FINAL REPORT
OF THE
INTERIM STUDY COMMITTEE ON
ECONOMIC DEVELOPMENT

Indiana Legislative Services Agency
200 W. Washington St., Suite 301
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November 2010

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2010

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Interim Study Committee on Economic Development

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November 2010

A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at http://www.in.gov/legislative/.

FINAL REPORT

Interim Study Committee on Economic Development

I. LEGISLATIVE COUNCIL DIRECTIVE

The Legislative Council directed the Committee to study the topics assigned to the Committee in HEA 1086-2010, SECTION 184.

II. INTRODUCTION AND REASONS FOR STUDY

The General Assembly is interested in examining the scope, focus, and efficacy of Indiana's economic development assistance and incentive programs and to evaluate the extent that Indiana's tax policies or educational system influence economic development. In particular, the General Assembly wants to review and evaluate the effectiveness of programs in the state's current economic development toolbox, consider new programs that may enhance the state's economic development toolbox, and determine whether the state's economic development programs operate within the parameters of best practices established around the U.S. The General Assembly enacted legislation establishing the Committee and directing the Committee to study the following:

(1) Best practices in state and local economic development policies and activities.
(2) The use and effectiveness of tax credits and deductions.
(3) Whether there are any specific sectors of the economy for which Indiana might have comparative advantages over other states.
(4) The extent to which Indiana's tax laws encourage business investment, and any improvements that might be made to Indiana's tax laws.
(5) The extent to which Indiana's education systems support economic development.
(6) The benefits of existing community revitalization enhancement districts and possible new community revitalization enhancement districts as an economic development tool.
(7) Any other issue assigned to the Committee by the Legislative Council or as directed by the Committee's co-chairs.

III. SUMMARY OF WORK PROGRAM

The Committee held a total of four meetings. These meetings were held in Anderson on September 22nd, Indianapolis on September 27th, West Lafayette on October 5th, and Indianapolis on October 26th.

(1) At the September 22nd meeting, the Committee considered the following topics:
- (A) Access to capital issues experienced by small business and entrepreneurs.
- (B) The economic impact of entrepreneurs.
- (C) Social, economic, and governmental factors that affect entrepreneurship.
- (D) Financing and technical assistance programs that could assist entrepreneurs in their company's startup and growth stages.

(E) IEDC programs focusing on small business and entrepreneurs.
(F) The Neighborhood Assistance Tax Credit.
(G) The utility of state incentives and Tax Increment Financing (TIF) for attracting business investment and development.

(2) At the September 27th meeting, the Committee considered the following topics:
(A) Trends in employment, job creation, income, and labor force in Indiana and the Midwest.
(B) Factors that influence business location and investment decisions.
(C) The utility of the 21st Century Research and Technology Fund, the Venture Capital Investment Credit, and the Patent-Derived Income Exemption for high-tech business.
(D) The economic impact of logistics and logistics infrastructure in Indiana.
(E) The impact of local economic development organizations.
(F) Community Revitalization Enhancement Districts.
(G) Enterprise Zones and Enterprise Zone incentives.
(H) The Historic Rehabilitation Tax Credit.

(3) At the October 5th meeting, the Committee considered the following topics:
(A) The impact and effectiveness of the 21st Century Research and Technology Fund.
(B) The effectiveness of economic development tax incentives.
(C) Indiana's business tax climate.
(D) Indiana's corporate income tax rate relative to Indiana's individual income tax rate; and relative to corporate income taxes in other states.
(E) The relationship of cultural amenities and economic development.

(4) At the October 26th meeting, the Committee considered the following topics:
(A) The impact of personal property tax on farmers and on businesses.
(B) The Committee's proposed final report.

The Committee voted 9-0 to approve this final report after discussing the proposed findings and recommendations and agreeing to:

(1) Amend the finding on the economic development impact of Indiana's corporate income tax rate to make that finding relative to Indiana's personal property tax.

(2) Amend the recommendation for a permanent study committee to specify that it study economic development on a regional, national, and global scale.

(3) Amend the recommendations to include a recommendation regarding the study of eliminating or reducing Indiana's personal property tax.

IV. SUMMARY OF TESTIMONY

Testimony to the Committee is summarized below under four broad topical categories:

(1) IEDC Programs and Outcomes.
(2) Entrepreneurship and Small Business Issues.
(3) Local Economic Development Programs.
(4) Business Investment Factors and Effectiveness of Incentives.

IEDC Programs and Outcomes

The Committee received testimony from the Indiana Economic Development Corporation (IEDC). The testimony focused on the history and operational focus of the IEDC in comparison to it's predecessor, the Indiana Department of Commerce (IDOC). The testimony indicated that the IEDC is structured to execute competitive transactions with companies involving development incentives. In contrast, the IEDC reported that the IDOC not only executed competitive transactions involving development incentives, but also allocated substantial staffing and program resources to other activities, including community development activities.

As for recent economic results in Indiana, the IEDC reported that for CY 2010 (through August), Indiana experienced 2.4% year-over-year growth in net private sector employment. This growth rate is equal to the employment growth rate experienced by Massachusetts and is exceeded only by Oklahoma with a 2.7% growth rate. IEDC also reported that the employment growth translated into 54,700 additional private sector jobs during that period. The Indiana jobs total is higher than the growth totals registered in all but four other states: Texas, Florida, New York, and Massachusetts. In terms of program outcomes, the IEDC reported that for CY 2010 (through October 4, 2010) it succeeded in securing 150 competitive projects for Indiana, resulting in a projected 18,796 new jobs and $3.0 billion in investment. The incentive cost on these projects is expected to average about $8,649 per job, with an average hourly wage of about $21.63. In comparison, IEDC reports that the state average hourly wage in 2009 was $18.40.

IEDC highlighted other factors beside incentives that are attractive to businesses. These factors include Indiana's bond rating as well as its tax and regulatory climate. IEDC reports that Indiana is one of only nine states with a AAA bond rating and that Indiana was rated by the U.S. Chamber of Commerce and National Chamber Foundation as the fourth best state in terms of business taxes and regulation.

In the presentations, IEDC provided information on their major incentive programs as well as programs that focus on assisting small business and entrepreneurial startups. The programs highlighted by IEDC included the following:

(1) The EDGE tax credit, which is a refundable tax credit awarded based on net new jobs created by recipient companies. The tax credit is calculated after income taxes have been withheld by the companies from the new employees. The IEDC considers the EDGE tax credit to be the state's top incentive program because of the way it is calculated and its refundability.

(2) The Hoosier Business Investment tax credit is a nonrefundable tax credit for capital

investment. The IEDC indicates that while the credit is not refundable, it is particularly helpful for projects involving significant capital investment, but lower employment projections.

(3) The Venture Capital Investment tax credit improves access to capital for fast-growing Indiana businesses by providing a tax credit to investors in these businesses. Since 2003, IEDC reports, 208 companies have used the credit to leverage $138.4 M in private capital.

(4) The 21st Century Research and Technology Fund (21 Fund) provides funding to support young companies in the idea development, product development, and early growth stages. The 21 Fund currently focuses on supporting technology commercialization by companies in these development stages. The 21 Fund provides direct funding via grants to entrepreneurs as well as matching grants to entrepreneurs who are recipients of federal Small Business Innovation and Research (SBIR) grants. Under the SBIR matching program, the 21 Fund grants result in a 4 to 1 leveraging of federal funds. The IEDC also provided information on a study it obtained from the Ball State University Center for Business and Economic Research. This study indicates that about $238 M has been invested in 188 projects since the inception of the 21 Fund. The study estimates that the 21 Fund investments have created 11,000 high-paying jobs, with an impact on state GDP of about $427 M. The study also estimates that the 21 Fund investment has leveraged about $1 B in investment from private and institutional investors. The Committee also heard testimony (highlighted later) from four entrepreneurs who have received funding from the 21 Fund.

The IEDC presented information to the Committee on other incentive programs, including: (1) the Small Business Innovation and Research Initiative/Small Business Technology Transfer; (2) the Patent Income Tax Exemption; (3) the Research and Development Tax Credit; and (4) the Capital Access Program.

Entrepreneurship and Small Business Issues

The Committee heard testimony from several Indiana entrepreneurs and experts on entrepreneurship who identified the social and economic factors and government policies that facilitate entrepreneurship and the creation and expansion of high-tech and high-growth businesses.

The following entrepreneurs testified to the Committee: (1) Pete Bitar, President, Xtreme Alternative Defense Systems; (2) John Waters, Vice Chairman, Bright Automotive; (3) Jeff Ready, CEO, Scale Computing; (4) Ron Ellis, CEO, Endocyte; and (5) Chris Baggott, CEO, Compendium. This testimony indicated that the availability of venture capital and gap financing is an important facet of starting up and growing a small company and taking ideas and innovations through the development stage to the commercialization stage. Four of these entrepreneurs received funding from the 21 Fund and indicated that this funding was critical to starting up their businesses and leveraging venture capital from private investors.

The entrepreneur testimony indicated that the quality and skill levels of a region's existing workforce, the existing business and industry capacity in a region, and capital availability in a region are extremely important factors in determining where a company may locate and invest. Mr. Bitar and Mr. Waters indicated that the existing auto manufacturing and auto electronics capacity in and around Anderson was an important factor in their decisions to locate in central Indiana. Mr. Ready indicated that his decision to initially invest and locate Scale Computing in California was due to the greater availability of capital for his enterprise in that state. He indicated that his decision to relocate Scale Computing to Indiana was facilitated by a 21 Fund grant that was used to leverage significant capital from private investors. Mr. Ellis also discussed the importance of capital access and workforce expertise and skills. He also highlighted the importance of obtaining technical assistance via his location and connection with the Purdue Technology Center.

The Committee also received testimony from: (1) Dr. Vic Lechtenberg, Vice Provost, for Engagement, Purdue University; (2) Mark Lange, Executive Director, Edward Lowe Foundation; (3) Stephen Sandstedt, CEO, Priority Development Corporation; and (4) Dr. Susan Clark Muntean, Ball State University. This testimony dealt with the impact of entrepreneurs and small companies, the factors that encourage entrepreneurship, and the types of assistance needed to increase entrepreneurship and creation of high-growth companies in Indiana.

Dr. Muntean reported that the consensus among scholars who study entrepreneurship is that entrepreneurs play a critical role in the economy by creating employment, contributing to productivity growth, developing and commercializing innovations, and generating positive spillovers to the economy as a whole. She also reported that earnings of self-employed entrepreneurs are almost one-third higher than earnings of wage and salaried workers. Mr. Lange highlighted the economic impact of new business startups and startups that are offshoots of existing companies. He suggested that Indiana re-balance it's economic development strategy to more of an emphasis on nurturing small high-growth companies in the incubation stage and growth stages after incubation. Mr. Lange also highlighted the need for increased use of business incubators beyond the normal incubation stage and proposed a virtual technical assistance network for Indiana. Once established, this virtual network would provide a forum for entrepreneurs in the startup stage or later growth stages where they could reach for assistance from experts in areas such as market research, business strategy and management, new media, and Geographical Information Systems (GIS).

Dovetailing with Mr. Lange's testimony, Dr. Lechtenberg highlighted the efforts by the Purdue Research Foundation and the Purdue Research Parks to facilitate the creation of startup companies and the commercialization of technology and innovations. He reported that 191 companies currently operate in the research parks, with 67 Purdue faculty members and 250 students working with these companies. Besides these efforts to integrate university expertise and capacity with entrepreneurs, Purdue also operates a statewide Technical Assistance Program for existing businesses in Indiana. Dr. Lechtenberg also discussed how businesses have obtained technical assistance with a problem or issue at either no cost or low cost to the business.

Finally, Mr. Sandstedt discussed the problems that entrepreneurs face in obtaining capital to either launch a new company or to expand an existing company. He indicated that while capital access problems have increased during the recession for all business, that for larger companies this is likely a temporary problem. However, for smaller operations, access to capital issues are an ongoing problem. Mr. Sandstedt discussed the Michigan Business and Industrial Development Corporation program as an option for pooling capital that could be targeted to small entrepreneurs.

Local Economic Development Programs

The Committee received testimony from local officials about the status and need for local economic development programs, including tax abatement, TIF, County Economic Development Income Tax (CEDIT), community revitalization enhancement districts (CREDs), certified technology parks (CTPs), and enterprise zones (EZs). Local officials indicated that the top economic development incentives that they utilize are tax abatement and TIF. Bill Dory, Vice President, Indiana Economic Development Association, stated that the legislature has created a great economic development toolbox for local government. Local officials indicated that this toolbox includes tax abatement, TIF, CEDIT, and other programs such as CREDs, certified technology parks, and EZs. Linda Dawson, Director of Economic Development, city of Anderson, discussed the importance that the Flagship Enterprise Center (a CTP) has become to economic development in Anderson, and the important role TIF played in attracting the Nestle project. However, local officials cautioned that the legislature should continue to allow local governments substantial flexibility in implementing these economic development tools, in particular tax abatement and TIF.

The important contribution to local economic development by CREDs and EZs was also discussed by local officials. Mayor Wayne Seybold, city of Marion, described the status of the Marion CRED and the development that has occurred in the CRED. He discussed the Income Tax and Sales Tax capture that occurs within the CRED and indicated that these funds are used to fund CRED improvements and to provide assistance to businesses for equipment purchases. He indicated that the businesses within the CRED would not have located in Marion had the CRED not existed. He also indicated that CRED is an important tool for stimulating interest in Marion by businesses searching for a new location.

EZ directors from Fort Wayne, Hammond, Lafayette, and New Albany discussed the important contributions that the EZs make to local economic development efforts in their respective communities. They described how the urban enterprise associations that operate the EZs are self-supporting entities that are financed by payments from businesses that receive EZ tax incentives. They explained that these funds are plowed back into the community to pay for various other community development and economic development programs. They described the various tax incentives that are available for employment and investment within EZs, and discussed development projects in which the incentives have been instrumental to the project’s success.

Business Investment Factors and Effectiveness of Incentives

The Committee received testimony regarding economic factors that influence location and investment decisions of business and the efficacy of economic development incentives.

Larry Gigerich, Ginovus, provided testimony concerning site selection for businesses. He explained that the key cost drivers that impact site decisions for businesses include real estate, labor, utility rates, and transportation/infrastructure. He also reported that the key factors that encourage location of businesses in Indiana are the overall tax structure, meaningful economic development incentive programs, highway infrastructure, the IEDC, timely regulatory approvals, affordable utility costs, and available real estate. He considers the EDGE tax credit, Hoosier Business Investment tax credit, Skills Enhancement Fund, Research and Development tax credit, the 21 Fund, and High Growth Fund as Indiana's most effective tax credits and incentives for businesses. However, he cautioned that incentives are not a panacea for a bad business climate.

David Holt, Conexus Indiana, explained that Indiana's unique location and number of interstate miles provide a significant advantage to the state in the movement of products, which helps to influence business investment and location decisions.

Dr. Graham Toft, Growth Economics, Inc., discussed recent and long term economic trends in Indiana by providing rankings on outcome measurements from several publications. He explained that Indiana scores high on categories that measure the cost of doing business, but needs to improve on access to capital. Indiana also performs well on measures of the state's tax and fiscal, and legal climate, while results are mixed on Indiana's regulatory climate. Indiana also ranks low compared to other Midwest states on measures of entrepreneurial infrastructure and business activity, but ranks in the top half of states on measures of international business activity. Dr. Toft reported that there is room for improvement for Indiana's K-12 education systems.

Tetia Lee, Tippecanoe Arts Federation, testified on the relationship between cultural issues and economic development. She explained that site locators for businesses do consider cultural amenities in communities.

Scott Hodge, Tax Foundation, shared that there are many factors that may attract businesses to a state and that taxes are becoming an increasingly important factor. He recommended lowering the corporate income tax rate, preferably to the same rate as the individual income tax rate, so that the rate difference would no longer affect business organization decisions. He also recommended that the state not rely on business incentives to generate economic activity in the state. He explained that incentives may shift resources around a region rather than produce new economic activity.

David Lewis, Eli Lilly and Co., also recommended that the Indiana corporate income tax rate be lowered. He expressed that Indiana needs incentives to draw investment because the corporate income tax rate is so high. Mr. Lewis remarked that the Indiana Research and Development tax credit is important to the life sciences industry.

Dr. Dagney Faulk and Dr. Michael Hicks, Ball State University Center for Business and Economic Research, presented findings from research they have conducted concerning the effectiveness of job creation tax credits. Dr. Faulk's study focused on the effectiveness of "statutory" job creation tax credits in Georgia, whether these tax credits helped to create jobs that would not have been created otherwise, and if the tax credits affected job creation in distressed areas. Her findings were that about 75% of jobs created would have been created without the incentive and that the tax credits were not effective in assisting job creation in distressed areas.

Dr. Hicks studied the effectiveness of "discretionary" job creation tax credits by examining the Michigan Economic Growth Authority (MEGA) tax credit. He found no evidence to support that the MEGA tax credit created more jobs in the targeted business sectors and found no net growth in employment. Dr. Hicks indicated that other research on the MEGA tax credit suggests that the tax credit does affect employment growth. Dr. Hicks suggested that low tax rates and a broad tax base are preferable and that incentives may hide problems in a state's tax structure.

Impact of Personal Property Tax

Katrina Hall, Indiana Farm Bureau, testified about the impact of the personal property tax on farmers. She explained that farming is capital intensive and requires expensive machinery and equipment. She also cited the purchase costs of various types of farm equipment and discussed the impediment that the personal property tax represents for young farmers just starting in the business. Ms. Hall discussed the impact of the 30% depreciation floor on farm equipment tax burdens, and indicated that elimination of the personal property tax would make the farming industry in Indiana more profitable and more competitive.

Bill Waltz, Indiana Chamber of Commerce, testified about the impact of the personal property tax on business. He explained that the personal property tax is a tax on capital investment and that the tax falls on machinery and equipment necessary for production. He also explained that the tax is an impediment to investment, raising the amount of capital needed for a company to start up operations. This causes startup companies either to wait longer to make investments or to scale back investment. Mr. Waltz also explained that many other states, including Ohio and Illinois, do not have a personal property tax and that the tax is an impediment for companies choosing whether to locate to Indiana. Mr. Waltz suggested that attempts to estimate the fiscal impact of eliminating the personal property tax should account for the positive economic impact of the elimination.

V. COMMITTEE FINDINGS AND RECOMMENDATIONS

The Committee made the following findings of fact:

(1) Insufficient access to capital for growth companies in Indiana is restricting economic development.

(2) The entrepreneurship culture in Indiana could be strengthened through educational programming.

(3) The 21st Century Research and Technology Fund has a useful and important role in economic development in Indiana.

(4) Economic development collaboration between the state and local governments in Indiana and between the states in the Midwest region should be enhanced.

(5) Indiana’s corporate income tax and personal property tax rates are high in comparison to Midwestern states and other U.S. states and may be a hindrance to Indiana's competitiveness.

(6) Commercialization of university-based research is vital to Indiana’s economic development.

(7) Community revitalization enhancement districts are a strong tool for local economic development efforts in Indiana, but must be balanced with their revenue impact.

(8) Local economic development tools represent a preponderance of the incentive dollars in many economic development transactions.

(9) Vocational programs are most successful when focused on strong local industry sectors and regional industry clusters.

The Committee made the following recommendations:

(1) Make the Economic Development Study Committee a statutory committee to sunset on December 31, 2014, with a membership including legislative and non-legislative members, in order to study economic development on a regional, national, and global scale.

(2) Review existing funding for the state's economic development incentives to see if resources can be moved to the Capital Access Program. Require peer review of the business merits of the loan applicant's proposed business and business plan. Require loan recipients to participate in specified technical assistance programs.

(3) Encourage more collaboration between IEDC and local economic development organizations.

(4) Encourage the State Board of Education and the Commission for Higher Education to develop entrepreneurship education programs at the K-12, higher education, and work force development levels.

(5) Formalize regional collaboration on economic development efforts in Indiana, and explore new economic development tools available for regional economic development activities.

(6) Participate with other states to develop a structure for collaboration on economic development policies in the Midwest.

(7) Require IEDC to conduct a statewide study to determine specific economic sectors that should be emphasized for economic development purposes by the state and by individual regions in Indiana.

(8) Ensure that vocational programs and work force development programs funded through the state are responsive to local industry sectors and regional industry clusters to maximize the effectiveness of the investments made in Indiana's community college system.

(9) Begin to restructure Indiana's corporate income tax rate and accompanying credits and deductions to establish as low an overall rate as possible while protecting the state's revenue stream and simplify administration and compliance for both businesses and the state to lower costs and improve competitiveness.

(10) Better define IEDC functions to further improve the effectiveness of Indiana’s economic development efforts.

(11) Encourage IEDC to study whether tax policy and incentive programs should be adjusted to provide more emphasis on small, mid-sized, and entrepreneurial growth companies serving regional or national markets, and that are in the early stages of growth.

(12) Improve the flexibility of local government economic development incentives.

(13) Support and expand technology and innovation commercialization programs at Indiana’s universities.

(14) Maintain the Neighborhood Assistance Program tax credit.

(15) Maintain the historic rehabilitation tax credit.

(16) Encourage further study to determine the methods for eliminating or reducing the personal property tax statewide. Consider providing local governments the option of eliminating or abating personal property tax for new investment and economic development purposes.

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