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## **Vermont Legislative Research Shop**

### **Attracting and Retaining Businesses in Vermont**

Traditional state economic development strategies involve public policies that cut the cost of doing business, such as lowering taxes, providing land or subsidies to firms, and building needed infrastructure. Now states are targeting growth processes, regions, and economic sectors rather than individual firms. States do this by “participating in public-private partnerships, establishing venture capital funds and foreign trade offices, offering seed money for new ventures, encouraging collaboration and networking among clusters of firms, creating high-tech research centers at public universities, and devising other innovative strategies” (Saiz and Clarke, p. 417, 2008).

Economic growth models traditionally used by policymakers to assess their states’ economic development problems follow the “locational” or “smokestack-chasing” strategies. These theories “emphasize the importance of low costs for basic production factors, such as land, labor, raw materials, and capital, in attracting investment to a particular location” (Saiz and Clarke, p. 421, 2008). A new “entrepreneurial strategy” model has emerged since the prevalence of globalization. This model suggests that state development problems “stem not from high production costs but from environments not receptive to new and innovative technologies and business activities. State officials persuaded by this new entrepreneurial perspective are experimenting with policies that emphasize flexibility, risk taking, and market structuring on the part of state government to minimize barriers to innovation” (Saiz and Clarke, p. 421, 2008).

### **Economic Growth Models**

The three policy strategies that dominate the current state economic development agenda are entrepreneurial strategies, location-related incentives, and infrastructure strategies (Saiz and Clarke, p. 423, 2008).

#### **Entrepreneurial Strategies**

Entrepreneurial strategies are of the new economic model; they facilitate the growth process rather than influence particular firms in their choice of location (Saiz and Clarke, p. 423, 2008). This strategy gives government a central role, using, “leadership, information, strategic planning, public-private partnerships, and policy-brokering” (Saiz and Clarke, p.431, 2008).

When compared to models that utilize subsidy strategies, entrepreneurial strategies usually produce more equitable distributions of income (Saiz and Clarke, p. 437, 2008).

### **Example: North Carolina**

North Carolina focuses on *productivity* as the key that drives economic expansion by generating quality jobs, stimulating investment, and improving businesses' bottom-lines. A productive economy also produces more goods and services at competitive prices, strengthens the export base, attracts competitive companies, increases local investment, and promotes sustainability by competing on innovation and quality rather than low-costs alone. "Most importantly, productivity growth can contribute to economic prosperity by increasing employment and wages" (Cole, p. 1, 2008).

North Carolina's Department of Commerce Division of Policy, Research, and Strategic Planning identified four primary ways in which economic development efforts support productivity growth in North Carolina. These include: 1) workforce training; 2) business process innovation; 3) technology adoption; and 4) business recruitment.

1. **Workforce Training:** A highly skilled workforce is essential for businesses attempting to increase productivity and determine a business' ability to adopt new technologies and process innovations. The North Carolina Community College System (NCCCS) is a major proponent of workforce training for the state working in cooperation with the Department of Commerce and other agencies to offer customized industrial training for new and existing companies.
2. **Business Process Innovation:** Assistance for innovation in business processes— processes such as research and development, production, marketing, quality and inventory control, and communications— is a service most often associated with the incremental upgrading strategy and improved efficiency in testing products and managing design processes. "The end result is better customer service and a higher value product. Several organizations provide process innovation assistance in North Carolina. Of particular note is the North Carolina State University's Industrial Extension Service (IES). IES partners with businesses across a variety of industries to transfer knowledge and technology that lowers costs, improves quality, and shortens lead times" (Cole, p. 4, 2008).
3. **Technology Adoption:** The technology adoption aspect of the program seeks to raise awareness of, and encourage investment in new technologies, often a challenge for small and medium-size companies and businesses located in remote areas. "Several organizations, including IES and the Small Business and Technology Development Center, make companies aware of the latest relevant technologies in their industry. There are incentives that address the challenge in acquiring new technologies for North Carolina companies. The Article 3J Business Property Investment tax credit incentivizes investment in new capital and technology. Also, the R&D tax credit, the Small Business Innovation Research program, and the Small Business Technology Transfer program provide incentives for businesses to develop new technologies" (Cole, p. 4, 2008).

4. **Business Recruitment:** Strategically targeted recruitment efforts help increase productivity levels if they are more productive than existing businesses in that industry. When highly competitive companies are recruited to the state they bring new best practices with them that other companies learn from and replicate. Companies may be strategically targeted to expand export industries or to fill gaps in the local supply-chain, strengthening the economy by ratcheting up North Carolina's competitiveness, exerting pressures to improve productivity in return (Cole, p. 4, 2008).

### **Location-related Incentives**

Location-related incentives “seek to reduce the costs of doing business in relation to other locations; they may be aimed at attracting businesses that wish to relocate, retaining those tempted by other states to relocate, or encouraging existing businesses to expand in place” (Saiz and Clarke, p. 422, 2008). These policies aim to make communities competitive locations for industry, based on the “economic location theory, which suggests that, other things being equal, firms will seek those locations where the combined costs of land, labor, capital, energy, and transportation are minimal” (Weber 1984; Saiz and Clarke, p. 428, 2008). Location-related incentives use tax credits, deferments, exemptions, abatements, industrial revenue bonds, as well as fostering a business-friendly environment.

### **Infrastructure Strategies**

Infrastructural strategies “emphasize the construction and maintenance of physical infrastructure such as roads and highways to encourage and support development” (Saiz and Clarke, p. 422, 2008). “The term infrastructure now signifies a concern with both technological systems of physical facilities and the roles, particularly the economic role, these assets play in future growth and development” (Saiz and Clarke, p. 423, 2008). Infrastructure strategies include the building and maintenance of a traditional transportation infrastructure, informational technologies, and culture (art museums, libraries, etc) with the goal of ultimately attracting the young, educated, metropolitan type of citizen.

### **State Trends**

*Forbes Magazine* has ranked “The Best States for Business” in a special report by Kurt Badenhausen. Included in this report are state rankings in terms of business costs, labor, regulatory environment, economic climate, growth prospects, quality of life (measured by comparing indexes of schools, health, crime, cost of living, and poverty rates), and best overall rank for the year 2007. The overall top ranked states include Virginia, Utah, Washington, North Carolina, Georgia, Colorado, Idaho, Florida, Texas, and Nebraska. Vermont ranked thirty-sixth.<sup>1</sup>

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<sup>1</sup> The rankings can be viewed at [http://www.forbes.com/2008/07/30/virginia-georgia-utah-biz-cz\\_kb\\_0731beststates\\_table.html](http://www.forbes.com/2008/07/30/virginia-georgia-utah-biz-cz_kb_0731beststates_table.html)

The states that were ranked in the top five for business cost included one of those located in the top ten for overall top ranking: North Carolina. Business costs were measured by comparing costs of labor, energy, and taxes. Vermont ranked forty-third for business cost. When analyzing the strategies for North Carolina in a study that compared trends directed toward entrepreneurial, location-related, and infrastructure-related strategies, its overall economic development efforts seemed to be directed at entrepreneurial strategies from 1998 through 2002 (Saiz and Clarke pp.427-435, 2008).

The states that were ranked in the top five for labor included three of those located in the top ten: Washington, Colorado, and Florida. Labor was measured by comparing educational attainment, net migration, and projected population growth. Vermont ranked twelfth for labor. Colorado directed their economic development growth strategies toward location-related incentive strategies, while Washington and Florida directed their efforts toward entrepreneurial strategies.

The states that were ranked in the top five for regulatory environment included three of those in the top ten for overall top ranking: Virginia, North Carolina, and Georgia. Regulatory environment was measured by comparing tort climate, incentives, transportation, and bond ratings. Vermont ranked thirty-third for regulatory environment. The trend of Virginia and North Carolina was directed effort toward entrepreneurial strategies, while Georgia directed their efforts toward location-related incentive strategies.

The top five states for economic climate included two from the top ten: Idaho and Florida. Economic climate was measured by comparing job, income, gross state product growth, unemployment, and presence of big companies. Vermont ranked thirty-first for economic climate. Florida directed their economic development efforts toward entrepreneurial strategies, while Idaho did so toward location-related incentive strategies.

The states ranked in the top five for growth prospects included four states from the overall top ten: Washington, Colorado, Florida, and Texas. Growth prospects were measured by comparing projected job, income, gross state product growth, business openings/closings, and venture capital investments. Vermont ranked forty-fourth for growth prospects. Colorado directed their economic development efforts toward location-related incentive strategies, while Washington, Florida, and Texas both directed their efforts toward entrepreneurial strategies.

The states ranked in the top five for quality of life did not include any states that were ranked in the overall top ten. Vermont ranked tenth for quality of life. Most of the states located in the top ten overall ranking have directed their efforts toward either location-related incentive strategies or entrepreneurial strategies (Saiz and Clarke pp.427-435, 2008; [http://www.forbes.com/2008/07/30/virginia-georgia-utah-biz-cz\\_kb\\_0731beststates.html](http://www.forbes.com/2008/07/30/virginia-georgia-utah-biz-cz_kb_0731beststates.html)).

## Microenterprise Development

Microenterprise development strategies are aimed at small-scale entrepreneurs in need of less than \$35,000 as start-up money, usually assisting clients at or below the 150 percent poverty line. These entrepreneurs usually have businesses with fewer than five employees, and are in industries such as textile, arts and crafts, jewelry making, day care, computer technology, and other businesses that are service related. More than half of these businesses are run out of the owner's home. Microenterprise development strategies include consulting and funding. Business education and training provides technical training, peer-networking, and mentoring (Pulsipher p. 1, 2004).

Funding usually comes in the form of micro loans, which are usually for under \$35,000, have market interest rates, and are short term loans. Lending is usually done through separate, private credit programs. Results have been positive with this strategy. A report by Ian Pulsipher describes benefits to states over a five-year study done by the Aspen Institute's Self-Employment Learning Project (1999). Benefits include high increases in gain in household income for microentrepreneurs (78 percent increase), high survival rate of new businesses (49 percent), significant decrease in microentrepreneur receipt of food stamps and other food supplemental assistance, and decreased reliance of government assistance (Pulsipher, p. 2, 2004).

### Example: Nebraska

The Nebraska Enterprise Fund (NEF) was created to act as an intermediary between local, state, and national level contributions and investments and local microenterprise programs. The Nebraska Enterprise Fund (NEF) provides interest-only loans<sup>2</sup> for lending to community and micro finance programs with revolving funds. The NEF also awards microenterprises with grants to support pre- and post-loan business management training and technical assistance. The NEF is funded from the Nebraska Microenterprise Partnership Act of 1997, which appropriated state funds to support lending and training to Nebraskan microenterprise. The Department of Economic Development assisted by the Nebraska Enterprise Fund report annually on the state sponsored activities, and evaluate the NEF's work (<http://www.nebbiz.org/aboutus.html>).

### Example: Massachusetts

Massachusetts created the Massachusetts Banking Partners Small Business Loan Program ("Banking Partners" for short) to foster partnerships between financial and technical assistance and entrepreneurs. "Very small businesses represent a large share of all business in the Commonwealth, making up just over 91 percent of all business establishments and employing 17 percent of the workforce" (Green, p. 1, 2007), therefore they are a very important part of

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<sup>2</sup> Interest-only loans are loans where monthly payments consist only of payments on interest, an example of which is a line of credit.

the state economic backbone. “Everyday entrepreneurs” are business owners without any formal business experience. This lack of expertise can be a disadvantage when juggling a business that requires informed decision-making. While this partnership looks promising, it has not been running long enough to evaluate.

### **Enterprise Zoning**

Enterprise zoning is a popular strategy that many states have adopted to attract business investment to economically distressed areas. The goal of these programs is usually “the ultimate increase of the well-being of the communities and families inside the zone” (Pulsipher 2005, p. 2). They function as “zone-based initiative programs,” and usually involve a set of tax incentives (Pulsipher 2005, p.1). Connecticut, Louisiana, Ohio, and New Mexico all have some kind of enterprise zone. New Mexico has 1,700 separate enterprise zones within the states; however, Arkansas, South Carolina, and Kansas have only one, constituting the entire state (Pulsipher pp. 1-2). “Academic reviews of enterprise zones, often prepared using econometric models, have found little evidence that programs actually result in net job creation and increased community investment” (Pulsipher 2005, p.2).

#### **Example: New York**

New York State’s Empire Zones combine a variety of tax incentives, entrepreneurial assistance projects, and low rate loans in order to “modernize facilities and operations, access new markets, and develop new products and improve competitiveness” ([http://www.empire.state.ny.us/Tax and Financial Incentives/Empire Zones/default.asp](http://www.empire.state.ny.us/Tax_and_Financial_Incentives/Empire_Zones/default.asp)). It has public-private partnerships with commercial and savings banks, farm credit institutions, and with savings and loan institutions that provide low rate loans (usually around 2 to 3 percentage points lower than prevalent interest rates ([http://www.empire.state.ny.us/-Small and Growing Businesses/loan discounts.asp](http://www.empire.state.ny.us/-Small_and_Growing_Businesses/loan_discounts.asp))).

### **Incentives**

Business incentives consist of tax instruments, such as tax exemptions, tax credits, property tax abatements, tax credits, and non-tax incentives that are often grants and loans for businesses. Incentives most often make businesses, rather than individuals, the recipient of incentives. Incentives are used to attract new business, and retain current business in communities (Peters, 27, 2004).

#### **Example: Chicago, Illinois**

Chicago won Boeing’s relocation in 2001 by offering Boeing a \$63 million offer: \$41 million in state credits, ten years of income tax grants for Boeing’s employees, \$20 million in job training, technology, and capital improvements, \$2 million in property tax abatements and improvements to Midway Airport’s hangars. This is an example of an unsuccessful attempt to

employ a location-related incentive strategy—no local jobs were created, and the multiplier effect was minimal (Saiz and Clarke p. 428-429, 2008).

### **Example: Mississippi/Alabama**

“A new twist on the incentives game is a recent “alliance” between Mississippi governor Haley Barbour and Alabama governor Bob Riley in which Barbour purportedly agreed to coordinate incentives...to support a steel mill locating in Alabama if Alabama would stand aside so that a Toyota plant would locate in Mississippi” (Saiz and Clarke, p. 429, 2008; Mazurak and Kanangiser, 2007). States making allied movements is a new characteristic that we may see more of in the future.

### **Example: Alabama**

Though the new Kia Motors Corp. factory will be located in Georgia, Alabama is vying for Kia’s suppliers. Alabama officials estimate the project will add 2,000 jobs to the state. The state has taken a different approach to incentives with Kia suppliers than it did previously with Mercedes-Benz and Honda. Instead of offering lump sums to Kia and Hyundai suppliers, the state is partnering with local governments to help pay for site acquisition and infrastructure improvements. Statutory exemptions, including income tax capital credits and property and sales tax credits, will still apply.

### **Example: Maryland**

One Maryland Income Tax Credit Program is a tax credit for businesses that “invest in an economic development project in a ‘qualified distressed county’” (<http://www.choosemaryland.org/businessservices/taxincentives/onemaryland.html>).<sup>3</sup> They offer a Project Tax credit as well as a Start-up Tax Credit. The Project Tax credit is offered to qualifying businesses to use to cover costs that include things like obtaining land, building facilities, insurance, etc. Projects must cost between \$500,000 and \$5 million to be eligible. The Start-up Tax Credit is offered to businesses to cover the costs of moving their business to Maryland, such as costs related to equipment, office furnishings, etc. There are specific requirements for this credit: “The start-up credit earned may not exceed the lesser of \$500,000 of eligible start-up costs or \$10,000 times the number of new, qualified positions created” (<http://www.choosemaryland.org/businessservices/taxincentives/onemaryland.html>).

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<sup>3</sup> Maryland Department of Business and Economic Development, <http://www.choosemaryland.org/>

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Disclaimer: This report has been compiled by undergraduate students at the University of Vermont under the supervision of Professor Anthony Gierzynski. The material contained in the report does not reflect the official policy of the University of Vermont.