of stimulating economic development, thereby increasing employment and the tax base. Both the federal government, and the state of Michigan are currently promoting economic development, primarily by permitting the granting of certain economic incentives to private businesses under specific conditions, and in some cases, by providing funds for local governmental use to develop governmental infra-structure and expertise in the area of economic development.

The purpose of this article is to highlight the important aspects of the field of economic development today in Michigan. Because of the many laws, governmental agencies, and different levels of government that are involved in economic development, it is often difficult to see the "big picture" and how the pieces fit together. Therefore, this article merely attempts to identify some of the pieces, or components parts, and provide some insight into how the process of the promotion of economic development functions. As such, this is not intended as an advocacy of any or all of the specific economic development programs.

A Brief History of Economic Development in Michigan

A strong interest in promoting economic development in Michigan didn't come to the fore until recently; 1974 can be cited as the watershed mark for economic development programs. Prior to this time Michigan was only nominally involved in economic development in comparison to many other states. Southern states in particular have granted economic incentives since the 1930's.

Promoting economic development involves the general process of creating a favorable business climate for industrial and commercial enterprises conducive to the retention of existing firms and the attraction of new firms. Because of Michigan's status as a prime industrial state with an excellent transportation network and other important infra-structure, Michigan did not consider it necessary to actively promote economic development through state programs and economic incentives.

Yet in the last decade Michigan has begun to feel increasingly threatened by competition from other states, as the state has begun to experience the loss of industry to other locations. Because of factors such as Michigan's high worker's compensation the state has begun to see economic development programs as a way to put Michigan on a more competitive standing with respect to other states.

Michigan Economic Incentives

There are three general types of economic incentives which are currently provided for by Michigan economic development legislation. Some of the most important laws and programs are enumerated below:

The first type of incentive includes the following: Industrial Development Corporations, provided for by the Michigan General Corporation Act of 1931 (M.A. 327); the Michigan Industrial Development Revenue Bond Act of 1963 (M.A. 62); and the Economic Development Corporations Act of 1974

(M.A. 338). These incentives provide for the creation of lower cost sources of financing to expanding private businesses.

The second type of incentive includes the Economic Development Commission Act of 1966 (M.A. 46); and the Michigan Economic Development Incentive Concept, a program established by the Michigan Legislature in 1976. This type of incentive promotes the improvement of the ability of local governments to plan and develop governmental infra-structure and expertise in the area of economic development. Thus in contrast to the first case these are not incentives to private businesses, private businesses are affected only in an indirect sense.

The third type of incentive includes the Plant Rehabilitation and Industrial Development Districts Law of 1974 (M.A. 198); and the Commercial Redevelopment Districts Act of 1978 (M.A. 255). These incentives allow for the granting of tax abatement to private businesses by means of a reduction in the ad valorem property tax.

The Emergence of Economic Incentives in Michigan

Although Michigan's economic development program was weak prior to 1974, the legislation cited demonstrates that the program wasn't nonexistent. In fact, several of the economic incentives created in 1974 grew out of the foundation established by Act 327, Act 62, and Act 46, taking on broader functions. The power to issue industrial revenue bonds was expanded by combining the concepts of Industrial Development Corporations and Act 62 incorporating them into Economic Development Corporations. Similarly, local governmental planning in the area of economic development originated with Economic Development Commissions and probably provided the base for the Michigan Economic Development Incentive Concept (MEDIC).

A Federal Economic Incentive

This paper deals primarily with the state of Michigan's economic development programs. However, an important federal law to note relating to many aspects of economic development is the Public Works and Economic Development Act of 1965 (P.L. 89-136). This act created the Economic Development Administration (EDA) within the U.S. Department of Commerce.

Organizations Involved in Economic Development

There are several state organizations with jurisdiction in the area of economic development (see Table 1). The first and foremost is the Office of Economic Development of the Michigan Department of Commerce, dedicated solely to the purpose of promoting economic development. The OED first appeared in a slightly different form in 1947-48 as the Economic Development Department, a separate agency. In 1963 it was incorporated into the Michigan Commerce Department as the Office of Economic Expansion. Only recently it was renamed the Office of Economic Development.

The OED consists of five different divisions (see Table 2). The involvement of specific divisions in the economic incentives we're considering will be demonstrated later. In general, the Office of Economic Development serves as a statewide coordinator, organizer, information source, and promoter of development.

Secondly, the Municipal Finance Commission and the State Tax Commission, which are both part of the Michigan Department of Treasury, are involved in the final approval of applications for economic incentives under some of the acts mentioned above.

At the federal level, the Economic Development Administration (EDA) consists of seven divisions (see Table 3). The most important division for our purposes is the EDA grants for Public Works and Development Facilities Division.

TABLE 1

Agencies Involved in Economic Development

State Level

Michigan Department of Commerce	Michigan Department of Treasury
Office of Economic Development 517/373-3530 See Table 2 for further information	1. Municipal Finance Commission 517/373-0660 AND 2. State Tax Commission 517/373-0500

MEDIC

Program administered by the office of Economic Development, Community Economic Development Division
517/373-2375

Federal Level

U.S. Department of Commerce

Economic Development Administration
517/372-1910 ext. 621

See Table 3 for further information

TABLE 2

Divisions Within the Office of Economic Development

Michigan Department of Commerce

OFFICE OF ECONOMIC DEVELOPMENT

P.O. Box 30225
Lansing, Michigan 48909
800/292-9544 (toll free in Michigan)
Wayne Workman, Director

Community Economic Development Division Pete Walters, Director 517/373-2375	
Industrial Development Division Domestic Section 393-3550 International Section 373-6390 Clifford A. Kleier, Director 517/373-3550	Small Business Development Division Burt Jones, Director 517/373-0637
Research and Marketing Division John Hanieski, Director 517/373-8312	Division of Minority Business Enterprise Larry Leatherwood, Director 517/373-8430

TABLE 3

Divisions Within the Economic Development Administration

U.S. Department of Commerce

ECONOMIC DEVELOPMENT ADMINISTRATION

For local information:
306 Capital Savings and Loan Building
112 East Allegan Street
Lansing, Michigan 48933
517/372-1910 ext. 621
Jim Collison, Director

EDA Grants for Public Works and Development Facilities
306 Capital Savings and Loan Building
112 East Allegan St.
Lansing, Michigan 48933

Business Development Assistance
175 West Jackson St.
Suite A-1630
Chicago, Illinois 60604

Technical Assistance
32 West Randolph St.
1025 Civi~~c~~ Towers Building
Chicago, Illinois 60601

Planning Grants for Economic Development
32 West Randolph St.
1125 Civic Tower Building
Chicago, Illinois 60601

Special Economic Development and Adjustment Assistance - Title IX (An amendment)
175 West Jackson St.
Suite A-1630
Chicago, Ill. 60604

Trade Adjustment Assistance Program
32 West Randolph St.
1025 Civic Tower Building
Chicago, Illinois 60601

Indian Industrial Development Program
Indian Industrial Development Office
Room 7312
U.S. Department of Commerce
Washington, D.C. 20230
202/377-5321

Economic Development Corporations Act (M.A. 338-74)

The purpose of the Michigan Economic Development Corporations Act of 1974 is to encourage employment opportunity and expansion of the tax base in Michigan through the renovation of industrial and commercial areas. It encourages cooperation between local governmental units, the private business sector and state government. Specifically, it provides for the creation of Economic Development Corporations at the local level (see Table 4).

An Economic Development Corporation (EDC) is a public corporation (non-profit) which is exempt from all taxation on its earnings and property. The attractiveness of EDC's stems from their having the power to issue tax exempt revenue bonds for the purpose of financing proposed projects of both commercial and industrial enterprises. This enables businesses to obtain financing for expansion purposes at a rate of interest lower than the market interest rate. The original reduction in the interest rate was approximately 2% but with the recent rise in commercial interest rates, the rate savings can reach up to 5 to 6%. With availability of lower cost financing a firm may be able to undertake an expansionary project that wouldn't have proved economically feasible otherwise. In doing so the firm creates new job opportunities and/or retains old jobs at the same time it expands the tax base.

Economic Development Corporations may be formed at the county, city, village or township level. As of April 10, 1979 there were 153 EDC's, 77 of which were at the city level, 34 at the county level, and 42 at the township and village level. The exact number of EDC's is constantly changing as new EDCs are formed monthly. Many of the EDC's in existence are not currently active, however. The formation of an EDC doesn't automatically

TABLE 4

APPROVAL PROCESS for Act 338 - 1974

Economic Development Corporations Act (M.A. 338 - 74 as amended)

1. Local municipality (county, city, village or township) - receives an application for incorporation to form an Economic Development Corporation; local governing board gives final approval of the application and Articles of Incorporation.

↓

2. Secretary of State receives and files a certified copy of the Articles of Incorporation along with an affidavit of publication.

For information contact:

Office of Economic Development
Community Economic Development Division
P.O. Box 30225
Lansing, Michigan 48909
517/373-2375

signify the initiation of projects. Other necessary conditons for active EDC's are cooperation between local government, private business and banking interests, and a strong commitment to fund projects.

This paper gives special attention to EDC's due to their emergence as one of the most widely used economic incentives today. The general process for forming an EDC and then for approving a project possibility within an EDC is mapped out, and a general explanation of EDC's and how they function is set forth. In addition case studies of Economic Development Corporations in three counties are presented. These studies examine the motivations behind and the participation of different sectors in the creation of actively functioning EDC's in each case.

Establishment of an Economic Development Corporation

The process for establishing an EDC is mapped out in Table 5 and described further in Table 6. These tables are self-explanatory and need not be discussed further.

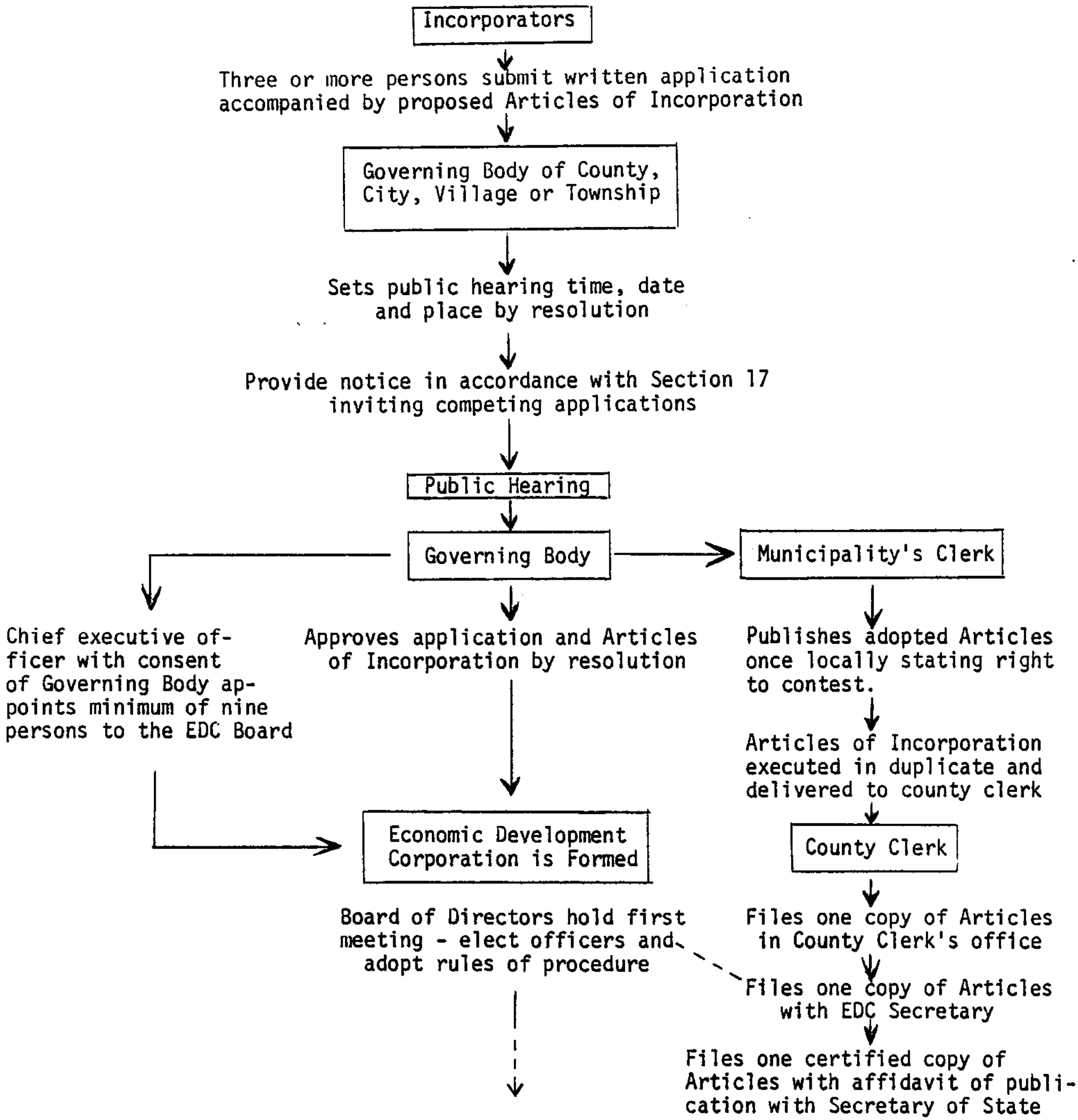
It may be helpful to emphasize that once an Economic Development Corporation is formed the EDC financing mechanism may be used to fund any number of projects within the jurisdictional boundaries of the EDC (city, county, etc.). This eliminates the need to create an EDC for each project possibility. In addition, the approval process for the establishment of an EDC is completely local; approval at the state level is in no way required.

The Approval Process for the EDC Financing of an Industrial or Commercial Prospect

Once an Economic Development Corporation is created and a project is identified, there is an established procedure for approving the project possibility. The approval process is mapped out in Table 7 and described further in Table 8. Again it is important to note the completely local control over the approval process, the state is not involved.

TABLE 5

ESTABLISHMENT OF AN ECONOMIC DEVELOPMENT CORPORATION



Source for Tables 7-10: O.E.D., Community Economic Development Division.

TABLE 6

E D C

SCHEDULE OF NON FINANCING EVENTS

FORMATION

1. Written application by three or more persons to incorporate EDC with proposed Articles of Incorporation filed with governing body.

2. Municipality adopts resolution setting time, date and place for a public hearing regarding application and municipality publishes notice of hearing, inviting competing applications, at least once, not less than 10 days prior to the hearing.

3. Municipality holds public hearing on application.

4. Municipality adopts resolution approving the application and Articles of Incorporation.

5. Incorporation of the EDC as public corporation.

   A. Articles of Incorporation executed in duplicate and delivered to County Clerk.

   B. Municipality's clerk publishes copy of Articles once locally accompanied by statement of right to contest.

   C. County Clerk:

      (1) Files one copy of Articles in office of County Clerk;
      (2) Files one copy with EDC secretary (once designated);
      (3) Files one certified copy of Articles along with affidavit of publication with Secretary of State.

6. Chief executive officer of municipality, with the advise and consent of the governing body, appoints a minimum of nine persons to the EDC Board of Directors.

7. EDC Board of Directors first meeting at which Board of Directors organizes by electing officers and adopting rules of procedure.

TABLE 7

THE APPROVAL PROCESS FOR THE EDC FINANCING
OF AN INDUSTRIAL OR COMMERCIAL PROSPECT

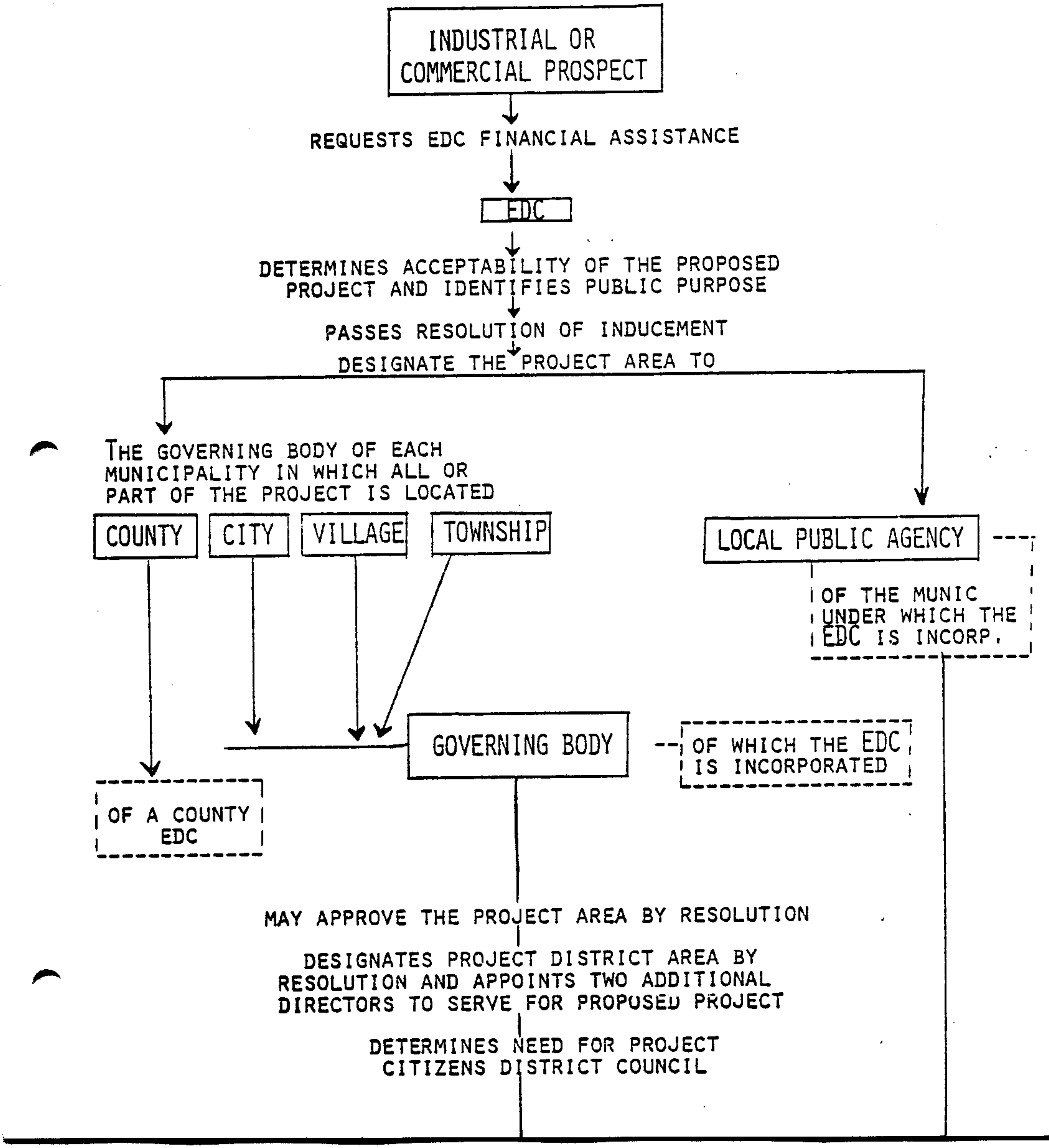


TABLE 7 (CONT.)

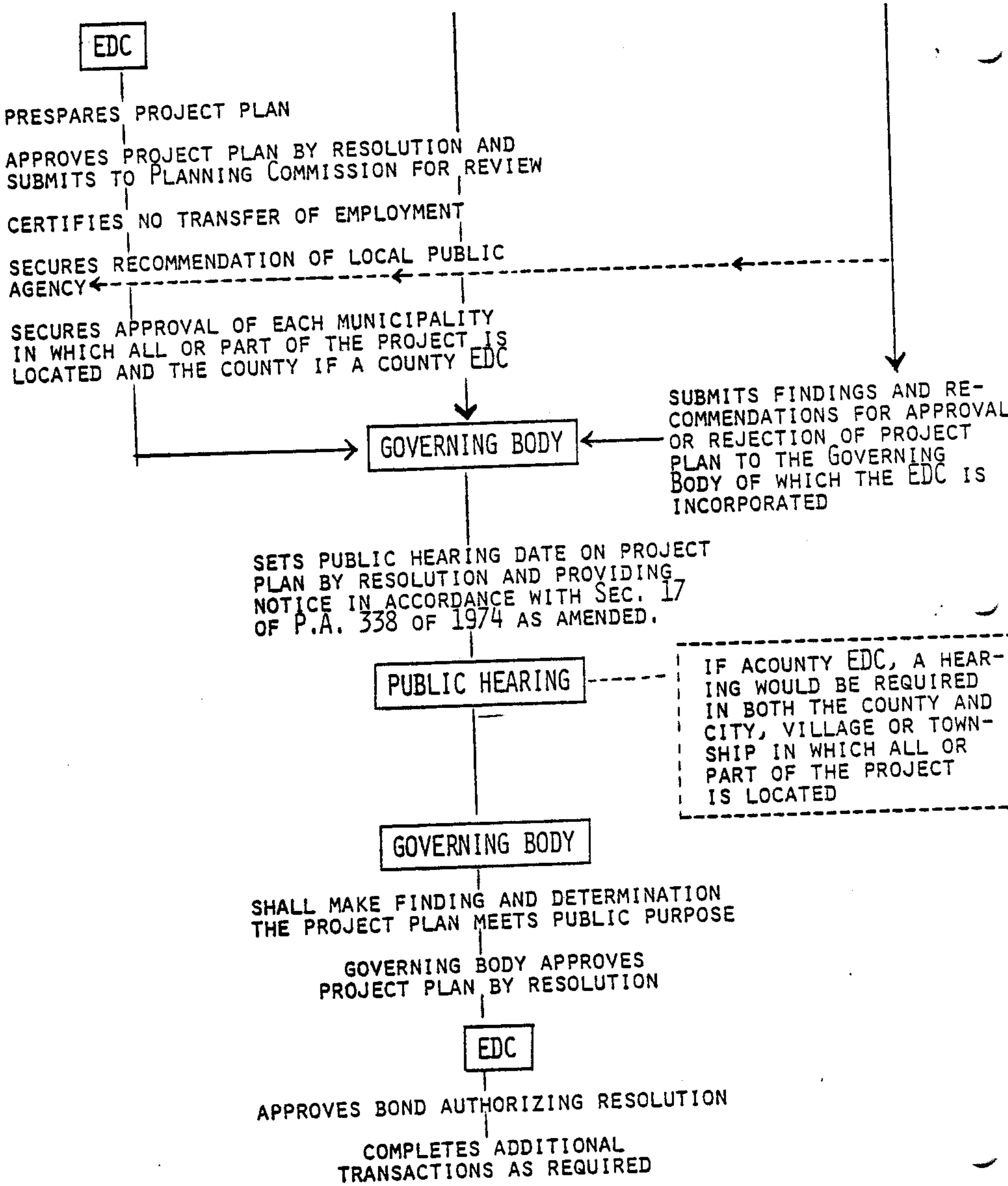

EDC
PRESPARES PROJECT PLAN
APPROVES PROJECT PLAN BY RESOLUTION AND SUBMITS TO PLANNING COMMISSION FOR REVIEW
CERTIFIES NO TRANSFER OF EMPLOYMENT
SECURES RECOMMENDATION OF LOCAL PUBLIC AGENCY
SECURES APPROVAL OF EACH MUNICIPALITY IN WHICH ALL OR PART OF THE PROJECT IS LOCATED AND THE COUNTY IF A COUNTY EDC
SUBMITS FINDINGS AND RECOMMENDATIONS FOR APPROVAL OR REJECTION OF PROJECT PLAN TO THE GOVERNING BODY OF WHICH THE EDC IS INCORPORATED
GOVERNING BODY
SETS PUBLIC HEARING DATE ON PROJECT PLAN BY RESOLUTION AND PROVIDING NOTICE IN ACCORDANCE WITH SEC. 17 OF P.A. 338 OF 1974 AS AMENDED.
PUBLIC HEARING
IF ACOUNTY EDC, A HEARING WOULD BE REQUIRED IN BOTH THE COUNTY AND CITY, VILLAGE OR TOWNSHIP IN WHICH ALL OR PART OF THE PROJECT IS LOCATED
GOVERNING BODY
SHALL MAKE FINDING AND DETERMINATION THE PROJECT PLAN MEETS PUBLIC PURPOSE
GOVERNING BODY APPROVES PROJECT PLAN BY RESOLUTION
EDC
APPROVES BOND AUTHORIZING RESOLUTION
COMPLETES ADDITIONAL TRANSACTIONS AS REQUIRED

TABLE 8

PROJECT PROCEDURE

1. EDC & Company meet to explore feasibility of project.

2. EDC Board passes a resolution of inducement.

3. EDC designates the project area to the planning commission and the governing body of the municipality for which the EDC is incorporated. If a county corporation, the EDC shall also designate the project area to the governing body of each city, village, or township in which all or part of a proposed project is located.

4. The governing body (under which the EDC is incorporated):

   A. May approve the project area by resolution.
   B. Establish the project district area by resolution.
   C. Appoints two additional directors to the EDC to serve in respect to the proposed project.
   D. Determine the need for a project citizens district council.
   E. Sets public hearing by resolution.

5. EDC;

   A. Through the company, prepares the project plan in accordance with Section 8 (4).
   B. Approves the project plan by resolution.
   C. Certifies to the governing body that the project does not have the effect of transferring employment within the state.
   D. Secures the recommendation of the local public agency (planning commission) of the municipality for which the EDC is incorporated.
   E. Secures the approval of the governing body of each city, village, or township in which all or part of the project is located, and the approval of the county, if the corporation is an EDC for the county.

6. Local public agency submits its findings and recommendations for approval or rejection of the project plan, with any recommendations for midification, to the governing body of which the EDC is incorporated.

7. Public Hearings: City, Village or Township EDC:

   A. Notice of public hearing published not less than 10 days before the date set for the hearing.
   B. Notice of public hearing posted in at least 10 conspicuous and public places in the proposed project district area not less than 10 days before the date set for the hearing.
   C. Public hearing on the proposed project plan.

County EDC;

Should the EDC proposing the project be at the county level, a public hearing would be required by the County Board of Commissioners. This public hearing would be in addition to the public hearing in the city, village or township in which all or a part of the proposed project is located.

8. The governing body:

   A. Determines that the project plan constitutes a public purpose.
   B. By resolution approves the plan or approves it with modifications.

9. EDC:

   A. Approves bond authorizing resolution (if bonds involved).
   B. Complete any additional required transactions.

The Incorporators and Board of Directors of an EDC

The process for formation of an EDC begins with a petition for incorporation by three people. The petitioners may be drawn from any walk of life and generally are interested citizens or representatives of government, banking, business, real estate, legal or extension interests. The incorporators may become members of the 9-member board of directors once an EDC is formed but this is not required.

A cross-section of interests are usually represented on the board of directors with business interests forming the predominant group. In the past labor interests haven't participated in EDC's; their inclusion on the board of directors has been suggested as a means of increasing business-labor cooperation in an informal setting.

Many EDC board members interpret their role as being relatively non-political because of their status as appointed rather than elected officials. This enables them to serve as a liaison between not only the business community and government but between different levels of government such as city and state as well.

The flexibility regarding the appointment of the three incorporators to the board of directors may at times lead to the creation of EDC's on a completely unplanned basis. A business desiring EDC financing can petition for incorporation of an EDC and, if approved, attempt to obtain EDC financing without any further involvement with the board of directors. This type of approach is often not perceived to represent the public interest and businesses using it encounter obstacles in the EDC project approval process. In the case of most active EDC's at least part of the incorporators became participants on the EDC boards. In addition, it is ideal if each of the three incorporators represents a different sector, demonstrating board public support of the EDC.

Inactivity of EDC's - A Common Occurrence

The incorporation of an EDC is only the first step. The identification of projects, the technicalities of bond financing, and local political differences, often make it difficult for municipalities to achieve an active EDC rapidly. In cases where the EDC Board of Directors tends to be passive, and a strong, broad-based community committment to funding projects doesn't exist, a successful EDC may elude a municipality. There are several reasons for the inactivity of an EDC once it is formed, a few may be elaborated on here.

The local business interests which are represented on the EDC Board may perceive some project possibilities as being potential competitors with their businesses. This tends to occur particularly in small communities and with respect to commercial projects. Thus, if an acceptable industrial project doesn't appear, a sufficient consensus to approve a project might not be forthcoming, and the EDC may be inactive as a result.

Another explanation is the prevalence of multiple EDC's at different municipal levels within the county. If this is the case, EDC's must coordinate their efforts in order to avoid working against each other. In these instances it is helpful to designate one EDC as the main financier, working in a cooperative fashion with the rest.

The problem of inactivity is at times a function of the local banking interests and their unwillingness to buy bonds. Progressive local banking interests are helpful and this might be lacking in a small community where the degree of sophistication of the local bank, particularly in dealing with bonds, may not be great. Typically, a receptive local bank is one that is interested in long term investment and one that is in a high tax bracket, which increases the attractiveness of tax free revenue bonds.

Where local banks aren't willing to buy EDC bonds, the interest of a large bank (or other investors, which will be elaborated on later) must be obtained. If the prospect being considered for EDC financing is itself a large company with contacts to big banks the process of interesting a large bank in purchasing the bonds will be facilitated. Where this isn't the case, and support doesn't come from the EDC or the municipal government, serious problems may arise.

An approach that municipalities and companies desiring EDC financing can use to encourage the purchase of EDC bonds by a bank, (where the parties involved have an account with the bank in question), is to threaten to take their bank accounts elsewhere, to a bank that has proven to be receptive to bond purchasing.

Some Benefits to Banks of Purchasing EDC Revenue Bonds

In contrast to the latter example, the purchase of bonds is often used as a marketing tool by progressive large banks, serving as a way to acquire corporate clients. Once a bank becomes involved with a company in the purchase of bonds, the bank is in a favorable position to suggest that the company expand its dealings with the bank, opening the company's account with them. Thus, the purchase of bonds also has indirect benefits to banks.

Tax-free revenue bonds, generally yielding a 7 to 10% interest rate, definitely represent a profitable proposition for banks. Because of income tax rates, it is estimated that a 7 to 10% tax free interest rate yields an effective interest rate from 15 to 16% for many banks (depending on their tax bracket). According to the technicalities of the law in the unlikely event that revenue bonds were ever declared taxable, the recipients of revenue bond financing would automatically be required to pay double the interest rate being charged them currently, regardless of the interest rate. In other words, the effective earnings to banks on revenue bonds are approaching 100% more than the actual interest rate shown on a tax free bond. Therefore, the benefits to banks of purchasing EDC revenue bonds are quite significant.

Some Financial Aspects of EDC's

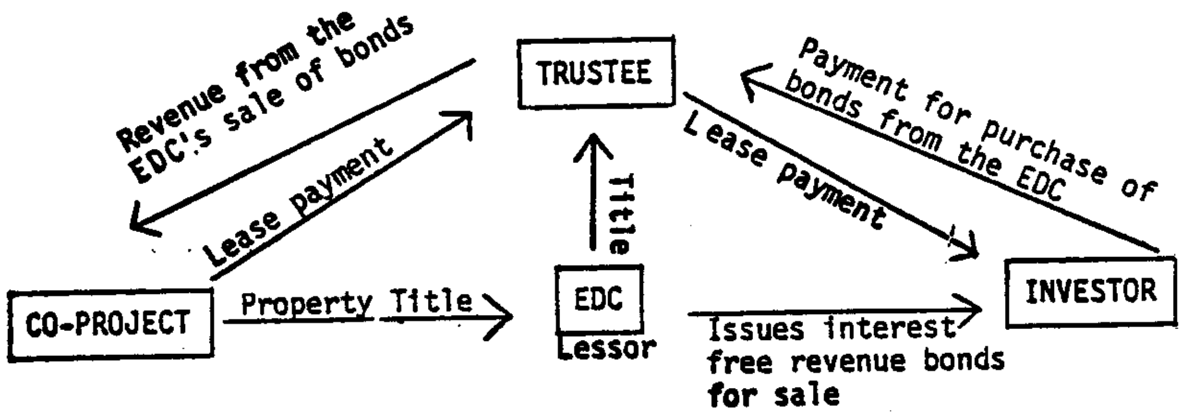
The question of liability for the bonds sold by an EDC is an important one. The bonds are repaid entirely by funds generated by the firm receiving EDC financing (the co-project). The EDC is in no way liable for repayment of the bonds. In addition, the status of EDC's as independent, non-profit corporations precludes liability for the bonds on the part of the local municipality. If a business were to default on the repayment of the bonds, the loss would be incurred by the bond purchaser, usually a bank.

Because of the existence of the possibility of a loss to the bond purchaser, banks conduct a financial investigation of the potential co-projects to determine their credit worthiness before buying the bonds. Banks also require about 20% collateral before purchasing bonds as a rule. Thus, only financially sound companies with good credit ratings obtain EDC financing. Act 338 isn't set up to help struggling businesses.

The general financial procedure followed by EDC's and co-projects, with some variation, is the following. The EDC issues the tax exempt revenue bonds and once the bonds are floated the EDC is the owner of the property and holds title to the property. The EDC then leases it to the user (co-project); the user "buys" it and obtains the title when the bonds are repaid. Thus, it becomes a lease-purchase agreement.

Under this procedure no money actually flows through the EDC. The EDC passes on the property title to a trustee. The trustee acts as an intermediary between the investor (bank) and the co-project (firm) and performs the actual financial transactions. Specifically, the bonds and lease payments are channeled through the trustee. The role of the EDC is merely to issue the tax free revenue bonds and act as a lessor. The procedure is illustrated in the following diagram:

THE EDC FINANCING MECHANISM



In summary, withstanding the issuance of the tax free revenue bonds, everything is channeled through the private market utilizing a trustee mechanism.

The Costs of Bond Financing

Revenue bonds are usually issued for projects of $300,000 and above. Generally, if the amount is any smaller, the costs of bond financing exceed the savings. It should be emphasized that the costs of bond financing are incurred completely by the co-project. Costs to the co-project include a processing fee charged by the EDC's which usually ranges from $250 to around $1000. This is charged to cover the operating costs of the EDC. The greatest cost is for bond counsel. Bond counsel performs the service of drafting the necessary documents, insuring that statutory procedures are followed, and that the bonds meet the requirements of IRS regulations and rulings regarding industrial revenue bonds in order to retain their tax exempt status.

Services Provided by Bond Counsel

The information provided by bond counsel is presented in the form of a bond transcript, a part of which consists of the bond opinion, affirming the legality and tax-exempt status of the bonds. The bond counsel also does a credit verification of the co-project, and a non-litigation verification to insure that there aren't any outstanding legal claims against the co-project. While the bond counsel investigates the financial viability of a co-project to a limited extent, and points out any financial problems it may find, it officially disclaims any liability for assuring the financial viability of a firm. The official role of bond counsel is expressed as caveat emptor (let the buyer beware).

The Employment of Attorneys and a Trustee

There are usually at least three attorneys involved in the EDC financing process. Besides the bond counsel, the bank and the co-project (borrower) both employ attorneys, and possibly the EDC itself may employ an attorney.

The trustee is employed by the bank and usually a bank uses its own trust department. If an independent trustee is desired by the borrower, the costs increase, and as previously mentioned, these costs will be borne by the borrower.

The bond counsel works in conjunction with the bank with regards to the financial terms of the bonds; such as the length of the note, the interest rate, mortgage indenture, etc. There may be one bond and one maturity date, or a mix. The maturity dates on EDC revenue bonds usually vary from 15-25 years.

Identification of Different Types of Lendors

While the lendor has been referred to as being a bank, it should be clarified that the lendor can be any type of investor, such as an insurance company or investment company. An investment company buys bonds and then resells them among several clients. In the case of EDC revenue bonds, however, in the majority of instances the investors are actually banks, and the banks do not buy the bonds for the purposes of resale.

Although the lendor (investor), rather than the EDC, takes the risk as to bond repayment, many EDC's emphasize the importance of the EDC in insuring that the co-project is a sound project. If a co-project were to default, it would be a reflection on the judgement of the EDC which approved the project. Confidence in the EDC would be marred, and it would create difficulty in marketing bonds in the future. Therefore, while banks perform the investigation into the credit worthiness of a firm, EDC's should exhibit a perceptive and responsible ability to examine the strength of a project possibility. Whether an EDC exhibits this ability or not is, of course, a function of the expertise of the members of the board of directors.

Right of Condemnation

Outside of the people of the financial aspects of EDC's, one part of Act 338 that has generated concern is the right of condemnation. Actually an EDC does not have this right, rather the act allows local municipalities to condemn property and then turn it over to the EDC. The EDC would in turn lease the property to the co-project (firm). In these cases, the EDC would have the power to generate replacement housing for the displaced people. This part of the act was included mainly because of Detroit, it has not been used. Businesses fear they would immediately make enemies of the public, and that would be counter-productive.

Tax Abatement

Tax abatement has been another area of concern. Again, the EDC may not grant tax abatement directly (exemption from ad valorem taxation). However, a municipality may do so if the project is owned by the EDC or if the EDC has a controlling interest in it. This has only occurred in one instance to date, though EDC's prefer to recommend to companies that tax abatement be applied under Acts 198 and 255 instead.

Project Citizens District Councils

Another part of Act 338 which has been little used is the section allowing for the direct participation of citizens by the establishment of a "Project Citizens District Council" for the area included in the project plan. Generally the project approval process doesn't generate sufficient interest to stimulate citizen demand for the creation of a citizens council. When controversy does exist, it is usually handled through the general approval process which calls for public hearings before the incorporation of an EDC, the designation of a project area, or the approval of a project plan. Difficulties are usually worked out and compromises reached by the Planning Commission. The Commission determines whether the project fits into the community's zoning requirements and is consistent with local needs. The only other citizen participation occurs through the automatic appointment of two citizens as additional directors to serve for each new project area.

Summary of Current Activity of EDC's in Michigan

Given that the approval process both for the formation of EDC's and for EDC bond issues is completely local, it is not surprising that there is no precise information on the activity of EDC's on a state-wide level. In order to begin to gather information the Community Economic Development Division (Office of Economic Development) conducted a survey of 125 EDC's from January to March of 1979. The results of this survey are helpful in indicating the general scale of activities of EDC's throughout the state.

While only 67 questionnaires were returned, it is felt that this captures the activity of EDC's. The EDC's not responding are assumed to be inactive. Thirty-nine of the EDC's who responded have completed or are in the process of completing a bond issue. This low figure again highlights the difficulties EDC's experience in achieving rapid activity. These issues represent 150 projects which include $231,650,000 of revenue bond financing and total project costs of over $245,000,000.

The Community Economic Development Division feels that Act 338 should promote primarily job growth (vs. retention), thus only new job growth was measured. It is estimated that 5,700 new jobs were created as a result of EDC financing. This job growth occurred as a result of only 29 of the 39 EDC's financing projects. The lack of job growth demonstrated by the other ten EDC's illustrates that not all EDC projects automatically generate new jobs.

The 150 projects can be loosely classified as 46 in the industrial sector and 104 in the commercial sector. The industrial projects total $60.9 million and represent the creation of 2,014 jobs. The commercial projects total $170,750,000 and created almost 3,700 jobs.

The range of interest rates reported on bond issues is from 6 to 10%, and figures compiled on the average interests rate of 12 projects completed during the last quarter of 1978 reflect a 7.22% average rate. This rate was approximately 3-4% below the market interest rate at the time. Currently the average interest rate on EDC bonds has increased somewhat but still remains between 8 to 10% as a rule, while commercial rates have climbed 15 to 16%.

This yields an interest rate differential of 5 to 6% at the present time. The interest rate is obviously flexible and the particular rate a firm will obtain depends in part on the bank's interpretation of the financial soundness and credit worthiness of the firm. Banks will be willing to accept a lower interest rate for their better customers where less risk is present.

Most of the 125 EDC's surveyed were formed during 1977 and 1978 and 40-50 new EDC's are expected to be formed in 1979. Furthermore, most of the EDC bond issues were completed during 1978 or are still in process. Thus, it is reasonable to conclude that as new EDC's experience the initial organization, legitimization, and project identification period, there will be a substantial increase in EDC financing activity in the future. Therefore, conceivably, the job growth and economic development potential resulting from Act 338 will continue to increase in the future.

Some Possible Impacts of Act 338

At this point it would be enlightening to discuss the validity of the claims to increased job growth and economic development potential resulting from Act 338. In order to confront the issue of the impact of Act 338, the "with and without" situation must be considered. Specifically, there must be a recognition that the results of the "with" Act 338 situation, don't necessarily imply that none of the same results would have occurred "without" the existence of Act 338.

What would have happened without Act 338 is difficult to determine, however, particularly since there is no state regulation of the act and no attempt to insure that EDC financing is only granted in marginal cases. However, some of the pros and cons may be discussed.

A major criticism of Act 338 is that it is applied in a discriminatory manner. In otherwords, while some firms receive the benefits of EDC financing, others do not. This tends to create an artificial advantage for some firms over others.

In addition, in many cases this advantage was probably given unnecessarily in the sense that the firm's expansion would have occurred even without the existence of Act 338. Particularly with regards to such firms as McDonalds and Elias Brothers, who are receiving EDC financing throughout the state, EDC financing was probably a minor part of the decision to locate in certain areas. These firms are known for doing a very thorough market investigation, and they locate where they will make a profit.

On the other hand, it is pointed out that EDC financing is granted in many cases to firms not usually entering the capital market. For some firms many expansionary or replacement projects are definitely marginal, and an interest rate differential of 2-5% makes the difference between whether a firm will undergo the new activity or not. In these instances, the jobs that were created probably wouldn't have been without the existence of Act 338.

Many people are quick to point out the trend of some Michigan based companies to leave Michigan, seeking a better business climate elsewhere. While this may not happen overnight, some see major corporations gradually discontinuing the replacement of Michigan plants as they become obsolete. EDC financing can be seen as part of a program to put Michigan on an equal standing with other states, compensating for higher taxes, worker's compensation, etc. Thus, some see job retention, rather than new job creation, as the major benefit of Act 338.

In response, others claim that threats of businesses to leave Michigan are often idle because of the many advantages of Michigan as a prominent industrial state. Thus, some businesses may use such threats only as a ploy to obtain the special privilages of economic incentives.

In summary, the question to be considered is: does Act 338 merely give special advantages to certain firms at the expense of others, while not affecting the end results of job creation and economic development, since basically the same amount of investment would have occurred even without EDC financing? This question will most likely be debated for quite some time.

Michigan Economic Development Incentive Concept (MEDIC)

The Michigan Economic Development Incentive Concept (MEDIC) is a state assistance program for local economic development which is administered by the Community Economic Development Division of the Office of Economic Development, Michigan Department of Commerce. MEDIC was established by action of the Michigan Legislature and the Governor in 1976. The purpose of MEDIC is to carry out state-local economic development goals and strategies by assisting communities to improve their own abilities to develop and inplement economic development programs.

The primary role of the state in the program is to act as a catalyst to stimulate the creation of local "umbrella" organizations for economic development. These organizations should insure the establishment of a comprehensive, coordinated economic development structure, with each "umbrella" organization then acting as the primary promoter and implementer of the local development program. MEDIC programs are generally on a county level since the state has found that this tends to yield the broadestand most efficient local development effort.

Requirements for Participation in a MEDIC Program

In order to participate in a MEDIC program, certain requirements must be met. The most important is the concept of demonstrated need. A definite need for the project - that it will improve local economic development efforts - must be demonstrated and justified. The process of demonstrating need is based on the unique conditions of each municipality (county) because a standard application form is not used. Therefore, each municipality itself must determine what factors or information will create a solid case for MEDIC program and decide how to present them convincingly. They also must present an actual work program, specifying the activities that would be undertaken by their MEDIC programs once approved.

The second most important requirement deals with jobs. Unemployment must be above the state-wide average, or severe economic dislocations or cyclical economies must exist; and the use of MEDIC funds must be justifiable on the basis of jobs retained or created.

Another requirement is the existence of strong support for a MEDIC program from both public and private sectors. Without cooperation between these two sectors, the efforts of a MEDIC program to promote development would be in vain. Thus, the "umbrella" organization should include both sectors and take advantage of all local resources.

The MEDIC Funding Process

The entire approval process for a MEDIC usually takes about one year approved, the mechanism for funding MEDIC programs involves (in total) 50 percent state (in grant form) and 50 percent local (public/private) funds over a three year period. However, the state generally funds 75 percent the first year in order to help local government over the initial hump, and then gradually phases out completely by the fourth year. Contracts are written annually, therefore, if the state is dissatisfied with a municipality's performance, the program may be terminated at the end of the year. When state involvement based on the foundation created under MEDIC. In otherwords, this is not a dead end program; instead, it aims to be the beginning of an economic development program that will serve the municipality for many years.

Common MEDIC Activities

MEDIC funds are used for purely administrative purposes. One of the most common activities carried out in the first year of a MEDIC program is an inventory, the identification and cataloguing, of all of the available property in the municipality.

This serves as an important part of the organizational base created in the first year, as program administrators begin to obtain an idea of the actual commercial and industrial base that they have to work with. At this stage deficiencies and strengths are highlighted, narrowing the focus of their efforts to specific areas. The second year often involves an entrance into the commercial and marketing sectors, although state funds cannot be used for advertising. By the third year it is almost a necessity that an Economic Development Corporation often is set up expressly to serve as the "umbrella" organization required by MEDIC. Industrial Development Corporations are also used as "umbrella" organizations.

Currently there are twelve MEDIC programs in the state. There is a maximum of $750,000 in the state coffer allocated to MEDIC, so there is a funding limitation. The legislature is supportive of the program, however, and may allocate up to $1 million dollars to MEDIC next year. At the present time there is not an overwhelming demand on the part of municipalities to participate in the program, although this may change in the future as it becomes better publicized.

In summary, for a county facing severe unemployment problems and seeking a way to become involved in economic development in order to ameliorate these problems, MEDIC might provide a means to become acquainted with the concept of economic development and provide the framework for establishing a sound and lasting economic development program.

Tax Abatement

A. Plant Rehabilitation and Industrial Development Districts Law (Act 198, 1974)

The purpose of this act is to maintain existing jobs and create new jobs by granting tax benefits to companies who will either construct new industrial facilities or rehabilitate obsolete industrial facilities. The approval process begins locally where either a township, village or city may adopt a resolution establishing a Plant Rehabilitation District (for an obsolete facility) or an Industrial Development District (for a new facility) [see Table 9]. After the district has been created, the interested company may apply for an Industrial Facilities Exemption Certificate. If granted, this exempts the company from ad valorem property taxes for a period which may vary from one to twelve years. Originally the law allowed only for a standard twelve-year exemption, however, this was amended to allow for different exemption durations in each case. The possibility of using this as a political ploy is obvious, therefore, many communities have chosen to avoid this by granting only twelve-year exemptions.

The Industrial Facilities Tax

In place of property taxes, the company will pay the Industrial Facilities Tax. For a rehabilitated facility the Industrial Facilities Tax is applied at the same rate as the property tax. However, the state equalized valuation of the facility remains at the assessment level of the obsolete facility prior

TABLE 9

APPROVAL PROCESS for Act 198 - 1974

Plant Rehabilitation and Industrial Development Districts Law (M.A. 198 - 74 as amended)

1. Local municipality (township, village, city) - adoption of a resolution establishing a P.R.* OR I.D.** district; and approval of the application for an Industrial Facilities Exemption Certificate.

↓

2. Michigan Department of Commerce, Office of Economic Development, Industrial Development Division - reviews the applications for legality.

↓

3. State Tax Commission (a part of the Michigan Department of Treasury) - review and final approval.

For information contact:

Office of Economic Development
Industrial Development Division
P.O. Box 30225
Lansing, Michigan 48909
517/373-3550

* Plant Rehabilitation District (for a rehabilitation project)
** Industrial Development District (for a new facility)

to the improvements. "Therefore, the firm receives a 100% exemption from ad valorem property taxes on the value of the improvements." For a new plant, the Industrial Facilities Tax is half of the millage rate of the property tax normally applied. Thus, a firm receives a fifty percent exemption from the ad valorem property tax on the value of new construction.

<u>The Approval Process at the State Level</u>

The final stage in the approval process is at the state level. The Office of Economic Development (Industrial Development Division-Domestic Section) of the Michigan Department of Commerce, reviews the applications for legality and then refers them to the State Tax Commission (Michigan Department of Treasury) for final approval and issuance of the Industrial Facilities Exemption Certificate. Final approval is determined without a serious attempt to investigate the real need of an applicant for the exemption - need is not a requirement of Act 198. The effect of the expansion or rehabilitation on employment is considered and the applicant must meet basic legal and timetable requirements stated in the act (particulary in Section 9).

One of the most important requirements is that the total of tax exemptions already granted and currently in force, and the proposed new exemption, must not exceed 5% of the particular town's SEV (State Equalized Valuation). When this is the case, the application is referred to the State Treasurer where an economic analysis is done to determine whether the exemption would substantially hinder the operation of the municipality involved or damage the financial soundness of any of the tax units involved. It is not unusual for the State Treasurer to decide that the municipality will not be adversely affected and to grant the Industrial Facilities Exemption Certificate.

Estimated Impact on Investment

The state has seen a tremendous surge in Act 198 applications in the last two years and recently there has also been an increase in cases where the 5% of SEV is greatly exceeded. In contrast to MEDIC, a standardized application form is used at the state level, facilitating the approval process. (For further information see the address stated in Table 5.) According to the Office of Economic Development, as of December 31, 1977, 478 Industrial Facilities Exemption Certificates had been issued to businesses which had invested approximately $1.6 billion in new plants and equipment in Michigan; 31,000 new jobs had been created and about 40,000 have been saved. Of course, these figures may be misleading since it is not possible to prove whether these jobs would have been created or retained even without Act 198. However, since Michigan faces a highly competitive situation and is very anxious to create or maintain a favorable business climate in the state in order to retain and attract industry, the state feels that this type of economic incentive is an important part of its economic development program.

B. Commercial Redevelopment Districts Act (Act 255, 1978)

The Commercial Redevelopment Districts Act provides tax abatement for commercial enterprises, just as Act 198 does for industry. However, Act 255 only applies to the rehabilitation of obsolete commercial facilities and to the construction of new facilities in areas of declining commercial value or areas characterized by obsolete property.

The Approval Process

The local approval process for tax abatement under Act 255, involving first adoption of a resolution establishing a Commercial Redevelopment District, is the same as in Act 198 (see Table 10). The next step involves receiving applications for Commercial Facilities Exemption Certificates (on forms prescribed by the State Tax Commission) which are filed with the municipality

TABLE 10

APPROVAL PROCESS for Act 255 - 1978

Commercial Redevelopment Districts Act (M.A. 255-78)

1. Local municipality (township, village, city) - adoption of a resolution establishing a commercial redevelopment district; and final approval of the application for a Commercial Facilities Exemption Certificate.

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2. State Tax Commission (a part of the Michigan Department of Treasury) - receives and files copy of the Commercial Facilities Exemption Certificate.

For information contact:

Office of Economic Development
Community Economic Development Division
P.O. Box 30225
Lansing, Michigan 48909
800/292-9544 (toll-free, in-state)
517/373-2375
Detroit Regional Office: 313/256-9300

(city, township, village). However, in contrast to Act 198, the applications are not only reviewed locally, but final approval is granted locally also. Once granted, a copy of the Commercial Facilities Exemption Certificate is filed at the State Tax Commission (Michigan Department of Treasury.) This is the only direct involvement of the state in the approval process under Act 255.

The specific tax abatement granted is the same as in Act 198; an exemption from ad valorem property taxes is granted in each case and the Commercial Facilities Tax is applied in lieu of ad valorem property taxes. The tax is determined in the same manner as was previously outlined in Act 198 for the two cases of an obsolete or new facility.

The Use and Implementation of Act 255

There are several conditions that Act 255 requires to be met in order to obtain a Commercial Facilities Exemption Certificate (for further information see the address given in Table 6); yet in actuality there is no real enforcement procedure since final approval is granted locally. As a result, the State Tax Commission is beginning to receive copies of Commercial Facilities Exemption Certificates which do not meet the requirements. However, because of the high costs of regulation, the state is not anxious to require approval of Act 255 at the state level; thus, any future correcting activity is not foreseen.

Part of the questionable use of Act 255 stems from the lack of adequate guidelines defining redevelopment. The specific intent of the act is to provide incentives for run-down commercial areas and obsolete commercial facilities, yet since there isn't a strict definition of what is acceptable and meets the intent of the act, there is an opportunity for liberal interpretation of such terms as "declining commercial activity."

In order to help insure that municipalities make reasonable, consistent definitions, the OED suggests that cities (municipalities) identify the declining areas they're concerned with and publicize the fact that they'll entertain applications for Commercial Facilities Exemption Certificates in those areas. In other words, cities should establish concrete criteria for determining acceptable applications and enforce this. That helps to avoid such inconsistencies as cities declaring an empty lot in the middle of a thriving commercial zone to be run-down and declining in value, and thus eligible for tax abatement.

In reality, reasonable criteria and guidelines are often difficult to enforce because nearby municipalities may not show equal discretion in the use of Act 255; this often makes municipalities feel compelled to match another community's liberal use of Act 255, in order to compete.

Industrial Development Corporations

One of the first economic development tools, originating before the concept of economic development fully emerged, is the Industrial Development Corporation. IDC's are non-profit corporations, and as such are provided for and regulated by the Michigan General Corporation Act of 1931 (Act 327). The Office of Economic Development, Michigan Department of Commerce, encouraged the formation of Industrial Development Corporations according to the provisions governing non-profit corporations under Act 327, with the intention of creating a type of corporation designed for the purpose of promoting industrial developments.

Tools Open to IDC's

IDC's are generally formed by local businessmen at the city level, although as non-profit corporations they may be formed at any level. The tools open to IDC's to raise money range from accepting donations, borrowing money from banks, to selling stocks or notes on the street. IDC's don't have the power to issue industrial revenue bonds. Their activities are basically at the grass-roots level, involving a group of local businessmen who raise money in order to purchase property or to build shell buildings which can then be offered for sale at low rates to attract industry. This is in line with earlier attitudes that a limitation to a business locating in a particular area might be the lack of a building or facilities. In general, this approach was never very successful.

Small Business Administration 505 Loan Program

A stronger economic development program in which IDC's may participate is the Small Business Administration 505 loan program. This program is designed to assist local units of government and banks in their attempts to aid small businesses. Qualifying businesses may receive loans of up to 50% of the cost of an expansionary project or up to $500,000. The IDC is the direct recipient of the SBA loan, and the loan is then channeled to the respective business. SBA 505 loans are offered at subsidized interest rates, usually of about 6-1/2%.

The loan program requires the participation of local bank. The bank loans the equivalent of 40% of the project cost at normal interest rates. The remaining 10% of the project cost is provided from IDC funds.

Under the SBA 505 program the bank is given a first mortgage position, the SBA is given a second, and the IDC is given a third mortgage position. Therefore, IDC's do assume the majority of the risk or liability under the SBA 505 program.

Another program utilized by IDC's is the SBA 7a loan program, involving loans directly to the business in question for the purposes of covering working capital expenses. This program, utilized in conjunction with the SBA 505 program, may provide a total of $1½ million in loans to a small business.

Formation of IDC's

The formation of an IDC involves standard incorporation procedures for a non-profit corporation. The articles of incorporation are filed at the Corporation and Securities Bureau of the Michigan Commerce Department. The oversight procedure for IDC's is carried out by the Internal Revenue Service, by insuring that IDC's meet the IRS requirements for non-profit corporations.

Although many communities throughout the state have IDC's (approximately 150), there is not a record of substantial activity in most cases. Often IDC's are merely shell organizations, lacking the tools or expertise to function as development corporations. Since the advent of Economic Development Corporations however, some IDC's have been reactivated in conjunction with the general interest in economic development. In some instances, Industrial Development Corporations have also served as the "umbrella" organization required by MEDIC to organize a municipality's approach to economic development.

Nevertheless, the role of IDC's in promoting economic development in Michigan should not be downplayed. This was one of the few economic incentives available to offer to Michigan industry for many years. IDC's have been active in promoting Certified Industrial Parks, the fruits of which are often not seen until many years later. Furthermore, IDC's can still play an important role in communities without Economic Development Corporations.

Michigan Industrial Development Revenue Bond Act (Act 62, 1963)

Another example of the earlier economic development tools is the Michigan Industrial Development Revenue Bond Act (M.A. 62-63). This act allows a county, city, incorporated village, township or port district to issue industrial revenue bonds which are exempt from the federal or state income tax. This yields an interest rate about 2-5% lower than the market interest rate.

In order for industrial revenue bonds to be issued a public purpose must be defined, demonstrating that the economic welfare of the municipality will be benefited by the bond issue. The benefit to the industry, while important in encouraging the industry to locate in a particular community, is purportedly of secondary importance under Act 62. Yet in reality, the interpretation of the phrase "public purpose" is quite broad; thus, Act 62 has been applied in a relatively liberal fashion.

The IDRB Approval Process

The approval process for any bond issue under Act 62 involves approval at the state level (see Table 11). The first step requires the local municipality to adopt a resolution authorizing issuance of the bonds; this resolution is then sent to the Municipal Finance Commission (Michigan Department of Treasury) for final approval. Therefore, in contrast to Act 388 where final approval is obtained locally, Act 62 involves a more public, formal investigative process. This has begun to result in a diminishing usage of Act 62 and an increasing reliance on Act 338 since Act 338's inception in 1974. In addition, Act 62 is limited to use by industry and isn't extended to commercial enterprises as is permitted under Act 338.

However, Act 62 still serves an important function for communities without EDC's and also serves a complementary, lessor role for communities with active EDC's. Forty-six issues of Industrial Revenue Bonds with a total amount of $491.8 million had financed industrial expansion in Michigan from the inception of the program through May 15, 1974. (OED, MDC).

IRS Limitations to the Dollar Amount of Bond Issues

A limit to the dollar amount of bond issues under both Act 62 and Act 338 exists. This is federal limit regulating the dollar amount of a project that

TABLE 11

APPROVAL PROCESS for Act 62 - 1963

Industrial Development Revenue Bond Act (M.A. 62 - 63)

1. Local municipality (a county, city, incorporated village, township or port district) - adopts a resolution authorizing issuance of the bonds (including the specific terms thereof).

↓

2. Municipal Finance Commission (a part of the Michigan Department of Treasury) - final approval of the bond issue.

For information contact:

Office of Economic Development
Industrial Development Division
P.O. Box 30225
Lansing, Michigan 48909
517/373-3550

can be financed by tax-exempt revenue bonds to: "one million dollars free of any restrictions on capital expenditures; or ten million dollars, subject to the limitation that the company's capital expenditures in any one locations over a period of three years before and three years after the date of issues may not exceed ten million dollars. If capital expenditures exceed this limit, the bonds lose their tax exempt status. There is no limit on the size of bond issues to finance air and water pollution control facilities and solid waste disposal facilities."

The Economic Development Commission Act (Act 46, 1966)

The Economic Development Commission Act of 1966 represents another example of the first economic incentives. Act 46 provides for the creation of Economic Development Commissions at the county level, for the purpose of promoting economic development. Economic Development Commissions plan approaches to economic development and apply for and serve as recipients of economic development grants.

Economic Development Commissions are created by the board of commissioners of any county. The boards of commissioners of two or more contiguous counties may create a regional economic development commission. Commissioners are required to have from three to eleven members.

Economic Development Commissions have never been extensively utilized, probably because they are lacking in concrete development tools. However, the concept serves as a recognition of the potential role of counties as overall planners and investigators of economic development problems and solutions and as publicizers of the material economic and cultural advantages of an area. This concept was later strengthened in 1976 with the development of the Michigan Economic Development Incentive Concept (MEDIC).

Certified Industrial Parks

A third economic development tool is Michigan's Certified Industrial Parks Rating System. This represents the nation's first program of assured site characteristics for industrial parks. Out of great inconsistency in the quality of industrial parks, with characteristics ranging from highly organized industrial districts, to completely undeveloped and isolated corn fields for example, the need arose for a standardization of the term. In this way businesses can expect that any park rated as a "Certified Industrial Park" in Michigan, will meet certain minimum requirements.

Approximately 90 parks have been rated since 1970, and 71 have been certified. In order to be eligible for rating, an industrial park must meet the following basic requirements: minimum size of 40 acres, zoned for industrial use, have both external and internal paved streets, and have water and sanitary sewer installed. After meeting these requirements, promoters of an industrial park may request a rating.

The Rating Procedure

The Michigan Professional Development Association (mainly private) has established the criteria for rating and performs the rating in conjunction with the Industrial Development Division, Domestic Section, of the Office of Economic Development, Michigan Department of Commerce. The rating is done on a point basis, with a minimum number of points required in order to be certified, and beyond that, a park may receive an A, B, or C rating. The rating is granted by the Director of the Michigan Department of Commerce.

While the development of a "Certified Industrial Park" may require a substantial investment, it may also serve a significant role in attracting industry to a municipality. An important complement to a park is the existence of some type of economic development program, such as in the form of an Economic Development Corporation or an Industrial Development Corporation. Often parks are constructed at great cost, but remain unsold because of lack of an organized group backing and actively promoting economic development. Chambers of Commerce, which have strong ties to industry, can also be very helpful in promoting the sale of industrial parks. In order for Chambers of Commerce to participate, however, a rapport must first be established between local government, an EDC or IDC for example, and the Chamber. The importance of cooperation between business and government must again be emphasized, and will be seen later in an example involving Berrien County.

Clinton County

A Case Study of the Formation of an EDC

Clinton County is an example of a "bedroom" county. In 1970 only 33% of the county's population of 55,000 was employed within the county, while the majority traveled to nearby areas such as Lansing and Flint to work. This creates an imbalance between the demand for services and the tax base to provide these services, since in the long run residential premises tend to be draining on the tax base. A significant commercial and industrial base is needed in order to have a viable local tax system. Clinton County lacks this. Specifically its tax base is 54% residential, 34% agricultural, and only 3% industrial and 9% commercial.

The Economic Development Commission

Because of an increasing pressure on the part of residents for more services, the county recognized the need to expand the commercial and industrial base, thereby increasing tax revenue. In order to attract new industry and retain old, the County Board of Commissioners began actively promoting the concept of economic development. To this end an Economic Development Commission was formed (with county funding) for the purpose of gaining a better understanding of economic development and to create a general awareness of and support for economic development on the part of all members of the County Board of Commissioners, the Planning Commission, community leaders and businessmen.

The Economic Development Commission sought information from three sources - the Community Economic Development Division of the Michigan Department of Commerce; private business interests (successful developers); and other counties involved in economic development. The Commission's role was purely to gather and communicate information on economic development and no official studies were performed. The Commission members then determined that the formation of an Economic Development Corporation would be the best approach to economic development.

Formation of the Clinton County Economic Development Corporation

In January of 1977 three members of the Economic Development Commission petitioned for the incorporation of an Economic Development Corporation (EDC). The petitioners represented banking, farming and governmental (a former chairman of the Board of Commissioners) interests. Within a matter of two months the petition was approved. The road to acceptance of an EDC had been well paved in advance by the Economic Development Commission.

The nine-members of the EDC Board of Directors were chosen from the members of the Economic Development Commission, including the three EDC petitioners. In all, the different backgrounds existing on the Board of Directors are: six business (industrial, construction, and marketing), one governmental, one farming, and one banking. In addition, the Board has three ex-officio members. Two are well-known developers from the Lansing area, and one is the current chairman of the County Board of Commissioners. These people participate in order to provide specific and valuable expertise. Also, one of the Board of Directors members with a business and development background was hired by the county as a consultant for economic development. He not only serves on the Board but also works full-time on economic development. Thus, Clinton County has attracted experts in the field to assist them and has made a definite commitment to economic development. Also represented on the Board of Directors are different geographical areas and population centers of the county. There are three members from St. Johns, three from Watertown, and one each from DeWitt, Elsie, and Ovid.

Projects Receiving EDC Financing

Once the EDC was formed the first step (which is still on-going) was to actively publicize its existence and attributes among the local industrial and commercial enterprises. It is very important to become acquainted with the business community and to establish a supportive, cooperative rapport. The EDC Board can convince the community that county government is willing to work with and for them, particularly where the impetus for formation of the EDC comes from government rather than business.

This setting of the stage for economic development began to pay off quickly, as the first project proposal was received in October of 1977. In all, three projects are actually functioning currently and two more have been approved but construction not yet begun. All of the projects have been commercial rather than industrial, although the EDC Board is also interested in industrial projects. In each case the commercial enterprises themselves have approached the EDC board to express an interest in obtaining EDC financing, after having been made aware of the possibility through the Boards' communication efforts. The approval process has proceeded quite smoothly in each case, and no "Project Citizens District Councils" have been formed.

Specific information on the projects is as follows:

Project Type	Location	Jobs Created	Expension or New Construction
Shop Rite (grocery store)	DeWitt	40 (many youth)	New
Eagon Ford (auto dealership)	St. Johns	20	Expansion
Elias Brothers (restaurant)	St. Johns	40 (many youth)	New
APPROVED, BUT NOT YET CONSTRUCTED			
O'Shanessy (auto dealership)	DeWitt Township	25-35	New
Medical Center	St. Johns ?	20 ?	New

These projects have received financing at 7 - 7-1/2% interest rates. Each ranges in value from $1/2 - $1 million and in total they equal approximately $3-1/2 million.

Criteria for Selecting EDC Projects

The criteria used by the EDC Board of Directors in selecting projects is basically that they contribute to business retention, job creation, and tax base expansion, while at the same time meeting general needs of the community. For example, the medical center is being constructed to improve health service in the county. Clinton County has one of the lowest doctor/population ratios in the state. In the case of the Elias Brothers, it was felt that in order to attract restaurant customers off the highway and to bring business into St. Johns, a well-known restaurant chain was needed. Incidently, Elias Brothers is taking advantage of EDC financing in several municipalities throughout the state and is selling all of the bonds at the same time. The EDC Board of Directors felt that EDC financing as an incentive was necessary to help attract the Elias Brothers and the Shop Rite to their county. There is definitely competition between municipalities and EDC financing can provide them with a competitive edge to help insure that a business locates in their area. The auto dealerships are local businesses that probably would not have had the resources to expand without EDC financing.

Other Examples of County Involvement in Economic Development

Prior to the formation of the Economic Development Commission, there was not a history of government involvement in economic development. There was no MEDIC program since Clinton County is slightly below the state-wide unemployment average. Three Industrial Development Corporations existed in Ovid, Elsie, and St. Johns, but they hadn't been active. However, recently the

St. Johns IDC has begun to approach the development of an industrial park. The chairman of the Board of Commissioners and one of the prime promotors of economic development is now an ex-officio member of the St. Johns IDC. Thus, it may be possible that economic development expertise acquired by EDC members is helping to stimulate economic development at other levels in the community. EDC board members also provide a general information role for business, such as helping industries in obtaining Industrial Facilities Exemption Certificates under Act 198. To date none of the EDC projects (all commercial) have applied for Commercial Facilities Exemption Certificates under Act 255 since they have involved new construction rather than rehabilitation as Act 255 requires.

Another county activity related to economic development is a project of the Planning Commission to develop an overall economic development plan or program in order to apply for federal funding from the Economic Development Administration (EDA) of the U.S. Commerce Department. Currently Clinton County isn't eligible for EDA funding, but might possibly be in the future. Therefore, the Planning Commission is preparing in advance for the possibility of getting funding through an OEDP to assist in the development of an industrial park.

Conclusion

In conclusion, the Board of Commissioners (and Planning Commission) recognized a need to expand the county's tax base both industrially and commercially. They realized that in order to do so the county should strengthen its basic relations with business and demonstrate its support of industry and commerce. Given the competitive situation that exists between counties, county officials realized that Clinton County must provide incentives in order to attract and retain industry and promote expansion and development. County officials found that the formation of an Economic Development Corporation was the best tool to fit their needs.

Berrien County

A Case Study of the Formation of an EDC

Located in the southwestern corner of Michigan, Berrien County (population 170,000) is part of a huge tri-state industrial complex. In order to retain industry Berrien County must be able to effectively compete with municipalities providing economic incentives in northern Indiana and Illinois. Furthermore, because of factors such as Michigan's high worker's compensation laws, Berrien County faces the loss of large corporations to the south where labor costs are lower. Berrien County is particularly wary of the loss of industry because of a 9% county-wide unemployment rate and a 15-20% unemployment rate in Benton Harbor-St. Joseph.

As a result, there has been a history of interest in economic development in Berrien County, particularly since the closing of several large plants in the county in the early 1970's. When Michigan's new economic incentive laws were passed, Berrien County and the Twin Cities were among the first municipalities to take advantage of them. To Berrien County, economic development is a means to insure, first and foremost, job retention and secondly job creation. This implies industry retention and the attraction of new industry.

The Economic Development Department

The Twin Cities Area Chamber of Commerce has been the driving force behind economic development. The Chamber's commitment to economic development is demonstrated by the existence of a special department within the Chamber which has the sole purpose of promoting development -- the Economic Develop ment Department. The Economic Development Department of the Twin Cities Area Chamber of Commerce consists of eight employees (approximately 1/3 of the total

Chamber of Commerce employees). The Economic Development Department is synonymous with the following six organizations:

1. The Economic Development Corporation (EDC) of the County of Berrien.
2. Berrien County Department of Economic Expansion.
3. Twin Cities Area Development Corporation.
4. Overall Economic Development Planning Committee.
5. Economic Development Committee Board of Realtors.

The Economic Development Department (EDD) is funded under annual contract with the Berrien County Board of Commissioners. The Department's current budget is $190,600 and it is administered by the Economic Development Department without county approval. The Economic Development Department has objectives of organizing and coordinating all of the different economic development entities and tools on a county-wide basis, and providing economic development expertise for each entity.

For example, the Department promoted the creation of the Berrien County Economic Development Corporation in 1975. One of the three petitioners for incorporation of the EDC was the Executive Vice-President of the Twin Cities Area Chamber of Commerce. Although the EDC is a separate entity and only one Chamber of Commerce employee is a member of the Board of Directors, the Economic Development Department uses the EDC as a financing vehicle to fit the needs of its economic development program.

Another example of the Economic Development Department's functions is to serve an information role for those wishign to take advantage of such development tools as are permitted under Acts 198, 255, and 62. The EDD has assisted enterprises in the writing up of applications for seventy Act 198's, six Act 62's, and two Act 255's. In this manner, the EDD has strengthened its relationship with the business community, making a concrete effort to create a favorable business climate and attract and retain industry.

Berrien County Economic Development Corporation

It must be stressed that the Berrien County Economic Development Corporation is not used as a means of organizing economic development as is often the case in other counties. Instead, it is used along with other economic incentives as part of an already existing economic development framework.

Orginally, information about Act 338 was obtained by inviting representatives of the Community Economic Development Division of the Commerce Department to come and share their expertise. The Economic Development Department didn't visit any other counties to obtain information since they were the second municipality and the first county in the state to form an EDC. It was also unnecessary to seek outside expertise in the general area of economic development, since this expertise was already available right at home.

In addition to the EDC petitioner already mentions, the two other petitioners for incorporation of the EDC included a banker and a businessman both of whom served on the Board of Directors originally. The petition for formation of the EDC was approved rapidly by the Board of Commissioners, who along with the Planning Commission, were strong backers of the EDC as part of their general support for economic development.

The nine members of the Board of Directors include four with banking and finance backgrounds, three with business backgrounds, one governmental (County Drain Commissioner) and a Chamber of Commerce member. Also the EDC includes a lawyer as an ex-officio member. Four members are from Benton Harbor, two from St. Joseph, two from Niles, and one is from New Buffalo. Thus, there is an attempt at a geographical distribution representative of the population centers.

Projects Receiving EDC Financing

The EDC has financed twelve projects in the past and is in the process of approving three more projects. Table 12 provides a list of the companies involved, the size of the bond issues, and the jobs retained and created. In total there have been six industrial projects, 4 commercial, and one recreational. Of the projects currently in the approval process, two are industrial and one is commercial. The majority have involved new construction rather than expansion of existing facilities.

Difficulties Encountered in the EDC Project Approval Process

Approximately one year and a half elapsed from the date of incorporation untill the time of approval of the first project. This can in part be explained by a lack of familiarity on the part of the business community with the act.

In the beginning, it was necessary for the EDD to perform an active role in publicizing the existence and attributes of Act 338 among the local industrial, commercial, and banking enterprises. This process occurred on a one to one basis and by letter. A serious effort at specific project indentification was made. The local news media also played a helpful role by covering EDD activities.

The first project approved was a marina. This became a controversial issue because of questions concerning riparian rights, (rights of landowners along the water area that would be affected). Thus, the public approval process was stalled, representing a case where considerable citizen input and concern did occur. Out of this controversy came a renegotiation of the form of the project and a compromise was reached in the Planning Commission stage.

The EDD believes that the public approval process is the place for decisions concerning the desireability to the public of a project to be determined. The function of the EDC in contrast, is mainly to determine the financial

Table 12

Economic Development Corporation Revenue Bonds
Issued in Berrien County

Company	Municipality	Total Request	Existing Jobs	New Jobs
Pier 1000 Marina	St. Joe Twp.	$ 1,200,000	--	10
Sheller-Globe Corporation	Niles Twp.	1,000,000	--	200
Printco, Inc.	Niles	950,000	--	30
K-Mart	Benton Twp.	3,020,000	--	200
Sandvik, Inc.	Benton Twp.	1,800,000	21	35
Harbor Land Restaurant	St. Joe Twp.	2,000,000	--	90
Mac Engineering	Benton Twp.	600,000	26	5
Alro Steel	Benton Twp.	1,000,000	11	6
Elias Bros.	Lincoln Twp.	700,000	--	60
Scope Services	St. Joe Twp.	475,000	500	65
Ace Hardware	Royalton Twp.	500,000	54	10
Gast Manufacturing	Benton Twp.	735,000	--	10
		$13,980,000	612	721

soundness of an applicant. Thus, whether the project fits into an area's zoning standards and meets the needs of the community or not, is determined by the Planning Commission and the public hearing process. The marina was seen as being beneficial to the general public because while it would not create many jobs directly, it would serve as a tourist attraction to boaters and bring in business to restaurant owners among others.

Some Reasons for Selecting the EDC Projects

The size of the corporations receiving financing is quite large, several being in the Fortune 500 category and three projects were constructed in the Twin Cities Industrial Park. Berrien County's reason for financing such large corporations is because of the competitive nature of the industrial complex they're located within. Berrien County receives pressure from businesses threatening to go elsewhere and finds it often difficult to attract new industry because of a suspicious attitude about Michigan's business climate. Through the efforts of the EDD, Berrien County seeks to demonstrate a friendly, welcome attitude towards business, they want to create a positive image of Michigan, assuring businessmen that Michigan municipalities will cooperate and work with them. This is seen as being crucial to industry retention and to induce new industry location in the county.

The rationale behind financing the Elias Brothers and other chains such as Meijers is that if a company is considering expanding in Michigan and constructing a specific amount of stores or restaurants, if EDC financing is obtained it might construct several more outlets than had originally been planned. So while a lack of EDC financing might not prevent a large company from expanding, it might enable the company to expand beyond their original plans, thus creating more jobs in Michigan.

The Role of the Banking Sector in EDC Financing

The role of the local banking sector in the EDC process has been very important in Berrien County. Without receptive banks to buy the bonds the EDC would have encountered problems in becoming active. The procedure for determining a bank's interest as a prospective buyer is for a company to direct a letter of intent to the bank stating their plans and needs and their desire to obtain EDC bonds. The bank then investigates the credit worthiness of the client and makes a decision on purchase of the bonds. Once the bank agrees to buy the bonds, the company approaches the EDC with a request for EDC financing. Basically the financial soundness of a company (the most important concern to the EDC) has already been assured through the informal process mentioned.

Other Involvement in Economic Development

It should be noted that no citizen's councils have been formed to support EDC projects in Berrien County. When great citizen interest exists, the issue is resolved through the Planning Commission.

With respect to other types of economic development in the county, three Industrial Development Corporations exist in Niles, Berrien Springs, and St. Joseph. However, these have not really been active in the past. Niles and St. Joseph have industrial parks, but they have not yet been sold. However, there is a Twin Cities Area Development Corporation which created the I-94 Pipestone Certified Industrial Park. This industrial park has been successful and its creator is a section of the Economic Development Department. Thus, the Chamber of Commerce has been influential in promoting the sale of the industrial park. Benton Harbor has an EDC but it is not active as yet.

Industrial Development Revenue Bonds were not used in the county until 1974, although Act 62 was passed in 1963. This is probably because it wasn't until the early 1970's that Berrien County saw the need for industry retention, as a result of industry loss. Since then IDRB's have been issued six times, the last occasion being in 1975. Since this time EDC financing has in a sense replaced Industrial Development Revenue Bond financing. This is probably because IDRB's must be approved at the state level by the Municipal Finance Commission, Michigan Department of Treasury. This requires a much more detailed and public investigation of a company's financial situation. Since EDC financing is approved locally and the financial soundness of a company is determined in a more informal manner, the use of Act 338 has rapidly become more popular than Act 62.

Shiawassee County

A Case Study of the Formation of an EDC

Shiawassee County (pop. 73,000) is faced with an unemployment rate above the statewide average; the current rate is approximately 8%. This has caused Shiawassee County to be very concerned with attracting and retaining industry in order to improve employment opportunities. Thus, job creation is the first priority of Shiawassee County's economic development program.

Motivations Behind the Shiawassee County EDC

The impetus for the formation of the Shiawassee County Economic Development Corporation came in part from the Michigan Cooperative Extension Service and the County Planning Commission. Both perceived the formation of an EDC as the best means to organize and promote economic development in the county.

The recognition of the need to form an EDC came in conjunction with a recognition of the importance of developing a county land use planning program to support and improve the zoning regulations of the Planning Commission. Prior to about 1974, the Planning Commission was only involved in zoning, without a planning program to make it effective.

Both of the above recognitions developed out of the initiation of an application for an Overall Economic Development Program (OEDP), a federal program of the Economic Development Administration, U.S. Department of Commerce. In order to obtain the approval of an OEDP and receive federal grants for economic development, an overall plan stating the needs of the county and the proposed plan of action of the OEDP if approved, must be submitted to the EDA. Thus, in the process of applying for the OEDP and examining the weaknesses of the county, the two needs mentioned above came to the fore.

The OEDP application submitted to the EDA had several deficiencies and currently is in the process of revision. So while an OEDP hasn't actually been put into action, its importance rests on the fact that in collecting information during the application process, many of the county's problems were highlighted and feasible solutions were proposed.

Formation of the Shiawassee EDC

In March 1976, a petition for incorporation of the EDC was presented to the Board of Commissioners by a retiring drain commissioner, a local banker, and an Owosso businessman (also Chairman of the Owosso Industrial Development Corporation). The approval process for the EDC didn't proceed as smoothly as in the two other counties mentioned earlier, however. It wasn't until May 1977 that the EDC was established, a lapse of approximately 1-1/2 years.

The delay in approval of the EDC resulted in part because of a lack of information concerning Act 338 and it's implications on the part of the Board of Commissioners. Furthermore, Owosso has an active Industrial Development Corporation, thus the EDC may have been perceived on the part of some as being unnecessary or threatening to the I.D.C.

Members of the EDC Board of Directors

The members selected for the EDC Board of Directors include four representing business and banking interests, two with governmental backgrounds, and three representing agribusiness. In addition, a M.S.U. Extension agent was an ex-officio member, representing county extension interests. There is a wide geographical distribution of the Board of Directors members throughout the county.

Organization of the EDC

Once the EDC was formed, it did not become operational immediately. This was in part because of a lack of funds. County Public Policy Agent Roy Spangler recognized the need for funds and obtained a grant through the Michigan Economic Development Incentive Concept. In 1978 agreement was reached on the administrative requirements and money was allocated from the state on a shared basis as was described earlier in the discussion of MEDIC. With funds to operate, the EDC immediately began the identification of project possibilities under the direction of Gene Biondi, as Executive Director of the MEDIC funded EDC.

The EDC serves as the "umbrella" organization required under MEDIC, and is the only county-wide organizaton dedicated solely to improving the county's business and economic climate.

One of the first activities of the EDC after receiving MEDIC funding was to conduct an inventory of current available industrial and commercial property in the county. In general, a broad set of information was compiled on the economic status of the county, this information served to highlight the economic development related problems.

The Work Program of the EDC

With the receipt of MEDIC funding a work program was developed for the EDC. This program established the role of the EDC as the long range planner of economic development for the county. The plan includes a business and industry retention program and a marketing program to promote Shiawassee County as a desireable location for expansion.

An important element of the program is cooperation between government and private interests, there is an attempt to help cut governmental red-tape that often creates difficulties for businesses. In general, the EDC seeks to demonstrate and promote the responsiveness of government to business, thereby improving the business climate. The EDC carries out its program by providing information to firms in several areas, including the following: land suitable for expansion or relocation; sources of low interest financing for industrial and commercial needs; legal and tax incentives; assistance with labor and personnel; and supportive public relations.

The EDC Board of Directors emphasizes the importance of supporting existing businesses which are considered to be the county's greatest asset. Thus, industry retention rather than new industry attraction is a key element of the EDC's program.

Projects Receiving EDC Financing

As of July 1979, the Shiawassee County EDC has approved or is in the process of approving fourteen EDC bond issues. Table 13 provides a description of the companies involved, the size of the bond issues, and the jobs created and retained. In all there have been 7 commercial projects 5 industrial and and two health care facilities. Eight projects have involved new construction rather than the expansion of existing facilities.

Other EDC Activities

The EDC works in conjunction with the Owosso Industrial Development Corporation, which is a sub-component of the Owosso Area Chamber of Commerce. An example of a recent joint effort is the IDC's construction of a 20,000 square foot spec building and sale at cost to a new company. The company financed the purchase of the building with EDC revenue bonds, and the EDC also aided the company in obtaining tax abatement under Act 198. Thus, the EDC supports the utilization of several economic development tools simultaneously.

The EDC Board of Directors includes several members who represent agribusiness interests. As a result, the EDC is currently promoting the creation

TABLE 13

Economic Development Corporation Revenue Bonds

Shiawassee County

Description	New Jobs Anticipated	Existing jobs	New Investment Potential
Industrial Machine Mfgr. Building second plant.	35	25	$ 800,000
New auto dealership facility.	25	20	1,000,000
Auto part mfgr. plant expansion	20	30	700,000
New Medical Center	25	0	1,000,000
Shopping Center Expansion	60	0	800,000
Beer & Wine Whse. Distribution Center	6	6	1,000,000
New Auto Dealership Facility	10	10	800,000
New Supermarket	10	10	800,000
Financial Instituion Expansion	15	52	600,000
New Farm implement Sale and Service Facility	4	6	500,000
Tool Manufacturer Expansion	15	22	500,000
Private Convalescent Center Expansion	35	72	1,300,000
New Machine Tool Facility	20	0	750,000
New Auto Parts Mfg. Facility	15	0	350,000
TOTALS TO DATE	295		$10,900,000

of a soy bean processing plant, with the end products being soybean meal for animal consumption and soy bean oil for human consumption. This would be the first plant of its kind in Michigan, and is seen as being of great benefit to agriculture in the area.

In summary, Shiawassee County perceived the formation of an Economic Development Corporation as being the best approach to promoting and implementing an overall economic development program for the entire county. The rationale behind the promotion of economic development is first job creation, tax base generation is of secondary importance. MEDIC funding was used to help achieve an active EDC, and the EDC has been used to not only directly benefit the urban population of the county, but also the agricultural community, through the support of agri-business.