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Implementing Tax Abatements in Michigan: A Study of Best Practices

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Because the use of tax abatements to foster local economic development is widespread despite uncertainty about their effectiveness, is it possible to allocate abatements in a way that increases the likelihood that tangible benefits will result? This research suggests that few municipalities place conditions on abatements, most never evaluate the performance of firms granted abatements, and abatement requests are seldom or never rejected. The project focuses on the implementation of tax abatements, explores the use of tax abatements over a relatively long time period, and makes explicit policy recommendations for more effective policy implementation. Changes in state enabling legislation targeting abatements to distressed areas and adding requirements for evaluation may produce more effective use of abatements at the local level.

Keywords: *tax abatements; local economic development*

Probably more has been written on the use of tax incentives as economic development tools than on any other growth policy. In part, this is because of their widespread use. But there is also considerable controversy about their effects. Extant research suggests that too often tax abatements are granted to firms with little consideration of costs and benefits, to the detriment of the community. Costs appear to be significant although benefits are, at best, uncertain (Hood, 1994; Lynch, Fishgold, & Blackwood, 1996; Peters & Fisher, 2004; Schwarz & Volgy, 1992; Wassmer, 1994; Wassmer & Anderson, 2001). However, it has been suggested that there *are* cases where tax incentives can stimulate development when used under the right circumstances. The necessary conditions for this success seem to be that the abatements are granted based on a careful assessment of costs and benefits and when accompanied by performance requirements that ensure local benefits in return (Bartik, 1991; Calzonetti & Walker, 1991; Goss & Phillips, 2001; Gramlich, 1997; Premus, 1982; Rubin, 1991). Although not widespread, there is some research that indicates that a few cities implement tax abatements only after a careful assessment of likely outcomes and impose conditions, clawbacks, or performance guarantees (Reese & Rosenfeld, 2002).

If the use of tax abatements continues to be widespread despite the uncertain results, is it possible for communities to act strategically to allocate abatements in a way that increases the likelihood that tangible benefits will result? In an effort to answer that question, this project examines the implementation of industrial property tax abatements by municipalities in the state of Michigan.

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Two sources of data are employed: (a) a database of all Public Act (PA) 198 industrial property tax abatements granted in Michigan between 1980 and 2001, and (b) a survey of cities, villages, and townships in Michigan focusing on the use and implementation of a variety of economic development tools including tax abatements.¹ The analysis addresses the following research questions:

- (1) To what extent do municipalities in Michigan utilize the following recommended practices in granting PA 198 tax abatements:
 - assessment of costs and benefits before granting an abatement,
 - attachment of strings or performance requirements to the award, and
 - evaluation of the outcomes of abatements granted.
- (2) What kinds of municipalities in Michigan evidence the above best practices as part of their abatement decision process?

In short, this research adds to the extant literature by focusing on the implementation of tax abatements, exploring the use of tax abatements over a relatively long time period, and making explicit policy recommendations for more effective policy implementation.

WHAT WE “KNOW” ABOUT TAX INCENTIVES

Tax incentives, such as the PA 198 abatements examined here, have consistently evidenced mixed results in evaluations of their effectiveness. For example, surveys of recipients of tax abatements have generally reported that the incentives were effective in influencing the location decisions of firms, and thus generating economic growth (Calzonetti & Walker, 1991; Premus, 1982; Rubin, 1991). Other assessments, however, have concluded that incentives were basically ineffective in stimulating local economic growth (Schmenner, 1982). Much of the conflict in the evaluation literature on tax abatements stems from (a) differing research methodologies, (b) variation in the operationalization of “success” or effectiveness, (c) differences in geographic scale of analysis, and (d) the differing time periods evaluations have spanned.

Fisher and Peters (1998) and Goss and Phillips (2001) provide excellent meta-analyses of tax policy evaluations, categorizing methodologies into five types: surveys, case studies, general equilibrium models, hypothetical firm analyses, and econometric analyses. Overall, surveys, case studies, and econometric modeling have produced conflicting findings on the efficacy of tax abatements in stimulating development, however defined. Hypothetical firm analyses have suggested that tax incentives can increase company profitability, but they do not allow for an assessment of the contribution to local economic growth. To date, general equilibrium models have not generated sufficient findings to summarize them (Goss & Phillips, 2001).

A number of different indicators have been used to measure abatement outcomes. These commonly include employment, underemployment, job growth, firm profitability, average wages, average poverty rates, business relocation, business retention and expansion, intercity competition, and property values. The indicators have been measured at various levels of analysis—local, county, region, and state—limiting generalizability across studies.

Evaluation literature also shows effects of the time periods studied. For example, research from the 1980s, which typically did not employ regression or modeling methodologies, has most often been negative on the effects of tax incentives (see, e.g., Ahlbrandt & DeAngelis, 1987; Ambrosius, 1985; Kale, 1984; McCalley & Silkman, 1982). Much of this research concluded that economic development activity often was a zero-sum exercise, leading to unhealthy intercity competition (Glickman & Woodward, 1989; Hovey, 1986). The most positive work of this period suggested that tax abatements may be useful in certain limited circumstances (Warner, 1987). Research questioning the benefits of tax incentives extends across the 1990s, although with less consistent findings as methodologies become more robust and divergent in type.

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As suggested above, some studies support tax abatements as a positive facilitator of economic development. Proponents of tax incentive programs contend that the new investment and additional indirect and induced spending produce total revenues sufficient to improve the overall economic welfare of citizens (Goss & Phillips, 2001) and that abatements can improve underemployment in slack labor markets (Gramlich, 1997). In one evaluation, tax abatements appear to have had a positive and statistically significant impact on economic growth for low-unemployment counties but no significant impact on economic growth for high-income counties. This suggests that tax incentives *can* be used to more evenly spread development across jurisdictions within a state, but only if targeting is part of the incentive legislation (Goss & Phillips, 2001). Bartik (1991) has provided similar findings, measuring the effect of state and local fiscal variables on economic development and concluding that local taxes and expenditures exert a significant influence on the level of economic activity observed in a region.

Many studies, however, have documented that even when there are positive outcomes, tax abatements have not achieved the levels of growth desired, and they may have negative secondary impacts. For example, Hood (1994) concludes that because abatement packages offered to large corporations are so extensive, state and local burdens on the average small business owner or residential taxpayer increase because of the need for highways, access roads, water and sewer lines, and other infrastructure in anticipation of company relocation. Frequently, the relocated company fails to generate significant economic or employment gains, or they relocate again before local benefits can trickle down, thus distorting labor and consumer markets (Hood, 1994).

Similarly, Lynch and colleagues (1996) found that tax incentives do not increase economic development and impose significant costs in terms of forgone revenue to municipalities and states. Indeed, this study clearly suggested that incentives did not cause firms to relocate to the state offering them (New York in this case), because other location criteria are more important and taxes compose only a small portion of business expenses. Thus, the authors concluded that firms would have remained in place, or even expanded, absent the incentives. As a result, job growth reports were overestimated, cities were “pirating” jobs from each other, and the incentives actually reduced jobs among firms not receiving them (Lynch et al., 1996). Research in this vein highlights significant collateral damage from perhaps misapplied tax incentive systems.

On a more narrow scale, it appears that abatements fail to have an additive impact on overall business activity (Wassmer, 1994), and any positive effects are short-lived, occurring only in the time period right after the tax incentive program begins. For example, in a Detroit-area study, manufacturing property tax abatements were found to increase property values in only 1 year (the earliest, 1977) of a longitudinal study. By 1984, 1987, and 1992, there were no salutary effects of manufacturing property tax abatements, and commercial tax abatements had no effects in any time period (Wassmer & Anderson, 2001).

In a recent meta-analysis of tax incentive evaluations, Peters and Fisher (2004) found three studies that showed at least minor benefits, an equal number that showed no discernable impacts of incentives, and four that showed completely ambiguous effects. Even after four decades of research, there is no consensus on whether tax incentives have any effect at all. In summary, they note, “the best case is that incentives work about 10 percent of the time, and are simply a waste of money the other 90 percent” (p. 32).

The issue of whether abatements really work as economic development tools almost becomes moot when the number of communities using them is considered. For good or ill, the reality is that the use of abatements is widespread in many states. Eisinger (1988) suggested that traditional supply-side incentives such as tax abatements would be used less frequently over time, and Clarke and Gaile (1999) also predicted that cities would become more entrepreneurial, although acknowledging that this would not be a “wholesale conversion” (p. 173). Research based on panel data from the 1980s to the early 1990s, however, suggests little had changed in local economic development practice; cities were simply doing more of what they always had been doing to foster local economic development (Reese & Fasenfest, 1996). More recent research on development incentives during the 1990s and into the early 2000s clearly indicates that the use of tax abatements is alive and well in cities across the United States. For example, in the mid-1990s, tax policies were the seventh most commonly used economic development strategy, and by 2001, they had risen a

notch to the sixth most relied upon local technique. Overall, 54% of cities in the United States were using tax abatements and other tax incentives, at least to a moderate extent, to attract and retain business investment (Reese & Rosenfeld, 2004; Reese, Rosenfeld, & Fasenfest, 2002). The level among Michigan cities for the same time period is even higher, at 68%.

BACKGROUND AND DATA

The Origins and Evolution of PA 198

The restructuring of the global economy in the early 1970s prompted local and state public officials across the country to react with economic development incentives. Against this background of global change, the passage of PA 198 resulted from very specific circumstances. The Chrysler Corporation threatened to discontinue rehabilitation of its dilapidated Mack Avenue stamping plant on Detroit's east side. State and local officials, in an effort to reduce further economic hemorrhaging, responded to Chrysler's threat by passing the industrial property tax abatement law (Sands & Zalmezak, 2001).

The tax abatement process in Michigan allows a local government unit to establish a plant rehabilitation district or an industrial development district, or both, if it levies taxes that equal or exceed 30 mills. The establishment of the district may be initiated by the locality or at the request of the owner of the industrial property located within a proposed district. The eligible industrial property may consist of both real and personal property related to a manufacturing operation under the same ownership, including office, engineering, research and development, warehousing or parts distribution facilities, and research and development laboratories of suppliers to manufacturers. The local government must approve or disapprove the application within 60 days. If approved, the state issues an industrial facilities exemption certificate, and the applicant must comply with several requirements before tax benefits are realized:

- The restoration, replacement, or construction of the facility has not occurred earlier than 1 year before filing for the application;
- The facility will create employment, retain employment, or prevent loss of employment in the community in which the facility is situated;
- The activity primarily has the effect of restoring, replacing, or updating the technology of obsolete industrial property—not merely the addition of new machinery and equipment; and
- The abatement shall not exceed 5% of the total state equalized valuation of the local governmental unit unless the local government and the state determine such an amount shall not substantially impede the operation of the local government or impair its financial soundness.

The tax abatement may be granted for a maximum of 12 years from the completion of the facility, although the local legislative body may grant the abatement for a shorter time period. The abatement can be revoked if the industrial facility improvements or construction are not complete within 2 years or if the company leaves the area.

Eligible property within the district, although exempt from the general local property tax levies, is subject to an "industrial facilities tax." The amount of this tax, in the case of a replacement facility, is determined by applying the community's total millage rate by the state equalized value of the real and personal property of the obsolete industrial property for the tax year preceding the issuance of the tax exemption certificate. In essence, the company pays taxes based on the obsolete property, not the improved property. For investment in new real or personal property, the company is required to pay half of the property taxes that would be paid if not granted an exemption.

PA 198 has been a popular program with both firms and local governments. From 1980 through 2001, 721 of Michigan's 1,773 local governments (40% of the total) granted one or more PA 198 tax abatements. During this 21-year period, 137 municipalities granted only one industrial property tax abatement, and an additional 72 provided only two abatements. At the other extreme, the city of Grand Rapids granted 522 abatements, an average of 1 new abatement every 2 weeks. The

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top 5 Michigan communities in terms of total abatements granted (Grand Rapids, Holland, Holland Township, Detroit, and Wyoming) gave 13.5% of all abatements. The 35 communities granting the most abatements provided more than 6,000 abatements, almost 44% of the total.

Based on the projections provided in the abatement requests, the abatements were expected to generate private investment of more than \$53 billion. About 80% of this total represents investments in personal property (machinery and equipment). New real property investments were projected at more than \$11 billion. For the most part, the emphasis of abatements was on saving jobs. Firms receiving abatements indicated that more than 800,000 manufacturing jobs would be saved by the abatements, and almost 210,000 new jobs were promised.

The Data

The data for this study come from the files of the Michigan Economic Development Corporation (Douglas Drake, personal communication, July 11, 2002) and its predecessor agencies. The tax abatement data cover all abatements awarded from 1980 to 2001 and include the number of abatements, projected real and personal property investment, and projected retained and created jobs. Census data for the years 1980, 1990, and 2000 were also added to the abatement set.

A survey was conducted by the authors to assess tax abatement processes in communities across the state and to gain information on other economic development policies because abatements are only part of a community's overall development program. During the first half of 2003, questionnaires were mailed to the chief executive officer in all villages ($n = 262$) and cities ($n = 273$) in the state; response rate for cities was 30% and for villages 17%. Because of the large number of townships in the state ($n = 1,242$), a random sample of 312 was drawn, representing their proportion among municipalities in the state; response rate for townships was 21%. These response rates are comparable to most surveys of local development officials. For example, recent surveys of local economic development officials conducted by the International City/County Management Association (ICMA, 1989, 1999) had response rates of approximately 30%.

Responding communities are significantly larger in population than nonrespondents (see Appendix A). This probably results from the significant positive correlation between population size and the number of abatements granted (coefficient = .68, significant at .01). Communities responding to the survey are very likely those that are more active in development policies generally and in offering tax abatements in particular. Indeed, many communities called or e-mailed in response to the survey indicating that they did not implement any economic development policies, and these again tended to be less populous villages and townships. However, because the focus of the research is on the implementation of tax abatements, the response bias should provide a better sense of what those active in abatements are actually doing.

It is not surprising that the municipalities that completed the survey were much more likely to have granted abatements than was the case for the general population of local governments. As indicated in Table 1, the survey respondents generally gave more abatements per municipality, an average of about 1.5 per year, compared with slightly fewer than 1 per year for all municipalities. The amount of promised investment was also higher for sample communities, for both the average and median per community. The individual abatements granted by municipalities responding to the survey typically attracted more than \$1 million in total investment, whereas for all municipalities, just over half of all abatements were of this magnitude.

ANALYSIS

Abatement Best Practices

At the outset, a discussion of what would constitute best practices for granting tax abatements is useful. From a policy perspective, what should local governments consider before they grant a tax abatement? The earlier literature review points to several issues. Abatements appear to be successful in certain circumstances—in cities with high fiscal stress or where the marginal costs of doing

TABLE 1
Public Act 198 Activity in Sample Municipalities

	Sample Municipalities	All Municipalities
Abatements per municipality	30.8	19.6
Average investment per community (\$ million)	98.3	73.2
Median investment per community (\$ million)	12.8	4.5
% less than \$1 million investment	8	47

business are critically high, in limited or focused geographic areas, for firms that would not have located in a stressed city under normal market conditions, or for firms that serve an employment or skill niche compatible with the local population. This suggests, then, that processes need to be in place to assess whether those conditions are met. Thus, at a very minimum, a best practice would entail a policy spelling out guidelines or requirements to determine whether an individual firm should receive an abatement. In other words, it is assumed that under best practice conditions, some firms would not be granted an abatement.

Another integral part of a codified system for granting abatements would include “strings” or “clawbacks” (Ledebur & Woodward, 1990), which would impose sanctions if the conditions of the abatement—whether it be jobs, number of local hires, or length of operation in the community—are not met. Such clawbacks might include returning some or all of the value of the abatement to the community or paying some other kind of “reparation.” Thus, best practices would require that communities actually evaluate the outcomes of the abatement. Did the firm hire the requisite number of local workers? Did it create the promised number of jobs? Were the jobs of the quality or nature anticipated? The answers to some of these questions should be quite obvious; that is, did the firm stay in town for the time agreed to? But other indicators, such as job creation or local population composition in hiring or contracting, would be more opaque and would require systematic evaluation on the part of the locality. The following section examines to what extent these best practices are in place in Michigan municipalities.

First, many municipalities report having explicit guidelines governing the granting of tax abatements; in 31% of the communities these guidelines are formally codified (see Table 2). Another 40% have informal or unwritten guidelines, and 30% have no guidelines at all. An obvious concern about unwritten guidelines is that they may be unevenly applied, making it hard to convince any individual firm that they are indeed a requirement. However, the fact that 40% of respondents indicate that conditions are placed on *all* abatements suggests that even the informal guidelines are being applied, at least in some form. Still, 32% of communities never place conditions on abatements, reflecting a bimodal distribution in which conditions are either used regularly or not at all.

When performance conditions are placed on abatements, they are most likely related to the total number of jobs created; 45% of those that apply conditions always make the number of jobs a condition. More than 30% of communities placing conditions on abatements focus on the length of time the firm must stay in the locality and the amount of capital investment. Few municipalities make the quality of jobs or local hiring a requirement.

Although this evidence of best practices seems relatively positive—there are a number of communities that have policies governing the granting of abatements and many appear to consider the total number of jobs produced in awarding an abatement—the fact that few abatement requests are ever turned down may be cause for concern. In 88% of the municipalities that have granted abatements, requests are seldom or never rejected. Although it is possible that all requests for abatements are meritorious, this result may also imply that regardless of guidelines and potential benefits, most communities in Michigan grant all requests for abatements.

The evaluation picture is not much more promising (see Table 3); 55% of municipalities do not evaluate the outcomes of their abatements, and another 28% evaluate only occasionally. Of those actually conducting evaluations, it appears that several outcomes are considered with about the same frequency: number of jobs, amount of capital investment, and increase in the tax base. Still, these data suggest that for most communities, even if conditions are placed on the abatement (

... a best practice would entail a policy spelling out guidelines or requirements to determine whether an individual firm should receive an abatement . . . [and] would require that communities actually evaluate the outcomes of the abatement.

TABLE 2
Guidelines and Conditions

Are there policies or guidelines governing the granting of tax abatements? (% of $n = 124$)					
No					30
Yes, informal/unwritten					40
Yes, formal/written					31
How frequently have requested abatements been denied? (% of $n = 133$)					
Never					48
Seldom					40
Occasionally					10
Regularly					3
How frequently are conditions placed on abatements? (% of $n = 127$)					
	<i>Never</i>	2	3	4	<i>Always</i>
	32	12	9	7	40
How frequently are these conditions based on (% of $n = 89$)					
	<i>Rarely</i>	2	3	4	<i>Always</i>
Jobs	8	11	21	15	45
Tenure	28	10	9	12	38
Amount of investment	29	8	13	18	32
Quality of jobs	44	16	16	11	13
Local hires	57	14	14	8	7

typically on the numbers of jobs created), there are no mechanisms in place to assess the extent of job creation after the fact. Given this, it would be almost impossible to institute any clawbacks or impose other penalties if the abatement conditions were not met. And it is entirely possible that firms know going in that it is likely they will not be held accountable for any lack of performance on abatement conditions.

Finally, there appears to have been little change in abatement practices over time; 85% of communities have either made no or only marginal changes to their requirements, whereas only 4% of communities have added requirements to their abatements and 11% have actually relaxed requirements. Clearly, then, there neither appears to be any particular dissatisfaction with abatement practices within communities in the state nor has there been any trend toward making firms more responsible for investment decisions after the fact.

Best Practice Communities

It is important to understand what types of communities are more likely to use best practices with regard to granting tax abatements in the hopes that such attributes might be exploited in other municipalities, thereby increasing the use of such practices. To that end, correlations were run between an index measuring the extent of best practices present in communities² and a number of other variables: three decades of census profiles, form of government, extent of abatements granted during a 20-year period, and a number of survey questions related to other economic development practices as well as funding and growth profiles. Again, best practice communities are those that have written guidelines or criteria for issuing abatements, regularly or always place performance conditions on firms receiving abatements (e.g., hiring goals/quotas or tenure requirements), and evaluate the costs and benefits of abatements after the fact (e.g., the actual number of jobs generated or retained). Several municipalities in the state—Center Line, Grand Rapids, Hillsdale, Livonia, Rothbury, and St. Johns—evidence all of these best practices.

In general, a best practice community had a higher median income and lower poverty rate in 1980, lower unemployment and a larger population overall, and higher property values by 2000

TABLE 3
Evaluation Policy

Does municipality evaluate cost/benefits of abatements? (% of <i>n</i> = 118)	
No	55
Yes, occasionally	28
Yes, always	17
Effectiveness is evaluated on (% of <i>n</i> = 65)	
Number of new jobs	85
Increase in tax base	78
Number of retained jobs	76
Value of investment	71
Have your abatement policies changed? (% of <i>n</i> = 146)	
Relaxed regulations	11
Little or no change	85
Added requirements	4

(see Table 4). In short, communities using best practices in Michigan are more likely to be healthy and growing.

These are also the communities most likely to be granting abatements in all years of the program (see Table 5). Data on the number of abatements granted were organized into four time periods that also roughly correspond to economic cycles in Michigan: 1980 to 1985, 1986 to 1990, 1991 to 1995, and 1996 to 2001. The municipalities that consistently granted more certificates in every time period were also more likely to be using good abatement practices. That size and fiscal health are related to best practices is not surprising, given that the data also indicate a significant positive correlation between economic health, population size, and the total number of abatement certificates granted during two decades.³

Communities using best abatement practices pursue an interesting mix of other economic development policies (see Table 6). First, it is clear that they are not engaging in more economic development strategies across the board. Those communities with high scores on the Best Practice Index are significantly more likely to be engaging in 16 of the economic development policies included on the survey. There is no significant correlation between the Best Practice Index and the remaining 17 policies.⁴

The list of policies below includes a number of activities that are more entrepreneurial or demand-side in nature, according to Eisinger's (1988) classification: export market development, foreign business attraction, and provision of technical assistance to firms. Also included are several Type II or progressive policies (Goetz, 1990; Reese, 1998) that are designed to ensure that the benefits of development accrue to the community or particular segments of the community: linkage programs, performance guarantees, and requirements that firms train local workers. Thus, although there are several traditional location incentives included in the list—streamlined permitting process, tax increment finance authorities, and infrastructure investment—best practice communities also seem to be generally progressive and entrepreneurial in their overall approach to development.

Few other community attributes appear significantly related to good abatement practices. The only feature of local government structure related to best practices suggests that nonpartisan elections appear to enhance good abatement practices. Because Michigan is a reformed local government state, however, most cities and villages have nonpartisan elections (all townships have partisan elections). Communities with best practices are significantly more likely to have an overall economic development plan and are more likely to evaluate development policies generally. Otherwise, no other features such as funding for economic development, budget and staff size, and type of community (center city, rural community, edge city) have a significant relationship to abatement practices.

A regression analysis was run with the Best Practice Index as the dependent variable and all of the variables just noted as significant included as independent variables. The results are provided in Table 7. To simplify the analysis and reduce multicollinearity among several of the independent

TABLE 4
Census Correlates of Best Practice Index

	1980	1990	2000
Higher median household income	.24*	.18	.15
Higher median housing value	.18	.19	.20*
Lower poverty rate	-.23*	-.10	-.11
Lower unemployment rate	-.23*	-.11	-.29*
Larger population	.35**	.36**	.32**

*Significant at .05. **Significant at .01.

TABLE 5
Correlation of Abatement Profile and Best Practice Index

<i>Higher No. of Certificates</i>	<i>Coefficient</i>
1980 to 1985	.36**
1986 to 1990	.32**
1991 to 1995	.37**
1996 to 2001	.38**
Total	.36**

**Significant at .01.

TABLE 6
Correlation of Economic Development Policies and the Best Practice Index

General profile	
Economic development plan	.36**
Evaluation policies	.34**
Nonpartisan elections	.22*
Progressive policies	
Targeted employment	.29**
Export market development	.34**
Foreign business attraction	.32**
Linkage programs	.23*
Performance guarantees	.38**
Worker training	.28**
Traditional policies	
Industrial development districts	.27**
Business ombudsman	.37**
One stop	.35**
Promotion	.21*
Site inventory, marketing	.36**
Tax policies	.37**
Technical assistance	.30**
Tax increment finance authorities	.22*
Firm visits	.37**

*Significant at .05. **Significant at .01.

variables (primarily the census data and economic development policies), several additional indexes were created (see Appendix B). Only a few of the correlates previously discussed remain significantly related with best practices in the multiple regression. Cities with greater household wealth as reported in the 2000 census, that engage in more progressive economic development policies generally, that make development decisions in a more classic "rational planning mode" (i.e., based on a planning document, analysis of options, and evaluation of outcomes), and that offer more abatements in total are more likely to use best practices in granting abatements. Together,

TABLE 7
Good Practice Index Regression Analysis

	B	β	Significance
Household wealth	.21	.20	.02
Rationality	.23	.24	.02
Progressive policies	.23	.24	.01
Total 198 certificates	3.861E-03	.20	.03
Constant	-.22		.03
$R^2 = .31$			

these variables account for 31% of the variance in the Best Practice Index. In short, healthy, growing communities are more likely to offer abatements and are more likely to use best practices in doing so. Such communities are also more likely to use a broad array of progressive economic development policies.

The analysis of cross-sectional data indicates that those municipalities most likely to benefit from tax abatements (as a presumed result of requiring that firms create jobs and invest in the community for the long run) are those that are better off generally, that is, those that are growing and have the budgetary resources to devote to planning and evaluation. The foregoing analysis identified the correlates of best practices with the goal of finding characteristics that could be manipulated by changes in state enabling legislation. That municipal fiscal health appears so important in the use of best practices may narrow, but does not eliminate, the range of factors amenable to change through state policy. Making changes in enabling legislation to target abatements to stressed communities seems a logical first step. Even with better targeting, however, localities could be encouraged or required to adopt aspects of best practices.

CONCLUSIONS AND PUBLIC POLICY PERSPECTIVES

The good news here is that 71% of municipalities in the sample have some sort of guidelines for granting tax abatements and 31% of these have policies that are fully codified. Furthermore, 40% of the respondents indicate that they place conditions on all requests for abatement. The number of jobs generated or retained, the length of stay in the community, and the value of the property or personal investments are commonly applied conditions.

Unfortunately, the survey suggests far more bad news than good for abatement practices in Michigan. Almost one third of municipalities have never placed any conditions on abatements. When conditions are placed on abatements, communities do not appear to be focusing on the quality of jobs or the proportion of local residents hired. This suggests that the concept of community goals embodied in the conditions is too narrow. If jobs are created but are low paying or if the development creates other negative externalities (pollution, congestion, or higher crime, e.g.), have development goals really been met? Similarly, if nonresidents get most of the jobs although current residents and businesses are subsidizing the tax expenditure, there is a significant equity issue related to who bears the costs and who reaps the benefits.

That a majority of municipalities never evaluate the performance of firms granted abatements suggests that firms can ignore any conditions that are placed on them and that clawbacks or other reparations will never be assessed because the community lacks performance data. And because there has been little change in abatement practices over time, communities are not likely to start embracing model policies in the near future.

Another cause for concern, however, is that in 88% of the responding municipalities, abatement requests are seldom or never rejected. This implies that even where there are conditions, they seldom provide a basis to deny abatements. Presumably, their main purpose, then, is to provide political cover for the decision to grant an abatement. The correlation and regression analyses strongly suggest that community wealth translates to sufficient staff and budgetary resources to produce

The analysis . . . indicates that those municipalities most likely to benefit from tax abatements (as a presumed result of requiring that firms create jobs and invest in the community for the long run) are those that are better off generally, that is, those that are growing and have the budgetary resources to devote to planning and evaluation.

generally high levels of planning and evaluation, encompassing tax abatement best practices. This implies that best practices may be something only well-off communities can afford, and it is also the case that municipalities using best practices are significantly more likely to have higher retained- and new-job and investment figures.⁵ Although the lines of causality here are very unclear—do best practices lead to better outcomes or are better outcomes and policy codetermined by city wealth?—this suggests that community wealth may foster best practices, which then generate further community wealth. Simply put, the rich get richer.

The use of property tax abatements to attract and retain jobs and investments is likely to remain a staple of local government economic development policy in Michigan and other states for years to come. In many communities, abatements will continue to be offered with little regard for their effectiveness or efficiency in the use of public resources. But selectively reducing the burden of local property taxes seems to provide the greatest benefits to prosperous firms and prosperous communities, raising serious questions of equity.

The results here suggest that individual local governments are unlikely to seriously address these equity questions. Even when lip service is paid to using abatements only at the margin (offering a tax break only when it is necessary) or when some clear public benefit is expected, the reality is typically less impressive. A number of communities indicate that they are concerned with evaluation of their economic development policies; few of them, however, rigorously evaluate the outcomes or modify their behavior as a result.

This suggests that the problem is not just one of lack of knowledge about the importance of evaluation or the lack of resources to undertake monitoring of actual performance. Rather, for most local elected officials, the benefits derived from announcing that they have acted to preserve or attract jobs and investment are paramount. Few local officials want to risk being perceived as indifferent to their communities' economic well-being by turning down abatement requests.

If the prospects of improvements in tax abatement policies at the local level seem bleak, state enabling legislation may provide a venue for change. Although this article reflects only the experience of a single state, because of the extensive use of tax abatements by Michigan municipalities, the findings illustrate the challenges in implementing such state-side incentive programs. Requiring that local communities grant abatements only on demonstration of necessity (so-called but-for requirements) or that abatements be tied to minimum levels of investment or employment could encourage communities to be more selective in their abatement activity. The state of Michigan currently imposes conditions on some of the tax break programs that it administers directly, such as the Michigan Economic Growth Authority program. Similar policies could be incorporated in the statutes governing PA 198. Although no panacea, requiring best practices could encourage local communities to be more serious in their evaluations.

Another possible legislative change would be to increase the targeting of the property tax abatements, focusing on communities that have demonstrated that they face difficulty in retaining and attracting jobs. At present, some of the economic development programs in Michigan give preference to about 85 "core" communities that exhibit high levels of distress. In an effort to focus investment in areas already served by infrastructure, the Michigan legislature is currently debating the creation of "commerce centers" that would be likely to greatly expand the list of communities that would be targeted. This survey suggests that most communities, particularly those that are highly distressed or small populations, are unlikely to adopt and effectively utilize best practices. If the state does pursue the adoption of new targeting criteria, this might provide an opportunity to institutionalize best practices, especially by incorporating state technical assistance programs to support these efforts.

Most of the industrial property tax abatements that have been granted in Michigan during the past two decades have involved relatively small investments. There have been a number of large-scale investments that clearly have an impact on the regional and perhaps even the state's economy. The responsibility for granting property tax abatements for these large projects might be reserved to the state rather than delegating it to local governments. The burden of monitoring and evaluating these larger projects would then rest with the state. For investments of less than some threshold amount, monitoring and evaluation could remain a local concern. Setting the threshold at \$10 million in total projected investment would have given the state responsibility for evaluating fewer

than 1,000 (less than 7%) of the abatements granted between 1980 and 2001; a minimum project size of \$5 million would have involved just 11% of all abatements granted during this period. A policy change of this sort would ensure that at least the larger tax expenditures (forgone taxes) are assessed and monitored rather than being left to the vagaries of intermunicipal competition.

Several questions remain for consideration. Equity issues, in terms of indicators of community prosperity and racial composition, deserve more implicit attention. The extent to which meaningful performance evaluations are carried out should be examined. Although the database includes information on investments and job generation associated with each abatement, these data are projections drawn from application files. The extent to which actual outcomes match projections is a critical question about the overall effectiveness of PA 198 in the state and needs to be assessed.

In a perfect world, there would be little need for property tax abatements or other economic development incentives to increase equity and efficiency. Given the complexities of economic development in metropolitan markets in Michigan and elsewhere, it seems likely that tax abatements and other incentives will continue to be used extensively. This review of the Michigan industrial tax abatement program suggests that even if incentives continue to be widely used, modest changes could be made to increase their effectiveness and efficiency. Such changes, however, are unlikely to occur if discretion is retained at the local level.

APPENDIX A

The full census profile of respondents and nonrespondents is as follows:

	<i>Sample</i>	<i>Population</i>
2000POP	9,363	5,757
1990POP	11,061	6,123
980POP	10,978	6,085
MEDINCOME00	40,997	42,080
MEDINCOME90	28,552	29,798
MEDINCOME80	17,464	16,897
MEDHOUSE\$00	100,563	102,196
MEDHOUSE\$90	56,627	53,920
MEDHOUSE\$80	38,174	36,328
%BLACK00	2.750E-02	2.027E-02
%BLACK90	2.848E-02	1.859E-02
%BLACK80	2.487E-02	1.637E-02
%POV00	9.925E-02	9.133E-02
%POV90	0.12	0.12
%POV80	9.61E-02	0.11
%UNEMPLOY00	2.895E-02	2.946E-02
%UNEMPLOY90	5.672E-03	1.182E-02
%UNEMPLOY80	7.927E-03	1.611E-02
TOTHOUSEHOLD00	3,649	2,195
TOTHOUSEHOLD90	4,201	2,255
TOTHOUSEHOLD80	3,865	2,102
TOTOWNERUNITS00	2,590	1,620
TOTOWNERUNITS90	2,909	1,603
TOTOWNERUNITS80	2,779	1,527

NOTE: POP = population; MED = median; POV = poverty; UNEMPLOY = unemployment; TOT= total.

Communities responding to the survey are significantly larger than the population. They also have more total households and housing units. However, median household income and housing values are quite comparable, indicating similar levels of economic health between the sample and population of communities. The sample cities have slightly higher exponentials for unemployment, particularly in the earlier years.

APPENDIX B

Indexes were created in cases where several of the correlates of best practices were related to each other (i.e., to reduce multicollinearity). Factor analysis yielded the following indexes:

	<i>Factor Loading</i>
<hr/>	
Progressive Policies Index	
Service/impact fees	.75
Require worker training	.77
Expand public services	.52
Performance guarantees	.63
Local/targeted employment requirements	.69
Eligible local assessing districts	.64
Neighborhood enterprise zones	.49 ^a
Rationality Index	
Formal economic development plan	.83
Systematic evaluation of policy impact	.83
Family Wealth Index 2000 ^b	
% not in poverty	.85
% employed	.58
Median household income	.96
Median housing value	.92

a. Although not quite loading at .50, this technique was included because it represents an entrepreneurial focus on neighborhood development.

b. Only 2000 census data were used here because relationships were identical for 1980 and 1990 data.

NOTES

1. Although the focus on a single state may limit generalizability of findings, there are several reasons to believe that the Michigan case is instructive for other states and localities: the widespread eligibility and use of abatements among municipalities, the untargeted nature of Public Act 198, the long-term presence of the program, and the inclusion of both new and rehabilitative construction, making a wide range of investments eligible for abatement.

2. All of the elements of best practice discussed were entered into a factor analysis. For the factor analysis, the standard SPSS default modes were employed including varimax rotation, listwise deletion of missing data, and principle components analysis. A .50 or higher loading was the criterion used for inclusion in a factor. No variable loaded on more than one factor. Factor scores were converted to *f* or standardized scores and added to create an index score. The analysis resulted in the following:

<i>Best Practice Index</i>	<i>Factor Loading</i>
<hr/>	
Written guidelines	.57
Frequency of performance conditions	.84
Evaluate cost/benefits of abatements	.67

3. Correlations between size and total abatements are as follows:

	<i>1980 Population</i>	<i>1990 Population</i>	<i>2000 Population</i>
<hr/>			
Total tax abatements	.63**	.63**	.68**

**Significant at .01.

4. For clarity of presentation, only the policies significantly correlated with the Best Practice Index are shown in the table. Complete correlation analysis is available from the authors upon request.

5. Correlation coefficients with best practices are as follows:

Total real property investment	.288*
Total personal property investment	.27**
Total new jobs	.31**
Total retained jobs	.36**

*Significant at .05. **Significant at .01.

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