

Renaissance Zones As An Economic Development Tool



A Memorandum of the
*Citizens Research Council
of Michigan*

September 1995

Detroit Office

625 Shelby Street, Suite 1B
Detroit, Michigan 48226-3220
Phone (313) 961-5377
Fax (313) 961-0648
E-Mail 76534.2577@compuserve.com

Lansing Office

1502 Michigan National Tower
Lansing, Michigan 48933-1738
Phone (517) 485-9444
Fax (517) 485-0423
E-Mail 102514.2744@compuserve.com

Renaissance Zones As An Economic Development Tool

- MAJOR FINDINGS1**
- TAX FREE RENAISSANCE ZONES1**
- NUMBER OF RENAISSANCE ZONES1
- RENAISSANCE ZONE SELECTION.....2
 - Who Will Select the Renaissance Zones?2
 - When Will The Selection Take Place?.....2
 - What Criteria Will Be Used For Selection?2
- HOW LONG WOULD THE ZONES EXIST?.....2
- WHO WOULD QUALIFY FOR THESE TAX BREAKS?.....2
- WHAT STATE TAXES WOULD BE AFFECTED?.....2
 - Single Business Tax2
 - Public Utility Property Tax3
 - Other Business Taxes3
 - Personal Income Tax3
 - State Property Taxes.....4
- WHAT LOCAL TAXES WOULD BE AFFECTED?.....4
- LOCAL PROPERTY TAXES4
- LOCAL INCOME TAXES4
- UTILITY USERS TAX.....5
- EXISTING MICHIGAN ECONOMIC DEVELOPMENT INCENTIVES6**
- PUBLIC SPENDING FOR A SPECIFIC PRIVATE PARTY’S PURPOSES6
 - State Government6
 - Local Governments6
- TAX REDUCTION7
 - State Government7
 - Local Government7
- HAS ANYTHING LIKE RENAISSANCE ZONES EVER BEEN TRIED BEFORE?10**
- FEDERAL EMPOWERMENT ZONES10
- BENTON HARBOR’S ENTERPRISE ZONE.....10
 - Enterprise Zones Lessons Relative to Renaissance Zones11
 - Has The Enterprise Zone Made A Difference?11
- RENAISSANCE ZONE ISSUES.....13**
- WHY THIS PROPOSAL?13
- A NEW PHILOSOPHY13
- ZONE SELECTION PROCESS.....13
- TAX EXPENDITURE13
- WHY NOT ALLOW OTHER STATE TAXES TO BE WAIVED?.....14
- HOW EFFECTIVE CAN RENAISSANCE ZONES BE?.....14
 - Can Tax Credits Affect Business And Individual Location Decisions?14
 - Will Renaissance Zones Result In New Growth Or Relocations Of Existing Businesses?15
 - How Will Renaissance Zones Affect Surrounding Areas?15
 - Are Tax Incentives Enough To Turn An Area Around?15
 - Will Renaissance Zones Lead Municipalities To Streamline Their Provision of Services?16
 - Will Renaissance Zones Increase The Demand For City Services?.....16
- EFFECTS ON GOVERNMENT REVENUES17
 - The Effects Of Waiving These Taxes17
 - Schools17
 - Local Units of Government17
 - Will The Shifting Of Costs Be Acceptable To Other Taxpayers?18

Renaissance Zones As An Economic Development Tool

In July of 1995, the Governor introduced the concept of renaissance zones as an economic development tool. This paper describes how renaissance zones would work and analyzes how renaissance zones would fit in with the many economic development tools currently available in Michigan. In many ways, the rationale and implementation of renaissance zones is similar to the empowerment zones authorized by federal law.

Major Findings

- Renaissance zones would waive all local taxes and many of the state taxes on businesses and individuals located within a designated area. Most other tax incentive programs offered in Michigan allow for tax reduction of only one tax, typically the property tax, although the enterprise zones and Michigan Economic Growth Authority programs allow for credits against more than one tax.
- Tax credits would be extended to all taxpayers within the renaissance zones regardless of their intentions for use of the property. Most other tax incentive programs allow for a tax reduction in exchange for commercial and industrial investment, either through property development or through the hiring of workers who reside in the zone. The amount of investment commitments and tax benefits received in exchange have been bargained in some form between the individual businesses and the governmental unit. Only recently have real teeth been put into these programs in cases where businesses have not lived up to commitments.
- The governmental units with taxing authority in the renaissance zone will experience a revenue loss. The magnitude of a loss will depend on several factors, including: the amount of area encompassed by the zone, the types of properties located within the zone, whether the zone attracts new or relocating businesses, whether relocation occurs from other parts of the municipality or from other municipalities, and the effect that local tax waivers will have on state distributions of funds to local governments.
- Businesses have based location decisions on the receipt of tax incentives much less significant than what renaissance zones would offer. However, factors other than taxes play a role in business location decisions. State and local governments in Michigan, like most other states, use tax incentives as one of many tools to attract businesses as a means of addressing these issues.
- Past experience in Michigan and elsewhere is that tax incentives may attract business location or expansion, but they do little to improve other socio-economic factors. Tax incentives may work to create business and job growth, but little has changed relative to crime, home ownership, educational attainment, poverty levels, or welfare dependence in the areas where this growth was experienced.

Tax Free Renaissance Zones

Tax free renaissance zones are offered as an economic development incentive to try to revitalize economically distressed areas of the state, both urban and rural. Individuals and businesses located in a zone will benefit from the designation of a renaissance zone because the state will waive all state taxes, except sales taxes, within a renaissance zone if the local governments agree to waive all local taxes within the zone. The zone could consist of not more than ten percent of the municipality's total geographic area or 5,000 acres. The zone must be contiguous, a provision meant to discourage gerrymandering, although they could apparently be used to revitalize a major thoroughfare or corridor, perhaps

only a few blocks wide.

Number of Renaissance Zones

There would be no more than eight zones, including up to five urban zones and three rural zones. Every county could apply for one tax free zone. These zones would have to approved by the county board of commissioners, as well as all other taxing jurisdictions, whose taxes would be waived. Additionally, Detroit and Grand Rapids each could apply for one of the urban zones. These zones would be submitted by the mayor of each city, upon approval by the city council.

Renaissance Zone Selection

Who Will Select the Renaissance Zones?

A state review board, consisting of the State Treasurer, the Director of the Michigan Jobs Commission, and the Director of the Department of Management and Budget will recommend the eight zones for final approval to the State Administrative Board. The State Administrative Board consists of the Governor, Lieutenant Governor, the State Treasurer, the Secretary of State, the Attorney General, and the Superintendent of Public Instruction.

When Will The Selection Take Place?

The review board or the administrative board could not consider an application submitted after October 31, 1996. The decisions awarding renaissance zone designations would have to be made by December 31, 1996. With the general election scheduled for November 5, 1996, the selection process is framed around election time just as it was for federal empowerment zones.

What Criteria Will Be Used For Selection?

The proposal provides several criteria to be used for selection:

1. Evidence of adverse economic and socio-economic conditions;
2. Private sector involvement in the zone's plan and design;
3. Community commitment to the success of the tax free zone;

4. The municipality's commitment to providing essential services to the zone;
5. Other local resources committed to the zone;
6. How the zone relates to a broader plan for the community as a whole.

There would not be set criteria which a community must meet to be nominated. The nominating municipality must use the above criteria to illustrate why their nominated areas are more worthy of designation than other nominated areas. The development plan's creativity and innovativeness will be considered in the selection process. It is not readily apparent whether the level of services in the zone would be expected to be higher than in the tax-paying area surrounding the zone.

How Long Would The Zones Exist?

These tax free renaissance zones, once established, could exist for up to 15 years. The proposal offers the following scenario for how these 15 years might be structured to allow a period in which state and local taxes could be returned to their regular levels:

Year	Tax Credit
1 to 12	100% Tax Free Credit
13	75% Tax Free Credit
14	50% Tax Free Credit
15	25% Tax Free Credit
16 and thereafter	Tax Free Credit Eliminated

Who Would Qualify For These Tax Breaks?

As the goal of the renaissance zones is to create residential, commercial and industrial growth, these zones would be available for any use. This provision that the credits would be extended to everyone -- residential, commercial and industrial taxpayers -- is a key feature setting renaissance zones apart from previously established economic development incentive tools.

What State Taxes Would Be Affected?

Most state taxes would be subject to a waiver. Sales type taxes would not be subject to a waiver. The proposal explains that these taxes would not be subject to a waiver because of the difficulty of monitoring these taxes and the degree to which it would penalize existing businesses bordering the zone. The sales type taxes not subject to a waiver would include the general sales tax, the use tax, the tobacco products tax, the beer tax, the wine tax, liquor taxes, and the real estate transfer tax.

Single Business Tax

The single business tax is a value-added type tax, levied at 2.3 percent. It is imposed basically on business income plus compensation paid, interest paid and depreciation, with major deductions for new capital investments and labor intensity. Net collections from the single business tax totaled \$2.0 billion in fiscal year 1994.

The state has set a precedent for waiving the single business tax with the enterprise zone and the

Michigan Economic Growth Authority (MEGA) program. "Certified" business located within an enterprise zone qualify for credits of the personal income tax for ten years. The MEGA program provides a single business tax credit for up to 100 percent of the incremental tax liability attributable to an expansion or new location.

The Michigan Department of Treasury audits of the single business tax reveal that the tax is paid by only 22 percent of the businesses. Additionally, 87 percent of the single business tax revenues are paid by the top eight percent of single business tax taxpayers. As a result, there probably will be few businesses already located within a renaissance zone that will actually be better off by having the single business tax waived. Additionally, it raises the possibility that renaissance zones might be disproportionately attractive to firms with high single business tax liabilities.

Public Utility Property Tax

The state public utility property tax is levied in lieu of local property tax on 50 percent of the true cash value of all property of telephone and telegraph, railroad, car loaning, sleeping car, and express car companies including franchise owned and used in connection with doing business in Michigan. The tax is levied as the average state-wide general property tax paid by other business property in the preceding calendar year. Tax revenues from the collection of this tax for fiscal year 1994 totaled \$127.1 million.

Other Business Taxes

The renaissance zone proposal explicitly states that unemployment insurance taxes, social security taxes, workers' compensation taxes, sewer fees and water fees would not be subject to a waiver.

These taxes and fees either are imposed for a specific service or by the federal government.

Personal Income Tax

The personal income tax is levied on all individuals, estates, and trusts with federally adjusted gross

Table 1

Collections from Major Michigan State Taxes, FY1994

State Taxes	1994	Percent of Total
INCOME TAXES		
Personal Income	\$ 4,413	30.4%
BUSINESS PRIVILEGE TAXES		
Single Business	2,017	13.9
Unemployment Compensation	1,270	8.7
Oil & Gas Severance	33	0.2
Insurance Company Retaliatory	185	1.3
Horse Race Wagering	17	0.1
Subtotal	\$ 3,522	24.2
CONSUMPTION TAXES		
Sales	3,671	25.2
Use	701	4.8
Tobacco Products	366	2.5
Beer and Wine	49	0.3
Liquor	73	0.5
Subtotal	\$ 4,860	33.4
PROPERTY TAXES		
Utility Property	127	0.9
Intangibles	124	0.9
Inheritance	63	0.4
State Real Estate	--	---
State Education	156	1.1
Subtotal	\$ 470	3.2
TRANSPORTATION TAXES		
Gasoline	665	4.6
Diesel Fuel	95	0.7
Motor Vehicle Weight	492	3.4
Other	23	0.2
Subtotal	\$ 1,275	8.8
Total State Taxes	\$ 14,540	

Source: Annual Report of the State Treasurer and Michigan Employment Security Commission. Percents calculated by CRC.

income in the state. It is a flat-rate tax levied at 4.4 percent. Net collections from the personal income tax totaled \$4.4 billion in fiscal year 1994.

The state has set a precedent for waiving the personal income tax with Michigan Economic Growth Authority (MEGA) programs. MEGA provides a credit up to 100 percent of the personal income tax liability for net new job growth to eligible businesses for up to 20 years.

State Property Taxes

The state education tax was established in 1994 as part of the school finance reform efforts of Proposal A. It is a six-mill tax levied on all property in the state not exempt from general ad valorem taxation. The revenues from this tax are dedicated solely to the state school aid fund. The tax is levied on real and personal property. In fiscal year 1994, \$155.6 million was collected through the state education tax.

As with the single business and personal income taxes, abatement of the state property tax is not without precedent. As the state only began levying the state education tax in 1994, there is little history in abatement of this tax. However, in the compromises that ensued with the creation of school finance reform under Proposal A of 1994, it was agreed that not allowing the abatement of this tax would weaken the significance of a property tax abatement and abatement of this tax was allowed, generally with approval of the Director of the Michigan Jobs

Table 2
Collections from Michigan Local Taxes, 1994

State Taxes	1994 Percent of Total	
PROPERTY TAXES		
General Property	\$ 9,501	94.9
INCOME TAXES		
City Income	454	4.5
CONSUMPTION TAXES		
Utility Users	<u>55</u>	0.6
Total Local Taxes	\$ 10,010	

Source: State Tax Commission.

Commission. Property tax abatements will be given further discussion below in the discussion of currently existing economic development incentives.

What Local Taxes Would Be Affected?

- A. All property taxes except for:
 - 1. General obligation bonds issued with the full faith and credit of the local taxing unit,
 - 2. Special assessments,
 - 3. Taxes levied to pay principal and interest on bonds, and
 - a. Intermediate school district bonds,
 - b. Intermediate school district vocational technical bonds,
 - c. Payments to a sinking fund,
 - d. School district debt for building improvements, and
 - e. Bonds for special education facilities,
 - 4. Levies associated with school operations,
 - a. Levies for bonds for operational debt,

- b. Voted vocational technical,
- c. Regional enhancement, and
- d. Special education;
- B. Local income taxes; and
- C. Utility users taxes.

Local Property Taxes

Property taxes are the primary source of revenue for local governments. They are used by cities, villages, townships, counties, local school districts, intermediate school districts, and authorities. The State Tax Commission estimates that 1995 tax collections will total more than \$6.7 billion. Michigan has typically used property tax relief as its means of providing economic development incentives. Tax relief typically constituted a 50 percent reduction in applicable tax rates. Property tax abatements will be given further discussion below in the discussion of currently existing economic development incentives.

Local Income Taxes

Twenty-two cities in Michigan levy a local income tax under the uniform city income tax act. The

tax rates are generally one percent on residents and corporations; 0.5 percent on income of nonresidents earned in the imposing city. The nonresident rate cannot exceed one-half of the resident rate. The city council in cities with populations over one million people (Detroit) may impose rates of up to three percent on residents, two percent on corporations, 1.5 percent on nonresidents. The city council in certain cities with populations under one million people (Highland Park and Saginaw) may impose rates of up to two percent on residents and corporations and one percent on non-residents.

Table 3 is a list of the cities that currently levy a city income tax, the year it was adopted, the tax rates, and the 1994 net tax collections.

The waiving of city income taxes is something without precedent in Michigan. The extent to which cities that levy local income taxes are affected by renaissance zones will depend on the mix of the labor force composition of the businesses located within the zone. There will be two types of work-

ers. First are those who live and work in the renaissance zone. The city will forego all income tax revenue from these workers. Second are those who live outside the zone, either within the city or outside the city, but work within the renaissance zone. The city will continue to receive the revenues from these workers, either at the resident income tax rate or at the rate for non-residents.

Utility Users Tax

The utility users tax is authorized

for collection only by cities with populations over one million people (Detroit). It is levied at a five percent tax rate on consumption of public telephone, electric, steam, or gas services in the city. Each one percent of the tax yields approximately \$11 million. In fiscal year 1994, Detroit collected \$53.6 million from the utility users tax. As with the city income tax, the waiving of utility user tax is something without precedent in Michigan.

Table 3
Michigan Cities Levying Local Income Tax, 1994
(dollars in thousands)

City	Year Adopted	----- Tax Rates -----			1994 Net Collections
		Resident	Corporation	Nonresident	
Detroit	1962	3.0%	2.0%	1.5%	\$307,014
Highland Park	1966	2.0	2.0	1.0	4,534
Saginaw	1965	1.5	1.5	0.75	12,927
Albion	1972	1.0	1.0	0.5	722
Battle Creek	1967	1.0	1.0	0.5	10,641
Big Rapids	1970	1.0	1.0	0.5	1,109
Flint	1965	1.0	1.0	0.5	28,317
Grand Rapids	1967	1.0	1.0	0.5	31,846
Grayling	1972	1.0	1.0	0.5	235
Hamtramck	1962	1.0	1.0	0.5	1,636
Hudson	1971	1.0	1.0	0.5	286
Ionia	1994	1.0	1.0	0.5	1,123
Jackson	1970	1.0	1.0	0.5	5,142
Lansing	1968	1.0	1.0	0.5	19,325
Lapeer	1967	1.0	1.0	0.5	1,159
Muskegon	1993	1.0	1.0	0.5	5,072
Muskegon Heights	1990	1.0	1.0	0.5	935
Pontiac	1968	1.0	1.0	0.5	12,011
Port Huron	1969	1.0	1.0	0.5	4,644
Portland	1969	1.0	1.0	0.5	453
Springfield	1989	1.0	1.0	0.5	586
Walker	1988	1.0	1.0	0.5	4,325
TOTAL					\$454,042

Source: Michigan State Tax Commission.

Existing Michigan Economic Development Incentives

Economic development incentives can come in two forms, public spending for a specific private party's purposes or tax reduction given to specific taxpayers. Municipalities are able to mix and match economic development incentive programs to create a program of public financing and tax incentives that best meets their needs. Michigan has far more experience in providing economic development aid to specific, individual parties than in providing economic development incentives to a large geographic area and all taxpayers, either of a certain class or all classes, within that area.

Public Spending For A Specific Private Party's Purposes

State and local governments in Michigan have encouraged economic development by financing public improvements, such as road construction and water and sewer line installation, with public funds. In recent years, the scope of public sector involvement has grown from general encouragement to specific assistance. The following state and local programs were created to provide specific assistance in business location.

State Government

Transportation Economic Development Fund. The Transportation Economic Development Fund was created in 1987 to provide increased funding to all road authorities for highway, road, and street improvements associated with economic growth and devel-

opment. The stated objectives of this fund are to "improve the network of highway services essential to economic competitiveness, to improve accessibility to target industries, to support private initiatives that create or retain jobs, and to encourage economic developments that increase resources for improving the health, safety and welfare of Michigan's citizens."

The Transportation Economic Development Fund was created to assist local efforts in economic development, it does not fund any projects solely from state funds. It is funded from license and permit fees, federal aid, local participation, and interest earnings from money in the fund. It is administered by the Office Of Economic Development within the State Transportation Commission.

Michigan Strategic Fund. In 1984, the Michigan Strategic Fund was created to provide a mechanism to foster greater coordination of state policies and to make available public and private development finance opportunities to businesses and communities within the state, "in order to expand the number of jobs in the state and to help agriculture, forestry, business, and industry prosper..." It is this fund that is the state vehicle for financing a new baseball stadium in Detroit.

Local Governments

Public spending for a specific private party's purposes is much more common at the local level. This can occur either through direct city spending or through the creation of an authority or other sub-

sidary bodies created for the purposes of economic development.

Authorities Created for Tax Increment Financing. Downtown development authorities (DDAs), tax increment finance authorities (TIFAs), and local development finance authorities (LDFAs), have been available to local units of government beginning in 1974 as a tool for economic development. The fact that there are three types of these authorities is indicative of changing municipal needs over time. Each type of authority has a similar basic mission, structure, powers, and revenue sources. Each is a public body, created by the governing body of a local unit, controlled by a board of directors which is appointed by the elected officials of the municipality, and having jurisdiction for limited purposes over one or more districts within the municipality. The principal differences among these three authorities are what type of local unit may create them, which areas of the municipality may be included within the district, and what property contributes to the tax increment revenues.

These authorities could capture the revenues from the levy of non-debt (and in some cases, debt) property taxes on the increase of SEV in the district or development area over the base year in which the tax increment financing plan was approved. Tax increment financing is the major revenue source and is the most important aspect of these authorities: all other functions and powers are also functions and powers of local governments. Only through tax increment financ-

ing can the increase in property tax revenues resulting from economic development be directly funneled back into the creation of incentives for additional economic development. Municipalities have used the revenues from tax increment financing to fund a whole gamut of economic incentive activities, including, but not limited to, site preparation, landscaping, street beautification, and laying water and sewer lines.

The use of tax increment financing as an economic development tool has been fairly popular in Michigan. As of June 30, 1993, some 276 DDAs, 85 TIFAs, and 67 LDFAs had been created by 322 cities, villages, and townships, 91 of which have created more than one authority. Municipalities with established economic bases have been the most common users of these development authorities. Tax increment authorities were created to allow municipalities to capture local school operating property taxes, thus providing additional revenue for economic development. The long-term effect of the changes caused by Public Act 145 of 1993 and Proposal A of 1994, reducing the yield of the property tax and limiting what can and cannot be captured, will be to diminish the role of these authorities, eventually rendering them nearly useless.

Tax Reduction

State Government

Michigan Economic Growth Authority (MEGA). MEGA is a new state board, established in 1995, that administers a job expansion incentive program. This program provides a single business

tax credit for up to 100 percent of the incremental tax liability attributable to an expansion or new location and up to 100 percent of the personal income tax liability for net new job growth to eligible businesses for up to 20 years.

Qualified businesses must be engaged in manufacturing, research and development, wholesale and trade or office operations. The criteria used to determine whether to award tax credits and the amount of an incentive include the number of new jobs created, the average wage of the jobs being created, the total capital investment of the business, evidence that the expansion or location in Michigan would not have occurred without the incentives, a commitment for financial or economic cooperation from the local governments, and whether there are financial benefits to the state. The applying business must be financially sound and their proposed plans must be economically sound.

Applications for this program are evaluated by the Michigan Economic Growth Authority, and the final granting decision is made by an eight member board composed of the Director of the Michigan Jobs Commission, the State Treasurer, the Director of the Department of Management and Budget, the Director of the Department of Transportation, and four other members appointed by the Governor.

The Legislature has capped the granting of MEGA tax breaks at 25 projects per year. Projects cannot be approved after December 31, 1996, without permissive legislation allowing such actions. As of September 1995, five businesses

locating in Michigan have received MEGA credits. It is far too soon to make any sort of evaluations on how this program is working.

Local Government

Enterprise Zone Facilities Tax.

Enterprise zones are the closest economic development tool to the renaissance zone proposal that has been introduced currently available in Michigan. In January 1986, the City of Benton Harbor was designated as the first, and only, enterprise zone in Michigan. The boundaries of the enterprise zone are coterminous with the boundaries of the city. To receive tax breaks a new or expanding business must classify as a certified or qualified business by the city. The success of Benton Harbor's enterprise zone will be discussed below, this section will only attempt to describe what they are and how they work.

To be certified, the business must start-up or relocate into the enterprise zone or be an existing business that plans to increase its SEV within the enterprise zone. "Certified" businesses receive all the tax abatements for ten years, or until the year 2004, whichever comes first, including a property tax rate of one-half the state average and complete abatement of the state single business tax and sales and use taxes. Benton Harbor retains all state and local property tax revenues paid by certified businesses.¹

¹ Benton Harbor levies millages for 911 services, drug prevention, and for senior citizen services which are not included in the state and

Firms wishing to make lesser investments in the zone may also participate in a property tax credit program. To be "qualified," businesses must invest in and improve the value of their zone property, hire zone residents, or make a cash or in-kind contribution to zone taxing units (the City of Benton Harbor, Benton Harbor Area Schools, Lake Michigan College, the intermediate school district, or Berrien County). The property tax credit is against real property, reducing the tax rate to the statewide average millage rate. Benton Harbor retains the share of property taxes attributable to its millage as well as the state and local school millage portion of the property taxes paid by qualified businesses.

The enterprise zone act established a citizens council to advise the enterprise zone authority and the city of Benton Harbor on zone issues, to advocate for and assist businesses within the zone. Additionally, a revolving loan fund was created to provide seed money for economic development. This fund was capitalized with ten percent of the property taxes paid by qualified businesses.

Industrial Facilities Tax. First authorized in 1974, industrial facility exemption certificates allow local governments to exempt select properties from general ad valorem property taxation. Instead, these properties are subject to a specific tax. The abatement is granted for businesses creating new or reha-

local property taxes replaced by the statewide average property tax on non-homestead property.

bilitating old property. Industrial facility exemption certificates are granted for no more than 12 years after the completion of the construction or renovation of a facility. The local legislative body must approve issuance of the certificates with approval of the State Tax Commission and concurrence of the Michigan Department of Commerce. A 1993 amendment to the law now requires certificate applicants and the granting municipality to enter into a written agreement before the State Tax Commission can approve an exemption certificate.

Prior to Proposal A, the calculation of the industrial facility taxes in lieu of general ad valorem property taxes depended solely on the type of facility exempted. These specific taxes represented a 50 percent reduction in tax liability in most cases. While new specific taxes will continue to represent about a 50 percent reduction in tax liability, the specific tax rate of each individual abatement will now vary, depending on the type of facility, when the exemption was issued, and whether the state grants an abatement of its education tax. The specific tax rate for most industrial exemptions is currently calculated as one-half of the local millage levied on non-homestead property for that year plus whatever the state treasurer abates from the six-mill state education tax (the method of tax rate calculation is different for exemptions granted prior to January 1, 1994). The state treasurer may abate all, 50 percent, or none of this tax if doing so is "necessary to reduce unemployment, promote economic growth, and increase

capital investment in this state." Receipts from these specific taxes are distributed among the taxing units in the same manner as the property taxes on which they are based.

Tax abatements are used very commonly for economic development. As of December 31, 1993, 6,654 certificates were outstanding for abatement of new industrial facilities, accounting for over \$15.7 billion of state equalized valuation (SEV). There were 486 certificates outstanding for abatement of rehabilitated industrial facilities, abating about \$1.3 billion of investment.

Commercial Facilities Tax. Like industrial facility exemptions, commercial facility exemption certificates allowed local governments to exempt select properties from general ad valorem taxation. Instead, these properties were subject to a specific tax. Also like industrial facility exemptions, the abatement was granted to businesses investing in new or rehabilitated property. First authorized in 1978, exemption certificates were limited to 12 years after the completion of the construction or renovation of a facility. Local legislative bodies were solely responsible for the issuance of these certificates.

The calculation of the commercial facility taxes in lieu of general ad valorem property taxes depends on the type of facility exempted. The most common method of rate calculation includes one-half of the local and intermediate school operating mills levied on that property in 1993 plus one-half of all other, non-school mills currently

levied on that property. In other words, presently abated property will continue to pay one-half of the school operating tax rate that was levied in 1993 and will not receive the benefits of the school operating tax reduction. Receipts from these specific taxes are distributed among the taxing units in the same manner as the property taxes on which they are based.

The authority to issue commercial abatements expired on December 31, 1985, but an exemption then in effect continues until expiration of the certificate. While there were 2,620 commercial facility exemption certificates issued of various sorts between 1978 and 1985, worth approximately \$600 million of SEV, the number of existing abatements and their current value is unknown.

Technological Facilities Tax. Technological facility exemption certificates operate much the same as the industrial facility tax. These certificates were first authorized in 1984. Technological facility taxes are levied in lieu of general property taxation for up to 12 years after completion of facilities granted an exemption certificate within technology park districts. The specific tax rate is calculated as

one-half of the local and intermediate school operating mills levied on that property in 1993 plus one-half of all other, non-school mills currently levied on that property. Local legislative bodies must approve the issuance of these certificates. Receipts from these specific taxes are distributed among the taxing units in the same manner as the property taxes on which they are based.

Commercial Housing Facilities Tax. Commercial housing facility taxes, first authorized in 1976, are levied in lieu of general property taxation for up to 12 years after completion of new facilities granted exemption certificates within downtown development districts of cities levying local income taxes. The specific tax rate is calculated as one-half of the local property tax rate, unless waived by the local legislative body. Local legislative bodies were solely responsible for the issuance of these certificates. Receipts from these specific taxes are distributed among the taxing units in the same manner as the property taxes on which they are based. Authority to issue certificates expired December 31, 1986, but exemptions then in effect continue until expiration of the certificate.

Neighborhood Enterprise Zone Facilities Tax. The neighborhood enterprise zone program was begun in 1992 as an outgrowth of the enterprise zone program in Benton Harbor. A need was perceived for a housing revitalization program. This program allows taxes to be levied in lieu of general property taxation for up to 12 years after rehabilitation or completion of the facility granted an exemption. The specific tax rate for homesteads is calculated as one-half of the statewide average rate paid by other homestead or qualified agricultural property. The specific tax rate for non-homestead property is calculated as one-half of the statewide average rate paid by other commercial, industrial, and utility property. Receipts from these specific taxes are distributed among the taxing units in the same manner as the property taxes on which they are based.

As of December 1993, a total of 29 cities and one township were eligible to participate in the neighborhood enterprise zone program. Six of these units had established a zone, and three of those six had active programs.

Has Anything Like Renaissance Zones Ever Been Tried Before?

The short answer is no. As of 1993, 35 states and the District of Columbia reported having enterprise zones of some sort, offering tax incentives, regulatory streamlining, and site development to businesses and individuals. These programs typically offer tax reduction, similar to the Benton Harbor enterprise zone or other Michigan tax incentive programs, in exchange for an investment or hiring commitment within the zone. Benefits received by businesses are typically negotiated in some form between that business and the governmental unit.

The renaissance zone program would offer the most extensive tax credits to businesses of any state in the nation. Tax reduction would be for the entire tax liability for those taxes subject to waiver. No investment commitments would be necessary from those receiving the benefits. Additionally, this would be the first occasion in which businesses and individuals alike are offered tax incentives simply for being located within a designated area. Rather than government picking winners and losers by putting certain classes of business up against certain criteria, the market would be allowed to operate. Any business or individual willing to pay the market price for property in the zone would be eligible for benefits. Economic theory says this should increase the demand for zone property, and therefore make the entire zone better off as efforts are made to maintain investments. There are no examples of anything being done to this extent before, however,

there are examples that can be analyzed to draw upon for lessons.

Federal Empowerment Zones

In 1993, President Clinton introduced Empowerment Zones as a concept for revitalizing distressed urban and rural areas. The Revenue Reconciliation Act of 1993 provided special tax incentives to be granted to qualified businesses operating in empowerment zones and enterprise communities. State and local governments nominated areas for consideration. From the areas nominated, the Secretary of the United States Department of Housing and Urban Development designated six empowerment zones and 65 enterprise communities in urban areas, and the Secretary of the United States Department of Agriculture designated three empowerment zones and 30 enterprise communities in rural areas. Nominated empowerment zone areas had to meet eligibility criteria related to population, distress, size, and poverty rate. The areas receiving empowerment zone status have that designation for up to ten years, but the designation may be revoked if the state or local government modifies the boundaries of the area, or does not comply with the agreed strategic plan.

Businesses that qualify and operate within the empowerment zones are eligible for three incentives: an employer wage credit equal to 20 percent of the first \$15,000 of qualified wages paid or incurred to each employee who meets certain criteria; the "section 179" deduction for qualified zone property is increased from \$17,500 to \$37,500 in the year the property is placed in

service; and a new category of tax-exempt private activity bond is created. Detroit was awarded an empowerment zone in 1994 which covers 18.35 square miles of the city, and encompasses a population of over 101, 000 people and approximately 9,000 businesses.

Unlike renaissance zones, empowerment zone benefits are granted from the federal level. Once the city won designation as a zone, the only requirement of the city was to work to make it successful. Designation was not contingent on the reduction of local taxes. While there have been some early indications of success connected with the Detroit Empowerment Zone, it is still far too soon to attempt to evaluate this program. One early observation is that while tax benefits have made locating within the empowerment zone more attractive to businesses, it has done little to reduce the city's bureaucratic or regulatory burden or to change the way the city does business. To the contrary, the empowerment zone designation has led to the creation of an additional layer of bureaucracy, the Empowerment Zone Development Corporation.

Benton Harbor's Enterprise Zone

Benton Harbor is the only Michigan community to be designated as an enterprise zone. The functioning of the enterprise zone is described above, this section is meant to provide some evaluation of its success.

Enterprise Zones Lessons Relative to Renaissance Zones

While both enterprise zones and renaissance zones would attempt to address the same urban problems, some major differences in how these economic development tools can be used are worth noting.

Definition of Economically Distressed Area. Under the original provisions of the enterprise zone act, an economically distressed area was one which had an average unemployment rate in the most recent calendar year of more than 25 percent; which had a median family income less than 55 percent of the state average median family income; which had a governmental unit levying more than 30 mills; and, in which the SEV in the governmental unit was less than \$4,000 per capita. The definition of economically distressed areas to qualify for a new enterprise zone, as amended in 1994, requires the qualifying unit to have the designation of an empowerment zone, rural enterprise community, or enterprise community as defined by the U.S. Department Of Housing and Urban Development or the U.S. Department Of Agriculture.

Renaissance zones, which use the same phrase, “economically distressed” area, set the criteria loosely to judge the levels of poverty, unemployment, and educational achievement in a nominated area relative to other areas competing for nomination. This is necessary because the state has determined that eight zones will exist.

Benefit and Revenue Differences. Differences between enterprise zones and renaissance zones will

affect the attractiveness of locating within a zone to businesses and the ability to improve government services. First, the enterprise zone was defined to encompass all of the City of Benton Harbor. A renaissance zone could encompass no more than 5,000 acres.

Second, the ability to receive tax benefits in the enterprise zone is contingent upon businesses' willingness to invest in the zone, initially a fairly significant investment. A renaissance zone would grant tax benefits to all taxpayers located within the zone, regardless of class of property or intentions relative to investment.

Third, enterprise zone benefits allow for a partial reduction in local taxes and a complete reduction of some state taxes. Taxpayers located in a renaissance zone would receive complete reduction of their local taxes and complete reduction of some state taxes.

Fourth, the enterprise zone actually allows for the City of Benton Harbor to receive more tax revenues than would otherwise be the case. The city can capture property tax revenues from other taxing bodies to finance improvements in infrastructure and city services. The renaissance zone would result in lost revenues to the municipality in the short run, the magnitude of which would be too difficult to estimate.

Finally, the enterprise zone act provides for creation of a revolving loan fund, capitalized from property taxes paid by qualified business, to aid expansion and provide seed money for new businesses. Any such efforts in a ren-

naissance zone would have to come out of other city funds.

Has The Enterprise Zone Made A Difference?

The enterprise zone act limits the duration of the program. The act provides that the zone report to the Michigan Legislature to “...present an analysis of the economic impacts...” of the zone program. The fourth such report (“Michigan Enterprise Zone Program: Seven Years of Progress,” 1993) was accepted by the Legislature and the enterprise zone act was amended in 1994 to continue through the year 2004.

This report concluded that “while some comparisons showed that Benton Harbor sustained little growth, economic growth in the number of jobs created and increases in the value of commercial and industrial property were dramatic. For these reasons the enterprise zone is determined to be successful.” The report considered a number of demographic, economic, social, and governmental indicators to evaluate Benton Harbor relative to surrounding communities and the state as a whole. It was clear that commercial and industrial property values have grown under the enterprise zone act. Benton Harbor has received over \$75 million in new investment. Over 800 jobs have been created by business growth within the enterprise zone. Finally, the zone has allowed the city the opportunity to make critical improvements to services and infrastructure, and the revenue generated has enabled the city to reduce its budget shortfall problems.

However, while these factors indicate that Benton Harbor fared well

in some areas, the city has sustained little or no growth in other areas. Crime rates, population loss, home ownership patterns, and occupational shifting experienced little improvement. Educational attainment, unemployment rates, and poverty levels experienced no growth under the enterprise zone.

One of the problems identified with the creation of an enterprise zone in Benton Harbor was the failure to create a comprehensive plan for development. The enter-

prise zone with its tax benefits and employment credits have been successful in creating business and employment growth. Business in the downtown area has grown. However, ideas for economic development were not intertwined with ideas for community development. Businesses were interested in hiring city residents to gain the offered credits, but there was a lack of adequately trained, qualified work force. City residents were hired as businesses attempted to take advantage of the

tax credits, but the lack of adequate housing meant that as these workers accumulated wealth and endeavored to improve their lot in life, they were forced to move outside the city to do so. This resulted in the businesses losing their worker credits. To the credit of renaissance zones, the fact that tax benefits would be extended to residents as well as businesses may address this need for comprehensive development.

Renaissance Zone Issues

Why This Proposal?

The stated purpose of the proposal in the introduced legislation is “to assist certain local governmental units in encouraging economic development, the consequent job creation and retention, and ancillary economic growth in this state.” It is not as readily apparent the extent to which this proposal is offered as a tool to spur business and employment growth, or to provide test cases for measuring the consequences of drastic tax reduction.

A New Philosophy

Renaissance zones would bring a new philosophy to tax incentives. As is evident with the plethora of tax incentive programs available in Michigan, previous tax incentive programs have attempted to target individual classes or types of property. Industrial, commercial, technological, and housing facilities have all been the target of individual programs in which a specific tax is levied in lieu of the general ad valorem property tax.

Renaissance zones would make no such distinctions between classes or types of property. The only role of government will be the local government’s role in setting zoning restrictions on the land and the tendency of developers to look to local governments for other non-tax related economic development incentives, such as site development. Renaissance zones will reduce the ability of government to hand pick the winners, those benefiting from tax incentives.

Zone Selection Process

The problem with any program like this, in which the selection criteria are ambiguously defined, is that politics and favoritism may work their way, or appear to work their way, into the selection process. On September 13, it was reported that the Office of the Inspector General for the U.S. Department of Housing and Urban Development found that the process for selecting empowerment zone cities “was flawed and in some cases ‘open to favoritism.’” The process “did not provide reasonable assurance that the best eligible applications were selected for benefit designations and funding awards.” Instead, final picks were largely at the discretion of HUD Secretary Henry Ciseneros. The audit found that a number of applications of award winners were not recommended for final consideration by the overseeing task force, while others that were recommended seemed to have been passed over. (“Selection of Empowerment Zones Flawed, Audit Finds,” Detroit News, September 13, 1995) Such findings lead to lost confidence in government and doubts about whether such programs are serving their purported purposes.

Considering the stakes of receiving a renaissance zone designation, it would seem to be in the interest of all taxpayers of the state to keep politics to a minimum in the selection process. In the case of renaissance zones, the review board and selection board are primarily from the same political party. Many state bodies making decisions of this na-

ture require an even distribution of members from the two major political parties, to avoid partisan politics and promote compromise.

Tax Expenditure

In the world of tax vernacular, excluding individual groups from the collection of a tax is known as “tax expenditures.” Tax expenditures are defined in the Tax Expenditure Appendix to the State of Michigan Executive Budget in general as:

... revenue foregone due to exemptions, exclusions or deductions from the tax base, credits applied to tax liability, or preferential tax rates.... Traditionally, tax expenditures have had two purposes. The first is to reduce taxes for specific individuals or firms and thus change the distribution of tax burden.... The second purpose of tax expenditures is to create an incentive for individuals or firms to change behavior.

Renaissance zones attempt to “create an incentive for individuals or firms to change behavior” by reducing the costs of locating in economically distressed areas. These incentives are meant to encourage economic development within renaissance zones, relative to non-economically distressed areas. Tax expenditures are granted, not because decisions are made solely on the receipt of tax benefits, but because they help to sway decisions in a way the government deems socially beneficial.

Why Not Allow Other State Taxes To Be Waived?

Creating an area where sales taxes are not collected would provide a huge incentive for commercial investment, especially for retailers of big ticket items such as autos, furniture and major appliances. The state relies fairly heavily on the revenues of the sales tax for its revenues. However, if this is a reason for its exclusion, why is the state asking local governments to forego 100 percent of their revenues in these renaissance zones? Renaissance zones would comprise a much smaller percent of the state's tax base than it would for any individual municipality. The areas that will be nominated for renaissance zones by definition do not have many commercial businesses. The amount of lost sales tax revenues from existing businesses in the zone would not be all that significant. In the long term however, the state would benefit from building its retail sales tax base up for when these zone designations expire.

However, such an area is likely to draw a large concentration of retailers of "big ticket" consumer goods, such as automobiles and major appliances. Such movement into a renaissance zone would affect retail businesses for a great distance surrounding a zone.

Other states have allowed businesses in their enterprise zones to reduce the sales tax rate with some success. It is important to note, however, that these enterprise zones in other states are relatively close to large cities in neighboring states. The aim is generally to draw shoppers from the large city,

such as New Jersey enterprise zones attempting to draw shoppers from New York City.

What about the use tax, the intangibles tax, the estate tax, or the real estate transfer tax? These are all taxes that affect decision making. The use tax is a transaction tax that would be difficult to monitor. The intangibles and estate taxes are both taxes on the property of a business or individual. Intangibles are stocks, bonds, pensions, and other non-tangible investments. The tax is levied at different rates depending on whether the property is an income producing (i.e., interest, dividends, and other earnings) or non-income producing property. In fiscal year 1994, intangibles tax collections totaled \$124.3 million. This tax is to be phased out effective January 1, 1998. Estate taxes are paid on the estates of deceased individuals. In Michigan, the rate is imposed up to the maximum allowable federal credit for state inheritance taxes paid. Estate taxes totaled \$63 million for fiscal year 1994. Real estate transfer taxes are levied by the counties and by the state. They are paid by the seller of real estate on the fair

market value of property at a rate of 0.75 percent to the state and 0.15 percent to Wayne County or 0.11 percent to all other counties. The first year of collections of the state real estate transfer tax is 1995.

How Effective Can Renaissance Zones Be?

Can Tax Credits Affect Business And Individual Location Decisions?

Yes, they probably can. Businesses have based location decisions on the receipt of tax credits much less significant than what renaissance zones would offer. However, state and local taxes typically represent only about five percent of the operating costs of a business. It is possible that the negative factors defining a renaissance zone as an economically distressed area, things defined below as "indirect taxes," could add more than five percent to the costs of businesses and individuals locating in a renaissance zone. State and local governments in Michigan, like most other states, use tax incentives as one of many tools to attract businesses.

Economic Experiment

Typically with tax incentives, policy makers do not know if the tax incentives actually make a difference. They do not know if development would have occurred as it did with or without tax incentives. In the case of renaissance zones, it might be possible to make a judgment on their effectiveness.

Assuming every city and county participates in the nomination process, there will be 85 areas nominated for renaissance zone designation. Only eight will receive designation, leaving 77, presumably economically distressed, areas to serve as control areas. A treatment will be applied to one group, the eight zones, and no treatment will be applied to the other zone, the 77 non-recipients. After 15 years, it might be possible to compare the changes that have occurred in each group and judge to what extent renaissance zones made a difference.

Will Renaissance Zones Result In New Growth Or Relocations Of Existing Businesses?

Past thinking is that tax incentives should not be so much, and the qualifications for tax benefits so lax, that the businesses that are attracted are leaving other areas of the state. It is likely that renaissance zones will be disproportionately attractive to businesses with high single business tax liability. Of the 105 current certified businesses in the Benton Harbor enterprise zone, 98 (93 percent) started operations in Benton Harbor; seven (seven percent) transferred to Benton Harbor from other Michigan locations. However, the enterprise zone has restrictions for relocating businesses desiring certification:

... location of the new facility or qualified new business in the enterprise zone will not have the effect of transferring employment from another local governmental unit or from an area in the local governmental unit to the enterprise zone located within that local governmental unit.

Such restrictions are not included in the proposal for renaissance zones. The significance of business relocation into the zone of a municipality would depend on the area from which the business was relocating. If businesses opt to relocate into a renaissance zone from other municipalities without blighted areas, it is arguable that, in aggregate, little harm is done to the exited municipality and the region as a whole is better off.

However, economically distressed areas are rarely limited to the geo-

graphical confines that would limit a renaissance zone. Allowing businesses and individuals to simply relocate within the same municipality to enjoy the tax free status of a designated area would further deplete the economically distressed areas not included in a zone. The effects of such intra-municipality relocation could be felt in the area immediately surrounding a renaissance zone, or it could be felt in parts of the municipality removed from the renaissance zone. In either case, not only is the municipality foregoing the tax revenues from those located in the renaissance zone at the time of designation, but now a shifting between properties outside the zone to properties inside the zone could cause further deterioration of the tax base. The risk of such movement could lead municipalities to nominate areas bordering neighboring municipalities, so that any relocation into the zone is at another municipality's expense.

To the state, any business relocating into a zone would decrease its tax base, unless the business located from another state. If the state is willing to absorb that lost revenue to better these economically distressed areas, then relocation does not matter.

How Will Renaissance Zones Affect Surrounding Areas?

The type of business sites developed within a renaissance zone should also be of concern. Examples can be found where businesses located in blighted areas, but secluded the facility from its surroundings. Workers commute rather than reside in the surrounding areas and the facility is equipped to feed and care for the

workers while on the job. Such properties do not create spin-off growth in the surrounding area in terms of business or job growth. Under normal taxing conditions, the municipality still benefits from an expanded tax base from such a site. No such benefits will be incurred in a renaissance zone for several years.

Again drawing on the experience of the Benton Harbor enterprise zone, the firms qualifying for enterprise zone certified benefits are primarily new, small, commercial businesses, often maintained in leased space and staffed with a small number of employees. Enterprise zones have allowed individuals with entrepreneurial ideas to put their ideas into action. The creation of new businesses in a renaissance zone would generally avoid the risk of site development on properties secluded from its surroundings. It is not readily apparent that such business development will be duplicated in renaissance zones without the relocation restrictions of enterprise zones. If successful, tax free credits will increase the demand for property within a zone. Increased property values may negate the reduced cost of taxes to a young entrepreneur with little start-up capital.

Are Tax Incentives Enough To Turn An Area Around?

Presumably, a nominated renaissance zone area must be very blighted to have a good chance of receiving designation as a renaissance zone. Nominating such an area would be advantageous to the municipalities, because there would be less lost revenue. Thus, the short term incentive would be

to designate an area with the worst possible conditions.

However, it is arguable that these areas also have less potential for growth. Taxes, whether state or city taxes, are just one reason why people and businesses have chosen not to locate in these areas. Other reasons are what might be called "indirect taxes." The high costs of associated with locating in economically distressed areas have played a key role in business decisions locating to the green fields of the suburbs. Indirect taxes might include such factors as location, environmental contamination, governmental bureaucratic and regulatory burdens, poor schools, high crime rates, high insurance rates, inadequate infrastructure, and an inadequate level of city services.

A different strategy might be to nominate a less blighted area, but one with more potential for growth and expansion. Such an area would not possess all of the "indirect taxes" that also play an important role in where people and businesses opt to locate. The growth of such an area might better serve as a foundation upon which the surrounding area might grow. However, such an area would probably result in greater revenue loss to the municipality.

Some argue that indirect taxes must be considered in creating incentives for economic development. Rodney Erickson of Pennsylvania State University's Center for Regional Business Analysis argues that tax incentives are not enough, that the basic ingredients for business success -- "a skilled workforce, social order, a function-

ing infrastructure, intelligent government, and markets" -- must be in as a catalyst to get businesses going. ("Recasting Enterprise Zones," John S. DeMott, *Nation's Business*, February 1993) These are generally not things that tax incentives can play a role in creating or improving.

The American Association of Enterprise Zones reports that tax incentives alone are not very effective at changing the socio-economic conditions that make an area economically distressed. Businesses and individuals locate where they feel safe and where they can access their suppliers and customers. Tax incentives as part of an overall plan to improve the economically distressed areas, plans that include additional spending to make the area more attractive for living and working in, have proven more successful. These are things that require spending, for police and fire services, for road improvements, and for sound schools.

Will Renaissance Zones Lead Municipalities To Streamline Their Provision of Services?

It is arguable that requiring municipalities to provide the same level of services with fewer financial resources will lead to streamlining, by forcing local governments to find efficiencies and become more effective in the delivery of essential services.

A different possibility is that renaissance zones, like many other cost factors that have preceded them, will lead municipalities to increase taxes. The remaining tax base will be left to pay more taxes so that those located in a renaissance

zone might have a chance to improve their economic circumstances.

Will Renaissance Zones Increase The Demand For City Services?

One of the stated criteria of the renaissance zone proposal is the municipality's commitment to providing essential services to the zone. If renaissance zones are successful, if they attract people and businesses into the zone and spur economic development, they will also create a greater demand for increased essential services from the municipality. More people living close together will require greater police services, roads capable of handling the increased traffic, and other services that cities provide. This increase in services, if it takes place, will have to come at the expense of those located in areas outside the renaissance zone designation of the municipality, because the new people and businesses in the zone are not fully taxed until the end of the 15-year renaissance zone designation. This problem will become compounded if the creation of a renaissance

Zone Selection Strategy

The very fact that income and property within the zone will not be subject to local taxation may lead a municipality to nominate areas in which large concentrations of land are owned by that municipality or by non-profit agencies. Such a strategy would result in less lost municipal tax revenue. Successful economic development would remove these tracts of land from city ownership, increase the tax base and would provide available land for larger types of economic development projects.

sance zone becomes a game of musical chairs within the municipality, with residents of the local government located outside of the renaissance zone moving into the zone to gain tax exempt status, rather than attracting new people and businesses from other cities or states.

Effects On Government Revenues

The Effects Of Waiving These Taxes

It is possible that waiving these taxes will affect state school funding distributions and the revenues of local governments, both the host governments and local governments throughout the state. With the new foundation grant system of distributing school aid, the revenues per pupil are not affected by changes in local SEV. These changes only affect the percentage of revenues that come from local sources as opposed to the state.

Schools

The proposal provides that the state would reimburse the local school districts, at the current SEV, for the revenues lost from a tax free renaissance zone. Individual school districts will be held harmless for having a renaissance zone in their taxing jurisdiction. Since the creation of the new, foundation grant method for distributing state school aid fund revenues was begun following adoption of Proposal A, local school operating property taxes play a much less important role than they did under the previous power equalization distribution

method. Schools receive a per pupil allocation each year. Local property taxes are a part of this allocation. State funding makes up the difference between the property tax revenues and the per pupil amount. The state will simply have to pay more to maintain per pupil funding in school districts with renaissance zones.

However, state tax revenues that are used in the index calculation for the per pupil state distributions of school aid to the local school district are among the taxes that the state will waive. All revenues from the state education tax and 14.4 percent of the personal income tax are dedicated to the state school aid fund. Waiving collection of these taxes in parts of the state will reduce the yield from these taxes and thus slow down growth in the index. Because increases in state distributions to local school districts are tied to increases in the state tax revenues dedicated to the school aid fund, distributions to all school districts in the state would be less than if no state tax collections were waived.

This effect should not be over emphasized. State taxes that would be subject to a waiver, assuming the sales tax remains excluded, constitute a minor percentage of the state school aid fund. Additionally, the areas that will be nominated for renaissance zones, by definition, have little economic activity in the first place.

Local Units of Government

Renaissance zones would affect the revenues of local units of government in three ways. First, there

are no provisions in the proposal providing for local units of government to adjust for lost revenues. Most of the municipalities that might have what are called economically distressed areas are struggling to provide services with their current level of revenues. This proposal would ask municipalities to continue the current level of service provision, but with the people and businesses in as much as ten percent of the municipality's total geographic area removed from the tax base. This effect could be compounded in two ways, by reductions to the tax base outside the renaissance zone and by increased demand for services caused by growth in the renaissance zone. These compounding effects are discussed below.

Second, in addition to the lost local revenues, municipalities stand to lose an amount of state revenue sharing. Unrestricted state revenue sharing is currently distributed to the local units of government based on their relative tax effort. The relative tax effort is measured as the yield of each unit's property tax, local income tax, and utility users tax relative to the SEV of property within that unit. Two possible solutions to this consequence would be to remove the renaissance zone tax base from the municipality's SEV, as is done for property tax abatement programs, thus more or less keeping the ratio of revenues to tax base intact, or to amend the state law to remove relative tax effort as the factor used for distributing state revenue sharing.

Finally, as with the tax revenues dedicated to the state school aid fund, waiving collection of state taxes would result in reduced revenues for all local governments in the state. About 6.9 percent of state personal income tax revenues and about 13 percent of single business tax revenues are dedicated to unrestricted state revenue sharing. Should sales taxes become included in the waived taxes, ten percent of the sales tax revenues are distributed through state revenue sharing. Because distributions of state tax revenues through revenue sharing is based in part on the amount of revenues collected, distributions to all local units of government in the state would be less than if these state tax collections were not waived.

The interaction of these three factors, as well as the interaction of the effects described above make it difficult, if not impossible, to determine the exact effects of the creation of a renaissance zone will have on the government finances.

Tax Changes Can Affect State Revenue Sharing

In 1994, a judgment levy of about 30 mills was added to the tax bill of Hamtramck property taxpayers to pay for environmental cleanup. In 1995, the result of this is to greatly increase the share of state revenue sharing distributed to Hamtramck, as tax revenues increased greatly relative to SEV. State revenue sharing is used for city operations and cannot be returned to the taxpayers to compensate for the extra property taxes they paid in 1994. If the city reduces property taxes as compensation, which they can now afford to do with the increased state revenue sharing, it will have the opposite effect of reducing their share of next year's state revenue sharing. This shows the unintended consequences on state revenue sharing of manipulating either the tax revenues or the tax base unilaterally.

Will The Shifting Of Costs Be Acceptable To Other Taxpayers?

Table 4 illustrates the number of taxing bodies that would have to consent to waiving their levy

within a Detroit zone. City residents pay property taxes to six individual governmental bodies with taxing authority. Abating property taxes would affect not only the residents of the City and school district, but also the residents of Wayne County, and the residents of Oakland, Macomb, Washtenaw and Livingston Counties. This would be true for cities, villages and townships across the state.

**Table 4
Property Tax Rates in the City of Detroit - 1995**

	Residential	Non-Residential
City of Detroit:		
General	20.000	20.000
Garbage	3.000	3.000
Debt	<u>8.506</u>	<u>8.506</u>
Total City	31.506	31.506
Detroit Public Library:		
Operating	2.640	2.640
Detroit Public Schools:		
Allocated for Library	0.640	0.640
Non-Residential	---	18.000
State Education Tax	6.000	6.000
Bonds (Capital & Deficit)	<u>7.040</u>	<u>7.040</u>
Total School	13.680	31.680
Wayne County:		
Charter	5.739	5.739
Extra Voted	1.940	1.940
HCMA	0.224	0.224
WCCC Operating	0.974	0.974
WCCC Debt	0.300	0.300
RESA Allocated	0.098	0.098
RESA Special Ed.	0.945	0.945
RESA Special Ed.	<u>0.953</u>	<u>0.953</u>
Total County	<u>11.174</u>	<u>11.174</u>
Grand Total	<u>59.000</u>	<u>77.000</u>

Sources: City of Detroit Budget Department, Detroit Public Schools, and Wayne County Assessments and Equalization Division.