Informing the Debate

The Michigan Economic Development Toolkit

Finding Policies That Matter

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Cities throughout North America are increasingly faced with the challenge of retaining and attracting employment, and thus residents, to ensure their continued vitality. Those in Michigan are no exception. The State of Michigan has been enabling local economic development incentives since the 1970s and development policy is on the agendas of almost all municipalities in the state, at least to some extent. Several general observations can be made about the field of economic development policy as a whole. First, absent a uniform and robust understanding of the dynamics of local growth, economic development policies have largely been driven by fads and fashions, as policy-makers emulate strategies employed in other communities. Second, a general absence of analysis and evaluation, either before or after the application of economic development tools, has served to trap local officials into these fads because they lack information about which policies should be pursued and which should be stopped or forgone entirely. Third, because every state and municipality is different and because there is no "one best way" to stimulate growth that applies to every case, the reliance on widely used policies and the lack of evaluation combine to virtually guarantee that economic development tools are less effective in their application to specific local goals and conditions. Fourth, conceptions of what constitutes an economic development tool or incentive tend to be narrow and are most commonly focused on efforts to offset the perceived disadvantages of a location or to make an already attractive place more so, through combinations of subsidies and abatements to lower the costs of living for residents and production costs for businesses. Finally, as a result of all of these factors, economic development policies tend to be highly path dependent; older techniques continue to be used even while new ones are added. The end result is often a scattershot approach to growth with limited benefits at high cost to local communities.

This report constitutes an assessment of five of Michigan's local economic development programs: Cool Cities Grants and Planning Programs; Industrial Facilities Tax Abatements; Renaissance Zones; Tax Increment Financing Authorities; and MEGA (Michigan Economic Growth Authority) grants. These specific tools are the focus of the research for several important policy and theoretical reasons:

- Their widespread use;
- Their availability to a broad spectrum of Michigan municipalities;
- Statewide data availability;
- The inherently different natures of these tools in terms of public costs and their potential effectiveness in diversifying Michigan's economic base and generating healthy communities for residents of the State.

In addition to the five economic development programs enabled at the state level, local spending for a variety of basic government functions, including economic development, is also considered. These data provide a local context for the programmatic assessment and broaden the definition of what constitutes a local development strategy.

This review of economic development incentives and strategies excludes federal programs such as empowerment zones, enterprise communities, and foreign trade zones. This was done because the focus is on local programs and there is only very limited representation of these programs in the State. For example Michigan had only one empowerment zone (Detroit), two enterprise communities (in Clare and Lake Counties), and six foreign trade zones (Battle Creek, Detroit, Flint, Kent/Ottawa/Muskegon Counties, Sault Ste. Marie, and St. Clair County (CRC, 2007).

The primary questions addressed in this project are: What contributions do each of these programs make to the economic health of municipalities in the State? In a time of increasingly limited state and local government resources, which economic development tools appear to offer the greatest potential contribution to prosperous local communities? Are there other types of local activities that might be more effective in contributing to local economic prosperity? What do the findings suggest for economic development in Michigan?

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<u>Executive Summary</u>

The summary below is organized by the various economic development and government spending policies detailed in the full report (see Figures 4 and 5).

Tax Abatements: There are no significant relationships between economic health and the use of tax abatements, regardless of which factor is considered the independent variable. In other words, consistent with extant research on Michigan municipalities, there is no relationship between the health of a city and its use of PA 198 tax abatements, and there is no relationship between past use of tax abatements and future economic health or changes in health. In short, abatements are completely unrelated to economic health as measured in this report.

Cool Cities Grants: there are several significant relationships between the use of Cool Cities grants and the economic health of Michigan cities. First, more economically stressed cities received more Neighborhoods in Progress and Blueprints for Downtown grants. And, the use of these grants is significantly correlated with improvements in economic health over time.

Tax Increment Finance Authorities: In most cases, there are no significant relationships between the use of TIFA and economic health. Poorer cities have tended to exhibit greater use of downtown development authorities, however use of DDAs does not appear to have eased the economic stress in these cities. For the other TIFA programs, there is no relationship between program use and health.

Renaissance Zones: Cities with poorer economic health have used RZs to a greater extant and this is related to improved economic health over time.

MEGA: There are no relationships between the use of MEGA and economic health.

Government Spending: There are a number of significant and positive relationships between government spending and economic health. Spending for public safety, recreation and culture, and general government services and buildings is positively correlated with economic health. Additionally, investment in instruction and support services in local public schools also shows consistent and positive relationships with economic health. Although per capita education spending does not appear to be positively correlated with economic growth over time it is important to note that research has not found consistent relationships between gross spending levels and educational quality in terms of test scores. Clearly, many factors in addition to money lead to a quality public education system. Yet, the consistent positive correlations between graduation rates and economic health support the contention that local school quality is an important element in local prosperity.

Figure 4: Incentive Summary

Incentive	Relationship to future health	Relationship to change in health
Tax Abatements	None	None
Cool Cities		
Neighborhoods in Progress	Negative	Positive
Main street	None	None
Blueprints for Downtowns	Negative	Positive
Blueprints for Neighborhoods	None	None
TIF		
Local development Finance Authorities	None	None
Community improvement areas	None	None
Brownfield Redevelopment Financing Authorities	None	None
Tax increment Finance Authorities	None	None
Downtown Development Authorities	Negative	None
Renaissance Zones	Negative	Negative
MEGA	None	None
Government Spending		
General government	Positive	Positive
Public works	None	None
Economic Development	None	None
Public Safety	Positive	Positive
Recreation/culture	Positive	None
Education	Positive	Negative

Combinations of Development Incentives: Of the 17 combinations of economic development programs examined, 12 have either negative or no relationship with economic health, with the latter predominating. The combinations that appear to offer some promise include: doing all types of incentives; utilizing no incentives at all; Tax Increment Finance Authorities (TIFA) and Renaissance Zones (RZs); MEGA, TIFA, abatements, and Cool Cities; and, RZs and MEGA. Doing all types of incentives appears to have had positive results for only the very sickest cities and it has not allowed them to make health improvements relative to other cities in the state.

Figure 5: Strategy Summary

Incentive Combination	Relationship to future health	Relationship to change in health
All	Negative	Positive
TIF, IFT, RZ, Cool	None	None
MEGA, TIF, IFT, Cool	None	None
MEGA, RZ, Cool	None	None
RZ, Cool	None	None
MEGA, IFT, Cool	None	None
IFT, Cool	None	None
IFT, RZ, MEGA	None	Positive
IFT, RZ	None	None
TIF, RZ	None	None
MEGA, TIF, IFT	Positive	Negative
TIF, IFT	Negative	None
MEGA, IFT	None	None
IFT	None	None
MEGA, TIF	None	None
TIF	None	None
MEGA	Positive	Negative
None	Positive	None

<u>Caveats</u>

Before policy recommendations are offered a number of caveats must be raised about the limitations of the data and analysis contained in this report. These are delineated below.

- The variables measuring combinations of economic development incentives simply indicate whether a particular number or combination is used, not the extent to which it is used. It is possible that very high and intensive use of all incentives (large numbers of large abatements, many TIF districts with a lot of land for example) would be more effective.

- Much census data for 2010 is not available.
- Causation cannot be ascertained with certainty even with the comparison of past incentive use to current economic health due to the inability to identify an instrumental variable which would allow the establishment of cause.
- Absent an experimental design it is impossible to determine what would have happened without the use of development incentives in the cities that rely on them heavily. It is possible that cities like Detroit and Benton Harbor would be even worse off absent the use of incentives.
- The findings here apply only to cities in the state. Townships also use many of these development incentives at high rates. Indeed, this is particularly true of tax abatements. Based on past research including townships it seems safe to conclude that the findings including them would be very similar, however (see Sands and Reese, 2012).
- Related to the above, because the criteria for inclusion was incorporation as a city, there is wide variation in population size from Lake Angeles to Detroit.
- It should be remembered that the health measure used here is residential economic health. Other measures of economic wellbeing might elicit different results. Further, only relative health is measured.
- In some cases such as the Cool Cities program, there are relatively few cities using the incentive. Thus, some significant relationships might be muted in the data; this is unlikely to change the direction of the relationships however. In particular Cool Cities may have had a greater positive effect than is represent here.

<u>Policy Recommendations</u>

The factors most consistently and positively related to economic health are investments in the downtown, spending on basic local public services, and doing no economic development incentives at all. These findings suggest one primary policy recommendation; the wisest course of action for most cities in the state would be to avoid particularized development incentives, particularly those that require tax expenditures, and instead, be thrifty with local revenues to be able to support basic services to residents and allow for investments in place. Using municipal revenues to provide high quality local services, particularly in the areas of public safety, education, recreation, and the arts appears to be the most effective economic development strategy.

There are limitations to this study; most importantly, the lack of controls to determine time ordering and to rule out other local forces that logically effect residential health. However, including such controls will not likely create relationships between most of the incentives and health where none exist. It is possible, however, that the problem with incentives lies not in the use of them but in their application. In other words, if incentives were used differently, greater effectiveness might result. Indeed, past research on Michigan's tax abatement and Renaissance Zone programs and national studies of tax increment financing authorities has highlighted how such incentives can be used to greater effect.

It has been suggested that **tax abatements** can be used more effectively if they are targeted, limited, and evaluated (Sands and Reese, 2012). More specifically it is recommended that tax abatements:

- Be limited in their use based on need of the local unit, type of investment proposed, the likelihood of verifiable new jobs, and industry of the firm.
- Incorporate limits on the length of time periods for use, the number of abatements received by the same firms, and on the number of the same jobs supported by abatements.
- Link benefits to performance whereby tax relief is in proportion to the achievement of specific targets involving jobs and investment.
- Include evaluation of requests based on necessity and consistency with local economic objectives.
- Include monitoring of results with mandatory reporting of investment and job creation.

Policy research on **TIFs** has made similar recommendations again focusing on targeting and assessment but also involving community oversight (Sands et al, 2006). Specifically it has been recommended that:

- Designation criteria at both the state and local levels should include findings of blight and "but for" requirements to ensure that TIF districts are being targeted to areas that really need them.
- TIFs should be targeted regarding both which municipalities are eligible to use them and which areas within eligible communities may receive designation understanding that there are some areas so distressed that TIF alone or even in combination with other activities, is unlikely to help.

State enabling statute should require the development of a neighborhood plan that assesses existing deficiencies and outlines steps proposed to address them. If necessary improvements cannot reasonably be expected to achieve objectives, designation as a TIF would not be appropriate. Plans should address site selection, infrastructure or capital plans, process specifications, and public participation.

- Limitations should be considered on the number of TIFs allowed, and the length of time that a TIF district can main in effect.
- TIF governance should involve citizens in project and spending decisions to assure that public needs and goals ar addressed also increasing the transparency of the TIF decision-making process.
- Financial strategies in designating TIFs should be made explicit. Designating some already growing areas as TI districts will allow prior investments to generate revenue that can be used in other locations (if TIF life spans are limited) or contribute to other projects within the initial area.
- Developers should be required to assist with upfront costs via developer notes.

Early research on **Renaissance Zones** made similar recommendations with respect to targeting and assessment (Sands, 2003):

- Communities should make the benefits of zone designation known to current occupants.
- Instead of emphasizing the creation of new industrial parks or reusing derelict sites, zones should be designated so as to include significant amounts of established businesses. Nurturing the local job base may be more effective than efforts to expand it where markets do not exist.
- Municipalities should limit the size of the areas designated as tax free so as to avoid having more space than the market can absorb. The overextension of the zone boundaries results in costs to the State and local governments that produce no direct benefits.
- A more thoughtful and targeted approach to the utilization of this tax benefit is recommended. This would include a negotiated approach, with the geographic area of the zone tailored to a specific development proposal. Tax exemptions should be tied directly to a firm commitment with respect to the amount and timing of investment and job creation. Consideration should also be given to adjusting the length of the zone tax benefits to the amount of investment or job creation. Proposals that would produce few jobs should be given a shorter tax free period.
- Assessments of zones should include: project activity tracking; benchmarking to compare outcomes in the absence of zones, spillovers to areas and businesses outside the zones; resident surveys; the extent of property speculation; additional public costs from the zones; and impacts from an expansion of tax free zones.

In summary, these findings from the state of Michigan suggest that public subsidies in the form of tax abatements, tax increment financing arrangements, and the most extreme tax remission, RZs appear to do little to change local economic fortunes either for better or worse, at least as typically implemented. Recommendations for more effective use focus on better planning and evaluation, targeting, and limitations. While it is tempting to suggest that these types of incentives should be "disenabled" at the state level, it is unlikely that this would be a politically feasible solution given their widespread use and long history. But, it is just as unreasonable to expect that local governments will curtail their use voluntarily even in the face of negative evaluations. As the old saying goes, "if all you have is a hammer, then every problem looks like a nail." Unless limitations are built into state enabling legislation, then municipalities will continue to use these hammers because they are readily available.

A broader understanding of the process and goals of economic development and greater limitations on particularized development tools may foster an environment where local officials look to other ways of fostering fiscal prosperity. Recognizing investment in local services, including public schools, as a potentially effective economic development strategy is a critical first step. Making clear the trade-offs between tax expenditures and the ability to provide high quality local services is another. Exploring how the state might support and enhance the ability of its municipalities to provide essential local services may be the best way to offer local policy-makers a more complete and sustainable toolbox.

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