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Buying growth, or selling out? : a study of the Massachusetts Economic Development Incentive Program

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Buying Growth, or Selling Out? A Student of the Massachusetts Economic Development Incentive Program

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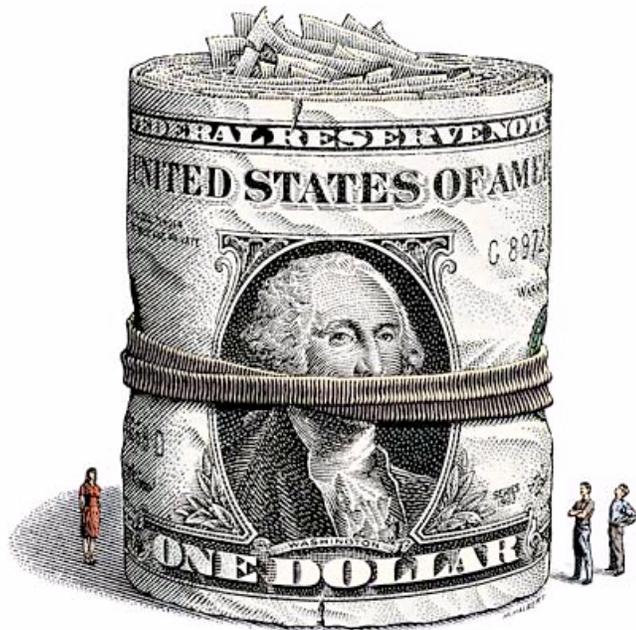
Abstract:

Launched in 1994, the Massachusetts Economic Development Incentive Program (EDIP) is a state and local partnership designed to relieve unemployment, redevelop blighted commercial districts and promote economic growth by providing tax incentives for businesses relocating or expanding in Massachusetts communities. Despite the size and scope of EDIP – over 1,000 companies have likely received over \$100 million in tax relief through the program – the Commonwealth has neglected to conduct elementary oversight or basic cost-benefit analyses of EDIP. This paper attempts to examine, through new quantitative and qualitative data, whether EDIP has created lower levels of unemployment or higher levels of business activity in the communities it serves. The paper concludes with ten legislative recommendations for reforming EDIP.

Buying Growth, or Selling Out?

A study of the
Massachusetts
Economic
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Program.

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Shepherd



Buying Growth or Selling Out?

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The content herein, including any errors, is solely the responsibility of this project's author. Additionally, your comments and thoughts on this study are welcome. Please contact Toby Shepherd at TobyShepherd@gmail.com

Chapter One: Introduction

Having recently emerged from one of the worst recessions in the state's history, Massachusetts' economy is a perennial subject of political campaigns, talk-radio punditry and scholarly research. While consensus is easily reached on ambiguous slogans like the need for "good jobs" and "a strong economy," disagreement abounds on the means of achieving sustainable economic development.

This chapter illustrates in detail one town's experience with a controversial economic growth policy tool: tax-increment financing programs. The infamous "Raytheon Bill" – nationally recognized as a flagrant example of publicly funded corporate subsidization – is discussed as an introduction to the concept of tax-oriented economic development policy generally and Massachusetts' history with tax incentive programs specifically. With this case study as a backdrop, the structure of this paper, the purpose and inspiration for this study, and the methodology of this investigation's research are introduced and discussed.

Plainville's debate

The town of Plainville Massachusetts was described by Boston Magazine in April 2005 as a "heavily forested and unpretentious town [that] proudly – and quietly – lives up to its name" (Blanding, 2005). Located about an hour southwest of Boston, this bedroom community of 7,000 has unwittingly become embroiled in a troubling trend that has afflicted communities across the Commonwealth: namely, a



Plainville's public library

desperate attempt by town officials to avoid constantly increasing property taxation while maintaining the delivery of increasingly expensive local services.

One obvious solution is to grow Plainville's commercial tax base, but with other local towns facing similar circumstances the ability of any individual municipality to lure prospective businesses into relocating in their town is limited by competition from neighboring communities. Enter tax incentive programs: the furor of town editorial pages and the substance of controversial Town Meetings. Critics claim that these giveaways are leading to a subsidy arms race, where towns 'race to the bottom' by diverting public resources from already strained municipal budgets into profitable private enterprises. Defenders of tax-incentive programs claim, conversely, that investments in economic development result in new jobs, stronger local economies and larger municipal tax bases.

In recent years, Plainville has received multiple requests for corporate tax forgiveness – more often than not from large retail department stores which can hardly claim a necessity for publicly-sponsored encouragement. Retail merchandiser Target approached Plainville to request a tax-abatement in the spring of 2004 after the company had already acquired property for their store and broken ground on construction. Selectmen put the request on a warrant for Town Meeting to decide; Target ultimately removed their bid and completed construction. At the time, residents questioned the utility of awarding a tax break designed to attract prospective businesses in an instance where a corporation had already committed to opening. Moreover, the \$5,000 a year loss in tax revenues, while insignificant compared to Target's overall yearly profits, would have approximately equaled the cost of educating a student in the town's public schools system for a single year (Kocian, 2004).

“I was under no illusion that they were going to locate [in Plainville] because Plainville was going to give them a tax credit,” says Town administrator Joe Fernandes. “They had already announced they were coming. They had already broken ground. The commitment was clear; they were just waiting for the permitting process to complete itself.” Fernandes went on to cite the prime retail location of the parcel in question at the intersection of Routes one and 152, arguing “if not Target, then Walmart or Kohls, or someone would have located there.”

Although Target opened their store without the requested tax break, one year later home and garden retailer Lowe’s made a similar request for public assistance on a plot of land directly adjacent to the new Target. Just as in the Target case, Lowe’s sought a 20-year property tax waiver after having already committed to locating a new store in Plainville. This time, the town’s three selectmen unanimously voted to deny the request (Russo, 2006).

The debate over corporate tax-cuts reached a head in early 2006 when the outdoor hunting and fishing superstore Cabela’s indicated in a letter to town officials that it was considering Plainville as the location of its next 250,000 square-foot megastore. Unlike Target and Lowe’s (which already boasted 24 and 19 locations in Massachusetts, respectively) this would be Cabela’s first expansion into New England. Moreover, the store billed itself as a shopping destination capable of drawing hundreds visitors from neighboring states to visit the store’s archery range, deer museum, and 55,000 gallon fish tank. In addition, Cabela’s location in Plainville would mean hundreds of new jobs for the region. But in return for the decision to locate in Plainville, the store sought \$25 million in property tax forgiveness. A company spokesman reasoned to the Boston

Globe: “We are an economic engine. When we come to a community we bring a lot with us. We think it is a wise investment for communities.” (Bailey, 2006).

Specifically, Cabela’s planned on applying for approval through a joint town and state partnership known as the Economic Development Incentive Program (EDIP). Designed as a method of rehabilitating “blighted” town eyesores and cutting high-unemployment rates, EDIP rewards companies who locate themselves in previously designated needy areas, of which Plainville qualified. The program had recently garnered public notoriety after it was revealed that Amalgamated Managers Group, an asset management firm headed by Lieutenant Governor Healey’s husband, with annual revenues just short of \$1 billion, had received over \$1 million for relocating to one of the state’s wealthiest communities. The AMG scandal prompted scathing public criticism of the program and became hotly political when Massachusetts Inspector General Gregory Sullivan charged that the tax-reward was given out as a “favor” to the company’s politically connected CEO. AMG ultimately remitted their tax-cut while maintaining that



This Cabela's in Lehi, UT received over \$10 million from state and county officials.

it committed no wrongdoing.

“If you believe their PR, Cabela’s provides a catalyst for further development,” Mr. Fernandes explained. “The spin behind Cabela’s is that they’re a *regional* retailer.

They attract from something like a hundred mile radius.” Lofty visions of spin-off

development, in the form of hotels and restaurants throughout a primarily neglected section of town, captured the imagination of town officials.

For Plainville, discussions of Cabela's bid and EDIP's potential advantages and disadvantages elicited uncharacteristically heated debate in town forums. But for the Cabela's corporation, negotiating public assistance was an integral part of the company's national business model: in Buda, Texas Cabela's \$61 million from a similar state program; Reno, Nevada gave Cabela's \$52 million; Hamburg, Pennsylvania: \$32 million. In Lehi, Utah, state and county officials not only agreed to go into \$9 million worth of debt to provide Cabela's with new roads, parking lots, power lines and sewage infrastructure, but they also approved \$2 million in revenue bonds for a "indoor public museum" of stuffed wildlife that would be dispersed throughout the store. According to Deseret Morning News, "The wildlife museum planned at Cabela's won't be a separate, stand-alone part of the store. It will be mixed in with the tents, fishing poles and outdoor gear that has made Cabela's a favorite with outdoor enthusiasts" (Haddock, 2004). Critics accused public officials of using tax-payer money to pay for Cabela's indoor decorating, but Utah County Commissioner Gary Herbert deftly described the situation as "a unique circumstance in that we have the chance to get a museum in combination with a new retail unit" (Choate, 2004).

In fact, state subsidization is so critical to Cabela's that in their 2004 public offering prospectus, Cabela's felt it was necessary to warn potential investors of their reliance on financial assistance:

"Historically, we have been able to negotiate economic development arrangements relating to the construction of a number of our new destination retail stores, including free land, monetary grants and the recapture of incremental sales, property or other taxes through economic development bonds, with many local and state governments...we may not be able to obtain similar economic packages in the future. The failure could cause us to significantly alter our destination retail store strategy or format. As a result, we could be forced to invest less capital in our stores

which could have an adverse effect on our ability to construct the stores as attractive tourist and entertainment shopping destinations, possibly leading to a decrease in revenues or revenue growth.”

Cabela’s ultimately passed over Plainville to choose East Hartford Connecticut as the site for their first New England store after the Connecticut state legislature pledged \$120 million in infrastructure development for the company’s desired location and another \$9.9 million in the form a direct grant for the new store (Uhlinger, 2006). Asked many months later to comment on whether or not it was appropriate for a nationally successful company to rely so heavily on public assistance, Town Administrator Fernandes demurred. “Like any other program,” Fernandes asked, “if its there and they attempt to avail themselves of it, who am I to fault them for doing it? The question of appropriateness [is]: should we offer it?” Still, Fernandes defends the utility of EDIP and related tax-abatement programs. “In a case where it’s not necessarily a home run, where [companies] need that extra push, and we as a community can get those extra tax dollars – or just as importantly those added chances for employment – do we want to at least have that option to consider? Yes. I think even the dumbest among us would say that we’ll offer than incentive only when necessary, but it takes the brightest of us to figure out when it *is* necessary. That’s the problem.”

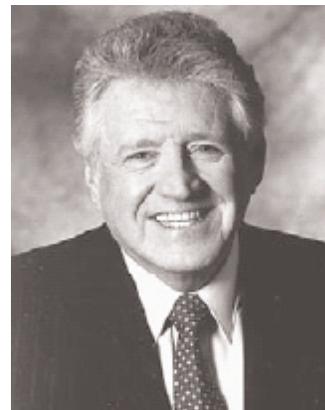
“In the final analysis,” Mr. Fernandes concluded later, “you want to have [tax incentive programs] in your arsenal. It’s almost like nuclear weapons, you don’t want to use them, but you don’t want to be the last guy on the block that doesn’t have them either.”

Raytheon & The Massachusetts corporate income tax.

Perhaps Massachusetts's most notorious fight over corporate subsidization was the 1995 decision to overhaul the corporate income tax in response to Lexington-based defense contractor Raytheon's threat to move thousands of jobs to Tennessee. Derided as "job blackmail" and "corporate welfare," the 1995 battle between Raytheon and the legislature provoked new national deliberations on the appropriate role between the private and public sectors, and, more importantly, publicly acknowledged the emerging trend of inter-state competition for business (Vennoch, 1998).

Typically, state corporate income taxes are determined on the basis of three equally weighted components: property, payroll and sales. States which adopt a "sales-only" formula, conversely, tax corporations only on the sales they make in the state, thereby shifting the corporate tax burden from firms with few in-state sales and large quantities of real estate and/or many employees to corporations headquartered in other states with a higher volume of in-state sales. Advocates of the sales-only tax codes argue that their apportionment formula encourages manufacturing businesses who heavily export their products around the country or the world to expand their existing facilities and create new jobs at no additional tax expense to the manufacturer. Additionally, supporters argue, export-oriented businesses seeking new locations for their manufacturing facilities are strongly inveigled to locate in single-sales states.

With over 25,000 Massachusetts employees throughout most of the 1990s, Raytheon – a leading defense, engineering and commercial manufacturing firm – was easily Massachusetts'



Raytheon CEO Dennis J. Picard

largest private employer. A sudden drop in the demand for defense related contracts (due to international forces beyond the scope of Massachusetts) forced the company to convert from a primarily defense-related enterprise to a primarily commercial one. The transformation came with evident success for the company, but unfortunately the reorganization had negative consequences for thousands of its Massachusetts's employees. By 1995, the firm had cut 40% of its Massachusetts jobs, including shutting down an entire 600,000 square foot missile factory in Lowell (Zitner, 1994). Unless it could cut \$600 million from its annual budget, the firm warned, future lay-offs were likely inevitable (Ackerman, Zitner, 1995). One component of the \$600 million - in addition to salary-freezes and layoffs – would need to come in the form of tax breaks from the state.

The company was straight-forward about its requests; according to Allen, “Most of what we are asking would require changes in legislation. We are in a situation where two of our top competitors have moved from California, another high-cost state, to Arizona, where they were given incentives and the costs are lower . . . We'd like the same kinds of incentives that our competitors in Arizona have been given,” (Lewis, 1995). Described on the Boston Globe editorial page as “Raytheon's Ransom,” the company's list of “incentives” included a property tax credit of up to 50%, reduction in the length of time the unemployed can collect benefits from 30 to 26 weeks, a \$3,000 tax-credit for workers employed in defense related jobs, a shortening of the period to depreciate capital equipment from five years to two and an exemption from Massachusetts's sales tax on electricity, gas, steam and fuel (Boston Globe, 1995). As originally envisioned, a switch

in the state's corporate income tax formula to a single-sales apportionment did not factor predominately into Raytheon's laundry-list of legislative suggestions (Lewis, 1995).

Initially, the reaction of legislative leaders could be described as lukewarm at best; Governor Weld told the Boston Globe, "I'm not saying I would veto them if the Legislature does them, but I think they would cost another 40 million bucks or something like that, and I didn't have that kind of cash lying around, even for a good friend, which Raytheon is." (Ackerman, Zitner, 1995). When the Boston Globe reported that Raytheon was considering relocating its 19,500 remaining defense jobs to three existing plants in Bristol Tennessee where Governor Don Sundquist had personally hosted a lunch for top Raytheon executives to discuss possible incentives for relocation, Governor Weld reacted hostilely, publicly rejecting the notion of a "bidding war" with other states over the prized company (Ackerman, Wong, 1995). But when a report underwritten by Raytheon illustrated the boon manufacturers could receive if Massachusetts altered its corporate income tax formula to a sales-only scheme the state's major businesses organizations – the Associated Industries of Massachusetts, the New England Council, the Greater Boston Chamber of Commerce and the Massachusetts Business Roundtable – abandoned their reservations for the Raytheon package and rallied under the banner of a sales-only apportionment formula. Although the coalition conceded that the reconfiguration of the tax code would likely cost the Commonwealth approximately \$160 million in lost revenues in the first year alone (and unknowable amounts in subsequent years), they argued that the resulting economic development would ultimately offset any short-term loss (Ackerman, 1995). As labor leaders representing Raytheon employees joined in the call for the tax-cut, Governor Weld filed legislation calling for the tax cut, and began

winning over key Democrats in the legislature and fiercely lobbying state officials and the public alike (Wong, 1995; Golden, 1995; Shao, Wong 1995). “This is a jobs package, not a Raytheon package" Governor Weld declared at the press conference introducing the legislation (Golden, 1995).

Whether or not the bill was targeted to Raytheon specifically was answered explicitly when the legislation moved out of the House Taxation Committee with the caveat that the new apportionment formula apply only to defense-related manufacturers. When public criticism forced an immediate revocation the next day, an alternative plan whereby the sales-only formula would be applied to the state’s defense industry by January 1st of 1996, and for all other industries under a phased-in 5-year timeline, passed the legislature easily (Wong, 1995). The final version of the bill required that defense contractors keep 90% of their 1995 payroll in the state in order to qualify for the tax break each year, with the exception that the payroll requirement could be waived if defense contracts slumped. Signing the bill at a shoe factory in Boston, Governor Weld proudly proclaimed, “at the end of the day, lower taxes do not mean lost revenues, if they make you a better place to do business” (Patriot Ledger, 1995).

While Governor Weld’s comments may indeed be true in some general sense, they didn’t turn out to be so for Raytheon. Criticism of the tax-cut grew after it was revealed that the company had spent over half of a million dollars in lobbying efforts, as well as abandoned their loudly touted salary-freeze (Wong, 1996; Convey 1996). Later in 1996 the company bought out about 3,000 of its Massachusetts employees – but because the legislative requirement related to the size of the company’s payroll, and not actual jobs, Raytheon was allowed to continue qualifying for the tax break. Shortly thereafter

two high profile acquisitions that totaled over \$10 billion in two – first, for Texas-based Texas Instruments Inc., and secondly for Arizona-based Hughes Electronics Corporation – resulted in nearly 1,500 jobs being cut from Massachusetts (Wallack, 1998; Lynch, 1998).

Waltham mayor William F. Stanley, among others, complained that while Raytheon was making record profits and constantly laying off workers, they were still qualifying for what appeared to be an unnecessary tax break. “They asked me to help them when they were seeking tax relief at the state level,” Stanley told the Associated Press. “I testified to that effect, and they won their tax relief,” he added. “Now, three years later, they're going anyway” (Lynch, 1998).

By January 1st of 2000, when the 90% payroll requirement expired, the tax-cut hadn't saved a single job – in fact, Raytheon had cut approximately 6,000 jobs overall. Throughout the late 1990's labor leaders joined with legislators to file numerous bills to create bipartisan commissions to study the tax-break, and to tie eligibility to actual employee headcounts, rather than payroll size, but such efforts have repeatedly failed (McMillan, 1999). Simply put, Massachusetts forgoes approximately \$300 million annually in return for thousands of blue-collar layoffs, despite increasingly large corporate profits. As Boston Globe writer Ross Kerber wrote in 2000, “More than four years after Massachusetts enacted a controversial tax break to save manufacturing jobs in the state, there's scant evidence the policy has worked as advertised” (Kerber, 2000).

Economic Development Policy – A New Role for the States?

How relevant is the Raytheon example to state-driven economic development policy generally and Massachusetts specifically? Has the Commonwealth been

intimidated by large employers to award tax breaks and benefits for little in return, or can a case still be made that subsidization policies ultimately prove to be smart investments for local and statewide economic growth? Economic development policies aimed at reducing the cost of business development take many different forms on the national, state and local level. Historical examples of publicly funded bailouts such as the Savings and Loans scandal have figured prominently in national debates over the proper usage of tax-dollars to spur private development. Today, the average state employs over forty different tax-incentive programs and Massachusetts is par for the course: major state-sponsored tax incentives include generous credits for the purchase and lease of business equipment, for the costs of research and development, for job creation and more.

Some forms of public subsidization of private business are unintentional and even surprising. In 2005, for example, the Massachusetts legislature added a requirement to the annual budget that directed the state's Division of Health Care Finance and Policy to assemble an annual list of all companies with 50 or more employees utilizing the state's public healthcare programs (namely MassHealth, the Commonwealth's Medicare program, and the Uncompensated Care Pool, which primarily reimburses medical providers for medical services rendered to the uninsured). The agency's first report, released on February 1st of 2005, singled out 138 qualifying employers; the most egregious offender, fast food franchise Dunkin' Donuts, was discovered to have 2,905 employees utilizing the state's public health programs. The agency's second report, released the following year with an updated methodology, listed a total 437 employers who met the 50-employee threshold. The top five offenders together accounted for

11,144 employees using public services, costing the Commonwealth a total \$28,636,662 in 2006.¹

Some would argue that Massachusetts's internal struggle to keep an esteemed company in the state while maintaining a semblance of fairness for other taxpayers – business and private citizens alike – is one result of a well-documented, nationwide trend of interstate competition in which corporate subsidies are the weapons and the dream of “economic development,” however loosely defined, is the prize. Automobile manufacturers set the precedent in the late 1970s and early 1980s, commanding large subsidies of theretofore unheard of size years before other industries caught on. The compelling allure for states to grant such large tax incentive packages was driven by the large number of jobs associated with automobile manufacturing: in 1980, Tennessee paid \$33 million in return for a Nissan plant with nearly 2,000 jobs; five years later Tennessee paid another \$150 million for a General Motors' Saturn plant with 6,000 jobs. Similar stories played out in Kentucky and South Carolina. In Alabama (the state that today ranks last in public spending on elementary- and secondary-education), Mercedes-Benz wrested a whopping \$300 million in return for a company plant. According to a 1996 report in the New York Times:

“Alabama offered \$77.5 million in sewer, water and other utility improvements, \$92.2 million to buy and develop the site [for Mercedes-Benz] and about \$5 million annually for employee training and other programs. The total, which was put at \$253 million then and has since escalated to about \$300 million, did not include another sweetener. The state agreed to buy 2,500 Mercedes utility vehicles, for use by everyone

¹ The five companies noted in 2006 were WalMart (with 2,866 employees on either program), Stop & Shop (2,737 employees), McDonalds (2,162 employees), UNICCO (1,728 employees) and Shaws/Star Market (1,621 employees). Northeastern University, the institution supporting the present research, was listed as having 152 employees who utilized the state's public healthcare programs the previous year, costing the Commonwealth an annual \$296,955.

from highway construction supervisors to agricultural agents. The expense: about \$75 million” (Myerson, 1996).

Massachusetts’s experience with tax-incentive programs grew out of the state’s recession of the late 1980’s and early 1990’s. Although Massachusetts’s economic doldrums mirrored similar circumstances in states throughout the Northeast,² Massachusetts suffered a worst-in-the-nation job loss of 5.1% in 1991 – this despite maintaining an unemployment rate consistently below the national average (by as much as three percentage points) during throughout the 1980s (Stein, 1991). Many credit Republican William Weld’s success in the 1990 gubernatorial election to his non-partisan campaign promise of rejuvenating the state’s economy without raising taxes (in the process winning over more than a third of the state’s registered Democrats) (Malone, 1990; Mooney, 1990). In truth, Weld’s free-market, anti-regulatory rhetoric (“I’ve never met a tax cut I didn’t like,” Weld often declared on the campaign trail) echoed similar themes present at the national level. Nearby, similar economic anxieties swept in new business-oriented chief executives – Democrat and Republican alike – in Rhode Island, Connecticut and Vermont.

Pitched to a rare joint session of the legislature in September of 1992, Massachusetts’s Economic Development Incentive Program was an integral part of a larger business tax-deduction “jobs package” that included an increase in the Massachusetts investment credit as well as various loan guarantees for growing businesses. Six months after originally outlining the bill, Lieutenant Governor Paul

² In fact, Massachusetts’s FY1991 \$100 million budget deficit was larger than Vermont’s \$40 million budget deficit, but dwarfed by deficits of \$1 billion in New York, \$600 million in New Jersey, \$560 million in Connecticut, \$400 million in New Hampshire, \$160 million in Rhode Island and \$110 million in Maine.

Celluci signed a slimmed-down version of the stimulus bill, framing it as “a critical step in our economic recovery” (Howe, 1993).

Purpose and methodology of this study

Even though EDIP made Massachusetts the 37th state in the nation to adopt a state-wide tax incentive program designed to boost employment and develop neglected areas³, economists still debate whether or not the cost of ‘buying growth’ actually manifests new jobs or new growth. If, for example, Plainville had granted Cabela’s the \$25 million it requested, each of the 225 \$10/hour projected jobs would have cost the town and the state a combined \$111,000. The inspiration for this study – to systematically analyze the economic impact of awarding tax increment finance (TIF) programs, and specifically EDIP, to towns in Massachusetts – came from my experience as an elected official in Plainville during the Cabela’s debate. As Plainville’s representative to the King Philip Regional School District, a middle- and high-school public school system that serves three towns including Plainville, I saw how Plainville’s budget would be directly impacted if Cabela’s was given a \$25 million tax break. Thus, this study will attempt to uncover empirically whether EDIP has – as advocates claimed would happen fifteen years ago – created new jobs or provided significant new tax revenues, or – as some critics today charge – EDIP has resulted in little more than public subsidization of already profitable private enterprises.

The second chapter of this thesis undertakes a comprehensive review of the relevant literature on tax-abatement economic development policy as a means of fostering job creation and economic growth at the national, state and local levels. After introducing the relevant conceptual frameworks for understanding the debate over

³ Forty seven states and the District of Columbia currently allow tax increment financing.

economic development policy, my review will consider the impact of economic development policies on inter-city competition, business location decisions, and ultimately the overall health of local and state economies. The review will also consider the role of court jurisprudence in determining the policy tools available to development practitioners, concluding with a discussion of common themes in the literature.

The third chapter of this study will introduce the origins, intent and function of Massachusetts' Economic Development Incentive Program. After explaining the program's design, a discussion will be presented on EDIP's implementation, early challenges and some major programmatic reforms that have been enacted. Subsequently, EDIP's myriad and diverse evaluations – from varying agencies, legislative committees and journalistic enterprises – will be recounted, along with criticisms of some of the questionable methodologies used and highlights of notable recurrent themes.

In this paper's fourth chapter, I will introduce a new evaluation of EDIP that is derived from both quantitative and qualitative research. As a researcher, I am duly cognizant of the limitations of – and need for an appropriate combination of – both quantitative and qualitative research in uncovering the somewhat amorphous economic and social benefits of a tax incentive program such as EDIP. Some metrics discussed are difficult to examine quantitatively: for example, statistical analyses cannot explain how persuasive EDIP's tax credits are in swaying business executives into locating in particular communities. Similarly, qualitative discussions with policy makers and economic development practitioners cannot demonstrate empirically whether EDIP has resulted in significant unemployment relief or new business activity. Therefore, when appropriate I will perform statistical analyses to determine EDIP's impact on measurable

metrics of economic development. Likewise, when investigating topics that defy quantitative measurement I will relate my findings from extensive interviews with scholars, policymakers and other relevant stakeholders.

Data on the employment levels of each town and city in Massachusetts from 1990 until 2006 is available online through the Department of Revenue's Division of Local Services website. Admittedly, without a control group one can merely speculate whether employment fluctuations are directly attributable to EDIP's tax credits; even in the scenario of *declining* employment levels one could argue that EDIP staved off a potentially higher job-loss rate in a given city or town. However, it seems useful and relevant to compare the aggregate levels of employment in EDIP participating towns to non-participating towns to determine whether, on average, EDIP communities have maintained significantly higher rates of unemployment. Moreover, although EDIP was originally intended to be an employment catalyst, the program is increasingly being viewed by local officials as a tool of residential property tax relief. Therefore, I will examine the percent change in commercially taxable properties in both those communities that do and those that do not participate in the EDIP program by utilizing municipal-specific commercial tax revenue data also available through the Department of Revenue.

These two empirical indicators of EDIP's effectiveness are based in quantitative research. As mentioned, however, other themes common in the literature regarding tax-incentive programs defy quantitative measurement. Thus, in order to uncover both EDIP's ability to draw existing and prospective businesses into expanding and/or relocation in Massachusetts and, secondly, EDIP's potential to force municipalities into

‘competing’ for a prospective business, I will report on my findings from interviews with academic experts, local municipal administrators and other economic development practitioners, as well as from my research of statements made in the public record.

This study does not conclude with a proposal to suspend the Economic Development Incentive Program – such a suggestion could only be made after a much more thorough and exhaustive review has been conducted of EDIP’s economic results in the communities the program serves. Based on the data analyzed here, however, which casts doubt on the positive impacts of EDIP, this paper does recommend that an appropriate government agency immediately undertake just such a review. In addition, a total of ten pragmatic reforms designed to ensure that tax credits are awarded in a judicious and effective manner are offered for policymakers to review and consider.

Chapter Two: Relevant Scholarship on Tax Incentive Programs

A comprehensive body of research regarding corporate subsidization in general, and business location tax-incentive policies specifically, has been published contemporaneously with the intensification of the practice since the mid-1970s⁴. While a significant portion of this research has been conducted on a national and interstate comparative basis, the scholarship conducted on these questions is very much applicable to the local level. The concepts and theories developed by scholars of economic development policy generally pertain directly to the questions raised by this paper: do tax-incentive oriented economic development programs reduce exceptionally high rates of unemployment, redevelop swaths of blighted, commercially vacant neighborhoods, or help intensify the growth of commercial tax bases? Do tax-incentive programs significantly impact a business's decision to locate within a given state or municipality? Do they unintentionally force municipalities and/or states to compete with one another for the location of a business?

Conceptual frameworks

Two conceptual frameworks have defined the parameters for the research on economic development policies. The first, developed by Richard Musgrave in 1959, offers an understanding of municipal spending based on dividing public expenditures into three branches: allocation (programs that satisfy public necessities), distribution (tools that compensate for disparities in income), and economic stabilization (programs designed to manipulate the community's overall economic health). An anti-smoking

⁴ In *Choosing the Form for Tax Incentives*, Hicks (1978) provides readers with an exhaustive introduction to the various forms of business tax-incentives. Specifically, Hicks distinguishes between "tax credits, accelerated deductions, additional deductions, exclusions, exemptions, reduced tax rates, and specially-taxed organizations" (Hicks, 1978).

public-health initiative constitutes “allocation” spending; a redistributive program that taxes wealth and provides services to the poor qualifies as “distribution” spending; economic development programs whereby governments assist business expansion or relocation in their jurisdictions qualify for Musgrave’s third theoretical branch of public spending.

The second fundamental concept of economic development studies concerns rational decision making processes and business mobility. In his seminal 1956 publication “A Pure Theory of Local Public Expenditures,” economist Charles Tiebout posited that citizens, acting as consumers, would ‘shop’ for a municipality where they could receive the best ‘goods’ (e.g. public education, or garbage disposal) at the lowest ‘prices’ (taxes). The implication of Tiebout’s findings has been described as “interjurisdictional competition” (Keeok 1997) for citizens. Tiebout’s proposition assumes that citizens are rational actors possessing the luxury of mobility and constantly perform cost-benefit analyses (consciously or not) to determine whether or not they are paying the optimum price for the services they receive.

Scholars have expanded Tiebout’s model to attempt to explain why municipalities employ economic development policies, and what predictors predispose communities to awarding them. Political scientist Paul Peterson, for example, used Tiebout’s framework for analyzing the constraints of urban municipal decision-making processes in his 1981 work “City Limits.” Peterson argued that city officials, because of the structural limitations of city government, place developmental policies above all other considerations, leading to widespread intercity competition for both residents and businesses. Moreover, Peterson argued, city officials are largely insensitive to objective

conditions and instead are influenced predominantly by local elite decision-makers. Peterson's findings ran counter to a growing consensus that economic distress is the likeliest predictor of urban subsidy-oriented economic development policies (Rubin, Rubin 1987; Jones & Bachelor 1986). Additionally, the "city-limits" theory has been criticized as overly simplistic and neglectful of the impact of external forces such as globalization and national economic forces (Agranoff & McGuire, 1998; Clark & Ferguson, 1983; Clarke & Gaile, 1997; Stone, 1989; Waste, 1989; Wong, 1990). Elaine Sharp offered a reconciliation of these disparate findings by suggesting that the connection between economic distress and economic development policies is qualified by the varying degree of citizen participation in policy formulation as well as the institutional arrangement of the given municipality (Sharp, 1991).

Impact on local economies, employment levels, and urban blight

If the research has reached consensus on why municipalities pursue economic development policies, it remains less definitive on impacts of such policies on state and city economies. Writing in 1994, authors Bingham and Bowen concluded one study of the performance of economic development programs by stating that "...the literature is nothing if not inconclusive: uncertainty abounds. How effective are these expenditures? Despite the fact that one would expect a record of some success to be used to justify these expenditures, one finds that a definitive, scientifically-established answer clearly is lacking" (Bingham, Bowen 1994).

Law professor and critic of tax incentive programs Peter Enrich echoed Bingham and Bowen's frustrations in his 1996 Harvard Law Review article *Saving the States from Themselves* by asking rhetorically: "Why have the states invested so much of their

ingenuity and resources over the past twenty years in the competition to provide tax incentives to businesses? The simplest explanation would be that they have proven to be an effective tool. But, in fact, for as long as states have been racing to outdo each other in the tax breaks they offer, economists and other researchers have been searching for evidence of the influence of states' tax policies on the vitality of their economies. The conclusion from these efforts has been, at best, inconclusive" (Enrich, 1996).

Historically, the majority of economic development literature has shown that state and local tax codes have little impact on economic conditions such as employment or industry growth (Bloom, 1955; Thompson and Matilla, 1959; Bridges, 1965; Wilson, 1989; Brace & Mucciaroni, 1990; Blair & Premus, 1987; Wolman, 1996; Reese & Fasenfest, 1997; Philips and Goss, 1995; Schweke et al. 1994). More recent econometric studies, however, have begun to argue that state and local taxation may have a modest but statistically significant negative impact on these indicators. For example, in Timothy Bartik's survey of 75 studies conducted between the 1970's and 1990's, the author found that "recent studies differ from those of studies in the 1950s, 1960s, and early and mid-1970s, which generally did not find statistically significant and negative effects of taxes on state and local growth" (Bartik, 1991). Michael Wasylenko updated Bartik's study in 1997 to conclude that the average long-run elasticity of job creation on local and state taxation was -.02.⁵

⁵ One method of economic development policy in particular – public sponsorship of the construction of private sports-stadiums – has been the subject of multiple studies; authors Noll and Zimbalist combined empirical data of stadium subsidization and local economic growth, including job creation, to conclude that stadiums almost invariably cost more in public revenues than they contribute to the local economy (Noll, Zimbalist 1997). Similar major studies on stadium subsidization conducted since have reached similar conclusions (Cagan, DeMause 1999; Rosentraub 1999; Delaney, Eckstein 2003).

Still, some advocates have contended that carefully targeted subsidy programs are warranted if coupled with explicit goals (such as alleviating exceptionally high-unemployment in a given community, or boosting the productive capacity of a specific business or industry), measurable results, and immediately triggered “claw-back” clauses that cancel preferential tax awards at the first sign of improper or unsatisfactory behavior on behalf of the company. Timothy Bartik, a prolific author and senior economist at the Upjohn Institute for Employment Research, has been a vocal proponent of this reformist camp, arguing that “Tax and financial subsidies should have rules to guide when subsidies are to be given and their amount.” “Without rules,” Bartik warns, “political pressures may lead to excessive subsidies for large projects” (Bartik, 1994). Meanwhile, other scholars such as Richard Feiock have challenged the consensus that corporate subsidy programs are a poor catalyst for economic growth altogether. In his 1991 publication of his study “The Effects of Economic Development Policy on Local Economic Growth,” Feiock criticizes the many case studies showing that business subsidies rarely compensate for foregone tax revenues by arguing that this interpretation ignores secondary “spin-off” effects such as “investment, industrial linkages, and improved business climate that result indirectly from development policy and the attraction of industry” (Feiock, 1991).

In his comprehensive work *Rethinking Growth Strategies*, Robert Lynch (2004) disputed the favorable interpretations of recent data on subsidy policies by pointing out that these studies omit the reductions in public services that, in reality, invariably accompany tax reductions. Holding public services constant while studying the effects of reducing the tax rate, Lynch argues, “essentially prove(s) something both obvious and

largely unattainable: state and local economies would be stronger if they could maintain public services while paying less for them” (2004). Lynch persuasively argues that jobs created in the private sector from tax cuts may have a neutral or negative effect on overall employment, when public sector jobs eliminated are taken into account.

One theme missing from scholarly research is the effect subsidization policies, specifically the creation of property tax-less “enterprise zones,” has had on reducing urban blight by rehabilitating abandoned buildings or neighborhoods, reversing neighborhood disinvestment and reducing commercial vacancy. Such a review is warranted, overdue and pressingly necessary for the consideration of policymakers and practitioners of economic development.

Impact on business location decision making processes

Despite inconclusive results on the impact of subsidy programs on local employment, research has uncovered that state and local taxation rates are too small of a business’s overall costs to play a critical role in their deciding where to locate. Compared to such factors as the availability of markets, the level of education in the available workforce, the reliability of local infrastructure and other external factors, corporate executives invariably cite town and state business taxes as insignificant variables in locating decisions. In the 1960’s and 1970’s major works utilizing survey data from multiple states illustrated that access to markets, materials, labor and transportation were significant factors in business location decisions – but not tax rates (Due, 1961; Mueller, Wilken and Woods, 1961; Greenhut and Goldberg, 1962; Morgan, 1964; Stafford 1974). In Roger Schmenner’s 1982 work “Making Business Location Decisions,” for example, the author utilized census data, business questionnaires and nearly 100 interviews with

the executives of large Fortune 500 companies to discover that only one percent of executives considered state and local tax rates a critical factor in making location decisions. Similar works conducted since have reached comparable findings (Heckman 1982; Humberger 1983; Kieschnick 1981; Wheat 1986).

Impact on interjurisdictional competition

One implication of the analyses of Peterson and Sharp is that actions by one municipality are likely to affect the actions of its neighbors (Fleischmann, Green, Kwong 1991). Mark Schneider, in his 1989 work *The Competitive City*, lent substantial support to this inference by illustrating that the limitations imposed on city governments by their structural limitations (namely their lack of revenue-raising tools) leave economic development policies as one of the only tools accessible to local officials seeking to affect development of private industry. Schneider predicted widespread interjurisdictional competition as the result – a theory compounded by authors Fleischmann, Green and Kwong of the University of Georgia in their study *What's a City to Do?* According to Fleischmann et al, a strong and positive correlation exists between the number of economic development programs offered by a region and the level of interjurisdictional competition (1992).

Impact of investing in public and human capital

While the research had tended to show that subsidy-oriented tax expenditures have little effect on achieving significant economic development, investments in public services as well as public and human capital – public education, road construction, public transportation – have definitively proven to have profoundly positive impacts on economic output. David Aschauer (1989), for example, persuasively argued that the

economic decline of the 1970s could be attributed to a corresponding decline in public investment: comparing the rate of return between investments in public and private capital, Aschauer argued in 1990 that “increases in GNP resulting from increased public infrastructure spending are estimated to exceed those from private investment by a factor of between two and five.” Since Aschauer’s pioneering work, subsequent scholars have found that state and local expenditures on public capital have a similar, if somewhat varied, positive impact on private output (Mera, 1973; Costa, Ellson and Martin, 1987; Garcia-Mila and McGuire, 1992).

A role for the courts?

In addition to receiving continued interest from economists and other public policy researchers, the legal aspects of tax incentive programs have very recently become a topic of interest in scholarly research, litigation and court jurisprudence. Northeastern University professor of law Peter Enrich has promoted the opinion, for example, that interjurisdictional competition must be refereed by the courts, for “not only can the measures taken by each state undermine the economies of the others, but states may also find themselves caught in a ‘race to the bottom’ in which competition pressures compel them each to adopt measures contrary to their citizen’s needs” (Enrich, 1996). Enrich argues that the Constitution’s explicit charge that Congress, and not the individual states, should “regulate Commerce...among the several states...” renders some of the high profile interstate bidding wars unconstitutionally discriminatory to out of state businesses.

In 2006, Enrich served as a pro-bono counsel to Ohio taxpayers in the United States Supreme Court case *DaimlerChrysler Corporation V. Charlotte Cuno et al.* Enrich

and plaintiffs argued that Ohio's practice of awarding investment tax-credits to businesses located within the state was equivalent to taxing in-state businesses at a lower rate than out of state businesses. Ultimately the Supreme Court ruled that the plaintiffs, as individual taxpayers, did not have standing to challenge state tax law in federal court.

Past Supreme Court jurisprudence, however, seems to confirm Enrich's view: in 1977 the Court invalidated a New York State law that favored in-state exchanges made on the New York Stock Exchange over out-of-state exchanges; in 1984 the Court struck down a Hawaiian state excise tax on liquor that exempted certain locally produced products; and again in 1994 invalidated a Massachusetts tax program that unfairly protected Massachusetts dairy farmers. Writing for the majority in the *West Lynn Creamery v.*

Healy, the case dealing with Massachusetts dairy farmers, Justice Stevens opined:

“The order is clearly unconstitutional under this Court's decisions invalidating state laws designed to benefit local producers of goods by creating tariff like barriers that neutralized the competitive and economic advantages possessed by lower cost out of state producers.”

Summary

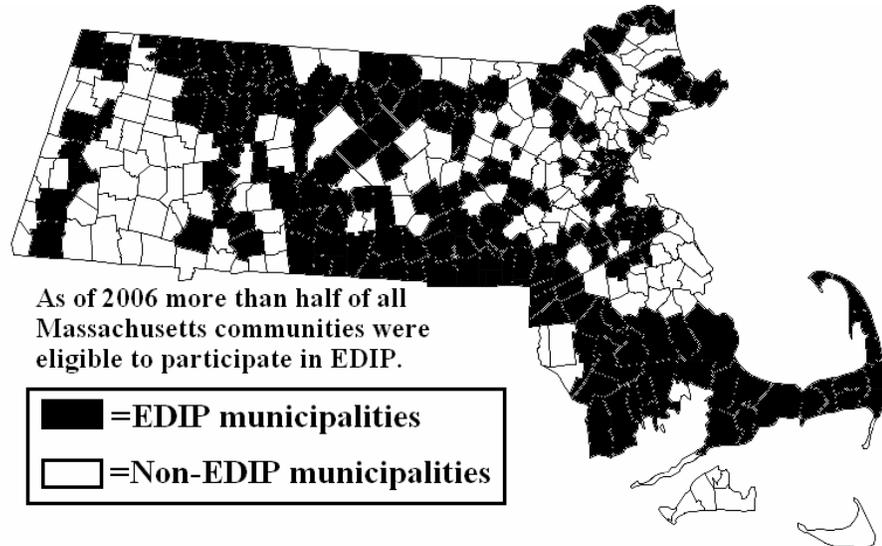
In an interview, Professor Enrich accepted that “There is some limited evidence that incentives, particularly property incentives, can have *some* impact on where in a metro area a business locates, but even that is relatively modest.” The literature supports Enrich's opinion. Despite their increasing frequency of use, little empirical evidence exists to support claims of tax incentive advocates that property tax abatement programs either significantly affect a company's decision to relocate or expand, or significantly impact local economic conditions for the better. Conversely, a mounting body of evidence illustrates that smart investments in public resources pay large long-term economic dividends.

Chapter Three: The Massachusetts Economic Development Incentive Program

Program

Massachusetts' Economic Development Incentive Program (EDIP) is a locally driven, widely used economic development tool that offers multiple tax incentives to businesses located in participating municipalities. Though originally intended only for use by

communities with demonstrated economic hardship, today more than half of Massachusetts towns qualify for



participation in EDIP. This chapter will explain the origins and development of EDIP's legislation, how the program functions, how it has been implemented, and the varying evaluations EDIP has received.

Origins and intention

Despite strong economic growth and low rates of unemployment throughout the 1980's, Massachusetts suffered its worst economic slump since the Great Depression in the four years between 1989 and 1992 (Stein, 1996). Massachusetts' cumulative job loss for the four year period was the highest in the nation – over 350,000 jobs, or 11 percent of Massachusetts employment – culminating in a rate of state-wide unemployment that reached an unprecedented nine percent (Stein, 1996). In response, Governor Weld

unveiled a comprehensive, \$600 million “job creation” economic stimulus bill in September of 1992 that included everything from targeted tax cuts to new public works projects. The House Speaker and Senate President lauded parts of the Governor’s eight-point plan, including, in the words of Speaker Flaherty, the “recognition that there’s a need for government to be proactive in solving our economic problems,” but protested the proposed loan programs and tax cuts (Howe, 1992). In December, the House approved a diluted version of stimulus bill that permitted tax credits for companies committed to relocating or expanding in needy areas; the Governor, however, criticized the bill as “a shell” of his original platform and signaled that his disappointment would likely entail a veto. In January of 1993 – the following legislative year – Governor Weld resubmitted the original bill and renewed his campaign for legislative approval. Finally, a coalition of first- and second-term Democratic legislators dubbed the “Progressive Legislators Group” broke the impasse by introducing a third version of the “jobs bill” that passed both Houses the following month. In March of 1993, Lieutenant Governor Paul Cellucci signed the bill into law, noting at the time that “It’s not everything we wanted. It’s not everything we liked. But I think there’s enough there to help the economy,” (Locy, 1993).

Chapter 19 of the Acts of 1993, titled: “An Act Relative to Incentives for Economic Development,” established not only the multifunctional tax-incentive program “designed to stimulate job creation in targeted areas, attract new businesses, and encourage existing businesses to expand, assist in infrastructure improvements and to also function as a tool for hazardous waste clean up and remediation” known as EDIP, but also its oversight body the Economic Assistance Coordinating Committee (EACC),

located under the jurisdiction of the Massachusetts Office of Business Development (MOBD) (itself an agency within the Executive Office of Economic Development).

Program function

EDIP is primarily a tax-increment financing program. Generally a tax-increment financing (TIF) agreement allows the added value of a developed parcel (the “increment”) to be exempted from local property taxation for an agreed upon limited duration of time in order to subsidize the development. In instances wherein the development is entirely new, the “incremental” value of the new property may include the entire value of the property, thereby making the entire parcel eligible for property tax exemption for the duration of the TIF agreement.

In Massachusetts, businesses participating in the EDIP program (called “Certified Projects” or CPs) must be located within either a state-designated Economic Target Area (ETA) or Economic Opportunity Area (EOA). In order to qualify as an ETA or an EOA, municipalities must apply for approval from the Economic Assistance Coordinating Council (EACC), a fourteen person body consisting of seven gubernatorial appointees and seven statutory appointments and co-chaired by the Director of Business and Technology and the Director of Community Development. The qualification process is entirely locally driven: in order to participate as an ETA or an EOA, boards of selectmen or city councils must first contact the MOBD and submit the requisite paperwork. Ultimately, any agreed upon TIF – called a Special Tax Assessment (STA) in EDIP terminology – developed between a municipality and a CP must be approved by the voters of Town Meeting.

ETA's are defined as one or multiple municipalities that have proven, through three or more consecutive census tracts, one of eleven statutory requirements defined in MGL 23A section 3D. The original legislation included areas with:

- An unemployment rate exceeding the Commonwealth's by at least 25 percent;
- 51% of households' incomes at or below 80 percent of the area's median income;
- A poverty rate at least 20 percent higher than the Commonwealth's;
- A cumulative job loss of two thousand or more for the previous four years;
- A Distress Factor greater than one and thirty-three hundredths;
- 51 acres or more used to manufacture or repair maritime vessels.

In 1997, the legislature greatly expanded ETA eligibility with four new qualifications for municipalities:

- Commercial vacancy rate of 20 percent or more;
- A generation facility valued at less than or equal to 50 percent of its current book value sited in area;
- A facility of at least 1,000,000 square feet which qualifies as an abandoned building;
- A 200 acre parcel capable of supporting a 3,000,000 square foot regional technology center;

And finally, in 1998, the legislature added federally-designated “empowerment zones” and “enterprise communities” to the list of ETA qualifications.

EOAs are designated locations within ETAs that have been cited by the participating town as areas of particular need. These may include downtown areas, city centers or even individual buildings. Qualification for EOA status requires the ETA to provide the EACC with detailed maps of the proposed location and specific development goals regarding local employment. As defined by 402 CMR 22.00, EOA’s must meet one of five statutory requirements, including:

- a “blighted open area,”
- a “decadent area,”
- a “substandard area.”
- a generation facility valued at less than or equal to fifty percent of its current book value sited in area.⁶

Companies receive Certified Project (CP) status by committing to capital investment and the expansion or relocation of a business facility that ultimately results in job creation. In return for participating in the EDIP, CPs receive from the Commonwealth a five percent investment tax credit on qualifying investments (defined by the Federal Income Tax guidelines as tangible personal property or other depreciable property) and, if applicable, a 10 percent abandoned building tax deduction⁷. From the individual municipality, CPs receive a property tax-exemption based on a negotiated percentage of

⁶ See Appendix 1 for definitions.

⁷ Companies not participating in EDIP are still eligible for Massachusetts’s three percent investment tax credit, which is not associated with EDIP.

the incremental value added to the property, and a special tax assessment that applies to the entire assessed value of the parcel.

Special tax assessment agreements can exist for a minimum of five and a maximum of twenty years. While municipalities determine, along with the CP, the exact schedule of property tax collection, EDIP dictates the following general guidelines: during the first year the municipality is prohibited from collecting *any* property taxation, during the second year the municipality may collect *no more than 25* percent of the entire value of the parcel, during the third year the municipality may collect *no more than 50* percent of the entire value of the parcel, during the fourth year the municipality may collect *no more than 75* percent of the entire value of the parcel, and each subsequent year the municipality may collect the full and fair assessed value of the parcel.

Finally, municipalities not located within ETAs may apply for an “exceptional opportunity” designation from the Secretary of Economic Development and participate in the local tax exemptions contained in ETA and EOA status. Certified Projects located in a designated “exceptional opportunity” may not receive either the state’s five percent investment tax credit or the 10% abandoned building credit. Rather, these CPs are eligible only for local TIF and STA agreements.

Program implementation & early controversies

Like any ambitious and large-scale program, the implementation of EDIP provided state officials with valuable, though sometimes hard-learned lessons: the case of Ayer, one of the state’s earliest municipal participants, provides a case in point.

With the impending closure of Fort Devens only years away, the Nashoba valley community of Ayer struck state officials as the perfect candidate to be among the

Commonwealth's first communities to receive ETA status. By April of that 1994, two Ayer companies – pasta-flour producer New England Milling Company and soft-drink bottler Northeast Hotfill Co-op Inc. – had become the first in the state to receive EDIP tax breaks. Together, the companies invested a combined \$11.8 million in their existing plants and pledged to create 34 additional Ayer jobs. "It's the classic win-win," New England Milling Company's general manager Nancy Graves told Worcester Telegram & Gazette (Guilfoy, 1994).

Two years later town officials persuaded soy-product food producer Nasoya Foods Inc. to relocate from its native home in a Leominster barn to a dilapidated former shrimp producing facility in nearby Ayer. Citing a need to expand, Nasoya approached Leominster's planning department for assistance in finding a suitable existing plant in town that fit the company's needs. When the search came up fruitless, Nasoya explored the possibility of building a new plant on a vacant city-owned lot, but when the town placed the lot up for bid, Nasoya declined to make an offer. Concerned that the terms of the offering turned Nasoya away, Leominster made a second, more generous offer for the lot, but still Nasoya declined to submit a bid. The reason: unbeknownst to Leominster officials, Nasoya, with assistance from the MOBD, had already selected its new site in Ayer.

Officials in Leominster began to complain that the MOBD and Ayer had worked out a tax-incentive package with Nasoya while Leominster was still searching for ways to keep the company in town. When Leominster Mayor Dean J. Mazzarella learned of Nasoya's decision to leave town, he was still under the impression that "[Nasoya executives] were absolutely convinced they were building [a new facility in Leominster]"

(Guilfoy, 1996). In January, representatives of the EACC and Leominster met to determine guidelines for the new program that would ensure EDIP's proper administration in the future (Guilfoy, 1996).

Despite these and other early challenges, EDIP, while becoming a popular option for companies seeking tax breaks and municipalities seeking new businesses, remained relatively absent from newspaper editorial pages and public debates. This changed abruptly in May of 2002, when the Boston Globe reported on the aforementioned decision of the EACC to award AMG a \$1.2 million tax break in return for relocating to the Prides Crossing section of Beverly (Ebbert, 2002). The disputed location was once home to the mansion of William Loeb, publisher of the Union Leader of Manchester, until it burned down in 1987. AMG was but one of multiple parties interested in developing the site: ironically, TollBrothers, a construction firm that specializes in



A Toll Brother's house in North Attleborough, Massachusetts.

erecting mansions in affluent neighborhoods, proposed purchasing the land to develop 58 houses. Quite obviously, the Globe argued, the property could hardly be considered in need of publicly funded economic assistance (Ebbert, 2002). Moreover,

AMG indicated to local officials at the time that the company would not be seeking local or state tax waivers (Phillips, 2005).

A second Globe report, released the following July, highlighted Fall River Mayor Edward Lambert's effort to revoke a generous tax credit granted to a textile

manufacturer. According to the report, in return for the decision to construct a \$46 million facility (with the promise of 500 accompanying new jobs), the city of Fall River granted Main Street Textiles a 20-year property tax abatement – the maximum STA agreement allowed under EDIP. But, according to Mayor Lambert, not only did Main Street Textiles create no new jobs while receiving \$1.1 million in tax-assistance during the first two years of their expansion, company officials actually cut their Fall River workforce. When Mayor Lambert asked the EACC to revoke Main Street Textile’s eligibility, state officials resisted, instead encouraging Fall River to renegotiate a new agreement. Without an out-clause beside state revocation of CP status, Fall River officials found themselves unable to reclaim the more than \$1 million in lost revenue. Rebuffed, Lambert told the Globe: “If they're going to send a signal to local communities that we cannot enforce these agreements, that is going to set a very dangerous precedent, which I predict will spell the end of this program” (Ebbert, 2002). Responding to public pressure, the State Senate Post Audit and Oversight Committee conducted an investigation in late 2002 and their results revealed that nearly one third of the companies receiving tax breaks under EDIP had never filed the requisite paperwork to track job creation and investment levels. As a result, the EACC’s mandated “reports” on EDIP’s effectiveness, according to the Boston Globe, “amount[ed] to a recitation of the companies' original promises, rather than an accounting of the results” (Ebbert, 2002).

The Senate report called upon the EACC to begin corroborating employment data provided by the companies by conducting recurrent independent audits, and to study the cost of the state subsidy for each job created. Additionally, the committee recommended that the state establish so-called “clawback” stipulations that would allow the

municipalities to automatically terminate their agreements with corporations that failed to meet their obligations.

The EACC responded with a number of significant reforms. One year before, the EACC had already decided that they, and not the municipalities, should bear the responsibility for collecting company performance data with respect to job creation. According to the EACC's 10-year report on EDIP: "the percentage of companies complying with EDIP's annual reporting requirement rose to 73% in FY 2001, to 95% in FY 2002, and culminated in perfect 100% reporting rates in FY 2003 and FY 2004." Additionally, the EACC adopted a policy – effective as of FY2003 – of revoking CP status for projects that fail to meet EDIP's annual reporting requirement. The EACC did not, however, explore the Senate's recommendation to consider implementing "clawback" provisions.

Despite these reforms, public debate on the utility of EDIP was far from over. The following year Massachusetts Inspector General Gregory Sullivan, citing relevant instances where EDIP tax abatements seemed inconsistent with the program's intention, publicly called on Department of Revenue Commissioner Alan LeBovidge to revoke \$10.5 million in tax expenditures authorized under EDIP (Lewis, 2004). One of Sullivan's complaints involved the EACC's decision to award \$1 million to Canadian insurance firm Manulife in return for purchasing a site in South Boston offered for sale by the Massachusetts Port Authority in 2000. Although the Port Authority received six bids for the site, Manulife's promise of "900 new jobs" and "its approach of financing, developing, and operating the building" swayed the MassPort officials to select the Canadian firm (Phillips, Kindleberger, 2000). Manulife commenced construction in 2001,

and, two years later, filed for a tax-abatement through the state's EDIP program. The EACC approved Manulife's request, and granted the firm approximately \$7 million in tax breaks (Lewis, 2004).

In his letter, Sullivan accused the EACC of lax oversight by arguing that the multiple bids for the South Boston location proved that the project self-evidently did not qualify as a "blighted area" that was "unduly costly to develop...through the ordinary operations of private enterprise." But a spokesperson for Manulife defended the tax deal to the Boston Globe, stating that "in selecting the site of our new building in the Seaport District, the opportunity to qualify our project for economic development tax relief was an important consideration. Manulife is excited about helping to revitalize this area both through the addition of our new building and through the presence of Manulife employees. We're also grateful for the support and the partnership of city and state officials, and we are confident that the project merits the consideration it was given" (Lewis, 2004).

Sullivan's letter expounded on the two findings reported by the Senate Committee investigation: first, a lack of regulatory oversight ensuring corporations deliver the jobs promised (and an accompanying lack of automatically triggered punitive measures taken when they fail to do so), and, secondly, an increasing proliferation of qualifying towns that exceeds EDIP's original scope and intention. Even Governor Weld, EDIP's original champion during the 1990 recession, remarked to the Boston Globe when asked about the recent developments that it "sounds like everybody but Wellesley and Dover got [ETA status]."

In response to Sullivan's high-profile condemnation of EDIP, the legislature ordered the Department of Revenue to investigate whether EDIP was being awarded in a systematically inappropriate way. In October of 2004, LeBovidge's agency did file a sharply critical nine-page report with the legislature that confirmed Sullivan's allegations. The report, however, was immediately revoked five days later (Ebbert, 2002).

What caused LeBovidge to revoke his agencies report? LeBovidge claimed that the report was a "draft" that had been "inadvertently presented" to state lawmakers, but according to the Boston Globe, which received a copy of the confidential memorandum, "nothing in the department's report indicated that it was a draft, despite LeBovidge's assertion" (Phillips, 2005). LeBovidge acknowledged that members of the Executive Office of Economic Affairs, which oversees EDIP, had contacted him regarding his impending report, but emphatically denied that anybody affiliated with the Governor pressured the Department of Revenue into shelving criticism of the program. This too was countered by the Boston Globe after reviewing Department of Revenue e-mails acquired through a Freedom of Information Request. According to the Globe: "High-ranking Romney administration officials closely monitored and at times pressured the Department of Revenue after the tax agency issued a critical report of an economic development program that had awarded a \$1 million tax credit to a company headed by Lieutenant Governor Kerry Healey's husband" (Phillips, 2005).

A full twelve months passed until LeBovidge agency released their final findings on EDIP and the Inspector General's concerns. Although the Revenue Department decided to revoke tax credits given to six unnamed companies, they decided that both

AMG and Manulife would continue to qualify for their collective millions of dollars in tax breaks.⁸

The EACC's 10-year report

The EACC is charged with preparing annual reports on its activities for various executive agencies and legislative committees as well as a public, comprehensive report every ten years that evaluates the relative effectiveness of the entire program. In 2004 the EACC released its first such study, arguing that “EDIP’s benefits have far exceeded its identifiable costs” (Mass. EDIP FY95-FY04, p. 17). According to the report, 905 CP applications were approved between FY 1995 and FY 2004; 45 ETAs, encompassing 189 municipalities, were approved for EDIP eligibility status; 552 locations were designated as EOAs; and 65 CPs were revoked of their eligibility.

According to the report, which cites “rough” estimates provided by the Department of Revenue, \$49.5 million dollars has been paid out state-sponsored investment tax credits, and \$2.5 million in abandoned building tax deductions. Additionally, an estimated \$13.3 million was incurred by the MOBD in administrative costs over the ten years of program administration, as well as \$1 million to the Department of Revenue. In total, the report estimated that EDIP has cost the Commonwealth \$66.3 million in its first ten years of implementation.

⁸ AMG ultimately decided to return the value of their tax break to the state of Massachusetts. Writing to Revenue Commissioner LeBovidge, AMG CEO Sean Healey said: “Our decision to cease participation in the program results from a desire to avoid becoming the focus of controversy over public policy issues involving the awarding and administration of tax credits to businesses in the Commonwealth. AMG’s involvement in the controversy is a distraction to our business and risks impugning our corporate image and reputation,” (Phillips, 2005).

Table 1: EDIP Performance, 1995-2004:

| | |
|---|--------------|
| Certified Project Applications Approved: | 905 |
| Number of Economic Target Areas: | 45 |
| Number of Municipalities Designated as Economic Target Areas: | 189 |
| Number of Economic Opportunity Areas: | 552 |
| Number of Certified Projects Revoked: | 65 |
| Cost of Investment Tax Credits: | 49.5 million |
| Cost of Abandoned Building Tax Credits: | 2.5 million |
| Total Cost of Local Tax-Increment Financing: | Unknown |
| Administrative Costs: | 14.3 million |
| Total Reported Costs: | 66.3 million |

In determining EDIP’s operational cost to the state over the first ten years of the program’s use, the EACC included only the 5% investment tax credit and the 10% abandoned building tax deduction and omitted cost of forgone tax revenues absorbed by the individual towns through STA and TIF agreements. “It should be noted,” the report states, “that all locally exempted property and personal property taxes realized via municipally executed STA/TIF Agreements, as well as any additional locally derived staffing costs were not calculated as ‘state costs’ for this report” (Mass. EDIP FY95-FY04, p. 17).

In addition, the report states that 89,610 jobs were retained at CP locations throughout the Commonwealth between FY 1995 and FY 2004. Assuming that the average wage for each job is \$35,000, the Commonwealth receives \$1,855 in income tax revenue through the current 5.3% income tax rate for each job created or retained by EDIP. Therefore, the report concludes, the Commonwealth “breaks even” in the first ten years with the creation of 649.15 jobs – less than 2% of the nearly 90,000 jobs the EACC claims are directly attributable to EDIP’s tax incentives. “As the above Cost/Benefit

Analysis...illustrates,” the report concludes, “EDIP’s benefits have clearly outweighed the Program’s identified costs.”

The following chapter will argue that the EACC’s methodology for analyzing the costs and benefits of EDIP were gravely flawed, leading to inappropriate conclusions regarding the program’s overall success. Additionally, I will introduce a new method of studying EDIP’s ten-year performance record that includes new empirical quantitative and qualitative research, and conclude with a discussion of the implications of this research.

Chapter Four: Research and Results on Impact of EDIP

Since its inception as a program to relieve unemployment in targeted cities and towns, EDIP has evolved into an amorphous, multifunctional development tool, utilized for developing “blighted areas,” luring out-of-state businesses into relocating in Massachusetts and shifting municipal tax burdens from residential to commercial taxpayers. Yet despite its prominence as Massachusetts’ largest locally-driven tax abatement program, the Commonwealth has never conducted a comprehensive analysis of EDIP’s costs and benefits to the state.

Despite scholarly consensus that economic development programs, when funded through tax abatements, are poor catalysts for new business growth, state officials in Massachusetts continue to employ one such program with increasing frequency. This section will attempt to uncover, through new quantitative and qualitative research, the impact EDIP has had on two of the program’s most important measures of performance: local employment levels and municipal tax revenues. Further, through discussions with municipal administrators and other economic development practitioners, I will explore the contention that EDIP creates a sense of ‘competition’ for prospective businesses between Massachusetts municipalities and between Massachusetts and other states.

EACC study

The EACC’s 2004 study omitted the value associated with foregone property tax revenue in calculating the “costs” incurred by the state in administering EDIP.

Considering that the aggregate sum of foregone local property tax revenue represents a value *significantly larger* than the combined sum of moneys forgone by the statewide

investment tax and abandoned building credits, I suggest that the EACC's entire study is undeserving of serious consideration.

The EACC study contains numerous additional flaws. First, recognizing that by statute EDIP is designed to realize economic development for ETAs and EOAs specifically, it seems inappropriate for the EACC study to have focused exclusively on *state* costs (through investment credits and abandoned building tax deductions) and *state* benefits (namely the state income tax). Instead, the EACC would have better served Massachusetts taxpayers by determining the cost and benefits of participation in EDIP on an ETA by ETA basis. Imagine the following analogy: certain public schools across the state of Massachusetts suffer from particularly low MCAS scores and, in response, the Massachusetts Department of Education offers a targeted program designed to increase scores in a limited number of low performing school districts. If the Department of Education, in determining whether the program was achieving its desired results, took into account the aggregate change in *statewide* test scores, rather than the change in the school districts targeted, they would have chosen a fundamentally incorrect point of comparison. The EACC, in assessing statewide costs and benefits rather than individual ETA costs and benefits, has committed this same error of reasoning.

Secondly, it remains unclear how the EACC developed their job creation figure, considering that for seven of the program's first ten years individual municipalities failed to collect CP annual reports on job creation and capital investment. When asked about this directly, EDIP director Bob Foley had no answer. Similarly, there appears to be no rationale for the EACC to pick an arbitrary figure (\$35,000) for the average wage of an EDIP job. If the EACC had collected data, as mandated, on the wages of each job

attributable to EDIP tax-credits, then calculating the mean salary off the 89,610 purported jobs would be a rather simple task. Considering that a large percentage of EDIP tax credits are awarded to retailers and other employers who pay their part-time personnel hourly wages of less than ten dollars an hour, assuming an annual salary of \$35,000 may be unrealistic. (Low wages illustrate an additional omission in the EACC's calculation of costs incurred by local and state government, namely the very real cost of low-paid employees who utilize the state's subsidized healthcare and other welfare programs.)

What follows is an attempt to empirically study the costs and benefits EDIP by introducing two new metrics for measurement: EDIP's impact on business growth and local employment levels within ETAs.

EDIP and commercially taxable properties

Massachusetts municipalities receive the bulk of their revenues through property taxation and, to a lesser degree, state aid. Some communities charge all taxable property in a town (commercial, residential, industrial) the same flat rate, while others apportion different rates to different properties (in 2006, 110 Massachusetts communities had adopted this "split tax" rate); either way, increasing the number of commercially taxable properties relieves homeowners of the collective burden of residential property taxes. Because of its ability to shift the local property tax burden from individual homeowners to new businesses, EDIP has been promoted as a tool of residential property tax relief. The empirical evidence, however, shows this hypothesis to be unsubstantiated. Paradoxically, the data analyzed here show that there exists a slight negative correlation between the length of time a community participates in EDIP and the number of commercially taxable properties.

The Massachusetts Department of Revenue's Division of Local Service's Municipal Databank contains data on the number of commercially taxable properties for every town in the Commonwealth for the period between 1990 (two years before the onset of Massachusetts's recession and three years before the enactment of EDIP) and 2006. After isolating those communities that have received ETA status on the basis of their length of participation in the EDIP program, I have averaged the percent changes in the number of commercially taxable properties in each community after one year of ETA certification, after five years of ETA certification and after ten years of ETA certification with the number of commercially taxable properties in each community one year prior to ETA certification.⁹ The data, as illustrated in table 1.0, show that *on average* communities that participate in the EDIP program experience a moderate increase in the number of commercially taxable properties in the year immediately following ETA certification, followed by modest decreases in the number of commercially taxable properties in at the five year and ten year anniversary of ETA certification. Specifically, communities have experienced an increase of .02 percent in the number of commercially taxable properties in the year immediately following their certification, followed by decreases of .006 and .01 percent of their commercially taxable properties in five- and ten-year periods respectively following their ETA certification.¹⁰

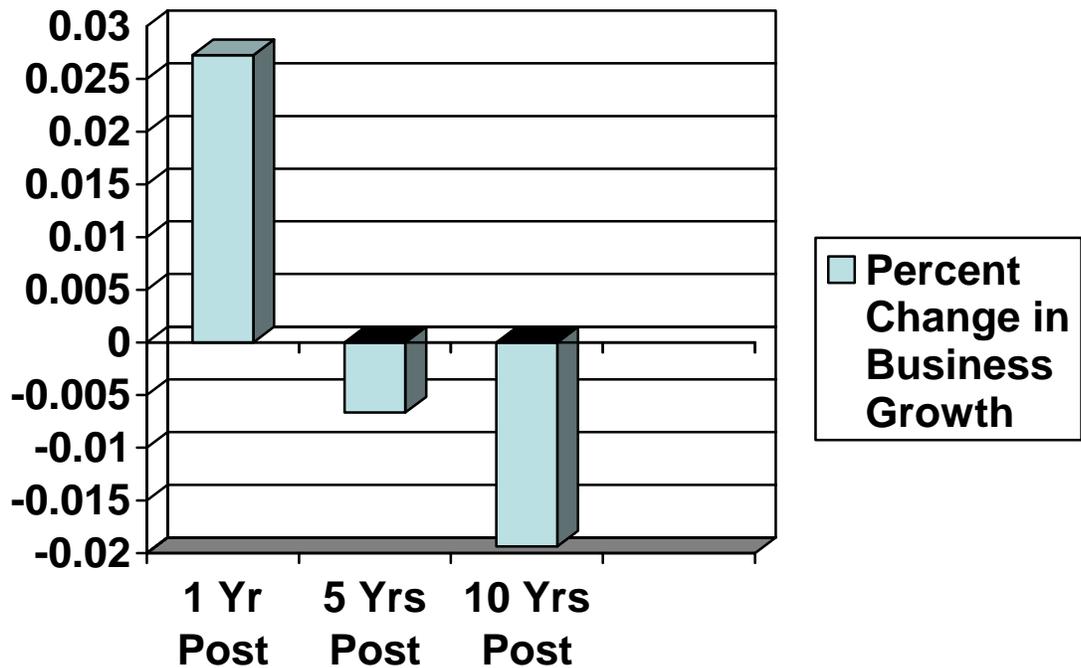
⁹ For example, if municipality A and municipality B received ETA status in years 1994 and 1995 respectively, I began by calculating the percent change in commercially taxable properties for one, five and ten year intervals for both municipality A and municipality B. Next, I calculated the average percent change for all ETA communities after one year, five years and ten years of certification. Thus, even though Municipality A and municipality B received ETA status in different years, they both contain values associated with the percent change in commercially taxable properties for one, five and ten year intervals. It should be noted that there exists a moderate declining rate of communities across this time span.

¹⁰ It should be noted that ETA certification does not necessarily indicate any utilization of tax-incentive programs.

Table 2: Percent Changes in Number of Commercially Taxable Businesses

| | One Year Post ETA (173 communities) | Five Years Post ETA (163 communities) | Ten Years Post ETA (134 communities) |
|-----------------|--|---|---|
| Percent Change: | +.027272 | -.006647 | -.019379 |

Graph 1: Percent Changes in Number of Commercially Taxable Businesses



Is there a strong correlation between the growth of businesses in a municipality and that municipality's participation in EDIP? Certainly the advocates of EDIP would argue that the program in some way encourages economic growth and, by extension, an expansion of the number of commercial properties eligible for municipalities to tax. The reality, however, shows just the opposite: over time, those communities that have participated in EDIP have found themselves losing existing businesses, rather than

gaining new businesses. Of course innumerable factors – a list that far exceeds the scope of this paper – contribute more to the number of businesses in a given municipality than local property tax rates or the role of the EDIP program. The data do suggest, however, that EDIP seems to have had a severely limited, and perhaps nonexistent, ability to grow the commercial tax bases of ETAs.

EDIP and state and local employment

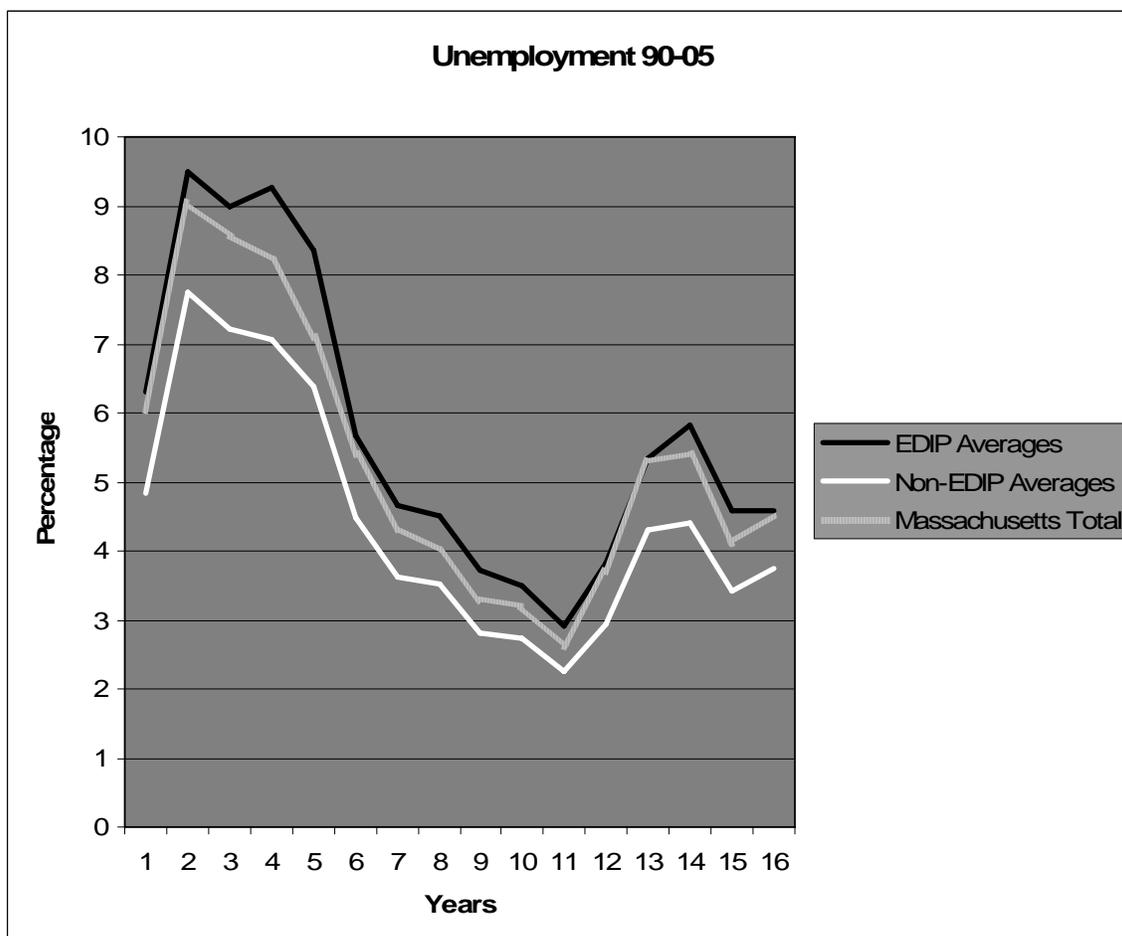
As noted, EDIP was designed with the specific purpose of reducing high rates of unemployment in those Massachusetts communities suffering from particular economic hardship. However, an examination of the available ten-year data shows that EDIP has not been seemingly successful in reducing the unemployment rate in ETAs. Contrarily, according to statistics available from the Massachusetts Department of Workforce Development as illustrated in graph 1.0, the average unemployment rate for ETA communities has stayed consistently above both the total Massachusetts unemployment rate and the average unemployment rate of those communities that do not participate in the EDIP program. Moreover, the trend in unemployment over time between EDIP and non-EDIP communities has been closely parallel, showing no evident effect from participation in the program.

Unemployment throughout the Commonwealth – in ETA and non-ETA communities – has steadily decreased since the disastrous recession of the early 1990s. Specifically, as table three and graph two both illustrate, ETA communities have seen their unemployment rates decrease by .23 percent in the first year of EDIP participation, by .41 percent after the first five years of participation, and by .46 percent after the first ten years of participation.

Table 3: Average Unemployment Change in ETA Communities by Length of Participation

| | Year 1 | Year 5 | Year 10 |
|---|--------|--------|---------|
| Percent Changes in Unemployment rate: ETA Communities | -.2306 | -.4109 | -.4651 |

Graph 2: Unemployment 1990-2005



The question, however, is whether or not ETA communities have witnessed significantly *greater* decreases in their rates of unemployment over their non-EDIP participating counterparts. Unfortunately no obvious point of comparison between ETA

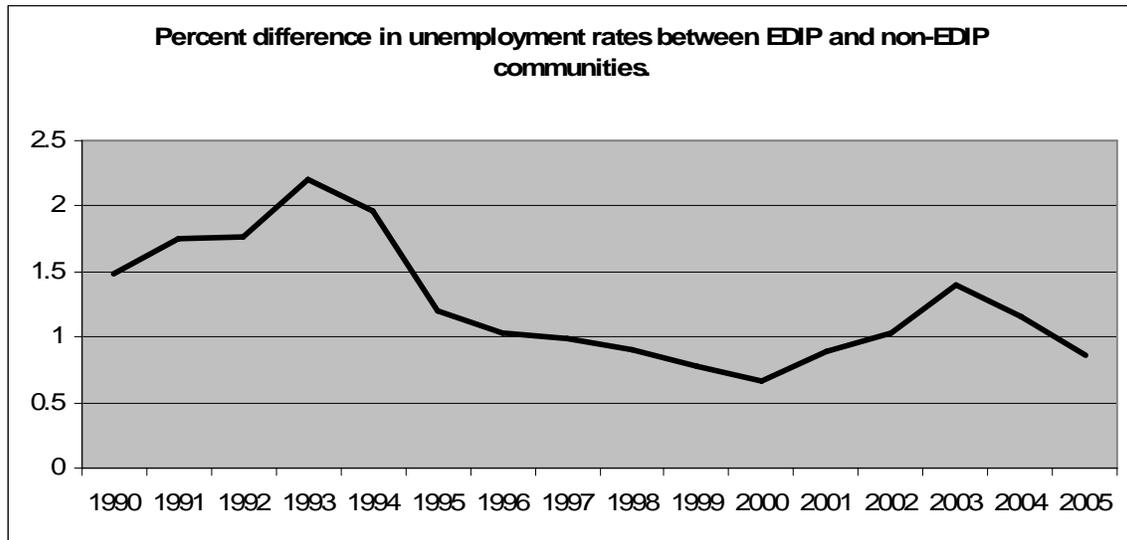
and non-ETA communities exists, for whereas one can easily calculate the change in an ETA’s unemployment rate over a given period of time since ETA certification, no such “post-certification” time frame exists for non-ETA communities. Comparing average unemployment rates between ETA and non-ETA communities over the past fifteen years, however, shows that unemployment among ETA communities has consistently remained higher than both the Massachusetts average and the average of non-ETA communities.

An analysis of the difference between average unemployment rates in ETA and non-ETA communities – illustrated in table 4 and graph 3 – shows that between 1993 and 2000 this difference narrowed from a high of 2.3% in 1993 to a low of .70% in the years 1999 and 2000. However, two important factors should be considered when considering this trend: first, the Massachusetts economy as a whole recovered during this period, reducing average unemployment rates across the Commonwealth. Secondly, and perhaps more importantly, throughout the 1990s the legislature significantly amended EDIP to allow more communities to gain ETA certification. Thus, the perceived “reduction” in the difference between average ETA unemployment and average non-ETA unemployment is likely due, in part, to the addition of ETAs that, by their nature of being included under the legislature’s more relaxed guidelines for ETA certification, enjoy historically low rates of unemployment.

Table 4: Unemployment Differences between 1990 and 1995

| | | | | | | | | |
|---|------------|------------|------------|------------|------------|------------|------------|------------|
| Percent Difference in Unemployment Rates between ETA and non-ETA Communities. | ‘90 | ‘91 | ‘92 | ‘93 | ‘94 | ‘95 | ‘96 | ‘97 |
| | 1.5 | 1.7 | 1.8 | 2.2 | 2.0 | 1.2 | 1 | 1 |
| | ‘98 | ‘99 | ‘00 | ‘01 | ‘02 | ‘03 | ‘04 | ‘05 |
| | 0.9 | 0.7 | 0.7 | 0.9 | 1 | 1.4 | 1.2 | 0.8 |

Graph 3: Percent Change in Unemployment Rates between ETA and Non-ETA Communities



EDIP and interjurisdictional competition

In September of 2006, Ohio governor Bob Taft made a personal visit to Boston in an attempt to persuade Massachusetts biotechnology firms Genzyme Corp., and Alkermes, Inc. to consider Ohio for future business expansions. Conceding that a personal sales pitch from a governor to individual out-of-state corporations was an unusual event, Taft remarked to the Boston Globe: “It’s really competitive out there, and there’s no substitute for governors actually going themselves. A governor can really get in the door. At each stop, I’ll be saying, ‘you should invest more in Ohio,’” (Gavin, 2006). Following Taft’s visit, the Associated Industries of Massachusetts, a lobbying organization representing hundreds of Massachusetts employers, raised an immediate alarm, prompting the Romney administration to highlight recent successful corporate

recruiting efforts – including the commitment of New York based Bristol-Myers Squibb Co. to build a \$660 million drug factory plant in Devens – and a recent \$2 million budget increase for the state’s Office of Business Development (Gavin, 2006).

As Governor Taft’s visit reveals, competition, whether real or perceived, undoubtedly exists between states for the location of businesses. Governor Taft tellingly referred to his personal visits to out-of-state businesses as “domestic trade missions.” Touting the recent decision of state officials to overhaul Ohio’s corporate income tax, Taft’s personal ‘trade missions’ have been accompanied by a \$500,000 advertising campaign aimed at promoting Ohio’s new commitment to drafting employers to the Buckeye State. As noted in Chapter 2, a common critique of tax-incentive oriented economic development policies is that they force state and local governments to compete for businesses by offering ever-greater tax reduction packages (Schneider 1989; Fleischmann, Green, Kwong 1991). Has EDIP realized similar pernicious effects in the Commonwealth of Massachusetts? In order to answer this question, we must distinguish between two distinct inquiries: first, does EDIP reflect a reaction to perceived economic competition, and if so has it exacerbated this phenomenon; and, secondly, has EDIP lead to increased competition with other states for business activity?

To answer the first question – does EDIP represent a conscious reaction to economic competition from other states – it is unambiguously clear, from my discussions with individuals affiliated administering EDIP in addition to comments made in the public record, that one reason Massachusetts officials employ EDIP is out of a perceived “threat” of losing prospective businesses to neighboring states and even neighboring towns. In fact, this sentiment is virtually unanimous at the both state and local level.

When asked if EDIP was necessary for Massachusetts to “stay competitive” with other states, EDIP director Bob Foley unhesitatingly responded that this was “absolutely” so, highlighting similar commercial cost reduction programs in the states of Ohio and the Carolinas. Similarly, in responding to Inspector General Gregory Sullivan’s previously mentioned public criticism of EDIP the Associated Press quoted Department of Revenue commissioner Alan LeBovidge as saying, “I think [EDIP is] a necessary program because most states have some kind of program like this. If we’re going to be competitive, we have to offer things that other states offer,” (Emery, 2005).

Local officials have expressed similar anxiety regarding the specter of interstate competition. Testifying before the Joint Legislative committee on Community Development and Small Business in June of 2005, Cassandra Acly, the director of economic development for the town of Southbridge, urged legislators to expand EDIP “because Connecticut is aggressively competing with us,” (Dignam, 2005). Even the corporations that make a habit of seeking these tax-breaks seem aware of the this: New England Economic Development Corporation president Harold Davis, who served as a consultant to Target when the firm sought tax-breaks under EDIP for its multiple locations in Massachusetts, stated to the Patriot Ledger that “[The tax breaks] probably won’t change the decision to go into a region, but it might change what town to go into,” (Adams, 2005).

Davis’ remarks help answer a third question regarding EDIP’s impacts on interjurisdictional competition, namely whether or not the program has aggravated competition for business recruitment at the local level. When asked to consider abstractly if the “race to the bottom” witnessed between states on the national level could likely be

repeated between towns on the local level, law Professor Peter Enrich indicated that such a possibility “certainly” existed. Local government officials similarly agree: Plainville Town Manager Joseph Fernandes, speaking about the town’s previously mentioned experience with TIF requests from retailers Target, Lowes and Cabelas, commented: “Whether Plainville eyes competition from [neighboring cities] Mansfield, or Worcester, or at the state level from the Rhode Islands and the South Carolinas, I think given the fact that [tax-incentive programs are] out there, that the genie’s out of the bottle, you have to deal with it. You have to be prepared to hold your own or up the ante as necessary.”

Discussion

The research presented here demonstrates three things: first, that EDIP has had no apparent positive impact on business development, as measured in terms of the number of commercially taxable properties in ETAs; secondly, that EDIP has done little to close the discrepancy in the unemployment rates between ETA and non-ETA communities; and finally, that EDIP is, in fact, reflecting – and possible exasperating – subsidy-oriented competition between Massachusetts municipalities, and between Massachusetts and other states, for businesses.

A note on the research that is missing here and necessary to be completed in the future is warranted. The claim that property-tax abatement programs are necessary and effective in rehabilitating “blighted” areas must be tested empirically, with data specific to Massachusetts and the EDIP program. Because the statutory definitions of the terms “blighted,” “decadent” and “sub-standard” are ambiguous, researchers must find ways to measure blight in manner that is objective and measurable such as the percent change in commercial vacancy rates in ETAs and EOAs. Additionally, it would be interesting to

determine whether or not EDIP has demonstrated an ability to perform better in some communities than in others. Research should be conducted, for example, to determine if larger ETAs have proven more effective in promoting business development than their smaller counterparts, or if poor communities have been more successful in reducing unemployment than wealthier ones.

Chapter Five: Ten Recommendations for Immediate Reform

At his 2001 confirmation hearing, former U.S. Secretary of the Treasury Paul O'Neill gave a candid – and often quoted – opinion on the business community's perception of tax incentives. "As a businessman," Secretary O'Neill stated, "I never made an investment decision based on the tax code. If you give money away I will take it, but good business people don't do things because of inducements," (Enrich, 2006).

Indeed, critics of tax-incentive programs often note that property taxation, on average, represents no more than one percent of a businesses overall costs. Conversely, the revenue generated by property taxation pays for most services – public schools, police and fire departments, library services and more – provided by local governments in Massachusetts. But if empirical research has repeatedly shown corporate subsidy programs to be excessively expensive for municipalities and states, and generally fruitless in terms of realizing significant, measurable gains in employment or revenue (see Chapter 2), then why do policymakers insist on continue to resist their abandonment? Timothy Bartik writes that "the emphasis on tax breaks for large new facilities and expansions has a strong political rationale. A ribbon cutting at a new plant or plant expansion attracts attention. Providing a tax break allows a governor or mayor to take credit for good news. Much of the cost of this tax break may be deferred to the future" (Bartik, 1994). Professor of law Peter Enrich agrees: when asked if tax-incentive programs were a simple example of political expediency trumping sound economic policy, his unhesitating answer was "undoubtedly."

As long as policymakers continue to employ tax-incentive oriented economic development policies in Massachusetts, a greater emphasis on stricter oversight and more

stringent compliance must be implemented. Following are ten recommendations specific to EDIP for Massachusetts policymakers to consider. These reforms are neither new nor untested; indeed, all of the following proposals have been discussed at length in the relevant literature and many have been implemented by municipalities seeking greater control over their ability to use tax-abatements to spur economic development. Together, these proposals have the potential to dramatically enhance EDIP's ability to improve the quality of living in Massachusetts' neediest communities

1. Develop and Implement a “But For” Clause

Who: Legislature

Most state legislation allowing for business tax-abatements in return for private investment requires the benefiting company to publicly demonstrate that moving into the incentive-offering community would be economically impermissible without the abatement in question. Such a stipulation – commonly referred to as a “but for” clause – is missing from EDIP and should be amended to the program's original legislation. Requiring that businesses seeking subsidization make their case directly to voters or their elected representatives seems is common sense; after all, families seeking public assistance for subsidized healthcare or disability benefits are expected to demonstrate their eligibility. Businesses should be held to the same standard.

In essence, if enacted, a “but for” clause would shift the burden of proving the necessity of a tax break from the voter or elected official to the TIF-seeking company. Such an amendment would set a precedent that favors granting tax breaks to smaller businesses – local grocery stores, medium-sized manufacturing firms – rather than larger retailers such as Target or Cabela's unlikely to prove the necessity of public assistance.

It should be noted, however, that in practice “but for” clauses are unlikely to prevent all conceivable abuse of EDIP’s tax-incentive program, particularly by large companies whose available resources far exceed those of individual ETAs. The town of Plainville, for example, maintains no individual person or body responsible for coordinating economic development; rather, Plainville shares an individual position with the entirety of Norfolk County. For this reason, all materials and presentations submitted in order to prove the economic necessity of a tax-incentive should be made public and subject to Massachusetts’ Open Meeting law (see recommendation number four).

2. Prohibit Publicly Subsidizing Poverty

Who: Municipal officials, Legislature

It is within the purview of municipalities that are paying for jobs by forgoing property tax revenue to demand that those jobs meet certain standards, the most obvious of which would be a requirement that they do not cost the state *additional* money by unduly relying on publicly sponsored healthcare, housing or other services.

EDIP can be amended in a number of ways to require that businesses receiving tax breaks compensate their employees in such a manner that the municipality is not unwittingly subsidizing poverty. This could include requirements that tax abatement receiving companies pay their employees living wages, or that they choose between offering employees health care or paying a fee for publicly funded health care services.

3. Require Constant Short- and Long-Term Oversight

Who: EACC, Legislature

In attempting to influence the marketplace by providing financial incentives to relocating businesses, the Commonwealth has adopted the methods of private business – yet what business never conducts analyses of its large expenditures to determine if its

investments are materializing the expected benefits? Rather than conduct comprehensive reports every ten-years, Massachusetts should conduct *yearly* analyses of EDIP with the explicit goal of comparing exactly how much money – in both forgone local property taxation and investment tax-credits – was spent on EDIP in the following year, and how much new revenue – state and local – is attributable to EDIP created jobs.

By allowing individuals ETAs to neglect their responsibility to collect job creation data for years, the EACC failed in their responsibility to safeguard the EDIP program from possible abuse. Had the EACC been conducting yearly assessments of EDIP, this blatant deficiency would have been more likely to pique concern by interested parties years earlier. In short, more timely data will allow regulators to respond to unforeseen challenges within months, rather than years.

4. Develop and Implement Meaningful Criteria for ETA Certification

Who: Legislature

By constantly relaxing the guidelines by which communities may participate in EDIP, the Massachusetts legislature has greatly expanded a program once intended for judiciously targeting needy communities, thereby weakening any real incentive for businesses to relocate in economically distressed neighborhoods. If the legislature intends on making EDIP work for the communities it was originally intended, it should move swiftly to restrict the criteria for achieving ETA status.

Simply capping the number of ETA communities at an arbitrary chosen level would be an unwise reform at this point given the fact that the majority of Massachusetts communities are now certified for EDIP participation. The legislature should, instead, develop new criteria for ETA certification and require the EACC to annually review community data to ensure accurate municipal compliance with the new criteria. If a

community fails to meet the criteria, the municipality and the state should continue to honor existing tax-abatement agreements, but the municipality should be prohibited from entering into new tax-abatement agreements for the following year.

What should the new requirements include? The legislature could begin by looking towards the metrics discussed in this paper such as unemployment, percent changes in business activity and commercial vacancy. The legislature should also consider using measures of aggregate wealth such as average income or residential property value in a community, and develop a threshold that excludes wealthy communities from participation.

The dynamics of political representation will likely make any effort at limiting ETA certification an exceedingly difficult task to accomplish. Thus, the legislature may wish to couple the proposal of more stringent ETA certification standards with an appropriate incentive – such as a one-time bonus in local aid – for those communities likely to lose their ETA status.

5. Develop and Implement Immediately Triggered Clawback Provisions

Who: Legislature

Barring unforeseen external economic forces that negatively impact business activity, CPs that fail to uphold previously agreed upon levels of investment or job creation should immediately lose their eligibility to receive property tax abatements and tax investment credits. Currently, municipalities that believe a CP has failed to deliver either the additional investment or employment required by participating in EDIP must either attempt to renegotiate the tax agreement with the CP or request that the EACC intervene to decide whether decertification is appropriate. This seems logically inconsistent: if the state allows individual towns the ability to enter into tax-abatement

agreements with CPs, then the state should grant those towns the ability to cancel the agreements as well without having to first seek state approval. Moreover, significant precedent exists for attaching performance-based “money-back guarantees” to tax incentive programs: according to one source, “nineteen states and dozens of cities already use clawbacks for at least one program” (LeRoy, 2005).

Immediately triggered clawback provisions ensure that the standard of investment-for-tax credits will apply in an absolute and indiscriminate manner to all companies participating in EDIP; they need not, however, be permanent. Rather, the legislature can devise these clawback provisions in such a way that the CP’s eligibility is merely suspended until such time that the CP returns to compliance.

6. Prohibit Companies from Receiving Tax Credits Retroactively
Who: Legislature

The entire notion of a business location “incentive” is to influence an undecided corporation into locating or expanding in a particular community. While the merit (in terms of benefit and utility) of utilizing tax incentives to persuade *undecided* businesses to consider locating in a municipality is debatable, providing tax “incentives” in instances where firms companies have already made clear commitments to developing properties (either by purchasing the property, or seeking the appropriate permits) clearly violates the entire notion of an incentive. On the contrary, these after-the-fact payments amount to little more than rewards to private companies for making a decision they would have made anyway.

The Legislature must amend EDIP to prohibit firms from seeking tax “incentives” in instances where a business has already decided to relocate or expand. This will

prohibit companies from using the threat of abandoning unfinished projects as leverage against for tax rewards against towns.

7. Prohibit Awarding Credits to Companies that Compete for Parcels

Who: Legislature

The primary function of EDIP is to reward businesses for choosing to locate in economically distressed areas of Massachusetts that would otherwise appear to business executives as less desirable locations. How do policymakers know whether or not an individual locality strikes business leaders as undesirable for investment? The obvious answer is whether businesses are competing, or have competed, to purchase or develop the location in question. Such instances represent successful market transactions at work; tax-payer funded rewards for the company who successfully outbids its peers for a parcel of land are redundant and unnecessary.

As written, EDIP allows for tax-incentive packages to be awarded to any company otherwise eligible to develop real estate located within an ETA, regardless of whether or not the company actually competed for the land in question. In the previously mentioned AMG and Manulife cases, for example, both companies that received EDIP tax-credits successfully outbid other companies for the parcels in question, but maintained their eligibility to participate in EDIP based on their decision to locate within ETAs.

If the legislature is unwilling to meaningfully rewrite the criteria municipalities must meet to achieve ETA status, it should at least move to prohibit the awarding of tax credits in instances where normal marketplace forces collude to produce successful results.

8. Encourage More Citizen Input
Who: Municipal administrators, Legislature

Requiring that TIF and STA agreements ultimately be approved by Town Meeting ensures that tax-payers have the final say over where, when and how their dollars are spent. The route to Town Meeting, however, is often marked by closed-door sales pitches and agreements held between mayors or other town managers and companies seeking public assistance. Similarly, crowded Town Meeting warrants combined with a public lack of knowledge on the length, cost and provisions of a particular TIF agreement are a recipe for hasty – and costly – decisions.

Engaging more citizens in the process of the designing and awarding of a tax incentive, rather than simply the tax-incentive vote, can be achieved in multiple ways. The EACC should first require that meetings between corporate entities and public officials in which a request for tax-credits will be discussed be held to the standards of Massachusetts’s Open Meeting law. When city councils debate spending tax dollars to pave a road or hire additional personnel, or a school committee debates raising fees or initiating programmatic changes, meetings must be both held in public and advertised two days in advance. The forgone property taxes typically associated with long-term TIF agreements often represent revenue significantly larger than the costs associated in the previously mentioned examples – thus, requiring corporate sales pitches to be public will allow tax-payers and media outlets to hear and publicize the proposals long before a final vote is required by Town Meeting.

Similarly, voters can and should have more of a voice in designing tax-incentive packages than a simple “yes” or “no” vote at Town Meeting. The legislature should amend EDIP to require that ETAs, in return for their eligibility to participate in EDIP,

form permanent tax-incentive study committees whose members' sole responsibility is to study abatement requests and make recommendations to Town Meeting. Reasonable provisions could be included that requires these bodies to consider only those tax incentives sufficiently large enough to necessitate this review process. The legislature would be wise to set guidelines regarding the composition of such a body and encourage stakeholders from each town service – school committee, infrastructural administrators, financial advisory boards – impacted by a TIF agreement to seek a seat on the board.

9. Require Site Location Consultants to Register as Lobbyists

Who: Secretary of State, Legislature

Corporations typically hire outside representatives to help broker a deal between a community and the company and these site location consultants often operate, in part, on commission. When the purpose of these consultants is to persuade local officials into granting the relocating company significant tax breaks then they are engaging in direct lobbying, albeit of a non-traditional manner. Massachusetts lobbying law, however, currently excludes requiring these corporate representatives to register with the Secretary of State's Office.

Currently, citizens can search the online database www.sec.state.ma.us/lobbyist to find information on which lobbyists are working for what companies and how much they are compensated for their efforts. Despite the fact that site location consultants, similarly to conventional lobbyists, are paid (often in the form of a commission) to convince public officials that their clients deserve preferential treatment, citizens have no method of tracking their activities. Recognizing site location consultants as lobbyists will keep taxpayers better informed about who is representing what corporation's interests and which public officials are listening.

10. Study Methods of Separating the 5% Investment Credit from Local Property Tax Abatements

Who: EACC, Legislative Committees on Economic Development

As mentioned, Massachusetts maintains a three percent investment tax credit on tangible depreciable assets for all state manufacturers irrespective of location. Companies participating in EDIP, however, qualify for a five percent investment tax credit in addition to local property tax relief. Although EDIP was intended as a state and town partnership, the five percent investment credit often represents a larger, more lucrative tax-break than a local community's property tax abatement. Town officials are cognizant of this, and often find themselves compelled to grant a small property tax abatement simply for the company to qualify for the larger five percent investment credit. This seems disingenuous and inconsistent with the goal of allowing the Commonwealth and the participating ETA to jointly share the burden and rewards of EDIP.

. The legislature should first seek to determine the extent of this problem on the local level and then consider solutions such as separating the two tax breaks or creating separate thresholds (a new classification of truly needy communities, for example) for the five percent investment tax credit.

Summary

These proposals stem from the belief that oversight, local autonomy, transparency and strictly enforced compliance – among both municipalities and companies – will improve the ability of local officials and businesspersons to realize sustainable economic development in their communities. Some reforms proposed, such as separating the investment tax credit from the tax increment financing, could fundamentally alter EDIP's design and require significant further research before

implementation. Others, such as prohibiting retroactively applied tax breaks and tax breaks to companies that successfully compete for parcels, are commonsense and should be applied with haste. Individually, each should be debated, questioned and improved upon by policymakers and citizens throughout the Commonwealth. Taken together, they should be viewed as a broader argument for more conscientious public supervision of Massachusetts' Economic Development Incentive Program.

Conclusion: National Implications

During the course of my interviews, I spoke with a senior Massachusetts economic development official affiliated with EDIP who requested anonymity after the interview because of the candor with which he spoke. The official told me that he had watched *Cuno v. DaimlerChrysler* with great interest and had in fact hoped that the Supreme Court would decide *in favor* of the plaintiffs and rule tax-incentive programs such as EDIP constitutionally impermissible. I was incredulous: essentially, the official told me that he hoped the program he was responsible for administering would be immediately terminated! “To be intellectually honest,” he told me, “I wish these programs didn’t exist. We have the intellectual capital to compete with the Carolinas and the Ohios,” he said, “and these programs give them an unfair advantage. We have to [use EDIP] to simply level the playing field. But do I think it’s a good thing? Of course not.”

This paper focuses exclusively on a particular state program, but it would be negligent to avoid a discussion of EDIP and Massachusetts’s various tax-incentive programs in a national context. In the introduction to this paper, Plainville Town Administrator Joe Fernandes is quoted jokingly comparing state tax incentives to nuclear weapons. Though obviously exaggerated, the analogy is relevant in the following sense: possessing nuclear capabilities is clearly in a country’s national interests, but nuclear proliferation is clearly *not* in the world’s best interests. Tax incentives programs follow the same logic: even if one accepts that tax-incentive programs give an individual state a comparative advantage over other states, they offer the nation at large nothing other than a net loss of revenue. Moreover, multinational corporations by their sheer size are even less likely than domestic firms to consider local property taxes as a determining factor in

location decisions. Thus, once a firm, domestic or multinational, decides to relocate or expand in a given area, what national benefit does the country receive by allowing two states or two cities to outbid each other in tax incentives? The cost, conversely, is stark: forgone revenues or outright expenditures represent tax dollars that could otherwise be spent on infrastructure, education, or other economic development policies proven to generate future benefits. This point of view, as evidenced by my conversation with the EDIP official, is prevalent not only among scholars, but even among policymakers and bureaucrats responsible for administering tax incentive programs. What can be done to move from frustration with the current system to reform?

The previously listed ten proposals for reform are good first steps for Massachusetts, but they are incremental and unlikely to change national policy. Peter Enrich has advocated a compelling argument for Federal oversight by citing the Constitution's explicit mandate that Congress, not the states, shall regulate interstate commerce. Jurisprudence has not affectively addressed Enrich's argument: the Supreme Court's decision to not grant standing to Ohio taxpayers in *Cuno v. DaimlerChrysler* merely skirted this complex and difficult question. Regardless of future Court decisions, Congress should accept its constitutional duty and work to find legislative solutions to this "race to the bottom."

Options are available for state legislatures as well. States could, for example, approve non-binding resolutions that would terminate their tax-incentive programs effective immediately upon similar resolutions being approved in other states. This way, no one state places itself at a disadvantage by being the first to remove their tax incentive programs.

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Appendix One: List of Interviews

The following individuals generously answered questions regarding economic development policy, tax policy and Massachusetts' Economic Development Incentive Program. I thank them for their willingness to share their insight on behalf of this project.

1. Peter Enrich, Professor of Law at Northeastern University.
2. Joseph Fernandes, Town Manager of Plainville Massachusetts.
3. Bob Foley, Program Director of the Economic Development Incentive Program.
4. Stephanie Mercandetti, Economic Development Coordinator for Norfolk County.
5. An anonymous Massachusetts official affiliated with the Economic Development Incentive Program.

Appendix Two: Definitions of “Blighted Open Area,” “Decadent Area,” and “Sub-standard Area.”

A “Blighted open area” is a predominantly open area which is detrimental to the safety, health, morals, welfare or sound growth of a community because it is unduly costly to develop it soundly through the ordinary operations of private enterprise by reason of the existence of ledge, rock, unsuitable soil, or other physical conditions, or by reason of the necessity for unduly expensive excavation, fill or grading, or by reason of the need for unduly expensive foundations, retaining walls or unduly expensive measures for waterproofing structures or for draining the area or for the prevention of the flooding thereof or for the protection of adjacent properties and the water table therein or for unduly expensive measures incident to building around or over rights of way through the area, or for otherwise making the area appropriate for sound development, or by reason of obsolete, inappropriate or otherwise faulty platting or subdivision, deterioration of site improvements or facilities, division of the area by rights of way, diversity of ownership of plots, or inadequacy of transportation facilities or other utilities, or by reason of tax and special assessment delinquencies, or because there has been a substantial change in business or economic conditions or practices, or an abandonment or cessation of a previous use or of work on improvements begun but not feasible to complete without the aids provided by this chapter, or by reason of any combination of the foregoing or other conditions; or a predominantly open area which by reason of any condition or combination of conditions which are not being remedied by the ordinary operations of private enterprise is of such a character that in essence it is detrimental to the safety, health, morals, welfare or sound growth of the community in which it is situated.

A “Decadent area” is an area which is detrimental to safety, health, morals, welfare or sound growth of a community because of the existence of buildings which are out of repair, physically deteriorated, unfit for human habitation, or obsolete, or in need of major maintenance or repair, or because much of the real estate in recent years has been sold or taken for non-payment of taxes or upon foreclosure of mortgages, or because buildings have been torn down and not replaced and in which under existing conditions it is improbable that the buildings will be replaced, or because of a substantial change in business or economic conditions, or because of inadequate light, air, or open space, or because of excessive land coverage, or because diversity of ownership, irregular lot sizes or obsolete street patterns make it improbable that the area will be redeveloped by the ordinary operations of private enterprise, or by reason of any combination of the foregoing conditions.

A “Sub-standard area” is an area wherein dwellings predominate which, by reason of dilapidation, overcrowding, faulty arrangement or design, lack of ventilation, light, or sanitation facilities, or any combination of these factors, are detrimental to safety, health, morals, welfare or sound growth of a community.

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