HOUSE JOINT RESOLUTION 21

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ENVIRONMENTAL QUALITY COUNCIL

STATE CAPITOL

HELENA, MONTANA

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BACKGROUND

ECONOMIC DEVELOPMENT ISSUES Despite their importance, economic development issues in Montana have, for some time, been a source of confusion and controversy. Appropriate research, literature and accepted "textbook" models of state government strategies and its administration are virtually nonexistent. Economic policies such as tax and fiscal concessions are usually poorly argued and documented. However, The Montana Economic Study (1970) addressed state development policies and much of that work remains pertinent.

Until recently, good research on economic issues has also been rare in other states, and legislatures have not recognized the need to pay for research. Consequently, well articulated criticisms of adopted policies have not been accessible to political leaders. The net result of this deficiency is that legislators or executive branch officers have preoccupied themselves with unimaginative development strategies (smokestack chasing--the indiscriminate hunt for out of state industries) rather than implementing well-coordinated fiscal, regulatory, and expenditure programs. Along with various forms of tax incentives, the process has become counterproductive. This in turn has masked attempts at new directions in economic development policy and resulted in a zero-sum game of economic development, each state competing at the expense of another.

When research has been conducted, it usually failed to inquire whether "captured" industry actually creates jobs for current residents of a state, or account for the heavy burdens placed on local infrastructures and tax bases by new plant locations. A newly relocated plant for example may have specialized labor requirements which oblige it to bring a significant portion of its workforce with it. Jobs for local residents may be few, menial, or both. This leads to a serious depletion of revenues, the net result being inadequate public facilities and services, some of the important drawing cards for industry in the first place. As a result of past experience and new relevant data, politicians and business interests alike are now discovering that state and local services require ultimate payment, and are recognizing the drawbacks of short-term attractions and long-term costs.

Although special interests support tax abatements, the level of business taxes and the number of abatements have far less impact on investment decisions than is often assumed, and rarely have much effect on interstate or interregional choice of industrial location. Recent studies have illustrated that efforts such as tax and fiscal concessions involve excessive costs, lead to abuses, and most serious of all, simply miss the mark of where the real potential lies for increased employment. Independent economists and other observers overwhelmingly distain them.

Tax incentives do however, perform a psychological function by assuring investors that an area is interested in economic development, but there is a thin line between legitimate encouragement of economic activity and raids on the public treasury for such purposes.

<u>STATE INVOLVEMENT</u> Given the past experience of other states, it is ill-advised for state officials to focus on smokestack chasing and tax incentives to create jobs. Recent research has shown that job generation is accomplished by the birth and expansion of independent corporations and not from branch plants, headquarters, or relocation of multi-plant operations. It therefore appears that state involvement and strategy, if any, should focus on retention and growth of existing businesses and the promotion of new industry in a fair and policially acceptable manner. Utilization of Montana's coal tax trust fund has been suggested as a vehicle to help accomplish this effort.

The revenue from this tax is non-recurring because it is obtained from a non-renewable resource. The use of this revenue would best be used for investments in economic development producing recurring revenues, i.e. invested in the creation of new growing, small, enterprises rather than the support of decaying large enterprises.

Major forces in Montana's economic future will be the state's distance from market areas and its raw materials based economy. Therefore rapid economic development and diversification may not be expected. The quality of economic policy decisions will depend on the quantity and quality of information on which they are based. Policy makers should insist that premium level information be available.

<u>STUDY PROPOSAL</u> Concerns and controversy have consistently reappeared in Montana as to the reasons for the exportation of the state's natural resources for manufacturing, refining, and processing elsewhere. A primary interest is the employment such activities could provide if carried on in the state.

The 46th Montana Legislature through HJR 21 sought answers to this question by proposing a study which would make available creditable, unbiased, factual information. The resolution requested research which would suggest ways state government could encourage the development of resource-based industries in Montana while preserving the state's physical environment.

Apparently recognizing the problems associated with the past forementioned economic development strategies, the legislature also called for new and innovative means to improve Montana's economic and social future.

HOUSE JOINT RESOLUTION 21

<u>DIRECTION AND PURPOSE</u> House Joint Resolution 21 requested the Environmental Quality Council to study the best means of promoting and developing industries that will use Montana's resources within the state while providing environmental protection.

The resolution directed the Council to provide information as to the controversy and reasons for exportation of Montana's resources and to assemble a creditable, unbiased fact base relative to the state's past, present, and future economic and social position.

The study was intended to afford the public and private sectors of Montana a basis for better management of our existing capabilities and for new and innovative means of future improvement for such capabilities.

<u>LITERATURE SEARCH</u> The Environmental Quality Council staff commenced work on the resolution by conducting a preliminary literature search. Materials relevant to general economic development issues were gathered and researched. Major items of this effort included state taxation, development finance, and job creation. Specific focus included tax incentives, property and severance taxes, plant locational factors, plant closings, and job generation processes.

<u>PRESENTATIONS</u> The scope of the study also included a series of oral presentations. Representatives of various industries, government officials and an independent economist were invited to present perspectives at the January 25, 1980 Environmental Quality Council meeting. The intent was to solicit input and identify problems pursuant to the directives of the resolution. The speakers were requested to focus attention on Montana's taxes and natural resource laws which were felt to be detrimental to the implementation of industry in Montana. Further, it was requested that specifics be sited and problems identified so that legislators could subsequently address them.

Following is a brief general summary and recommendations of each participant.

<u>SMELTING AND MINING</u> - This participant sited the need to recognize Montana's position as a basic resource state and the significance of the small miner in the mineral industry. Limited financing, government regulations, permit time frames, and anti-mining philosophy were identified as being problems for small miners. Recommendations included simplifying regulations and increasing cooperation and flow of information between agencies.

The speaker also sited the importance of Montana's smelting facilities to the tax base and employment and supplied data pertaining to the costs of implementing and maintaining pollution controls. The representative encouraged the examination of property taxation of pollution control facilities and recommended that remedial legislation be enacted to exempt these facilities from property taxes.

URANIUM - The speaker presented a summary of uranium exploration and development and explained how these phases of the uranium industry meets the regulations imposed upon them by various government agencies. Since no two deposits of uranium are alike, regional environmental impact statements were deemed objectional. To adequately protect the public and the environment, the environmental impact statement should be site-specific.

The spokesman did not advocate the abolition of regulation, but rather recommended rational legislation to govern the orderly development of all natural resources, and the avoidance of duplication when drafting and implementing such legislation.

Various procedures involved in the exploration of uranium were detailed and applicable laws of other states governing the disposition of drill holes were compared. It was recommended that Montana review the legislation of other states to determine how it might guide the development of legislation in the state.

REAL ESTATE AND DEVELOPMENT - This perspective included a discussion of economic development in general. It was recommended that basics be understood and considered by decision-makers before establishing an economic development policy for the state. The following five fundamentals were outlined for consideration.

(1) Value Added Concept - to generate wealth, land, labor, and capital must be combined to create a marketable, higher value product.

(2) Plant Location Process - includes the analysis of transportation, labor, raw materials, utilities, construction and subjective factors.

(3) Recognition of Montana's shortcomings and strengths - shortcomings include population, distance, labor skills, and lack of supportive operations. Those that indicate potential for profitability are lumber, mining, metals, and agricultural processing.

(4) Financing - despite a popular excuse for lack of development, money is available for viable projects in the state.

(5) Appreciation of the success of out of state entrepreneurs - Montanans do not have a corner on business, engineering, and management genesis. Unlike giant corporations, we lack staying power and the broad range of management and technical skills.

Public and government attitude toward development was displayed as being negative and thus contributed to lack of investment in Montana. Participatory government (public hearings) and administrative rules were also sited as factors which discourage investment. Well defined rules for decision-making were suggested as remedies.

Property taxes were not rated high as a major factor in plant location analysis, but Montana's 30% coal severance tax and the Major Facilities Siting Act were pictured as a burden, punitive, and anti-industry.

FOREST PRODUCTS - General concerns of the forest products industry were expressed. Specific problems of the industry include rail car shortages (retirement rate exceeds replacement) and high freight rates. Montana was sited as being heavily unionized which makes competition difficult with adjoining areas which are not.

Property taxes were identified as contributing to the problem of attracting businesses into the state. This representative urged the support of an orderly development of the timber resource in the state and advocated acceptable environmental standards. Coordination of federal and state laws was also recommended.

PETROLEUM INDUSTRY - Material relevant to petroleum products and drilling programs were presented to the Council. Tax comparisons between Montana and the adjacent states of Wyoming and North Dakota were drawn. The data presented, indicated that a lower level of exploration activity in Montana compared to the other states was due to the differences in tax rates.

The speaker advocated legislation that would provide uniform and reasonable tax rates in addition to reasonable rules and regulations.

GOVERNMENT REPRESENTATIVE - A former representative of state government presented general observations pursuant to Montana's environmental laws. Current laws were defended as not prohibiting the development of resources but rather, having a limiting controlling effect on the rate and manner in which the states resources are developed. Legislation which places these limits on development were passed by the legislature as a reflection of the intent of the people. If the intent changes, changes in the laws can be assumed and anticipated.

The Major Facilities Siting Act received specific attention. The Department of Natural Resources and Conservation and its board are instructed by law to determine the public need for major energy facilities in the state and places them in an adversary and controversial position. Yet no specific definition is written into the statute which identifies whether the need is state, regional, or national. Other problems identified were the lack of state forecasting capabilities and specific definition of environmental criteria. Legislative changes were suggested in these areas.

Montana's lack of comprehensive planning effort was sited as a major problem. Fragmented programs dealing with energy, agriculture, water, development, etc., are interrelated and require comprehensive and coordinated consideration. State wide educational television was recommended as a vehicle to provide citizens with a variety of issues and scenerios relevant to resource development proposals. This medium could be utilized to foster informed ideas, discussion, and gather citizen input for possible legislation. This public participation and feedback could then be implemented by the legislature and executive branch.

Montana's future economic development will depend upon resource extraction, and like all other activities, has adverse impacts on the environment. Improved and innovative technology can minimize these impacts, and research and development was suggested as an obvious place for the investment of state money.

Utilization of both renewable and nonrenewable resources were suggested as strategy to attract clean industry and foster future economic development.

Low pay for state employees and the practice of contracting work out of state were identified as having adverse effects. State agencies were encouraged to spend money locally on these activities to begin building technical skills within the state.

GOVERNOR'S OFFICE - A representative of the Governor's Office discussed state laws, regulations, and policy. Executive Branch work was described as the administration of laws passed by the legislature. Current laws concerning resource management and development largely reflect the will and express the desires of the people. State policy is therefore one of a cautious, sensitive, and balanced approach to resource development. Such policy is expressed by each of the following:

(1) The exercise of influence over major outside initiatives. This is implemented by the Major Facilities Siting Act (MFSA), pollution control regulations, mining laws, and water adjudication process.

(2) Maintenance of the integrity and productivity of the resource base. The Mine Reclamation Act and Subdivision laws implement this facet.

(3) Conservation of the resource base to provide intergenerational equity. Reclamation laws and severence taxes are involved in this effort.

(4) Utilization of nonrenewable resources to promote long-term economic welfare.

Involved here are idemnity trust taxes and coal severance set aside.

The implementation of this approach was described as consistent with the goal of enhancing long-term economic stability and maintaining the amenities of lifestyle cherished by Montanans.

Areas which may require some legislative and administrative attention are timber taxation, tax administration and coordination of permit procedures.

It was suggested that severance taxes are more consistent with the long term nature of timber production rather than the ad valorem approach.

The various taxes paid on a simple resource are administered separately and may require more paperwork than necessary if notification and collection were consolidated.

Environmental regulations are at times fragmented, however, separate review is necessary to retain the integrity of separate agencies' jurisdictions. Conversely, a coordinated approach may be effective in diminishing time frames.

The state's overall approach may leave an impression of a lack of interest in sensitive development. This was not viewed as a problem with existing statutes or administrative decision-making, but rather one of focus. It has been incumbent on the administration to institute effective regulatory mechanisms, a function that has been done. The focus should now be to investigate more distinct developmental policies and programs. The following suggestions were outlined.

(a) The continued cautious and sensitive development of both nonrenewable and renewable resources. Renewable resources, being the dominant factor in the economy and the basis of long-term wealth of the state, laws and regulations must insure that the productivity of the land resources and their renewable output is maintained.

The development of nonrenewable energy and mineral resources provide jobs, and revenues which enable the state to continue its economic and resource planning initiatives. The state must continue to sensitively develop these resources.

(b) First-stand timber, being in short supply, requires adequate funding for the USFS to intensively manage this resource, and should be a top priority. Research into site productivity and management techniques is encouraged along with the investigation of the impact of tree density and soil factors on rates of production.

(c) Due to Montana's remoteness, loss of competitive rail rates, and federal deregulation of air and motor carrier traffic, there is a need for federal assistance in financing Montana railroads, highways, and air service.

(d) To insure economic stability, strategies of diversification and import substitution are encouraged.

(e) Methods of providing public capital to address possible capital "gaps" or for beginning small businesses, should be explored.

(f) An economic study should be conducted which would fully investigate the possibilities for using more State of Montana funds for in-state investments. It should focus on evaluating the tradeoffs between safety of principal, rate of return, and other economic benefits accruing to the state from in-state investments.

INDEPENDENT ECONOMIST - This speaker addressed the topics of diversification of Montana's economy and the possibility of developing new natural resource based industries in the state.

The speaker first identified two strong market forces which discourage diversification, transportation costs, and labor market. Montana, being a raw materials source and not being a large market area, tends to attract resource oriented industries. Firms tend to locate where the costs of transporting their inputs and final products are minimized. Plants are typically, therefore, built either near product markets or near the source of raw materials.

Resource industries such as smelting, plywood, and ore concentrating through primary processing, greatly reduce the weight of raw materials creating a product with higher value per unit of weight. The unit cost of transportation (as a percentage of their unit value) is much lower than transporting unrefined raw materials.

As elaboration of raw materials progesses toward the production of final products, the raw materials source location loses its economic advantage because subsequent manufacturing stages do not reduce weight as much. The products become progressively more diversified, fragile, or perishable and require packaging. These activities are located near the final consuming market. Montana is therefore at a disadvantage if it wishes to extend itself from smelting to metals fabrication, from plywood production to furniture, or from wheat growing to bread making.

Industrialized areas with a high concentration of industrial customers provide a large, skilled, mobile, and flexible pool of workers, as well as a variety of managerial, technical, financial, and specialized services. The cost savings to industries which locate in such areas creates a disincentive to industrial diversification in Montana.

On the other hand, the low wage rates in Montana are an inducement to industry to locate in the state and in turn, promote diversification. It has also been suggested, that Montana's environmental amenities attracts and retains workers who voluntarily accept lower incomes.

Pursuant to environmental regulations, economists have not made any comprehensive analysis of the importance of regulations on industrial locations. Impacts may exist, but are very difficult to measure accurately.

Systematic studies of the effect of state and local taxes on plant locations conclude that firms typically place little emphasis on these factors. Cost analysis indicates that differences in tax burdens between states are rarely large enough to outweigh private market location factors.

In considering the effect of taxes or regulations, it is important to recognize that resource based industries are geographically immobile. Given this, a cost raising tax or regulation will cause the mining company to offer lower prices for the right to exploit the deposit. Owners of the right must sell the right for the price offered. The profitability and level of mining activities will not be affected. The same argument holds true if the right is already owned by the mining company and revenues cover the costs of the operation. Exceptions to this general conclusion can be sited.

Promotion of industrial development and diversification will require extremely substantial inducements. The effectivenss of those already employed in Montana has not been adequately measured. States who compete with similar inducements simply reduce the resources of state governments and results in no substantial rise in investment. It is advisable to consider "retaliatory" promotion by neighboring states and understand that inducements Montana might offer are not independent of those offered elsewhere.

Economic diversification is expected to reduce instability by reducing dependence on a single line of production. Diversification policy is however, complex and a strategy for example, of simply equalizing employment among industries, will not necessarily result in increased stability.

Regional stability may be attained by "risk pooling" which suggests that a well diversified industrial structure consists of industries which do not, in general, move up and down (in sales, employment, etc.) together in any systematic manner.

In examining the issue of taxes and environmental laws being detrimental to the development of Montana's resources, it should not be assumed that desirable resource development involves only the production of some output such as lumber or metal. Montana's environment produces substantial benefits and economic value as real as physical goods and services. From this perspective, we should consider the possibility that Montana's tax laws and regulations do not promote desirable resource development because they are too stringent, but rather because they are not stringent enough.

PROMOTING INDUSTRIAL GROWTH AND DEVELOPMENT IN MONTANA

The following is a summary of a report which reviews the available evidence concerning the impact of state and local taxes, regulations, and industrial promotion efforts on the level and pattern of business development.

INTRODUCTION Montana's history of "boom and bust" economy is the result of the exploitation of nonrenewable resources (exporting industries) and is thus dependent upon national and international markets for stability. This narrow economic base has prompted discussion of diversification of Montana's economy to reduce its sensitivity to fluctuations in national economic activity. This strategy would involve the establishment of industry other than those based on nonrenewables. Factors which influence locational decisions then become relevant.

LOCATION FACTORS Six fundamental factors are recognized as being necessary, to some degree, for the establishment of industry to be feasible. These are a market, raw materials, labor, transportation, energy resources, and capital.

MARKET - Final consumption businesses tend to locate near consumer markets. The stages of production which are oriented toward the market characteristically experience an increase in weight and/or bulk; produce fragile or perishable goods; are interdependent with other market-oriented stages of production; or acquire maximum economies in production only when producing on a large scale which requires an area of sufficient market capacity to absorb the massive output.

Montana's size, population, and low per capita income contributes to high distribution costs, and have not been attractive for market oriented industries.

Recent demographic trends, described as the "flight from pollution, crime, congestion, social alienation, and other suspected effects of large scale massing of people", are destined to change this situation. Quality of life amenities are attracting people. From a growth perspective, this means expansion of market capacity and an increase in labor supply. Montana's lag in economic growth should therefore be viewed positively, and important goals should be protection of these quality of life amenities and insuring that the state does not fall victim to the problems encountered elsewhere.

TRANSPORTATION - Transportation costs are a function of distance relative to the weight, bulk, and value of the goods. This results in firms locating near the market or source of raw materials. Stages of production which involve weight loss or bulk reduction tend to be oriented toward the raw materials source (prior to shipment). Those processes involving increase in weight and/or bulk, locate near the market.

High value goods are more "transportable" than low value goods. The cost of their transportation relative to the value is less significant than it would be for low value goods.

Transportation costs increase as goods become more fragile, perishable, or require special handling. Canning processes, for example, are thus located near the raw materials source.

Montana is geographically and demographically distant from major markets, and there is a strong disincentive for market oriented stages of production to locate here..

RAW MATERIALS - Primary stages of production are oriented towards the raw materials source because of the weight or bulk reduction involved. It becomes physically necessary therefore, to locate at the raw materials source. The location options of a materials oriented industry is limited by the geographical location of the raw material.

Montana, having timber, oil, copper, and coal is a raw materials source. Further, the state's agricultural output is a major component of the economic base.

> Most of Montana's natural resources are nonrenewable and the supplies of those which are not, such as timber, may be out-paced by production. The depletion of these resources threatens Montana's economic base and suggests the necessity for diversification. However, this goal should not be pursued blindly. Careful economic and social planning in regard to both existing industry and resources, and potential economic growth is necessary. More industry does not necessarily mean good stable economic growth.

LABOR - Labor is a major component of the cost structure of labor intensive firms. Basic factors involved are costs, supply, and productivity. Industries requiring pools of unskilled workers are attracted to regions in which wages are low.

The important elements of supply are availability, and stability. Availability is connected to the mobility of unskilled workers and this reduces the importance of large concentrated pools of labor.

Stability involves the historical record of labor-management relations. Poor labor relations provides a disincentive for firms to locate in areas with such a history.

Labor productivity is important but difficult to measure. It is influenced by the ratio of capital to labor, technology, and the skill, age, and physical and mental capabilities of the laborer.

Labor can be important to nonlabor intensive industry (highly technical) if the production process requires specially skilled labor.

Concerning stability, an analysis of appropriate data suggests that Montana's labor stability is above average when compared to other states.

ENERGY RESOURCES - Transportation costs tend to force energy intensive industries to locate near energy resources, or near cheap energy sources. Montana's aluminum plant illustrates this, as does the industry located near the Southern Appalachians and the Northwest.

Fuel requirements may influence the orientation of production relative to the market or materials source. Early stage processes requiring large amounts of energy typically involve weight loss such as metallurgy, cement, glass, etc.

CAPITAL - Economic expansion and diversification requires capital, which being mobile, can be brought into an area from an external source or generated by large corporations internally.

Regional capital "gaps" may exist for the small companies growing at too slow a rate to be of interest to the venture capitalist.

Start up businesses requiring seed capital illustrates a similar gap. The lack of capital here is attributed to the "altered risk-to-reward ratio." A systematic analysis of financial availability and need in Montana has not been conducted.

SECONDARY FACTORS - Included in this category are physical environment, governmental policies, research talent, perception of the industrial potential and personal considerations. As site locations are narrowed through the decision process, these factors become increasingly more important.

Most location factors are not susceptible to direct policy control, but the quality of any decision depends on the quality of information on which it is based. It also depends on the ease with which information can be obtained.

Thus it should be a matter of policy to make sure that the quantity and quality of information is at a premium level, not only to attract industry but also to protect against instability in the economy due to poor location decisions.

THE EFFECTS OF TAXATION, TAX CONCESSIONS, AND REGULATION ON INDUSTRY LOCATION

TAXES AND TAX CONCESSIONS - Forty states currently offer various types of tax relief as an incentive to attract new business or induce expansion of existing industry. The function of these incentives is to create a differential which favors a specific region. Competition between states is now too extreme, and the cost appears to exceed the benefits.

Effectiveness appears to be marginal and appropriate studies have concluded that the influence of taxes on industrial location decisions is not significant. At the state level, inducements tend to be outweighed by factors such as markets, raw materials, transportation, etc.

When taxes are compared to value added, (the actual contribution of a firm to the final market value of a good) state and local taxes represent one half to three percent of value added, and two to five percent of sales. Corporate and unincorporated business income averages about one eighth of value added which means that the average ratio of state and local taxes to value added is about 0.5 percent.

Small percentages can however, represent significant amounts of money, but the significance of tax incentives is reduced further by the fact that the amount deducted from state taxes, as a credit, is an addition to the firm's income and therefore subject to the 48 percent federal corporate income tax. This cuts saving nearly in half.

Tax supported public services can reduce the costs of a firm relative to another location. Taxes, as they represent the provision of services, may indirectly produce an incentive for industry to locate in a specific region. However, if tax revenues are not used to finance public goods and services, but instead finance transfer payments, there is no flow of benefits to resident firms and employed or employable persons. Adequate cost and tax information is therefore essential to guard against misinterpretation of tax data and to insure proper locational decisions.

In examining impacts of taxes on industry location, it is also important to consider whether or not differences in other cost factors among regions are greater than regional differences in taxes (quantitative effectiveness). The results of appropriate studies are consistent with the contention that tax differentials are less consequential than other cost differentials.

One must also investigate what kind (qualitative effectiveness) of business is attracted, and to what degree new jobs are created within a region.

Competiton between firms in an industry, being variable, affects their behavior. Perfect competition conditions requires firms to maximize profits. Product prices are determined by the market, not by the influence of an individual firm. Reduction in costs will induce changes in output and employment decisions.

Industries dominated by a few firms are less affected by external market conditions. Changes in cost or other external conditions must exceed some minimum amount in a given period of time. In this "threshold effect", firms will probably ignore the change since the real costs will be encountered in the process of adjustment.

Financial incentives which lower costs will, therefore, tend to have a larger impact on competitive firms. For others, tax concessions may simply be a "windfall profit" without inducing any change in production or employment.

The competitive sector, stimulated most by tax incentives, offers lower wages, provides less desirable jobs and poorer working conditions, and less stable employment. On the other hand, the windfalls are accruing to those firms which need them least.

Investment decisions depends not only on costs but also on expected returns, and anything that government can do to reduce the uncertainty about sales, reduction in consumer tax liabilities, for example, induces investment more than any other kind of public action.

If the benefits of tax incentives are marginal, what are the costs of providing such incentives? In addition to business promotional budgets and fees, the primary cost is foregone tax revenues.

> Tax relief for business cost cities and states more than promotional fees. In just over a year, New York City has exempted $461 million in properties from nearly $44 million in taxes. St. Louis has exempted nearly $1 billion worth of real estate-equal to half of the cities property value--including a property tax abatement for the First National Bank of St. Louis, estimated to cost the city $17 million alone. Michigan incentives may cost $50 million in state revenues and $30 million in local revenues annually if continued into the 1980's.

The overall cost to local governments, in the case of North Dakota, for the ten year period covered by the study done by the State Tax Commissioner was estimated to be in excess of $7 million.

Proponents of tax incentives argue that before a new capital investment is made, usually little tax was being collected on the site anyway. This argument fails to acknowledge the fact that new businesses may require an in-migration of workers which results in new costs to the community in the form of additional governmental services. Thus the use of tax incentives may result in a temporary increase in tax burden for existing home owners and businesses.

THE EFFECTS OF REGULATION ON INDUSTRY LOCATION - To function as a potential factor in a location decision, a regional cost differential must exist due to the specific factor. It is also necessary that the factor represent a significant proportion of the total cost experienced by firms, and that the differential be significant enough not to be superseded by other cost differentials.

Pollution abatement and control for 1977 (in 1972 dollars) was $13.918 billion. Manufacturing sales was $285.7 billion. The ratio of pollution abatement and control expenditures to total sales was approximately 0.049. This figure provides some indication of the importance of regulation as a cost factor. Like taxation, regulation appears to represent an insignificant proportion of total costs.

Cost differentials between states may exist, but it is doubtful that any are significant enough to alter the cost structure substantially. Expenditures include those necessary to meet both state and federal regulations, and only expenditures related to state regulations are relevant in determining differentials and their impact on location decisions.

Regulation may influence the businessman's perception of the business "climate", and may also have a negative effect on internal investment.

Montana, being a resource area, is also a high regulation state. Resource oriented industries usually lack flexibility in location decisions, and regulation should have very little impact.

TECHNIQUES USED BY OTHER STATES IN PROMOTING INDUSTRIAL DEVELOPMENT

Since World War II, the following five general types of inducement programs have evolved: (1) state industrial finance authorities; (2) local industrial bond financing; (3) tax concessions (discussed previously); (4) statewide development credit corporations; and (5) local industrial development corporations. A discussion of the general characteristics of each follows.

STATE INDUSTRIAL FINANCE AUTHORITIES (SIFA) - SIFA finance new plants or purchase and improve land for industrial purposes through direct loan and loan guarantee programs. Funds for direct loan programs are usually obtained from the state's general revenue funds or through the issuing of bonds.

Industrial development bonds receive criticism because they tend to attract small, marginal, labor intensive (low wages) firms operating in declining industries.

Loan guarantees induce private lenders to finance projects by insuring repayment of up to 90% of the loan. This program reduces risk to the lender and reduces the expenditure of public funds.

The New Hampshire Industrial Park Finance Authority provides prepared industrial sites by furnishing short-term money for real estate improvement and construction of industrial plants. It is repaid with interest by manufacturers who buy the sites and buildings.

The Pennsylvania Industrial Authority participates with community development corporations in financing new plants in chronic labor surplus areas. It is authorized to make loans out of the general revenue funds to local nonprofit development corporations of up to 40 percent of industrial facility costs in return for a second mortgage.

Missouri has a policy for the investment of inactive state funds. An Industrial Development Time Deposit Program promotes the availability of bank credit through the deposit of state funds in private banks. Loans are provided for working capital, interim construction and inventory financing, minor site development, and equipment. In three years, 780 new jobs were created due to expansion of existing plants and 65 due to new plants. It is estimated that $1.00 of state treasurers IDTD deposit has produced $4.19 of total new investment in Missouri and that $2,104.83 of IDTD deposits is needed to produce one new job.

LOCAL INDUSTRIAL BOND FINANCING - Industrial Development bonds are used to promote development and overcome imperfections in capital and labor markets. Bond interest payments are tax free, carry low interest rates, and the resulting properties are often exempted from local property taxes.

Two types of bonds are issued; general obligation bonds and revenue bonds. General obligation bonds are secured by the full faith and credit of the issuing government, and the community is required to meet unpaid obligations out of general tax revenues if firms fail or leave the area.

Many states have abandoned bonds of this type because it can endanger the credit rating of the issuing government. It may also endanger the borrowing power for the expansion of other public facilities if these bonds are included in the statutory debt limitations.

Revenue bonds are secured only by the facility financed. The tenant industry makes interest and principal payments, rather than local governments. In case of default, local governments are not required to retire local revenue bonds. Presently, 43 states authorize the use of revenue bonds.

STATEWIDE DEVELOPMENT CREDIT CORPORATIONS (SDCC) - The SDCC functions as a means of pooling financial resources from member banks, insurance companies, and other financial institutions. Funds are acquired from stockholders and members. Equity capital is obtained through the sale of stock to private individuals or to nonfinancial institutions and serves as a partial guarantee for loans obtained from members.

Members agree to lend small amounts of funds to the SDCC on call. A debt to capital ratio is usually maintained which is much higher than those of ordinary financial institutions. This gives the SDCC access to relatively large amounts of borrowed funds. The pooling of funds also spreads the risk among members and permits loans to be made which would not be granted by individual member financial institutions.

The amount which the corporation can lend depends on the amount of stock which can be sold to raise equity capital. This serves as a drawback, as selling stock in SDCC's may not always be a simple task. This is because the returns to stockholders, which are indirect in the form of improved business conditions, are uncertain.

LOCAL INDUSTRIAL DEVELOPMENT CORPORATIONS (LIDC) - LIDC's function to stimulate local economic growth by influencing and aiding firms in their final site selection. Local representatives provide analysis of the site and community, and local social and economic factors. Many corporations have been established as nonprofit organizations, but when profits are made, they are generally retained for further operations.

Financing by LIDC's takes various forms; loans or loan guarantees, purchase of existing buildings for lease, construction and/or leasing of industrial buildings. Funds are often used for the purchase and development of sites.

Funds are raised from the sale of stocks or bonds in the corporation and/or by soliciting contributions from the public or from local businessmen. They frequently borrow from existing financial institutions on a mortgage basis to supplement their own funds.

LIDC's vary in form, but all provide financing, improve employment opportunity, assist expanding and new firms, are supported by public subscription, and are incorporated.

They frequently make nonbankable loans, accept lower grade collateral, and require fewer restrictions on loans.

THE EFFECTIVENESS OF STATE AND LOCAL DEVELOPMENT PROGRAMS - Numerous surveys have been done which inquire into whether financial inducements are important as a location factor. Most of the results have been consistent in ranking inducements low on the list of factors.

Some programs seem to have a positive effect in stimulating investment and aiding industrial firms through other means of assistance, including the provision of information. When judged by their ability to influence location decisions, effectiveness is minimal.

A SURVEY OF INDUSTRY EXPERIENCES AND ATTITUDES IN MONTANA 1980

In pursuing the objective of HJR 21, the Environmental Quality Council approached the Bureau of Business and Economic Research to conduct a survey designed to obtain attitudes of natural resource firms toward Montana state regulatory activities. The Bureau consented with the understanding that it would represent opinion, not unbiased factual information, as called for in the resolution.

It should be noted that the survey respondents were officials of resource-based firms which are subject to broad and technical regulations. In addition, factors other than regulations affect the development of natural resources in the state: economic factors, such as markets, transportation labor, capital, materials, and energy; social considerations such as public services, and the physical and cultural environment are also important.

THE SURVEY RESPONDENTS - One hundred and seventeen questionnaires were mailed to high level officials of natural resource firms. Sixty-seven usable responses gave an effective return rate of 57 percent. Participants generally represented firms searching for new energy and mineral sources, and most of those reporting were involved in new or expanding operations.

Wood products manufacturing firms represented a sizeable portion of the respondents, along with electric power and gas utilities and other industries.

PROBLEMS ENCOUNTERED IN ESTABLISHING NEW OR EXPANDED ACTIVITIES IN MONTANA - Firms that reported initiating expanded activities since January 1, 1970 were questioned about significant or unusual difficulties, and were asked to describe the nature of the problems they encountered.

The greatest concern centered around what respondents considered to be "unnecessary and excessive" delays encountered in obtaining permits and/or project approval. Deficiencies and conflicts in statutes, dual state-federal regulation, agency performance, and lack of coordination were sited as creating delays. Compliance difficulties and changes in regulatory requirements were identified as problems related to regulatory activities.

Other problems were difficulties in obtaining capital, economic conditions, and excessive coal, oil, and gas net proceeds taxes.

Only twenty-four participants responded to a question asking them to specify significant problems.

FINANCING NEW PROJECTS - It appears that most large firms do not regard availability of capital in Montana a significant problem. The mobility of capital across state boundaries for investment opportunities is a likely factor. New projects are most commonly financed by retained profits and/or long term debt outside the state. Major nonlocal financial institutions are familiar with, and ready to serve Montana's resource industries.

Smaller firms suggested that limited financial resources do constitute a barrier to resource development. A few felt local financial institutions do not understand their industries.

The results are not conclusive, and few generalizations can be drawn from this data regarding the debate about capital availability in Montana.

DEALING WITH STATE REGULATORY AGENCIES - The most common (nearly half) type of contact survey respondents have with regulatory agencies involves applications for development permits. Other contacts include information requests, and contracts and leases.

Of those who reported having had difficulties with state regulations (39), very few identified any specific regulation, but did describe the problem. The most common problems cited were stringent requirements, inflexible or inconsistent personnel, lack of state agency coordination, and unrealistic data requirements. Time delays was the difficulty mentioned most often.

Important consequences to firms include increased or unnecessary costs, time delays, and project uncertainty.

When asked about what was right with regulatory procedures, respondents mentioned cooperative attitudes, the provision of useful information and suggestions for compliance.

RECOMMENDATIONS FOR IMPROVEMENT - When respondents were asked for recommendations for improving state regulations and/or regulatory procedures in Montana, thirty-six firms answered. The most common suggestions included streamlining regulations, revision of legislation and guidelines, and shortening the processing time on applications.

A number of respondents suggested that the state hire more qualified personnel--usually indicating awareness that higher salaries might be necessary. More coordination among state agencies and elimination of federal involvement was also mentioned.

The Governor and Legislature were sited as being ultimately responsible for state regulatory programs and attitudes, and should express an interest in proper development in Montana as well as protection of the physical environment.

ATTITUDES TOWARD MONTANA STATE REGULATIONS IN GENERAL AND TOWARD THEIR ADMINISTRATION

> In general, respondents did not feel that Montana regulations are either very unreasonable or very sensible. They had few strong feelings about the clarity of regulations, with responses rather evenly split among the middle reaction points; and most were either neutral about their usefulness or found the regulation in general only mildly useless or mildly worthwhile.

When asked about regulations as being necessary to promote the public welfare or not worth the cost, only a few respondents indicated the strongest negative position and a good number were willing to acknowledge some necessity.

A majority described Montana's regulation in general as rigid, difficult to comply with, idealistic, and ambiguous. They also believe regulation hinders industrial expansion, constitute excessive interference, and increase the cost.

Administration, like the regulations themselves tends to be rigid, and over half of the respondents said the original purpose is distorted. Some feel too many regulatory agencies are involved and administrators cause unnecessary delays.