



*An Evaluation of the  
Keystone Opportunity Zone  
and Keystone Opportunity  
Expansion Zone Programs  
in Rural Pennsylvania*

*The Center for*



*Rural Pennsylvania*

*A Legislative Agency of the Pennsylvania General Assembly*



**An Evaluation of the Keystone Opportunity Zone (KOZ)  
and Keystone Opportunity Expansion Zone (KOEZ) Programs  
in Rural Pennsylvania**

*By:*  
*Paula A. Holoviak, Ph.D. and Damian Carabello, M.P.A.*  
*Kutztown University*

*July 2008*

**The Center for Rural Pennsylvania Board of Directors**

**Senator John R. Gordner**, Chairman  
**Representative Tina Pickett**, Vice Chairman  
**Senator John Wozniak**, Treasurer  
**Dr. Nancy Falvo**, Clarion University, Secretary  
**Representative Tim Seip**  
**Dr. Theodore R. Alter**, Pennsylvania State University  
**Steve Crawford**, Governor's Representative  
**Dr. Stephan J. Goetz**, Northeast Regional Center for Rural Development  
**Dr. Keith T. Miller**, Lock Haven University  
**Dr. Robert F. Pack**, University of Pittsburgh  
**William Sturges**, Governor's Representative

This project was sponsored by a grant from the Center for Rural Pennsylvania, a legislative agency of the Pennsylvania General Assembly.

The Center for Rural Pennsylvania is a bipartisan, bicameral legislative agency that serves as a resource for rural policy within the Pennsylvania General Assembly. It was created in 1987 under Act 16, the Rural Revitalization Act, to promote and sustain the vitality of Pennsylvania's rural and small communities.

Information contained in this report does not necessarily reflect the views of individual board members or the Center for Rural Pennsylvania.

Copies of the full report are available by contacting the Center for Rural Pennsylvania, 200 North Third St., Suite 600, Harrisburg, PA 17101, telephone (717) 787-9555, email: [info@ruralpa.org](mailto:info@ruralpa.org).

## Table of Contents

Introduction.....	5
Literature Review .....	6
Enterprise Zone Effectiveness .....	6
Enterprise Zone Costs.....	6
Impact of KOZ/KOEZ: Econometric Models ...	7
Trend Data .....	7
Regression Models .....	8
Model Conclusions .....	10
Mail Survey Methodology .....	11
Local Governments/School Districts .....	11
EDCs .....	11
Business .....	12
Selection Factors.....	13
Effectiveness of KOZ .....	14
KOZ Case Studies .....	15
Case Study Findings .....	16
Conclusions .....	17
Policy Considerations .....	17
References .....	19

## Executive Summary

This research project, which was conducted in 2005, evaluated the effectiveness of the Pennsylvania Keystone Opportunity Zone (KOZ) program and the Keystone Opportunity Expansion Zone (KOEZ) program in meeting the legislative goals of increased employment, capital investment, and use of brownfields and blighted properties. In particular, it evaluated the programs' economic impact in rural KOZs, and the satisfaction of program participants including local government, school districts, economic development organizations and private businesses.

The research included an analysis of changes in employment, per capita income and state and local tax expenditures and revenues. Surveys were conducted of program participants and supplemented with case studies of three communities.

The research results showed that economic development professionals use the KOZ/KOEZ program for marketing, especially for brownfields or other less desirable industrial and commercial sites. KOZ/KOEZ has limited negative impact on the tax revenues and service expenditures of local government. KOZ/KOEZ also has relatively few administrative costs at the state level, and relies primarily on existing economic development organizations for implementation. Businesses do not have any substantial complaints about the program's implementation or reporting requirements. The program encourages local investment in housing, downtowns and brownfield sites.

The findings also suggest that there are program inequities due to administration challenges and professional promotion. These issues have resulted in some properties having zero activity and some businesses not taking advantage of other programs available in the zones that could increase the KOZ/KOEZ impact. A varying from the legislative intent of the program has resulted in inter-zone competition with greenfield properties competing with abandoned industrial sites.

Policy considerations from the research findings and conclusions include: centralization of the administration of the program in DCED rather than having the Department of Revenue determine tax abatement eligibility; more rigorous reporting requirements for businesses and zones; and focusing of resources on small business development, business incubators and locally owned and operated companies rather than the recruitment of larger out-of-state, out-of-region firms. Finally, the researchers recommend that tax abatement be phased-in by end-loading as much as possible. This could include rewarding firms with increased tax abatements after one, two, or three years rather than giving total abatement upfront and phasing in taxes slowly, beginning from years five to 10.

# Introduction

After decades of manufacturing decline, Pennsylvania was plagued with pockets of high unemployment, especially in rural areas, and littered with former industrial sites, many highly contaminated with industrial waste and byproducts of various types of manufacturing activities. In 1998, Pennsylvania enacted the Keystone Opportunity Zone (KOZ) Act (Act 92 of 1998) to offer tax incentives and tax abatement in exchange for private investment in designated economically distressed area of the state. The KOZ program provides 100 percent tax forgiveness for municipal, school district, and county real estate taxes. The program also forgives such taxes as earned income/net profits, business gross receipts, business privilege, sales and use, wage and net profits, realty use and occupancy, and mercantile license depending upon the classification of the county, school district and local government.

The KOZ program was enacted for a period from January 1, 1999 until December 31, 2008. This period was extended to 2013 by the Keystone Opportunity Expansion Zone (KOEZ) and Technical Change Act (Act 119 of 2000). In 2002, further changes were made to the program to allow zones to expand existing sub-zones by adding additional properties or by swapping current properties with new areas. In addition, a provision was enacted to allow the de-certification of a property within a sub-zone (Act 217 of 2002). KOZ's/KOEZ's expire in 2008, 2010, or 2013, depending upon when the zone was designated (roughly a 10-to-12-year tax abatement period).

The state was divided into 12 KOZ zones by the Pennsylvania Department of Community and Economic Development (DCED). Within each zone, "one or more political subdivisions, or a designee of one or more political subdivisions" had to apply to DCED to designate the actual acreage to be included in the zone (Section 301.7-301.9, KOZ Act 92). A maximum of 5,000 acres could be included in each zone. This was later expanded to 6,500 acres under the KOEZ legislation. While all 67 counties were included in each of the 12 zones, only 60 counties chose to participate in the program. Once the zones were designated by DCED, the zones could then be divided into a maximum of 12

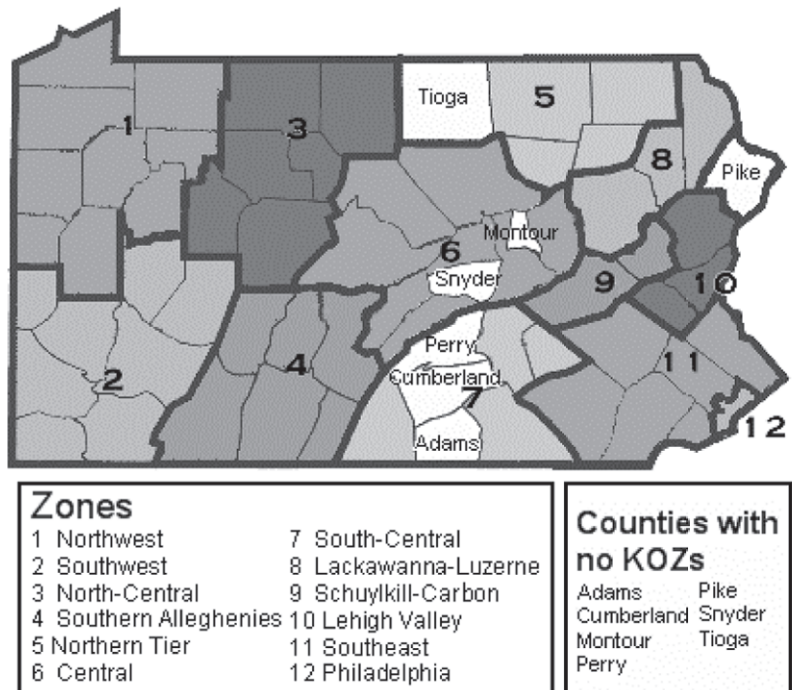
sub-zones, with a minimum size of 20 contiguous acres for urban areas and 10 contiguous acres for rural areas.

The 12 KOZ zones encompass 60 counties, with one to nine counties in each zone ranging in size from 363 acres to 6,121 acres. There are 193 designated sub-zones. In practice, each sub-zone exists entirely within a single county and school district but some encompass one or more municipalities. Figure 1 shows the DCED designated zones and the participating counties.

In 2002, DCED commissioned a four-year report summarizing the effects of KOZ. As of September 30, 2002, DCED maintains that KOZ/KOEZ has created 13,614 jobs and retained 7,962 jobs, resulting in \$1.5 billion in existing or planned capital investments. Also according to the report, thirty-five percent of this development occurred on former brownfield or old industrial sites. (DCED, 2003)

This research project evaluated the effectiveness of the KOZ/KOEZ program in meeting the legislative goals of increased employment, capital investment, and use of brownfields and blighted properties. In particular, it evaluated the program's economic impact in rural KOZs, and satisfaction from program participants including local government, school districts, economic development organizations and private businesses.

Figure 1: Designated Zones and Participating Counties



Unmodified KOZ map courtesy of Schuylkill County Dept. of Economic Development at <http://www.co.schuylkill.pa.us/Offices/EconomicDev/PA%20KOZ%20MAP.asp>

# Literature Review

The Keystone Opportunity Zone program resembles a particular type of economic development programming known as the enterprise zone. Enterprise zones were developed in Great Britain in the early 1970s in an attempt to revitalize abandoned or deteriorated former industrial sites. The philosophy involved stimulating “free market” investment in the sites through a combination of tax incentives and regulatory relief (Rubin, 1994).

Enterprise zones were first adapted to the United States economy by state governments in the 1980s. By the mid-1990s, state enterprise zones existed in 34 states. State enterprise zones offer a variety of incentives including business tax credits for job creation (especially hiring of targeted groups, such as minorities), investment tax credits, tax exemptions, special venture capital funds and direct business subsidies for infrastructure development. Many of these state zones combine state incentives with local government tax exemptions. The majority of these enterprise zones exist in urban areas and target issues of urban blight and inner city areas with chronic unemployment. (Rubin 1994; Wilder and Rubin, 1996).

Pennsylvania has experimented with both state and federal enterprise zone programs. In 1983, Pennsylvania created the state Enterprise Zone Program. Zones are comprised of several economically distressed communities as designated by DCED. Enterprise Zone communities are eligible for grants, which in turn are used to create a revolving loan fund for area high-tech, industrial or manufacturing sector businesses. This program encompasses 69 zones throughout the state. In addition to the state program, the federal government has designated Philadelphia-Camden as a bi-state Federal Empowerment Zone and also has designated 70 Federal Enterprise Communities and Federal Renewal Communities throughout the state (Policy Research Institute for the Region, 2006).

Given the similarity between Pennsylvania’s KOZ program and the federal and state enterprise zone programs, an analysis of the effectiveness of enterprise zones can provide some insight into the effectiveness of the KOZ. Studies conducted since the mid-1980s have tried to answer two basic questions: Do enterprise zones work and what is the cost of these programs? More specifically, the studies address the issues of job creation and retention, business creation, relocation, and investment. The studies also seek to quantify the costs to federal, state and local government and the increased burden placed on businesses and taxpayers outside the zones.

## Enterprise Zone Effectiveness

Enterprise zones operate on the premise that government tax and regulatory policies and government incentives can influence the decision making process of the individual firm. Enterprise zones seek to encourage firms to start-up or relocate in a specific designated area, to retain or create jobs, and to invest capital in technology and infrastructure at the zone site. Businesses, of course, seek to maximize profit relative to cost. When making decisions on location or investment, businesses will weigh any tax savings or government incentives against the cost of labor and energy, the availability of inputs, and the access to markets. A business will choose to invest in labor saving technology if the cost of labor outweighs the cost of the capital investment. Likewise, a business will only invest in new jobs if the government incentives outweigh the cost of additional labor. One economist estimates that the percentage change in business activity per percentage change in taxes (elasticity) ranges from -.3 to -.6. This means that a 10 percent decrease in taxes results in a 3 percent to 6 percent increase in business activity (Bartik, 1991; Peters and Fisher, 2002).

The general lessons derived from the various evaluations of enterprise zones are as follows:

- 1) Government incentives or tax breaks must be large enough to offset any major site disadvantages, such as the lack of a trained labor force, lack of transportation infrastructure or distance to markets.
- 2) Incentives for capital investment can work against job creation. Firms may invest in labor saving technology in lieu of jobs. Direct job creation credits work better in channeling businesses toward job creation.
- 3) Job and firm growth tend to be concentrated in smaller firms (fewer than 50 employees) and among start-up firms or firms already existing in the zone.
- 4) Job creation is largest in the manufacturing and wholesale/retail sectors.
- 5) Site targeted economic development programs can raise employment and business growth if they are well managed and promoted and if the incentives are large enough to offset site disadvantages.

## Enterprise Zone Costs

Peters and Fisher (2002), in their book on state enterprise zones, offer that, given a business’s decision-making process on location, states must first spend or reduce taxes at a substantial rate to influence

business behavior. Taxes play a marginal role in deciding whether or not to expand or relocate. Tax incentives only come into play when they are large enough to offset the costs of labor and capital.

The literature on the behavior of firms in response to government tax incentives paints a picture of effectiveness, but with a potentially high price tag. The real key to keeping down the cost of this type of job creation

program is to avoid giving too many tax incentives up front and to encourage firms to reap the tax rewards at a future date (end-loading). Some researchers have found that designating an area as an enterprise zone can be a powerful jump start for economic development and serves as a great marketing tool for properties with severe disadvantages (Wolkoff, 1992; Wilder and Rubin, 1996).

## Impact of KOZ/KOEZ: Econometric Models

As part of the project, the researchers looked at trends in employment, taxation, and personal income at several levels (state, zone, and sub-zone) and at trends over time. The 13-year time span (1990-2003) enabled the researchers to view a decade of economic and government tax and spending statistics prior to the implementation of the program as well as post implementation, for which complete data was available at the time of the research.

### Trend Data

The following graphs depict five economic indicators: unemployment rate, total employment, per capita income, personal income, and total state taxes. The data is measured from 1990 until 2003, the latest year in which total figures were available for the study period (2005). The trend line is interrupted by two events, the implementation of the KOZ program in 1999 and the implementation of the KOEZ in 2001.

Pennsylvania's economic health is compared to the general U.S. trends for three variables: unemployment rate (Figure 2), total employment (Figure 3), and per capita income (Figure 4). Figure 2 illustrates the economic factors leading up to the implementation of the KOZ program in 1999. Pennsylvania experienced chronically high unemployment, well above the national rate, from the late 1990s into 2002. Likewise, the growth in Pennsylvania's total employment lagged behind U.S. growth trends. Pennsylvania added new people to the employment rolls at a slower rate than the country as a whole. It is interesting to note, however, that the per capita income of Pennsylvania residents closely mirrored the national per capita

Figure 2: Unemployment (As Reported)

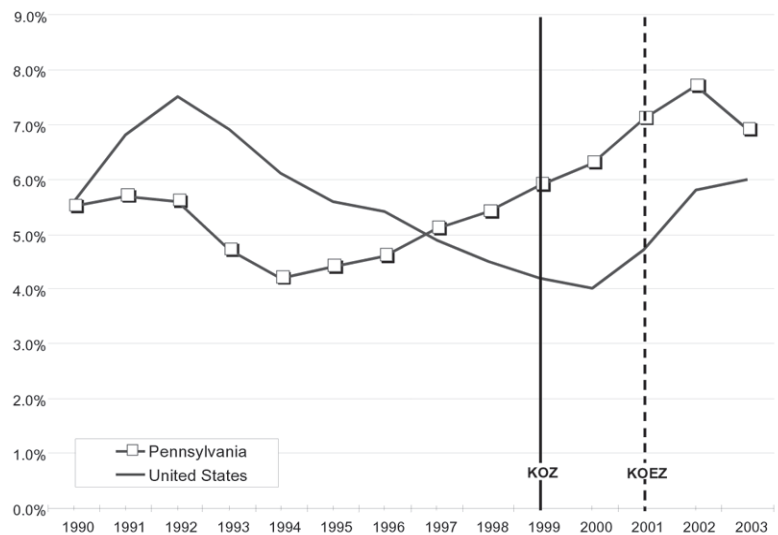


Figure 3: U.S. and Pennsylvania Employment

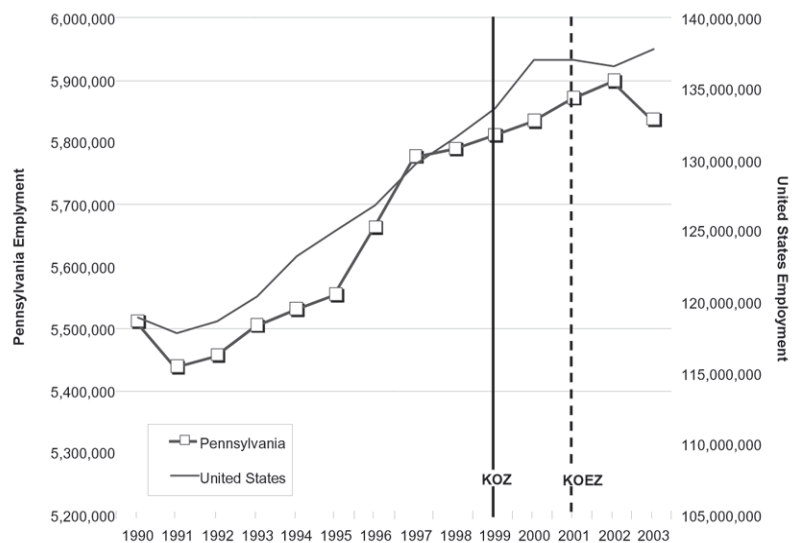


Figure 4: U.S. and Pennsylvania Per Capita Income

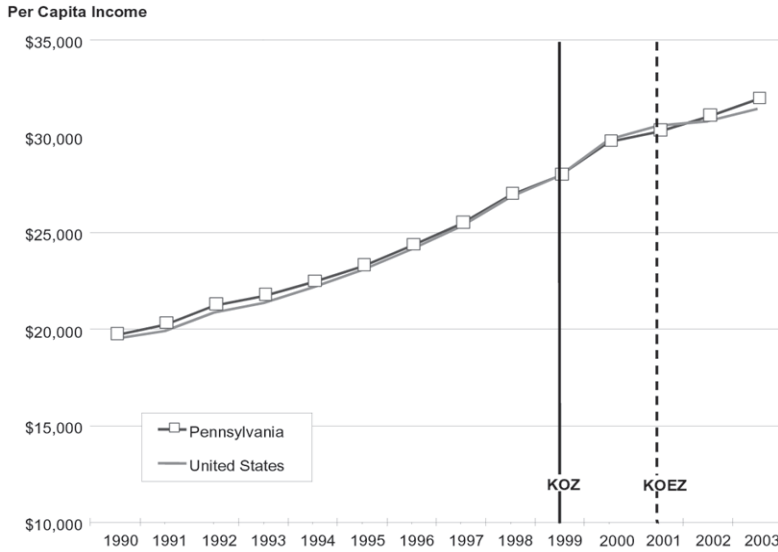
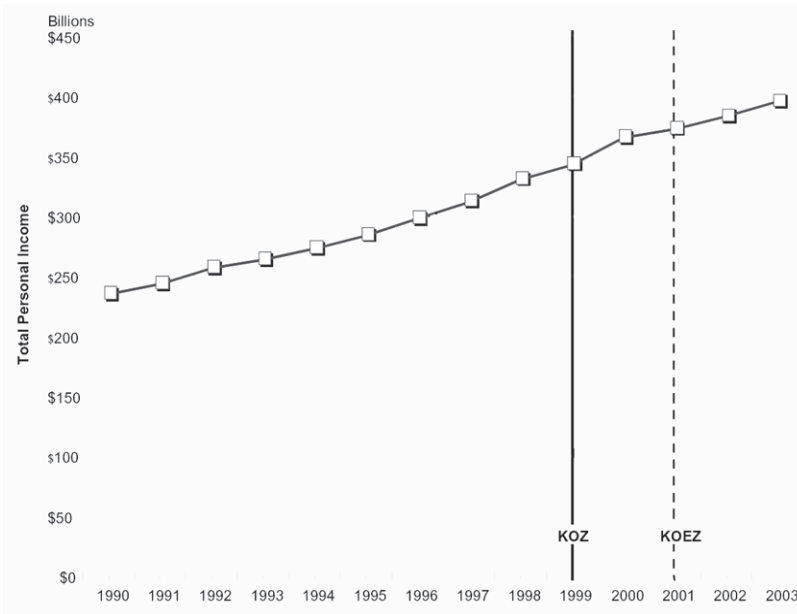


Figure 5: Pennsylvania Total Personal Income



figures in this same time period (Figure 4).

Figure 5 points to a slow and steady growth in Pennsylvania personal income, regardless of the implementation of the programs. KOZ/KOEZ did not adversely affect state tax revenues (Figure 6), which remained relatively steady since 1999 with a slight dip in 2002, (probably the result of the high state unemployment rate in that year).

To determine what, if any, impact the KOZ/KOEZ program had at the zone or sub-zone level, a series of trend models were created for each of the 12 zones covering the same time period as the state and national models, 1990 to 2003.

Market values across 11 of the 12 zones showed a steady increase in property values driven by market trends and inflation in housing prices since 1990. A number of rural zones experienced a sharp rise in employment since 1999 (Schuylkill-Carbon, Lehigh Valley, Northern Tier and Central). Philadelphia, meanwhile, has continued its steady loss of employment since 1990. In terms of percent unemployed, all of the zones show a post 1999 decrease in unemployment followed by a slow rise in unemployment.

All of the zones show a steady increase in government expenditures with a few notable exceptions. A number of zones experienced a spike in government spending in 2002 (Schuylkill-Carbon, Lehigh Valley, Southwest, North-Central, Lackawanna-Luzerne, Southeast, and South-Central). This spike is particularly pronounced in the Lackawanna-Luzerne zone where government expenses rose sharply from 2000 until 2002, before declining. Philadelphia, on the other hand, experienced a sharp decline in government expenditures in 1997 and has not exhibited substantial growth since that date. In terms of overall county tax revenues, all 12 zones show a slight leveling of tax revenues since 2000-2001. This appears to be an overall statewide trend.

A third set of time series graphs were constructed using school districts sampled from the 10 rural or partially rural zones. Figure 7 shows total school district revenues for the sampled school districts. These districts were randomly sampled for inclusion in the mail survey portion of the study. Again, the time series do not reveal any drastic drop in school district total revenues since the implementation of the program. Instead, the time series show a gradual increase in school district revenues since 1990. This gradual increase in revenues without any sharp declines is born out by all 10 zones.

### Regression Models

Two types of linear regression models were constructed to measure how certain variables impacted the effectiveness of the KOZ/KOEZ program. This allows for control of the effects of other variables upon the

Figure 6: Pennsylvania State Taxes

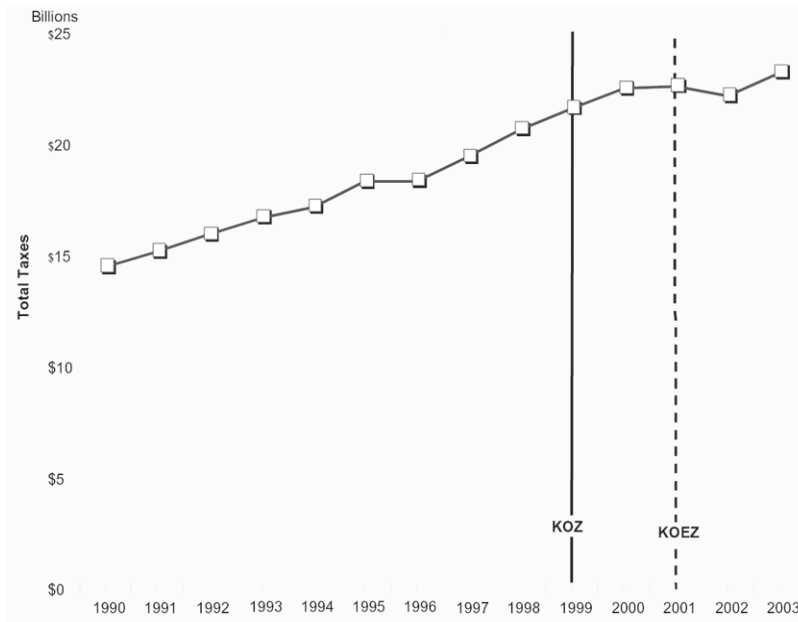
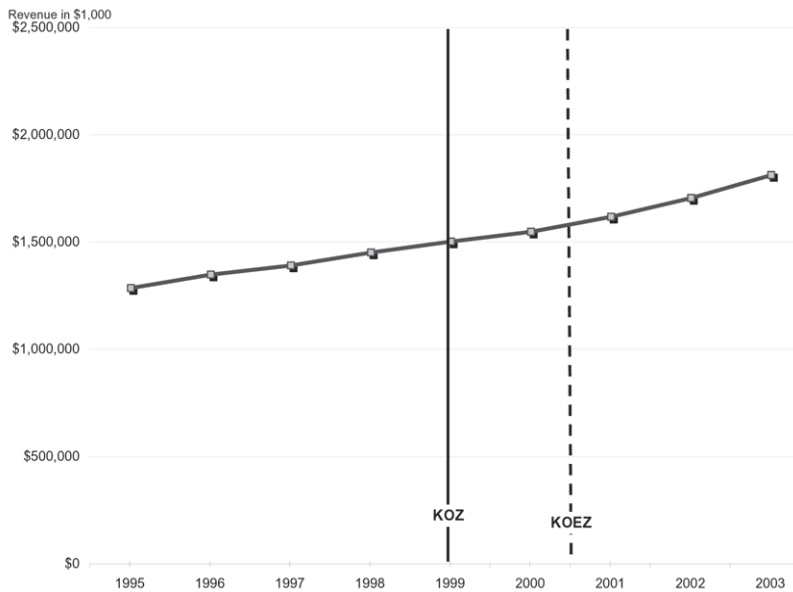


Figure 7: All Sampled School District Revenue



expected outcome for the program. By employing linear regression, it is possible to estimate how much of the job creation was caused by the program and how much was caused by outside factors, such as general economic factors.

Using November 30, 2003 data (the latest year for which complete figures were available for the study period) provided by DCED as the basis for measures of effectiveness, the researchers constructed two types of regression models. The first model looked at job

creation, job retention, total jobs created and retained, and total capital investment dollars in all 12 KOZ/KOEZ zones.

According to the economic development literature, the following variables were hypothesized as having some correlation on zone output: total zone acreage; total number of subzones; number of brownfields developed within the zone; number of site development projects; zone population; capital investment dollars; number of websites promoting the zone; number of projects within the zone; and zone type (urban, rural, mixed).

These independent variables are based upon the factors associated with the individual firm site location decision process, capital costs that may include site development, site clean-up, labor costs that may include access to a low-cost or trained labor force, access to transportation, and proximity to markets. Government programs, such as KOZ, seek to reduce the cost of doing business thus luring firms into a targeted area or inducing existing firms to expand (Bartik, 1989, 1991; Peters and Fisher, 2002). The number of brownfields developed, the amount of capital investment dollars and the number of site development projects are related to the cost of site development. Zone population tests access to both markets and labor force. Zone type controls for the effect of location and is related to the issues of transportation, markets and labor availability. Zone acreage and number of sub-zones are control factors partitioning out zone size as a factor. Website promotion is directly related to KOZ program management and arises from issues raised by EDC professionals during interviews by the researchers. It tests the theory that more active promotion by sub-zone or zone managers attracts more firms and generates better results.

Capital investment dollars were tested as both an independent (causal) variable and a dependent (outcome) variable. Models were found to be statistically significant at the .05 level, which means there is less than a 5 percent chance that the model does not reflect what is really happening in the zones. Two of the variables (website promotion and total number of projects in the zone) were immediately dropped from the testing because they had no statistical effect on the

outcome. The number of site development projects was also dropped from the analysis of job creation, job retention and total job activity since it is highly correlated with total capital investment dollars.

None of the variables affected job retention but a number of variables affected job creation, total jobs and investment dollars in the zones. Urban zones do better than both rural and mixed zones in terms of job creation. This finding is in keeping with the economic development literature. Urban locations already often have access to transportation, proximity to markets, and access to labor (Bartik, 1989). In short, the urban KOZ sites have some built-in advantages in terms of producing results. Acreage, brownfield development and capital investment also contribute to job creation. Interestingly enough, the greater the number of sub-zones in the zone, the lower the number of jobs created. Capital investment dollars and brownfield development had the highest correlation with new jobs. Every active brownfield site produces on average 58 jobs. The model shows, however, that substantial capital investment is required for job creation at an average rate of \$100,000 per job created.

When total employment activity was tested, only investment dollars, population and urban zone status impacted both job creation and job retention combined. Lastly, the factors affecting investment in the zone were tested. Only the number of site development projects was significant. Since site development projects usually involve substantial money invested to provide infrastructure and site cleanup, it makes sense that this would be highly correlated with investment dollars. These projects are usually funded by economic and community development corporations using a mix of public and private funding.

A second set of models was generated at the sub-zone level. These models used only the rural sub-zones sampled and included in the survey research portion of this project. In addition, due to the inability of zone or sub-zone coordinators to provide current statistics on jobs, businesses and investment dollars, the researchers only included those rural sub-zones for which outcome statistics (jobs, businesses and investment dollars) were found in the *KOZ/KOEZ Four-Year Report* (DCED, 2003).

The causal variables tested included: county employment; county population (2000); proximity of sub-zone to major highways (location factor); website promotion (yes/no); percent county employment manufacturing; percent county employment retail; and sub-zone investment dollars.

As discussed earlier, the independent variables are related to the costs of doing business in a sub-zone.

Investment dollars represents site development within the zone as well as the willingness of other firms to invest in the area. Population and employment are control variables to control for the effect of size and other economic factors that may influence business development in addition to the KOZ program. The employment in manufacturing and employment in retail variables were added as control variables. Based on the literature regarding recent economic trends, manufacturing employment has seen a steady decline in years while retail employment has shown the greatest growth. As noted earlier, retail employment also registered the greatest growth within enterprise zones (Moore, 2003). Thus the type of employers already in the area may affect KOZ sub-zone output.

Total employment activity in the sub-zone, the number of businesses in the sub-zone, and total investment dollars were tested as the dependent (outcome) variables. The only significant factor in terms of employment and businesses was investment dollars. Again this figure includes site development project money. Location was not a major factor in these rural sub-zones. This may be due to the fact that most of the rural sub-zones start out with the same location and site deficiencies, which make them more difficult to market in the first place. Also, there was no variation in website promotion. All sub-zones sampled used some sort of web-based promotion for their sites.

## Model Conclusions

Urban zones do better simply because they are in urban areas with access to markets, transportation and labor. Rural sub-zones must contend with disadvantages created by the distance to markets and the need for infrastructure, such as rail and sewer. Hence, rural and urban sites do best when they invest in site preparation and clean-up in addition to simply offering tax exemptions. Likewise, all zones make use of modern web technology for site promotion, thus leveling the playing field in terms of advertising.

The KOZ program is truly targeted economic development aimed at very specific sites. Complete sub-zone statistics would provide the clearest picture as to the impact of the program. Spillover impacts at the county level may not appear for several more years, if at all.

# Mail Survey Methodology

The researchers conducted a mail survey of local governments, school districts, economic development corporations (EDCs) and businesses located in the rural Keystone Opportunity Zones during the summer of 2005. The survey evaluated attitudes concerning the effectiveness and ease of use of the KOZ program.

The researchers used a disproportionate stratified random sampling to obtain a subset of participants from the 163 sub-zones. Sub-zones were chosen from within each of the rural KOZ zones and from each of the rural counties within urban and mixed zones to ensure proper geographic representation from across the state. Within each rural county, sub-zones were assigned a number. A total of 63 sub-zones were sampled. All local governments and school districts within the chosen sub-zones were surveyed as well as all EDCs believed to be working with the program in the sub-zone and all businesses operating in the sampled sub-zone. Seventy local governments, 65 school districts, 39 EDCs and 180 businesses were sampled and surveyed. Figure 8 illustrates the number and rate of responses per category surveyed.

## Local Government/School Districts

Local government mail surveys were completed primarily by borough council members and township supervisors, either as a whole or by one member of the elected body. School district surveys were mailed to district superintendents who then presented the surveys to the elected school boards.

Perhaps one of the best indicators of the attitude toward KOZ is found in response to the question: “Would participants be willing to extend their involvement in the program past 2013?” (Figure 9) Nearly one-third of the school districts and nearly one-quarter of municipalities had no opinion on the issue, while about 44 percent of both school districts and local governments would continue their involvement with KOZ if given the opportunity.

In response to an open-ended question on why or why not to continue in the program, responses from school districts and municipalities were mixed. Six of 21 responding municipalities deemed the KOZ as generally effective, compared to only two of 26 school districts. Some local governments see KOZ as an effective marketing tool while other local

Figure 8: Number and Rate of Responses Per Category Surveyed

Response Rates			
	N	#	%
Econ. Dev. Corps	39	26	67
Municipalities	70	49	70
School Districts	65	52	80
Businesses	180	95	53

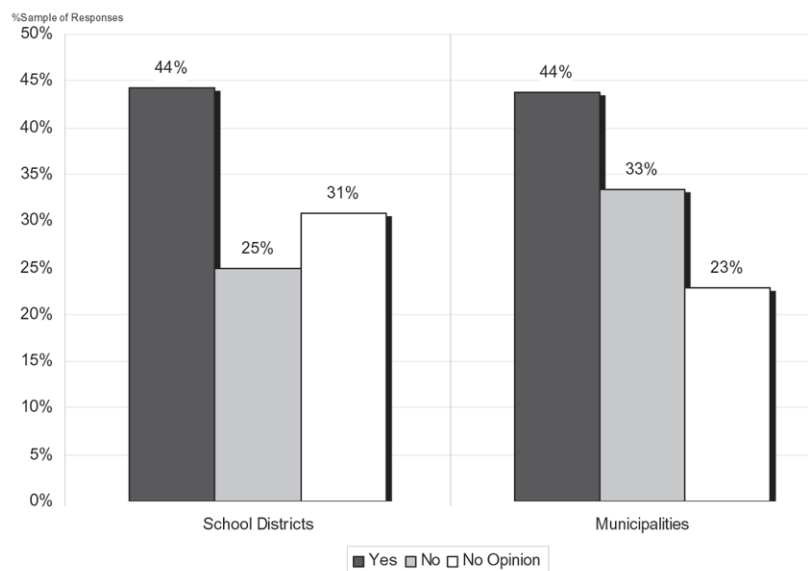
governments see it as an unfair tax break to businesses who may not stay or who offer low wages.

## EDCs

In many instances, EDCs or CDCs have assumed responsibility for managing and promoting the KOZ program at the zone and sub-zone levels. A related group that has assumed management for some KOZ sub-zones in rural Pennsylvania is chambers of commerce. Chambers operate for business promotion purposes but their focus is generally viewed as promoting existing business rather than developing new business through economic development. This survey included responses from 10 chambers and 16 EDCs out of the 39 rural chambers and EDCs sampled and surveyed.

The EDCs responding to the survey engage in business site promotion (92 percent), property development (88 percent), non-government financing for business (69 percent) and procurement of state grants (85 percent). However, only slightly more than half of

Figure 9: Continued Involvement Beyond 2010/2013



the EDCs responding (58 percent) engaged in direct loan financing through EDC loan funds. Fifty-four percent of the EDCs had three or fewer full-time employees and two respondents had no full-time employees at all. The EDCs manage an average of 4.6 sub-zones, with 50 percent managing or promoting three or fewer sub-zones and, again, two respondents not engaged in sub-zone management. According to the respondents, these EDCs manage a total of 111 rural sub-zones.

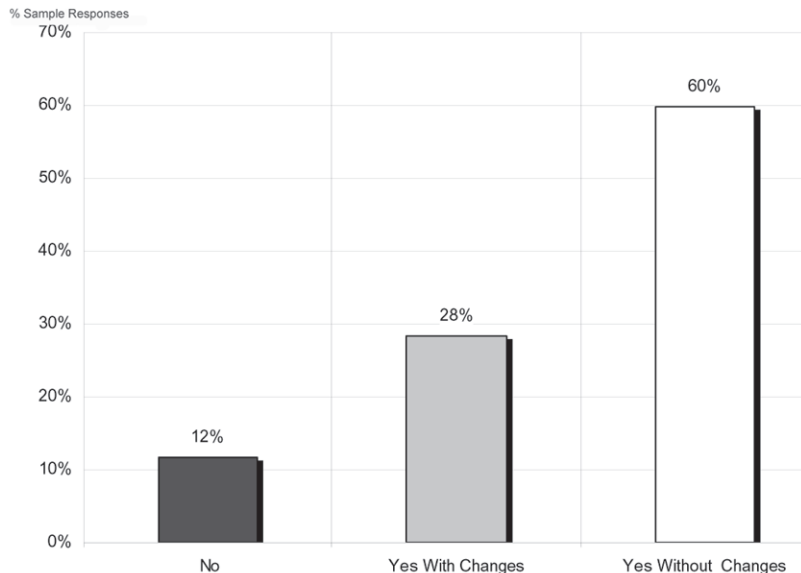
In describing their sub-zones, 64 percent report some level of new firm activity and 40 percent report some expansion of existing firms in their sub-zones. Fifty-two percent report no local relocations into the sub-zone and 76 percent report no relocation of state firms to the zone. However, 32 percent of the EDCs reported one or more out-of-state firms relocating into their KOZ sub-zones. The EDCs characterize their sub-zone firms as primarily manufacturing (77 percent), followed by wholesale distribution (38 percent) and service (35 percent). Only five EDCs report the existence of retail-type firms in their sub-zones.

EDCs would like more state money for promotion, site development and business expansion but only 50 percent of EDCs are interested in expanding KOZ acreage and few EDCs want increasing state involvement with direct oversight of the sub-zone businesses. Among the open-ended responses was the suggestion of tying the tax abatement period to the business, rather than the property, so that the 10-year abatement could begin when a business moves in instead of the site designation date. EDCs also cite the need for money for the sub-zone coordinators to promote and administer the program or to offset losses to local tax authorities. One final suggestion involves giving businesses a limited time to act on their property within the zone or else their property is automatically removed from the zone.

## Business

DCED provided the researchers with their most recent list of businesses operating in the rural KOZ/ KOEZ sub-zones and meeting the Pennsylvania Department of Revenue requirements for tax abatement. A total of 180 businesses were surveyed with a response rate of 53 percent. The 95 businesses responding to the survey opted into the program between 1999 and 2004, with 28 percent opting into the program as late as 2004. Only 12 percent of the

Figure 10: Percent of Businesses Willing to Enroll in KOZ

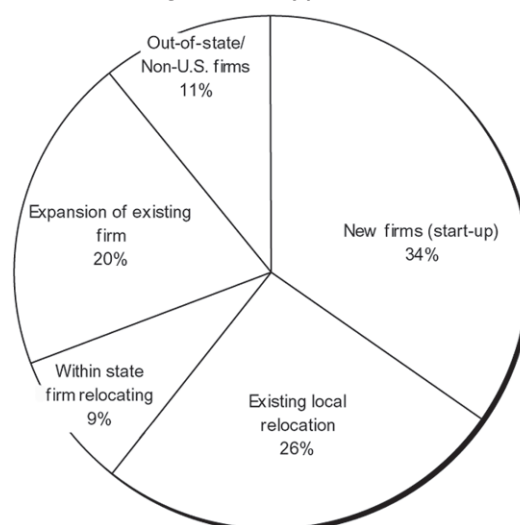


businesses would not choose to enter the program again (Figure 10). Figure 11 displays the type of firms responding to the survey. Thirty-five percent of the businesses described themselves as new firms, 26 percent as local firms relocating to the zone and 20 percent as in-zone firms that have chosen to expand. No non-U.S. enterprises responded to the survey.

While businesses feel that the state provides adequate financial assistance to their business (58 percent), they are less satisfied with the level of technical and promotional assistance (41 percent) for their business.

Businesses' critique of local governments is very mixed. Half of the businesses agreed or strongly agreed that local government provides adequate financial assistance, while more than one-third disagreed. A similar split occurred when rating local

Figure 11: Type of Firm



government technical and promotional assistance, with 37 percent agreeing that it is adequate and 45 percent disagreeing.

Businesses said that EDCs do an adequate job of providing financial assistance and site preparation (49 percent in agreement for both questions). When rating the overall business environment in Pennsylvania, 41 percent agreed that Pennsylvania is business friendly, while 53 percent disagreed. More than half of the respondents (56 percent) cited the KOZ program as the deciding factor in their business location decision. However, 36 percent disagreed that it was the deciding factor in locating their business. Perhaps most striking is the response regarding staying or expanding in the sub-zone once the program ends. More than 80 percent agreed or strongly agreed that they will continue to do business in the zone after the program ends. Since there is no penalty for leaving the zone when the program expires, this may reflect a commitment to the area in which they are located. Those that strongly agreed with the importance of the KOZ program in their site selection also tended to strongly agree that they will remain in the zone after the program expires.

Lastly, businesses were asked what could be done to improve the KOZ/KOEZ program. From a list of specific choices (businesses chose from a list of possibilities), a little over 33 percent of businesses would like to see increased state funding for site development and more than 50 percent would support increased state funding for business expansion. Businesses did not seem to feel overburdened by the reporting requirements; however, 60 percent supported a gradual phase-in of taxes when the program expires. Businesses were also given an opportunity to discuss their own perceptions of needed program adjustments. A number of businesses expressed a need for general corporate tax reform in the state. With regard to the zone, businesses wanted to see the state sales and income tax portion of the KOZ modified.

### Selection Factors

Figure 12 contrasts the top three site selection factors as selected by EDCs and businesses. When asked to choose (not rank) the top three factors in business site selection, 77 percent of EDCs chose proximity to markets; 58 percent chose the existence of a trained labor force; and 54 percent chose tax incentives. Businesses chose tax incentives (70 percent), proximity to markets (49 percent) and access to transportation (45 percent) as their top three site

selection factors. This may explain why sub-zones with extensive site development, usually in the form of rail or road access, have done better in terms of job creation.

Both businesses and EDCs were asked what other economic development programs they used. EDCs cited the following state funded programs most frequently: MELF, PIDA, CJT<sup>1</sup>, Main Street, Infrastructure/Facilities Improvement Program, and locally based revolving loan or micro-enterprise funds. These local loan funds are typically funded through county, EDC and local financial institution support. Businesses most frequently report using PIDA, with some use of MELF and CJT and lower use of Main Street and revolving loan funds. These differences in responses highlight the EDCs diverse economic activities outside the sub-zone.

Businesses gave the state higher ratings in financial and technical support than they gave to local government. EDCs were substantially less satisfied with the state, with only one third of the EDCs agreeing that the state provides adequate financial and logistical support for the KOZ program. Local government got an even lower rating from the EDCs. Sixty-nine percent did not agree that local government provides adequate financial support to the KOZ program and more than 60 percent find that local government did

*Figure 12: Top Three Site Selection Factors*

EDC's	
Proximity of markets	77%
Trained labor force	58%
Tax incentives	54%
Businesses	
Tax incentives	70%
Proximity of markets	49%
Access to Transportation	45%

*Figure 13: Average Ratings*

How would you rate the effectiveness of KOZ in the following areas:	School Districts	Municipalities	EDCs
...attracting new business?	1.71	1.75	2.16
...retaining existing business?	1.59	1.73	1.88
...creating jobs?	1.77	1.75	2.16
...rehabilitating brownfields?	1.53	1.33	1.70
...enhancing downtown development?	1.28	0.98	1.17
... increasing local tax base outside of zone?	1.35	1.13	1.37
1 = Not Effective 2 = Somewhat Effective 3 = Very Effective			

<sup>1</sup> Machinery and Equipment Loan Fund (MELF). Pennsylvania Industrial Development Authority (PIDA), Comprehensive Job Training (CJT)

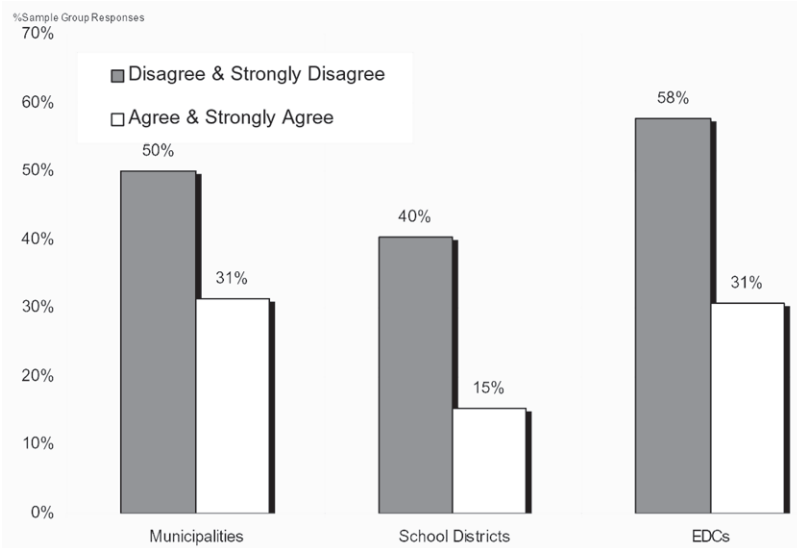
Figure 14: Perceptions of KOZ/KOEZ

	% That Agree		
	Schools	Municipalities	EDC's
Negative Impact on Local Tax Base	23%	25%	15%
Improved Business Environment	31%	48%	77%
Positively Affected Local Economic Development	35%	52%	77%
Created Tax Inequities	52%	29%	23%
Reduced Poverty in the Region	6%	21%	27%
Benefited Entire Community	21%	42%	54%
Benefited Only Specific Businesses/Individuals	48%	46%	58%
Increased Service Demands on Local Government	23%	44%	27%
Spurred Economic Development Outside the Zone	8%	17%	31%

Totals do not add up to 100 percent due to multiple responses

not provide adequate logistical support. It should be noted that EDCs and businesses are not evaluating government from the same vantage point. Businesses are concerned only with the money and assistance provided to their enterprise. EDCs are looking at governmental support for a larger economic development initiative.

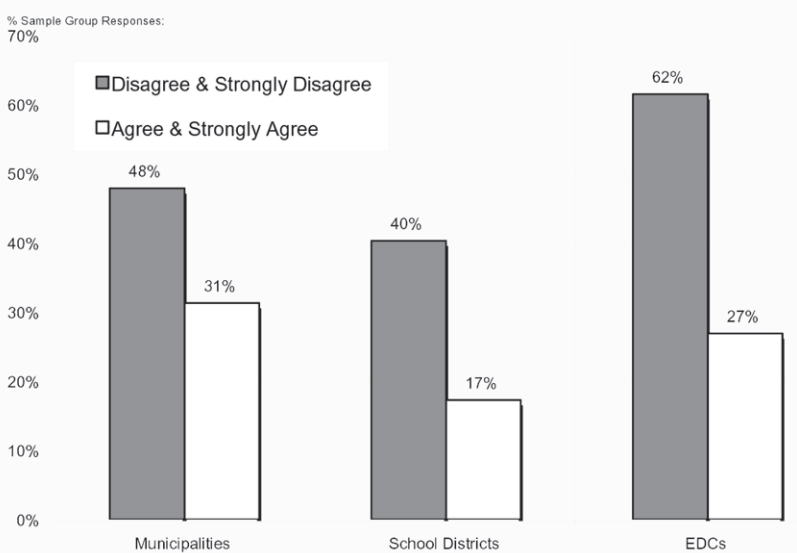
Figure 15: Adequate State Financial Assistance



**Effectiveness of KOZ**

Figure 13 illustrates the effectiveness rating of KOZs in achieving the legislatively designated outcomes as rated by municipalities, school districts and EDCs. Respondents were asked to rate the effectiveness of the program on a scale of one to three, with three being very effective, in the areas of attracting and retaining business, creating jobs, rehabilitating brownfields, enhancing downtowns, and increasing development outside the zone.

Figure 16: Adequate State Logistical Assistance



As shown in Figure 14, school districts are the least positive in their view of KOZ. In sharp contrast, 77 percent of EDCs believe that the KOZ has had a positive effect on local economic development and has improved the business environment. Municipalities are somewhat divided on their opinion of the program. They do not agree that KOZ has positively affected development outside the zone or positively impacted poverty.

The three types of respondents were also asked to rate the state in terms of its assistance with financing and marketing the KOZ program. Less than one-third of local governments agreed that the state was providing adequate logistical assistance as compared to about 15 percent of the school districts. (Figures 15 and 16)

All three groups agreed that businesses will remain in the zone after the program expires although to varying degrees, and both municipalities and EDCs believed KOZ is an important development tool. (Figure 17)

Overall the ratings of the program participants were fair to good in some areas with EDCs and business most satisfied with the operation and outcomes of the program. Local municipalities, and especially school districts, were split in their analysis. Some saw the value of the program but feared the political fallout from perceived tax inequities. This was born out by the specific survey comments as well as interviews conducted for the case studies. Others, where perhaps development has been slow to materialize, only saw the lost tax revenues. EDCs, who are without political pressure, can take the long-term view and look toward the return on the taxpayer dollar. Municipalities and school districts are tied to the present fiscal year and therefore more impatient for results. In the final analysis, elected officials gave KOZ a mediocre rating while EDCs and businesses remained fairly satisfied with many aspects of the program.

Figure 17: KOZ/KOEZ Very Important Economic Development Tool for Region:

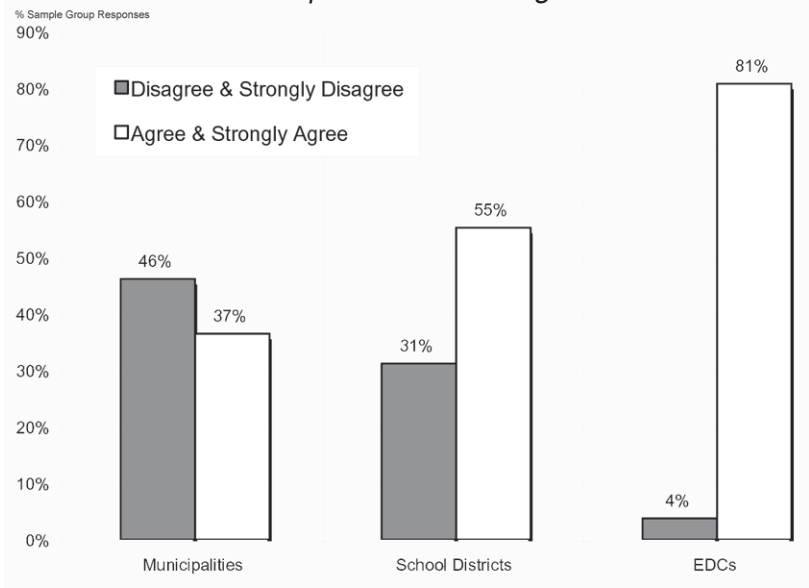


Figure 18: What changes to KOZ/KOEZ would you make if program continued?

	Municipalities	School Districts	EDCs
Increased state funding for site promotion	40%	65%	62%
Increased state funding for site development	40%	63%	81%
Increased state funding for business expansion	42%	52%	62%
Ability to add acres without deleting acreage	23%	27%	50%
Increased oversight of businesses by the state	15%	17%	8%

## KOZ Case Studies

The researchers conducted three case studies to help determine differences and similarities among KOZ sub-zones in rural Pennsylvania. Two of the cases studies involved boroughs in rural locations in North-eastern Pennsylvania and one involved a regional economic development agency in Western Pennsylvania.

Case Study A can best be described as a work in progress with some limited success at one site and a total lack of development at a second site. Case Study A highlighted the efforts of the borough manager to cooperate with local banks and private entrepreneurs. The borough at the center of the case study is typical of many small, rural Pennsylvania boroughs. Incorporated in the late 1800s, it encompasses approximately two square miles and has a population of almost 6,000 residents. Its economic history is deeply rooted in manufacturing and railway transportation. Hard hit by the decline of traditional manufacturing in the mid 1980s, the current major employer is a healthcare facility. The local tax structure relies heavily on wage

taxes as opposed to property taxes. From 1984 to 1995, the borough had a State Enterprise Zone managed by a regional authority. It was taken over by a chamber of commerce authority in 1995 and, in 2001, it added a KOEZ sub-zone. A small business incubator is located in the KOEZ.

An interview with the borough manager provided insight into the challenges of business promotion for a remote rural area. The area enjoys close access to a major interstate but lacks an educated workforce and is in need of infrastructure investments for highways and sewage. The manager believes that the KOZ sub-zone sites have suffered from conflicting levels of management at the local and county levels, and from a lack of promotion by both the county and state.

Case Study B was an example of KOZ success in bringing commercial, retail, and residential redevelopment into the downtown area.

The borough in Case Study B shares a similar history to the borough in Case Study A. It, too, is located in

Northeastern Pennsylvania but is not as remote. Borough B is about 10 square miles and has a population of just over 7,000. Case Study B focused on the importance of good sub-zone management. However, despite wide-scale success, Case Study B also illustrated the difficulties in developing certain problem-ridden properties with or without tax abatement. The borough's major employer until the late 1990s was a textile manufacturer. Its closing was coupled with a loss of small businesses, decaying storefront properties and a decline in housing stock. Borough B, though, made an organized and concentrated effort to redevelop key commercial properties in the downtown and to tap into tourism dollars. The KOZ/KOEZ program is part of a coordinated downtown revitalization effort and, thus, benefits from an active Main Street Program, facade loan program, and revolving commercial loan, sidewalk loan, and housing rehabilitation loan programs. An extensive walking tour of the borough with the manager brought out a number of success stories, particularly within the downtown business district. While some ongoing problems remain with several properties, the program in this community seems to have achieved the goals and objectives laid out in the KOZ legislation. From a community development standpoint, the KOZ serves as a major tool for the local economic development and business promotion organizations. While the number of jobs created is not large, the quality of investments will have long-term positive impacts, especially for the downtown business district.

Case Study C highlighted the importance of professional management and promotion in successfully developing KOZ brownfield sites. Case Study C confirmed that former industrial sites can be reinvigorated by developing and recruiting locally based firms. It involves a regional economic development corporation in western Pennsylvania. The collapse of the area's major industry, steel, in the mid 1980s, and subsequent decline in related industries, severely impacted the region. Population loss, a decline in community and business infrastructure, and chronic unemployment made this region a classic test case for the effectiveness of the KOZ program.

A site visit and in-depth interview with the regional EDC provided much insight into the process of using public funds and tax credits to leverage private investment in less than desirable real estate. This particular sub-zone benefits from the hands-on professional management of the regional EDC. The EDC participated in the original KOZ and KOEZ site designations and continues to promote cooperative relationships among the businesses, school districts, and local municipalities.

The EDC director attributed the KOZ designation with tipping the balance in favor of the sub-zone site. The KOZ program, coupled with other state funding from the Pennsylvania Departments of Transportation and Environmental Protection, MELF and PIDA, helped substantially to improve the property and to market it successfully. The EDC director believes the program has been most successful in retaining existing firms rather than the (re)location of outside firms. The director also believes the KOZ program suffers from a lack of visibility at the state level. Regional managers promote their respective sites; however, there is no regional marketing money and, since 2003, no money for regional administration. This results in widely varying degrees of promotion in western Pennsylvania. Lastly, the director emphasized that local governments took the biggest hit on tax revenues by participating in the KOZ program.

### **Case Study Findings**

The case studies point to some common themes for successful development of KOZ sub-zone properties.

- 1) Location and infrastructure are important determining factors.
- 2) Environmental remediation must be completed prior to marketing. It is a tough sell to ask firms to make both capital investments and take on major environmental clean-ups to use the site.
- 3) Locally owned and operated businesses and investors are most likely to be attracted to sites with location and infrastructure issues.
- 4) The KOZ designation is the marginal deciding factor in business location and expansion.
- 5) Professional site administration and promotion is the key to sub-zone property development. Sites must be actively managed and promoted by individuals with experience in economic development.

# Conclusions

Does KOZ/KOEZ work for rural Pennsylvania? The county, zone and sub-zone data, survey results, and case studies provide mixed results. The econometric models (time series and linear regression) indicate that the program has seemingly little impact at the state and county levels in terms of unemployment and poverty. Given the limited size of the program, this is to be expected. The greatest impact of KOZ/KOEZ is at the local or municipal level. Gains in jobs and capital investment are masked by overall economic trends at the county level. Does this mean that the KOZ/KOEZ program does not work? The survey and case study data paint a different picture. KOZ/KOEZ can have a real impact on rural economic development efforts if the program is implemented according to the legislative intent and if the program is properly implemented and managed at the zone and sub-zone level.

## *Positive Impacts: Zone and Sub-Zone Levels*

- Economic development professionals, including EDCs and chambers of commerce, use the program as an important marketing tool, especially for brownfields or other less than desirable industrial and commercial properties.
- Despite the perceptions of municipal officials and school districts, KOZ/KOEZ has limited negative impact on the tax revenues and service expenditures of local government.
- KOZ/KOEZ has relatively few administrative costs at the state level, and relies primarily on existing economic development organizations for implementation.
- Businesses do not have any substantial complaints

about program implementation or reporting requirements.

- KOZ/KOEZ can encourage local investment in housing, downtowns and brownfields sites.

## *Negative Impacts: Zone and Sub-Zone Levels*

- Program inequities exist due to poor administration and lack of professional promotion.
- Some properties have experienced zero activity and some businesses have not taken advantage of the other programs available in the zones (loans, grants, etc.), which would increase the impact of KOZ/KOEZ.
- A failure to abide by the legislative intent has resulted in inter-zone competition whereby greenfield properties compete with abandoned industrial sites for firm recruitment. All things being equal, a firm will choose the tax-exempt open space over a brownfield site.
- Businesses receive the promised full tax abatement on property tax only. While still small in amounts, municipalities and school districts lose tax revenues associated with the program. The state has a limited tax liability with the program given the formula for calculating within zone business activity.
- Given the quick deadline for including properties and the difficulties associated with re-designating new properties, some “lemon” sites exist in the sub-zones while other eligible and more marketable property is not included. As a result, the program is perceived as biased or inequitable by businesses and residents outside the zone, especially as many KOZ/KOEZ sites sit undeveloped.

# Policy Considerations

The researchers suggest that program administration be centralized within DCED. Currently the program is promoted by DCED but primary responsibility for determining tax abatement eligibility lies with the Department of Revenue.

The researchers also suggest requiring more rigorous reporting requirements for business and zones, since it was difficult to identify reliable data on the amount, or costs, of the tax dollars abated.

A third consideration was to focus resources on small business development, business incubator projects and locally owned and operated companies rather than on the recruitment of large firms from other states or regions.

## **Sub-Zone Level**

- All sub-zone managers should work with local municipalities to ensure that properties in each

designated KOZ/KOEZ sub-zone are up to code and current on property taxes, or are removed from the sub-zone. Although properties cannot take advantage of the tax exemption without meeting building and tax code obligations, vacant properties continue to exist within the sub-zones with no business or site development activity to report. A decertification process has existed since 2002 whereby a property may be removed from a zone; however all interested parties must agree to waive the tax benefits. The following statistics should be gathered and updated yearly through a form developed by DCED and distributed and collected by the sub-zone managers: 1) Acreage per sub-zone; 2) List of properties with current owners and contact information including address, phone numbers and email; 3) Current employment at each business in the sub-zone; 4) Esti-

mated capital investments, but preferably exact amounts; 5) Estimated taxes foregone for the given fiscal year on all sub-zone properties based on the current tax rate and assessed value at the time of KOZ/KOEZ designation; and 6) Number of firms leaving the zone and specific reasons for leaving. This function could also be the responsibility of the zone coordinators.

## Zone Level

- KOZ/KOEZ zone administration and promotion should be handled centrally by a regional county development agency or regional EDC.
- All business data should be aggregated at the zone level to protect the privacy of individual businesses and property owners.
- Zone managers should maintain up-to-date websites with correct contact information for sub-zone managers and a complete list of properties available (maps and site characteristics) for each sub-zone.
- Zone managers should consider preparing annual reports for municipalities and school districts stating the number of jobs and amount of investment and estimating taxes foregone as well as future tax revenues based on levels of investment.

## DCED

- Maintain a database with statistics on taxes foregone, jobs created and retained, and capital investment. These figures would be based on the numbers reported by the sub-zones to the zone manager and therefore reflect reality and not estimates.
- Update business listings to include companies still operating in the zone and total number of business failures and relocations outside the zone.
- Create descriptions of the sub-zone sites available including acreage, infrastructure, distance to major interstates, existence of rail, and other relevant statistics as provided by the zone coordinator.
- Update and simplify the KOZ/KOEZ website so that firms can readily identify KOZ properties and access correct contact information at the sub-zone level, especially phone and email.
- Encourage local investment and firm creation since these are the firms most likely to remain in the community once the tax breaks end. This can be done by increased partnerships among existing programs, such as Main Street, Elm Street, PIDA, and MELF. Simplify the process as much as possible for communities and businesses to encourage participation. Streamline paperwork and provide direct assistance in the application process.
- Request additional funding to cover administrative

costs at the zone and sub-zone level so that zone and sub-zone managers are no longer volunteer administrators.

- Require zone managers to pass along a percentage of any state administrative funds directly to the sub-zone managers. Tie administrative funding at the zone and sub-zone level to proper promotion and proper reporting of statistics and information to DCED as noted above.

## State Legislature

- Consider altering the program so that the clock starts ticking on tax abatement when the property is developed or a firm locates to the zone rather than tying the abatement to the property itself.
- End-loading tax abatements as much as possible. This could include: rewarding firms with increased tax abatements after one, two or three years rather than giving total abatement upfront; phasing in taxes slowly beginning from years five to 10; and shortening the total period of tax abatement
- Emphasize local investment by expanding the use of programs, such as KIZ, providing funding for incubators, increasing downtown development initiatives, such as the Main Street Program, and funding vocational and technical education.
- Consider modifying the enacting legislation to ban casinos and big box retailers from taking advantage of the tax breaks. Target the tax breaks at businesses that would otherwise not locate in the area or who already operate in the community.
- Provide adequate administrative funding for zone and sub-zone managers. This will result in more professional marketing and administration of the program.

The positive and negative impacts of the KOZ/KOEZ program on the rural Pennsylvania economy are limited. However, with proper program adjustments, there is real potential for positive economic effect. KOZ/KOEZ can be most effective by encouraging local entrepreneurs to reinvest in the community in which they live, work and own property. The program can bring redevelopment to downtowns and rehabilitate both commercial and residential property. KOZ/KOEZ is effective in marketing former brownfield sites and, with increased state financial and technical support, the program can assist in turning vacant former industrial sites into productive properties once again. State and local government and local EDCs have already committed considerable resources to the program. Adjustments made now can result in a better return on this investment of public tax dollars and private funds.

## References

- Bartik, Timothy J. 1989. "Small Business Start-Ups in the United States; Estimates of the Effects of the Characteristics of States." *Southern Economic Journal*, 55 (4) pp. 1004-1018.
- Bartik, Timothy J. 1991. *Who Benefits from State and Local Economic Development Policies?* (Kalamazoo: W.E. Upjohn Institute for Employment Research).
- Moore, William. 2003. "Enterprise Zones, Firm Attraction and Retention: A Study of the California Enterprise Zone Program." *Public Finance and Management*, 3(3) pp. 376-392.
- Pennsylvania Department of Community and Economic Development. January 2003. *KOZ/KOEZ Four-Year Report*. (Commonwealth of Pennsylvania).
- Pennsylvania Department of Revenue. June 2004. *Commonwealth of Pennsylvania Keystone Opportunity Zone Instruction Booklet*. (Commonwealth of Pennsylvania).
- Pennsylvania General Assembly. 1998. *Keystone Opportunity Zone Act 92*.
- Pennsylvania General Assembly. 2000. *Keystone Opportunity Zone Expansion Act 119*.
- Pennsylvania General Assembly. 2002. *Enhancement Extension Act 53*.
- Peters, Alan and Peter S. Fisher 2002. *State Enterprise Zone Programs. Have They Worked?* (Kalamazoo: W.E. Upjohn Institute for Employment Research).
- Rubin, Marilyn Marks. 1994. "Can Reorchestration of Historical Themes Reinvent Government? A Case Study of the Enterprise Zones and Empowerment Communities Act of 1993." *Public Administration Review*. 2 (54) pp. 161-169.
- Wilder, Margaret and Barry Rubin. 1988. "Targeted Redevelopment Through Urban Enterprise Zones," *Journal of Urban Affairs* 10 (1), pp. 1-17.
- Rubin, Barry and Margaret Wilder. 1989. "Urban Enterprise Zones: Employment Impacts and Fiscal Incentives." *Journal of the American Planning Association*. 4(55) pp. 418-431.
- Wilder, Margaret and Barry Rubin. 1996. "Rhetoric Versus Reality: A Review of Studies on State Enterprise Zone Programs." *Journal of the American Planning Association*. 4(62) pp. 472-492.
- Wolkoff, Michael. 1992. "Is Economic Development Decision Making Rational?" *Urban Affairs Quarterly* 3(27), pp. 340-355.

## Data Sources

Income and population: [www.census.gov/](http://www.census.gov/)

Governor's Center For Local Government Services – government expenditures and taxes: [www.newpa.com](http://www.newpa.com)

School district spending and income: [www.pde.state.pa.us](http://www.pde.state.pa.us)

Market values: [www.steb.state.pa.us](http://www.steb.state.pa.us)

Employment figures: [www.workforceinfo@state.pa.us](mailto:www.workforceinfo@state.pa.us)



**The Center for Rural Pennsylvania**

200 North Third St., Suite 600

Harrisburg, PA 17101

Phone: (717) 787-9555

Fax: (717) 772-3587

[www.ruralpa.org](http://www.ruralpa.org)

1P0708 - 400