Strategies for Economic Development

by Thomas F. Stinson and Margaret Dewar

State and local governments in Minnesota are changing. Higher costs for government services, particularly health care, coupled with strong pressures to hold the line on taxes have created a spending squeeze at all levels of government. The resulting fiscal realities are forcing a fundamental reevaluation of what citizens should expect from government. In both the legislature and the executive branch, hard questions are being asked about whether a particular program has outlived its usefulness, whether government programs are meeting their goals, and whether the same results can be produced in a smarter (less expensive) way.

Attention has focused on potential cuts in human services and education funding, but every activity of state and local government is under scrutiny. Recent reaction to a proposed $1 million payment from Minnesota's Economic Recovery Fund to defray Dayton Hudson Corporation's costs for relocating some of their credit operations is a clear signal that economic development assistance will not be excluded from efforts to make government more cost effective.

Public assistance for economic development will remain, but the way state and local governments undertake economic development should change. This report draws together research on three of Minnesota's largest economic development assistance programs—tax increment financing, local revolving loan funds, and the state Economic Recovery Fund—and
suggests ways to reorient economic development efforts to serve Minnesotans better. Our original research focused on the impact of economic development aid on communities outside the Twin Cities metropolitan area, but our conclusions have meaning for metro area policies as well.

**Economic Development Assistance in Minnesota**

In Minnesota local leaders initiate most economic development assistance; they decide which businesses to assist and they locate the funding. We examined two local programs and one state program where many of the projects are locally initiated.

Tax increment financing (TIF) districts have been the largest source of economic development assistance in the state. These districts allow a community to raise funds for economic development by borrowing against future property tax revenues generated by the new business activity. By 1990, 6 percent of statewide property valuations were included in TIF districts and more than $190 million in funding for economic development had been provided using TIF bonds. All but 18 of the 293 Minnesota cities with population over 2,500 had at least one TIF district.

At the same time, half of the nonmetropolitan communities with more than 2,500 people had a locally administered revolving loan fund. Initially capitalized by the payments on loans from Minnesota’s Economic Recovery Fund, by federal grants, or by contributions from foundations and private individuals, these funds make loans at below market interest rates to local businesses.

Minnesota’s Department of Trade and Economic Development (DTED) administers the Small Cities Economic Development Program, usually called the Economic Recovery Fund. Local governments apply to DTED for a grant on behalf of a business. The local jurisdiction makes the loan or grant, while the funds for the program come from the state-administered allocation of federal Small Cities Development Block Grants and from the state’s Economic Recovery Grants, a program created in 1984 to supplement the federal funds. From 1984 through 1988 (the period of our evaluation), the Economic Recovery Fund received annual funding of between $8 million and $9 million and approved funding for 219 projects. More recently DTED has disbursed between $5 million and $6 million per year for the state-funded part of the Economic Recovery Fund.

**How Successful Were These Programs?**

At first glance, Minnesota’s economic development programs appear somewhat successful. Funded projects were completed, grand openings held, and new jobs filled. Closer analysis, however, shows that these programs have failed to realize their full potential. The aid provided frequently has not led to more economic growth than would have occurred without public subsidy, and often failed to produce the kind of development that many citizens expected.

Determining whether a program’s efforts have been successful is not simple. Final judgements about a program’s success can be made only after the firms assisted have shown viability over a long time. Public subsidy can prop up inefficient businesses for several years, creating an illusion of success. Even when a particular public action to encourage economic development adds little or nothing to the regional economy, it may create the appearance of real economic growth by redistributing economic activity. When this occurs some communities see substantial gains, but the gains come only at the expense of other communities.

A true measure of the success of these programs requires separation of what occurred from what would have occurred in the absence of a public subsidy. Simple job counts, for instance, usually fail to measure true growth because public programs may have subsidized businesses that would have opened or expanded and generated new jobs without assistance.

Ideally, performance measures should look beyond a particular project’s statistics and examine what happened in the regional economy, identifying whether the new jobs really are new or simply jobs transferred from firms or locations elsewhere in the region. A new discount store opening on the edge of town, for example, may eventually lead to the closing of several existing businesses. In that case, no change has actually occurred in the size of the town’s retail sector.

These issues were examined in Dewar’s analysis of the Economic Recovery Fund for projects approved from 1984 through 1988. Slightly more than a third of the projects that the Economic Recovery Fund subsidized were the type most likely to lead to jobs and an expanded tax base that would not have existed without the subsidies. These projects created about 1,400 jobs that would not otherwise have existed by early 1989 (Table 1). The businesses undertaking these projects had promised to create or retain nearly 2,700 jobs by late 1990. Although only 11 percent of the jobs promised in the 219 approved projects were jobs that would not have existed without the subsidy, the cost to the state was low because most loans were repaid. The best estimate of the actual cost to the state for each new job is between $7,000 and $10,000. The cost varied considerably from region to region.

Nearly 20 percent of Economic Recovery Fund money went to large corporations. Although businesses normally received loans, in 40 percent of the cases involving large corporations, the funds were offered as grants to the companies rather than as loans.

Most jobs created were low wage jobs. More than 80 percent paid less than the average earnings in the county and almost half paid less than the poverty level for a family of four with one full-time wage earner. An explicit aim of the Economic Recovery Fund is to aid depressed local economies, but the program redistributed economic activity to some of the least distressed areas of the state. The 30 percent of counties with the lowest poverty rates in 1979 received 42 percent of the program funds.

Stinson’s studies of the results of tax increment financing and local revolving loan funds raised important concerns about the direction of these programs. Although supporters of tax increment financing often characterize projects as having no public cost, projects usually have a substantial hidden cost. Committing all the increase in property tax revenues from parcels within the TIF district to debt service on the TIF bonds freezes general fund property tax receipts from those parcels until the TIF

<table>
<thead>
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<th>Economic Development Assistance in Minnesota</th>
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<tbody>
<tr>
<td>Minnesota’s Economic Regions</td>
<td>Number of Jobs Created</td>
<td>Percent of Jobs Promised</td>
<td>Jobs Created per 1,000 Population</td>
</tr>
<tr>
<td>West</td>
<td>800</td>
<td>22.1</td>
<td>1.3</td>
</tr>
<tr>
<td>North</td>
<td>149</td>
<td>6.2</td>
<td>.5</td>
</tr>
<tr>
<td>Iron Range</td>
<td>170</td>
<td>12.5</td>
<td>.8</td>
</tr>
<tr>
<td>Metro</td>
<td>205</td>
<td>15.7</td>
<td>.1</td>
</tr>
<tr>
<td>Southeast</td>
<td>145</td>
<td>3.1</td>
<td>.2</td>
</tr>
<tr>
<td>Entire state</td>
<td>1,469</td>
<td>11.0</td>
<td>.3</td>
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Cover photo: Tax increment financing was used in Gaylord to fund the Waldbauer Company, a large egg processing plant.
An Economic Recovery Grant helped Jackson when Unisys closed their plant there in 1987. The state funds attracted Raven Industries, which set up Astoria Industries in the old Unisys plant. Astoria, which makes fiberglass truck bodies, reemployed a few of the laid off Unisys workers.

Table 2. Debt Coverage* of Selected Nonmetro TIF Projects in Southern Minnesota, 1990

<table>
<thead>
<tr>
<th>District</th>
<th>Date Established</th>
<th>Bonds Issued</th>
<th>No Growth</th>
<th>2% AR</th>
<th>5% AR</th>
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<tr>
<td>County #1</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>A</td>
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<td>$27,000</td>
<td>1.17</td>
<td>1.23</td>
<td>1.32</td>
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<tr>
<td>B</td>
<td>1989</td>
<td>14,000</td>
<td>.91</td>
<td>.97</td>
<td>1.06</td>
</tr>
<tr>
<td>C</td>
<td>1989</td>
<td>20,000</td>
<td>.33</td>
<td>.35</td>
<td>.40</td>
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<tr>
<td>County #2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>1984</td>
<td>80,000</td>
<td>.90</td>
<td>.94</td>
<td>.99</td>
</tr>
<tr>
<td>B</td>
<td>1985</td>
<td>142,000</td>
<td>1.76</td>
<td>1.91</td>
<td>2.16</td>
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<tr>
<td>C</td>
<td>1985</td>
<td>434,000</td>
<td>.79</td>
<td>.98</td>
<td>1.38</td>
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<tr>
<td>D</td>
<td>1987</td>
<td>1,200,000</td>
<td>.09</td>
<td>.11</td>
<td>.12</td>
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<tr>
<td>County #3</td>
<td></td>
<td></td>
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<tr>
<td>A</td>
<td>1988</td>
<td>243,000</td>
<td>1.67</td>
<td>1.82</td>
<td>2.08</td>
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<tr>
<td>B</td>
<td>1983</td>
<td>55,000</td>
<td>2.37</td>
<td>2.55</td>
<td>2.85</td>
</tr>
<tr>
<td>County #4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>1988</td>
<td>40,000</td>
<td>1.13</td>
<td>1.22</td>
<td>1.39</td>
</tr>
<tr>
<td>B</td>
<td>1989</td>
<td>600,000</td>
<td>.36</td>
<td>.43</td>
<td>.58</td>
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*Debt coverage of 1 means that property tax growth exactly covers the payments for the TIF bonds. Debt coverage of less than 1 means that property tax growth in the TIF district does not cover bond debt and that property taxes in the rest of the city have to increase to make the payments.

AR = annual rate
the payment from the state's general fund. Establishing a TIF district freezes the amount of revenue that can be collected through the school property tax, causing the state to pay more in school aid. Minnesota House Research staff estimated that state school aid payments were $100 million higher in 1994 than they would have been in the absence of TIF. These indirect, hidden costs of TIF financing for economic development substantially exceed the cost of visible economic development programs, the $5 million in direct appropriations for the Economic Recovery Fund, for instance.

Stinson and Lubov's study of local revolving loan funds raised issues of whether such funds can be effective in influencing economic development. Forty percent of the loan funds in nonmetropolitan cities had made only one loan in four and a half years, and slow repayments meant some funds did not have the capital to make additional loans, indicating that many loan funds were not becoming significant influences in local economic development. Nevertheless, a total of more than $6 million was available in loan funds in mid-1989. Such a large balance may indicate either a lack of lending opportunities or lending standards that are too strict. In general, community-based revolving loan funds had difficulty lending all available funds and protecting funds from the danger of default on a single loan that constituted all or most of the fund's activity.

With both TIF and the revolving loan funds, local decisions meant that the value of an economic development project for a wider region was not considered. When a revolving loan fund provided financing for Main Street stores in a small city, for instance, the funding often meant less retail activity on another city's Main Street or in a local shopping center, while the area's residents had much the same shopping opportunities as before. Financing through TIF might influence a business to locate in one jurisdiction rather than another, nearby, but job opportunities would be unchanged.

Why Aren't Economic Development Programs More Successful?

Most studies of economic development programs have focused on their technocratic problems. Our research also found instances where existing knowledge and best practices were not being applied in the operation and administration of the programs. Economic development programs, created and implemented by state and local elected officials, necessarily become part of a political process involving elected officials and program administrators, and therefore politics is important in explaining failures. Dewar has written extensively about this elsewhere. That issue is not dealt with here.


Local revolving loan funds are often used to help storefront businesses in downtown areas.

Often sources of problems are straightforward. For instance, the Economic Recovery Fund had an explicit goal of directing aid to distressed places, but its rating system allowed high rankings for applications to help businesses in prosperous areas. If that rating system were revised, more assistance might be directed to areas with higher unemployment, higher poverty levels, and lower median income. These problems are the kind that management audits quickly identify. Other explanations for problems do not emerge from management audits and lead to questions about whether current programs are the right vehicles for delivering aid.

To change the state's economic growth rate, Minnesota's development assistance programs must focus their efforts on providing financing to firms which, while otherwise viable, are unable to obtain conventional financing. The economic development programs that we examined did not limit funding to such firms.

Local assistance programs also did not recognize the impact that defaults have on the management of a program. No matter how well the credit quality and business plans of potential borrowers are screened, defaults occur. Strategies were not in place to cope with these defaults, despite the riskier public sector loan portfolios.

Emphasizing local control has left Minnesota's current economic development programs, such as TIF and revolving loan funds, unable to take advantage of the protection that portfolio diversification offers. Private lenders recognize that while the expected payoff from holding one large loan may be equal to that from a hundred smaller loans of the same quality, the impact of default on their fund's future is quite different. Should the one large loan default, the lender—the TIF district or the revolving loan fund—will be ruined. If one of the smaller loans is not repaid, losses are of a manageable scale.

The structure of the economic assistance programs currently available encourages local communities to make large one-time bets on economic development without offering an opportunity to diversify. Then, after a default occurs, problems are magnified. In addition to finding a replacement for the firm which defaulted, the city is saddled with the problem of finding funds to continue debt services on the TIF bonds. When TIF projects collapse, local property taxpayers see higher tax bills, and if a business defaults on a loan from a revolving loan fund, that fund has no resources to make further loans.

Reliance on tax-related subsidies, as in tax increment financing, also hides much of the cost of the program from the public. It shifts a substantial portion of the costs to those outside the community. Because the costs are invisible, few people object and needed reforms do not occur.

Finally, Minnesota's decentralized system often creates a conflict between what is best for a local area and what is best for the state. The local focus of many economic development programs promotes competition among cities that does little to improve the region's economic outlook. The
result can be the use of scarce public resources to subsidize new jobs in one community, when those same jobs would have occurred without subsidy elsewhere in the state or even elsewhere in the same region.

What Changes Could Make Programs More Effective?
Minnesota should further encourage the use of a regional approach to economic development. At least two models of regional coordination exist in the state. One is the tax-base-sharing arrangement in the Twin Cities metropolitan area, where new commercial and industrial activity in one jurisdiction contributes to the tax base in other cities in the metropolitan region as well. The McKnight Foundation regional initiative funds provide a second example of a regional approach; boards representing multi-county areas decide on economic development activities to fund. Each of these approaches has strengths and weaknesses. What the best model would be is not clear, but the potential advantages of a regional approach for economic development are striking.

First, a regional approach would broaden the perspective of economic development decision-making from the local jurisdiction to a region that more closely approximates an employment market or an area from which a larger city draws retail business. Therefore, it could reduce the competition for businesses among communities and could lessen the chance that businesses receive subsidies for decisions they would have made in any case. As many big city community economic development activists are recognizing as they form regional coalitions, an economy is regional, not local. A neighborhood’s or a small city’s residents can benefit from jobs created throughout a wide geographic area.

Second, a regional approach could help state programs such as the Economic Recovery Fund refocus on their explicit economic development goals. To accomplish this, the state should pass through economic development funds on a formula basis (as the federal government does with Community Development Block Grants, for instance) to sub-state regions. Decisions about economic development aid should be made by regional groups representing several counties, not by state officials.

Third, a regional fund could avoid the problem of large amounts of money in revolving loan funds that have not been lent to businesses. Good projects do not emerge every year in every community, but a region-wide fund would have more opportunities for investments. Future payments from city revolving loan funds could be dedicated to establishing the new regional funds.

Fourth, larger economic development programs addressing the problems of a region can have the capacity to make a larger number of loans than a city’s fund and therefore can avoid the problem of an unsecured loan portfolio. Larger, more diversified portfolios would make regional development funds more stable and viable than small cities’ funds now are.

Achieving the goal of creating more jobs and a larger tax base depends on programs that stimulate more economic growth than would have occurred without government intervention. Regional development bodies that use programs such as the Economic Recovery Fund, tax increment financing, and revolving loan funds need to finance projects that should have received financing in the private market but were incorrectly rejected for loans. These could be projects where the costs of getting information on the viability of a loan were significant for a private financing source or where information was lacking entirely; where private lenders discriminated on the basis of characteristics that did not relate to the viability of loans; and where significant benefits would accrue to people in the community who were not in the subsidized business.

These criteria imply that the programs should assist small businesses, businesses in distressed areas, especially with undiversified economies; businesses owned or managed by minorities and women; businesses that produce a new type of product or use a new process; start-up businesses; and projects that emphasize the training and education of workers to help them become more productive. Following these guidelines would not guarantee that programs always fund projects that will create real economic growth. An individual small business might get financing as readily as a large one. A business might fail to get private sector financing because the project was inviable. Nevertheless, an economic development program would be more likely to bring about economic growth if it made loans in instances where the characteristics listed above existed.

Tax increment financing has been the state’s largest and most costly economic development assistance program. Recent changes in state law require that additional state education aid due to the establishment of a TIF district be subtracted from the aid paid to the city that approved the TIF district. These changes will reduce the cost of this program to the state budget, but problems remain because costs to local residents are not visible. Tax increment districts should be phased out and the issuance of new TIF bonds restricted as part of a shift to a regional approach to economic development. Taking their place should be programs where the costs of assistance are visible.
Because creation of new economic activity for the state is so difficult, economic development programs principally shift economic activity among industries, businesses, and places without creating any real economic growth—growth that would not have existed without the programs. Therefore, we believe the distribution of state economic development funds should favor the areas of the state with the highest poverty rates and should favor projects that help people move out of poverty.

Changes in Minnesota’s approach to economic development assistance will not be easy to accomplish. Those benefiting from the current array of programs will oppose changes that will limit their future actions, and there is always local concern when control is shared with other communities. But, as fiscal pressures at the state and local levels increase, the need for change has become increasingly apparent. Policy makers at both the state and local level will need to adjust to a new reality where funds for economic development assistance are less available. Institutional innovations that encourage increased cooperation among communities and a regional outlook will be necessary if economic development programs are to serve Minnesotans well.

Fertilizing Twin Cities Lawns
by John W. Schultz and Terry H. Cooper

It’s common on any spring or summer day to see homeowners out working on their lawn. They might be fertilizing, mowing, aerifying, dethatching, watering, or applying pesticides. Turf quality is important to Twin Cities homeowners. One survey found that 93 percent of Twin Cities homeowners believe that having a nice lawn is either very important or somewhat important. Asked about their neighbors, 90 percent said that they also believe that having a nice looking lawn is either important or somewhat important. Yet management of turf quality remains an elusive science for homeowners.

Many studies have surveyed homeowners by phone or mail about their lawn maintenance practices. Often these surveys claim that homeowners are over applying lawn chemicals and thereby contributing to surface and ground water pollution. However, these surveys have not taken into account the complex nature of applying nutrients to control turf quality. In order to properly assess turf maintenance, a number of factors that cannot be assessed by phone or questionnaire must be considered.

Choices Involved in Lawn Maintenance
Homeowners can improve the health and quality of their turf substantially by applying fertilizer. They must consider, however, not only how many bags to buy, but also the fertilizer carrier, the application rate, and the time of application. Nitrogen, phosphorous, and potassium are the major nutrients needed to build a healthy turf. Fertilizers contain these three nutrients, expressed as percentages by the numbers on the front of each bag.

Often overlooked in choosing a fertilizer are the recommendations of turfgrass specialists and recommendations based on soil testing. Specialists recommend the amount of nitrogen to be applied based on the lawn’s grass type. Soil tests are used to determine the amount of phosphorous and potassium already contained in the lawn’s soil. Soils may naturally contain nitrogen, as well. If the soil tests high for any of these nutrients, the homeowner may not need to apply more or may need to apply only a small quantity since the soil acts as a reservoir in supplying the needed nutrients. If nutrients are over applied the excess could contribute to pollution when nutrients run off the lawn during rain storms or watering. This is especially true for phosphorous. Recent research shows that applying phosphorous to turf on soils already high in phosphorous results in run off, contributing to the eutrophication of area surface waters and decreasing water quality.

Achieving high quality turf on a lawn is difficult to define and can be complex for the homeowner to understand. Much of the turfgrass research has focused on highly maintained areas, like golf courses, athletic fields, and parks. The maintenance programs required to support these areas are not practical for homeowners and are expensive. No studies have been done in which the maintenance practices of homeowners were directly observed. To gain valid information about how homeowners impact the quality of their lawns, this type of study was needed.

The CURA/Department of Soil, Water, and Climate Study
In the summer of 1993, we studied the lawn fertilizing practices of twenty-one Twin Cities homeowners (Figure 1). The sites were all suburban and were chosen somewhat randomly. Representation of different soil types was stressed. Physical properties of the soils as well as their nitrate, phosphorous, and potassium levels were obtained. Fertilizer bags were collected after homeowners had applied the fertilizer in them; fertilizer spreaders were calibrated; and application dates were recorded. Fertilizer carriers, the chemical source of the nutri-