

**Accountability Mechanisms:
Smart Bombs in the Bidding Wars or False Sense of Security?**

by

Jennifer Gilbert

**Submitted to the Department of Urban Studies and Planning
in Partial Fulfillment of the Requirements for the Degree of**

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ABSTRACT

Reports of multi-state bidding wars for relocating industry are an increasingly common news story. Despite constant academic criticism that such interstate competition is largely ineffectual, politically-motivated and perhaps even counterproductive in the context of a global economy, state and local governments have consistently offered development incentives like tax breaks and favorable financing to lure firms. One commonly suggested remedy to cure the ill effects of bidding for business is accountability mechanisms, state or local level legislation designed to guarantee a defined return from business for the public investment it receives. Recently, organizations like the National Governors' Association have touted this strategy, and states have responded by adopting a broad range of legislation. There has not been, however, significant evaluation of accountability mechanisms. This thesis sets forth the case for using accountability mechanisms, reviews recent state legislation and uses two case studies to highlight design and implementation issues with such measures. I conclude that while accountability mechanisms are a useful, pragmatic approach to interjurisdictional economic competition, recent efforts are somewhat flawed. A more productive approach would include structuring incentive policies to more resemble some aspects of traditional private lending and defending strict adherence to such policies on the basis of the public's current demands for a clear return for its tax dollars.

**Thesis Supervisor: Dr. Paul Smoke
Title: Assistant Professor of City Planning**

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INTRODUCTION

In 1985, seven governors appeared on the Phil Donahue show offering tax breaks, plugging their workforce, and cajoling General Motors to locate its proposed Saturn plant in their state.¹ Besides the talk show appearance, the bidding for the Saturn plant included 38 states² and engendered a children's letter writing campaign as Iowa youths, encouraged by their teachers, wrote to the president of GM asking about the proposed plant.³

Had GM gone searching for a suitor in 1995 rather than 1985, however, the courting might have been quite different. Almost certainly, governors would still be offering development incentives like tax breaks to attract GM. Nevertheless, some governors might have asked GM to produce documentable estimates of the amount of investment they were contemplating, the number of jobs they would realistically create and even the amount of detriment the proposed plant might cause to the state's

¹Rodd Zolkos, *States Decrease Use of Incentives to Lure Business*, Crains Detroit Business, September 3, 1990 at 25.

²H. Brinton Milward & Heidi Newman, *State Incentive Packages and the Industrial Location Decision*, 3 Economic Development Quarterly 203, 216 (1989).

³Richard Brandt, *Wherever GM puts Saturn, it's Going to Get a Sweet Deal*, Business Week, April 1, 1985, at 36. General Motors ultimately sited Saturn in Spring Hill, Tennessee which offered a significantly smaller incentive package than competitors. The impact of the Saturn plant on the local economy has been questioned. Soon after GM announced its plan, a community group in Spring Hill discovered most of the initial jobs at Saturn would first go to GM's union employees, many of whom were laid-off and actively seeking work. In addition, critics complain that the plant destroyed the quiet, rural character of the community with rampant land speculation and made its economy totally dependent on the automaker's financial health. See Carter Garber, *Saturn: Tomorrow's Jobs, Yesterday's Myths in COMMUNITIES IN ECONOMIC CRISIS* 175-189 (John Gaventa, Barbara Ellen Smith and Alex Willinghouse, eds., 1990). Of course, whether Saturn is a success or failure in terms of economic development begs the entire question of this thesis. This lack of definition about what communities expect for their economic development dollar plagues not only the Saturn deal but most economic development incentive programs.

environment.⁴ Other governors might refuse GM tax credits unless the automaker guaranteed above-median wages and health benefits to its full time workers.⁵ Finally, some governors would force GM to promise to repay all or part of the incentives it received should the Saturn plant quickly relocate or fail to meet estimated job creation and investment goals.⁶

Development incentives in the United States have a history nearly as long as the country itself. In 1791, New Jersey granted a tax exemption to a manufacturing company owned by Alexander Hamilton.⁷ Since then, use of development incentives has spread to the fifty states. Nevertheless, it appears a new era is unfolding. Spurred by tight economies, public resentment of hand-outs to industry, and industrial flight, politicians, community activists and even some judges⁸ are increasingly recognizing the need to limit smokestack chasing.

One noticeable result, and the focus of this thesis, is a wave of state-level legislation employing accountability mechanisms for economic development incentives. The premise of these mechanisms is straightforward; if a city or state grants tax abatements or other incentives to lure business and relies on promises of job creation and investment, there should be a defined bargain from the start. Much of the

⁴See, e.g., Iowa Community Economic Betterment Program, Iowa Code §15.313 (1994) in which Iowa gives financial assistance to business based in part on the jobs it projects it will create.

⁵See, e.g., Ala. Code §41-10-44(1994) describing the powers of the Alabama Industrial Development Authority and limiting financing of non-agricultural businesses to those which pay at least \$8 per hour or offer a total compensation of all employees averaging \$10 per hour.

⁶See, e.g., Connecticut New Jobs Tax Credit, Conn. Gen. Stat. §12-217(m) mandating recapture of tax credits granted to firms which do not maintain minimum levels of employment during the six years following receipt of the tax credit.

⁷Roger Wilson, STATE BUSINESS INCENTIVES AND ECONOMIC GROWTH: ARE THEY EFFECTIVE? 2 (1989).

⁸In 1993, national attention focused on Judge Shelton of the Michigan Circuit Court who, in a decision later reversed by the Michigan Court of Appeals, enjoined General Motors from closing its Willow Run plant after the automaker received tax abatements from the town of Ypsilanti in anticipation that the plant would remain in operation. Noting the difficulty local government faces if it attempts to unilaterally disarm and cease using incentives to lure business, Shelton stated "[i]t is..perhaps for the federal government to finally intervene in this area on the basis that a national industrial policy regarding tax subsidies is needed. *Charter Township of Ypsilanti v. General Motors Corp.*, 1993 WL 132385 (Mich. Cir. Ct.) 10, 506 N.W. 2d (Mich. App.) 556 (1993), *aff'd* 443 Mich. 879 (1993).

legislation also operates on the premise that the public should be well informed about the value it receives for tax expenditures and be part of the decisionmaking process. These ordinances and statutes include a variety of mandates: notice and hearing requirements prior to granting a tax incentive to an enterprise; forced job or business quality standards (such as wage rates and environmental compliance records) for receiving assistance; cost-benefit evaluation requirements; and penalties on business for failing to fulfill job creation promises or leaving a community during the term of a tax abatement.

Accountability measures appear to be an especially attractive option for local officials concerned about bidding wars. Unlike other approaches to solving interjurisdictional competition, such as compacts or federal legislation, these measures can be implemented unilaterally. At the same time, accountability mechanisms still allow the benefits of interjurisdictional competition and political gain to governmental officials who can claim the high ground of attracting business without being suckered by empty promises. Government groups like the National Governor's Association and labor groups like the Federation for Industrial Retention and Renewal have touted accountability mechanisms as a policy to pull cities and states out of the business bidding deadlock.⁹

However, what little literature exists on accountability mechanisms has been largely descriptive and unflinchingly optimistic about how much such legislation can affect smokestack chasing. My research uncovered no source which attempted to evaluate accountability mechanisms or critique their usefulness. Indeed, I found no source that even looked at what happened after legislation employing accountability mechanisms was passed. That gap prompted this thesis.

⁹See Jay Kayne and Molly Shonka, *RETHINKING STATE DEVELOPMENT POLICIES AND PROGRAMS* (1994); Greg LeRoy, *NO MORE CANDY STORE* (1994)

In this thesis, I will explore the strategy of using legislation to make business accountable for the incentives it receives. Chapter 1 offers an overview of why such legislation is needed. Academic research indicates the incentive approach is ineffective, motivated by political concerns rather than real economic gain and even outmoded for the increasingly global economy. Chapter 2 examines three common strategies aside from accountability mechanisms for controlling the excesses of interjurisdictional incentive competition. Chapter 3 summarizes the most recent strategy for controlling competition, state-level legislation adopting accountability measures. Chapter 4 uses two case studies of early attempts to employ accountability mechanisms as a starting point to evaluate the current crop of legislation. Finally, in Chapter 5, I suggest how policymakers may more effectively structure current laws and begin to approach the politics of changing economic development policy.

CHAPTER ONE: CURRENT LITERATURE QUESTIONS THE VALUE OF INCENTIVES

Introduction: The Increasing Use of Incentives

The modern use of development incentives dates back at least to the 1930s when southern states subsidized new or existing business through various tax-exemption legislation and the construction and lease-back of new plants.¹⁰ Development incentives include a variety of measures which government uses to attract business: tax exemptions (property tax exemptions, tax exemptions for research and development, sales/use tax exemptions on new equipment, etc.); public financing and financing assistance (construction loans, machinery and equipment loans, bond financing, creation of an enterprise loan fund, etc.); and other miscellaneous assistance (job training, site locating assistance, etc.).¹¹ It is not known how much these incentives cost state and local government nationally in terms of spending and tax expenditure. Figures for specific incentives do exist, however, and demonstrate the substantial size of such spending. For example, in 1992, Massachusetts estimated it would exempt \$32.3 million of revenue through its investment tax credit.¹² The Louisiana Coalition for Tax Justice estimated that the Louisiana ten year exemption of industrial property (see Louisiana case study in Chapter 4) exempted \$2.5 billion dollars from local parish revenues between 1980 and 1989 or \$1,483 for every family in the state.¹³

¹⁰*Id.*

¹¹Though outside the range of this thesis, enterprise zones are an economic development policy quite similar in some respects to the incentives described here. England first experimented with the enterprise zone strategy in the early 1980s using lower tax rates and relaxed governmental regulation to attract business to distressed areas. Many states have implemented enterprise zone legislation; the effectiveness of the strategy has been widely debated. See Marilyn Rubin and Edward Trawinski, *New Jersey's Urban Enterprise Zones: A Program That Works*, 23 *The Urban Lawyer* 462 (1991). In addition, some states have used accountability mechanisms in their enterprise zone legislation. See, e.g. Ohio Rev. Code §5709.62 in which Ohio mandates that municipal corporations enter into written incentive agreements with enterprises in economic revitalization zones and creation of a tax incentive review council to review compliance with incentive agreements.

¹²Report on Tax Expenditures, Fiscal Year 1992 Appendix and Governor's Budget, at III-6 (1992).

¹³William Schweke, Carl Rist and Brian Dabson, *BIDDING FOR BUSINESS: ARE CITIES AND STATES SELLING THEMSELVES SHORT?* 21 (1994). The report also noted that almost three-quarters of the projects granted incentives added no new employees and the cost per new job at these projects was \$41,508.

The use of development incentives is increasingly widespread, and it appears competition among states is fattening incentive packages. In a 1988 survey, the National Governors' Association queried state economic development officials about their use of eleven different types of development incentives. Each of the eleven incentives was offered in at least half of the states. Many types of incentives were nearly universal. For example, thirty-five states offered property tax exemptions on land and capital improvements.¹⁴ In surveys of state development officials, the Council of State Government found increases in the use of every type of incentive offered by states between 1977 and 1988.¹⁵ Further, 64% of officials surveyed by the Council felt increasing pressure to offer a "better and better" set of incentives to business.¹⁶

Equally noteworthy (and irresistibly grim) are the anecdotal examples of continued smokestack chasing and the incentive wars it creates. In 1989, Milward and Newman studied six auto plant openings in a relatively narrow swath of the midwestern and southeastern United States and the accompanying state development incentive packages.¹⁷ In 1980, only Tennessee and Georgia actively wooed Nissan. Tennessee offered extensive worker training, road improvements and tax inducements to lure a \$64 million dollar expenditure by Nissan. After subsequent plant expansion and an additional financial incentive package, Milward and Newman estimate state costs at \$11,000 per worker.¹⁸ By 1986, Indiana promised an incentive package of over \$50,000 per worker to recruit an Isuzu-Fuji plant for which a dozen states had vied.¹⁹

¹⁴ Jay Kayne, *INVESTING IN AMERICA'S ECONOMIC FUTURE: STATES AND INDUSTRIAL INCENTIVES* 13 (1992).

¹⁵Keon Chi, *THE STATES AND BUSINESS INCENTIVES: AN INVENTORY OF TAX AND FINANCIAL INCENTIVE PROGRAMS*, 5 (1988).

¹⁶Lee Walker, *THE CHANGING ARENA: STATE STRATEGIC ECONOMIC DEVELOPMENT*, 13 (1989).

¹⁷H. Brinton Milward & Heidi Newman, *State Incentive Packages and the Industrial Location Decision*, 3 *Economic Development Quarterly* 203 (1989).

¹⁸*Id.* at 218.

¹⁹*Id.*

In the most recent auto plant site selection battle, a three state bidding skirmish in 1993 among North Carolina, Alabama and South Carolina for a Mercedes-Benz plant ended with Alabama promising Mercedes over \$300 million in incentives, about \$200,000 for each new job.²⁰ The package included large tax concessions, the state's promise to buy 2500 Mercedes-built vehicles for state use and free advertising in the form of the Mercedes' emblem placed high atop the scoreboard during the nationally televised Alabama-Tennessee football game.²¹ (See Fig. 1.)

The Economic Debate: Do Incentives Work?

At the same time, the preponderance of the literature on the use of development incentives casts doubt on their effectiveness. First, the economic literature offers at best a tepid endorsement of the use of incentives. Second, research in political economy attributes the continued use of tax breaks and other development incentives more to the potential for political gain and bureaucratic need to avoid risk than to any proof that such policies spur economic growth. Finally, recent literature heralding a "third-wave" of economic development policy regards incentives, especially when offered uniformly to any firm, as an outmoded and even counterproductive approach to economic growth in a global economy. Below, I briefly review these three types of academic literature.

²⁰Schweke, Rist and Dabson, *supra*, note 13 at 23.

²¹E.S. Browning and Helene Cooper, *Ante Up: States Bidding War Over Mercedes Plant Made for Costly Chase*, *The Wall Street Journal*, Nov. 24, 1993 at 1.

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Fig. 1

The Mercedes emblem is visible atop the scoreboard.

Location Theory and Analysis

Classic location theory states that three forces affect business location choice: 1) transportation costs which vary according to distances between a producer and its suppliers and customers; 2) input costs such as labor and land which vary from place to place and 3) economies and diseconomies of agglomeration which are a function of the amount of an activity clustered in one area.²² Overall, many of the reasons why business activities locate in a particular place are beyond anyone's control. As noted by Heilbrun:

The explanation [for why business locates where it does] has turned out to depend almost entirely on the existence of irregularities in space, including variations in the physical configuration of the land, discontinuities in the means of transportation, and the facts that resources are localized rather than ubiquitous and climate is not spatially uniform.²³

Location theory is not entirely lost on government officials; they are aware that they cannot change many of the factors Heilbrun mentions.²⁴ Nonetheless, they seem to believe they can change other factors and commonly attempt to influence an enterprise's input costs by offering tax breaks and other incentives.

On a more theoretical level, many argue such interjurisdictional competition through the use of incentives is at best ineffective and at most harmful. Critics claim bidding for business creates a national zero sum game as jobs are shuffled between regions rather than spurring economic growth.²⁵ In addition, business incentives may

²²James Heilbrun, *URBAN ECONOMICS AND PUBLIC POLICY*, 2nd ed., 67-68 (1984) *citing* Walter Isard, *LOCATION AND SPACE ECONOMY* 138 (1956).

²³*Id.* at 86-87.

²⁴When asked to name a factor influencing the Boston economy beyond the control of her agency, Boston economic development chief Marisa Lago replied, "February." *The Interview: Marisa Lago*, *The Boston Globe Magazine* (October 9, 1994).

²⁵*See, e.g.* Robert Goodman, *THE LAST ENTREPRENEURS: AMERICA'S REGIONAL WARS FOR JOBS AND DOLLARS* (1979).

be granted to enterprises that would have located in the area or gone ahead with expansion without the assistance.²⁶ Municipalities may give tax breaks in a uniform amount neglecting to limit inducements to the reciprocal benefit to the community.²⁷ Finally, tax expenditures equal foregone investment in goods such as schools, health care and housing which may be more productive of economic growth²⁸ Failure to invest in public goods, especially schools and physical infrastructure, may in turn be counterproductive to business attraction.

On the other side are commentators like Kincaid who maintains competition is essential to the federal system to control hierarchical and monopolistic tendencies.²⁹ "It has also been argued that the very pluralism and competitiveness of democratic institutions promote economic growth."³⁰ Additionally, arguments flowing from Tiebout's theories contend that variation in local policy surrounding development incentives is efficient, allowing business to search out amenity, the most satisfactory combination of incentives and public services.³¹ Thus, firms act rationally and look for locations which offer them the best mix of costs and services.

Finally, Bartik has defended the practice of offering incentives even if it were as critics like to claim a zero-sum game. Bartik assumes high unemployment areas would feel the most pressure to aggressively offer incentives. Consequently, more incentives would be offered in such areas and more jobs would be created in areas where job opportunities are most needed. Bartik has even gone so far as to suggest that this

²⁶Bennet Harrison & Sandra Kanter, *The Political Economy of States' Job Creation*, 44 AIP J. 424, 429 (1978).

²⁷Michael J. Wolkoff, *The Nature of Property Tax Abatement Awards*, J. Am. Planning Assn., Winter, 1983, at 78.

²⁸Harrison & Kanter, *supra*, note 26 at 429.

²⁹John Kincaid, *The Competitive Challenge to Cooperative Federalism: A Theory of Federal Democracy*, in COMPETITION AMONG STATES AND LOCAL GOVERNMENTS 87-114 (Daphne Kenyon & John Kincaid, eds., 1991).

³⁰*Id.* at 96. Kincaid refers to several studies advocating this position.

³¹See e.g. Albert Breton, *The Existence and Stability of Interjurisdictional Competition*, in COMPETITION AMONG STATES AND LOCAL GOVERNMENTS 37-56,40 (Daphne Kenyon & John Kincaid, eds., 1991) and John Kincaid, *supra*, note 29 at 105.

regional job shifting could reduce inflationary pressures while simultaneously reducing national unemployment.³²

At the same time, empirical research has not uncovered clear evidence that incentives substantially affect location choices. Empirical studies fall into two categories: 1) attempts to understand the location decision process and 2) analysis (often econometric) to determine whether state and local fiscal tax and incentive programs actually have any effect on business location and economic growth.

There is agreement among the researchers concerning the site selection process. First, researchers note most firms satisfy expansion needs by adding space on site or building a branch plant nearby. Putting aside for the moment whether incentives should be offered at all, this finding suggests incentive policies designed solely to aid business relocating from outside an area misdirect resources away from existing firms which may be a better bet for economic growth.³³

When a firm does relocate, research suggests there is a three-part location decision. In the first step, business selects a major geographic region given its current market or management strategy. Next, business compares communities on the basis of factors most important to the type of enterprise. These factors vary but often include such unchangeable factors as proximity of suppliers. In the final stage, more subjective factors become important as specific communities are compared. Here, incentives may exert influence if only to break a tie between communities within the region selected in the first stage.³⁴

³²Timothy Bartik, WHO BENEFITS FROM STATE AND LOCAL ECONOMIC DEVELOPMENT POLICY? 13-14 (1991). As noted below, Bartik also believes empirical research shows fiscal variables do influence firm location behavior.

³³Wasylenko, "Empirical Evidence on Interregional Business Location Decisions and the Role of Fiscal Incentives in Economic Development," in INDUSTRIAL LOCATION AND PUBLIC POLICY, Henry Herzog and Alan Schlottmann, ed., p. 15 (1991).

³⁴Ron Shaffer, COMMUNITY ECONOMICS 70-73 (1989). For a description of a real site search which closely follows this three-part structure, see B. William Dorsey, *Project Rosewood: The Mercedes-Benz Siting Strategy*, Site Selection, Apr., 1994, p. 246.

Empirical research on the general question of whether incentives influence firm behavior is quite contentious and has been called "a journey into both the contradictory and the ambiguous."³⁵ Generally, researchers conclude that state and local tax policies do not effect economic growth significantly and certainly do not carry the weight of factors such as wages, market access and energy costs.³⁶ However, as noted by Wasylenko after review of twelve econometric studies of firm location, "one cannot reject the possibility that fiscal variables may influence firm location."³⁷

Early econometric research suggested incentives and tax policy generally were not significant determinants of business location. In a 1979 study, Carlton examined Dun and Bradstreet data on firm births, deaths, moves, contractions and expansions to create a model of regional industrial location of births in the plastic production, electronic transmitting equipment and electronic components industries.³⁸ Carlton concluded wages matter a great deal in determining births of single establishment firms and pointed to a one percent increase in firm births for every one percent decrease in wages.³⁹ For certain industries, Carlton also found energy costs were a significant effect. However, Carlton's evidence did not demonstrate that taxes were a major deterrent to new business activity. At most, Carlton's models predicted a small negative impact for taxes on new businesses, principally through the effects of property taxes.⁴⁰

More recent econometric analysis does show tax differentials influence location. For example, Papke and Papke compared the after-tax rate of return on a marginal investment in alternative locations and concluded tax differentials could be an important

³⁵Milward & Newman, *supra*, note 17 at 204.

³⁶Wasylenko, *supra*, note 33 at 26.

³⁷*Id.*

³⁸Dennis Carlton, "Why New Firms Locate Where They Do: An Econometric Model," in INTERREGIONAL MOVEMENTS AND REGIONAL GROWTH, The Urban Institute, pp. 13-49 (1979).

³⁹*Id.* at 15.

⁴⁰*Id.* at 36.

locational factor, but noted the influence would vary significantly depending on the type of firm and its corresponding sensitivity to tax rates.⁴¹ Similarly, Wasylenko and McGuire noted total employment growth was slower in states which had a overall tax burden growing at a greater rate than in other states. For wholesale trade, retail trade and finance industries, total employment also slowed with increases in the personal tax rate. However, spending on education, a public service certainly linked to the tax rate, correlated positively with employment growth.⁴²

Recently, researchers have focused on the literature about fiscal variables and location decisions itself as a data set. The results are still contradictory and ambiguous. Bartik has argued that taxes, particularly property taxes, matter a great deal to firm location. In particular, Bartik claims there is consensus in the empirical research; seventy percent of the 57 location studies he reviewed report at least one statistically significant negative tax effect.⁴³ Wasylenko has countered that among Bartik's seventy percent are several studies where variables proved only barely significant. Further, the most recent research has added a time variable. Wasylenko now argues studies show differing effects for incentives in different time periods. He thus suggests during periods of increasing global competition (the current condition) state fiscal variables are less influential.⁴⁴

Political Economy Theory: What to do When the Research Says Your Tools Don't Work

⁴¹James Papke & Leslie Papke, *Measuring Differential State-Local Tax Liabilities and Their Implications for Business Investment Location*, National Tax Journal, Vol. 39, No. 3 at 357 (1987).

⁴²Michael Wasylenko and Theresa McGuire in "Jobs and Taxes: The Effects of Business Climate on States' Employment Growth Rates," *National Tax Journal*, 38 (1985) 497-511. (Check)

⁴³Bartik, *supra* at 32.

⁴⁴Robert Carroll and Michael Wasylenko, *Do State Business Climates Still Matter? Evidence of a Structural Change*, National Tax Journal (March, 1994) at 9.

Based on the literature from economics, one would be hard pressed to state unequivocally that development incentives themselves affect location choice. It would be even more perilous to conclude on the basis of the literature that any particular type of incentive exerts a significant effect on firm behavior. Finally, even if one could isolate particularly influential factors, one might still worry, based on the most recent time-sensitive analysis, about whether it was the appropriate time to offer such an incentive. Nevertheless, government officials continue to plug incentives and claim their success in attracting business depends on a business-friendly tax and incentive climate.⁴⁵

Several authors have confronted the economic and political issue of why government continues to offer tax breaks in light of the ambiguity of the academic research on their effectiveness. Wolman argues that a public official reviewing the economics literature summarized above could reasonably conclude that while tax differentials do not affect a firm's choice of location among regions, they may influence the ultimate decisions within a geographic area.⁴⁶ In addition, Wolman speculates that offering incentives is significant more as a symbolic act for public consumption than for its economic effect. Local politicians need to show that they are hustling business for their community and "any visible action, even if ineffective, may be politically advantageous."⁴⁷ The perception on the part of the public that officials are offering incentives that bring in business is thus itself the real "benefit" rather than any fiscal gains economic models might measure. Further, Wolman likens fiscal incentives to an "arms race," stating "not offering incentives while others do is the equivalent of

⁴⁵See, e.g. Tim Venable, *A Banner year for U.S. Business Climates: Taxes Fall, Incentives Fly*, Site Selection (October, 1994) at 854 in which the location of Tyson Foods' 700-employee food plant in Indiana is attributed to the state's Economic Development for a Growing Economy corporate income tax credits.

⁴⁶Harold Wolman, *Local Economic Development Policy: What Explains the Divergence Between Policy Analysis and Political Behavior?*, 10 *Journal of Urban Affairs*, 19, 22 (1988).

⁴⁷Wolman, *id.*, quoting R. Feick, *The Politics of Urban Economic Development*, paper presented at the annual meeting of the American Political Science Association at 4 (1986).

unilateral disarmament in the face of a first strike attack."⁴⁸ Ledebur and Woodward have labeled this an example of the "competitive adoption" phenomenon whereby one state's program causes its neighbors to change their offerings.⁴⁹ Though not convinced of the efficacy of offering incentives, local officials, especially in competitive regions offer breaks to business because "everyone else is doing it" and because the political fallout from not offering incentives and losing business investment is too great.⁵⁰

Similarly, Wolkoff argues government action in offering incentives with little distinction made among applicant firms and with little attempt at matching subsidies to the value the firm will deliver to the local economy is, in fact, perfectly rational given other considerations.⁵¹ Wolkoff emphasizes "informational asymmetries" as the cause of apparently illogical behavior by government. Policymakers cannot know which firms will locate elsewhere if they do not receive subsidies and which are merely bluffing. The community could respond by attempting to sort out firms with real relocation prospects from those without⁵²; however, because firms will make sorting difficult by failing to signal their real intentions, public officials will be unable to distinguish firms. Further, the consequences of failing to subsidize a deserving firm

⁴⁸*Id.* at 27; In 1992, DeLysa Burnier undertook research in Ohio interviewing policymakers to determine which of Wolman's theories was most plausible. Burnier concluded the interest in political symbols was most important and found the "arms-race" phenomena to be the least influential. See DeLysa Burnier, *Becoming Competitive: How Policymakers View Incentive-Based Development Policy*, 6 Economic Development Quarterly 14, 22 (1992)

⁴⁹Larry Ledebur & Douglas Woodward, *Adding a Stick to the Carrot: Location Incentives with Clawbacks, Recisions and Recalibrations*, 4 Economic Development Quarterly, 221, 225 (1990).

⁵⁰Recent events in the Midwest seem to reflect this phenomena. Kentucky passed an extremely business-friendly incentive program in 1992. Ohio rushed through a similar program soon thereafter. The director of the Ohio Development Department admitted, "We wanted something that would be competitive with our neighbor to the south." See Robert Guskind, *The New Civil War*, National Journal, April 3, 1993. Indiana struggled in 1993 to pass its EDGE program with literature from the Indiana Department of Commerce emphasizing the need for the state to maintain its competitive edge in the face of Kentucky and Ohio's "aggressive incentive programs designed to lure firms to these states." Indiana Department of Commerce, *Economic Development for a Growing Economy*, (1993)(hand-out on file with author)

⁵¹Michael Wolkoff, *Is Economic Development Decision Making Rational?*, 27 Urban Affairs Quarterly 340-355 (1992).

⁵² Some states are now attempting to sort firms. See e.g. Indiana Economic Development for a Growing Economy Tax Credit, Ind. Code §6-3.1-13-1, in which Indiana requires that applicant firms demonstrate that they are considered another state for their project before a credit may be granted.

outweigh the costs of oversupplying subsidies to undeserving firms in terms of public opinion. Thus, Wolkoff argues officials make a rational decision consistent with economic maximizing behavior in a situation with often imperfect information when awarding subsidies.⁵³

Finally, authors have raised institutional factors as strong influences on the tendencies of economic development officials to use development incentives. For example, Spindler and Forrester argue that public officials, motivated by a need to satisfy short-term political needs for reelection and retention of power, cope with environmental uncertainty and risks by using standardized approaches to common conflicts. Routine reduces risk. Thus, political and bureaucratic actors regularly engage in three policy "routines" that insulate them from risk: 1) quick adoption of incentives adopted in other states ; 2) use of universal incentives (incentives offered uniformly to "all-comers") rather than incentives scaled to the value of a project and 3) the adoption of symbolic economic development programs including such rituals as elaborate ribbon-cutting ceremonies at new plants.⁵⁴

⁵³*Id.* at 352.

⁵⁴Charles Spindler and John Forrester, *Economic Development Policy: Examining Policy Preferences Among Competing Models*, 29 *Urban Affairs Quarterly* 28-53 (1993).

The Emerging Wave: Cooperation, Demand-side Policy and the Rational Approach

Despite pessimism that economic development officials are locked in politically-motivated, ineffective and potentially fiscally irresponsible behavior, much recent literature heralds a new era in economic development policy. At the center of this era is the "entrepreneurial state," a term used by Eisinger to describe government which acts as a "company former" by devising laws and policies to encourage use of new technology, create markets for private producers and nurture businesses well-matched with a state's strategic development goals.⁵⁵ In the place of outdated supply-side policy for economic growth such as development incentives, interjurisdictional competition and scattershot attempts to lure any potential business, Eisinger favors demand side policy. Demand side policy focuses on creating new markets, small business expansion, supporting indigenous enterprises and strategic assistance to particular, desirable firms.⁵⁶

Ross and Friedman have labeled this approach the "emerging Third Wave," a new phase of economic development practice superseding the First Wave (attraction of industry from outside the state, principally through development incentives) and the Second Wave (increased focus on developing indigenous business activity through capacity building policies in areas like education).⁵⁷ Michael Porter has recently advocated a similar approach for inner city economic development. Porter criticizes policies which attempt to revitalize the inner city by offsetting competitive disadvantages through enterprise zone, tax breaks, government subsidies and preferences. Instead, Porter advocates a strategy of capitalizing on the unique

⁵⁵Peter Eisinger, *THE RISE OF THE ENTREPRENEURIAL STATE* (1988).

⁵⁶*Id.* at 12.

⁵⁷Doug Ross and Robert Friedman, *The Emerging Third Wave: New Economic Development Strategies*, in *LOCAL ECONOMIC DEVELOPMENT: STRATEGIES FOR A CHANGING ECONOMY* 125-137 (R. Scott Fosler, ed. 1991).

competitive advantages of urban area (such as location and access to particular consumer markets) to stimulate business growth.⁵⁸

At the same time, researchers have recognized any Third Wave of economic development policy will probably at most coexist with continued reliance on First Wave policies like development incentives.⁵⁹ Thus, a number of authors have examined mechanisms including clawbacks (forced recapture of credits if a business falls short of job creation or investment projections) and cost-benefit analyses to make the process of giving incentives more rational.⁶⁰ Indeed, even Bartik, perhaps the clearest recent advocate of the argument that development incentives foster economic growth, has endorsed an "optimal subsidy" policy whereby states "fine-tune their incentives" and may "set taxes and economic development incentives so as to exactly equal the net perceived additional benefits for the local area that result from that expansion, including net employment benefit, as well as the public service and environmental costs it might cause."⁶¹

These approaches recommended in the academic literature have been echoed in more practice-focused writing and even recent legislation. Most notably, the National Governors' Association recently published a report recommending strategic attraction of business, cost/benefit analysis when using incentives and the use of clawbacks with incentive agreements.⁶² In addition, The Council of State Government and Corporation for Enterprise Development, have recommended, in light of the poor evidence that

⁵⁸Michael Porter, *The Competitive Advantage of the Inner City*, (June 22, 1994)(discussion paper on file with author.)

⁵⁹ In a survey of economic development officials in Michigan, Reese found, despite the trends noted in the literature, supply side incentives still predominated. Eighty-three percent of cities surveyed offered property tax abatements while demand side measures such as incubator development were offered by only 24% of cities. Laura Reese, *Local Economic Development in Michigan: A Reliance on the Supply Side*, 6 *Economic Development Quarterly* 383, 389 (1992).

⁶⁰ See, e.g. Ledebur and Woodward, *supra*, note 49.

⁶¹Bartik, *supra*, note 32 at 202, n. 7.

⁶²Kayne and Shonka, *supra*, note 9.

incentives affect location, that state and local government eschew uniform tax breaks for "Third Wave" approaches.⁶³

This perspective, in turn, has trickled down to state representatives and policymakers. For example, the preamble to Iowa's 1994 New Jobs and Income Act mimics the NGA's policy, stating in part:

The general assembly finds and declares that the accelerated use of direct development incentives by the state to attract economic investment is symptomatic of the continuing slow rate of growth of the nation's economy. Iowa finds itself pressured to take whatever steps are necessary to support job creation that otherwise might occur unaided under more healthy economic conditions.

The general assembly also finds and declares that the current economic climate also affects the way the business community behave when making investment decisions. To minimize new investment in plant and equipment, businesses readily take advantage of available subsidies in the form of development incentives.

The general assembly further finds that the public and private sectors should undertake cooperative efforts that result in improvements to the general economic climate rather than focus on subsidies for individual projects or businesses. These efforts will require a behavioral change by both the state and business, balancing short-term self interest with the long-term common good.⁶⁴

⁶³Walker, *supra*, note 16; Schweke, Rist and Dabson, *supra*, note 13.

⁶⁴1994 Iowa Legis. Serv. HF 2180 (West).

CHAPTER TWO: ATTEMPTS TO CURB THE BIDDING WARS--ENDING COMPETITION, COOPERATING AND FIGHTING BACK

Given the shortcomings of traditional incentive-driven economic development, it is not surprising that there are many disgruntled parties in the business bidding wars. Even when one assumes there are clear benefits to bagging a relocating industry, there are obvious losers in the battle. Communities feeling stung or manipulated by relocating business have designed a number of remedies for the ill effects of interjurisdictional competition. Some strategies attempt systemic change. Others are approaches designed to penalize individual actors. Thus far, none has been entirely successful at eliminating the problems encountered when government competes for jobs with incentives.

Since the beginning of interstate competition for business, there have been calls to end the competition altogether or at least curb the ability of states to poach jobs from other areas and to use federal tax dollars in the process. In addition, some states have attempted to construct an economic peace by agreeing not to compete for jobs. In a more unilateral approach, communities have tried to fight back and legally enjoin plants from closing after they have received government financial assistance. Finally, local and state government have linked their incentive policy to accountability. This chapter focuses on three prevalent strategies aside from accountability mechanisms: federal intervention in interstate competition, cooperative action among states and litigation against individual firms. The next chapter reviews accountability legislation.

I. Federal Action

Primary among the remedies advanced for stopping interstate competition have been calls for federal action to change the system by limiting or entirely eliminating the

manner in which states may offer fiscal incentives. Two examples of this strategy have already been enacted: the constitutional ban on economic favoritism contained in the Commerce Clause and several statutory limitations on the use of federal funds to facilitate industrial relocation. In addition, commentators have consistently advocated, though never succeeded in passing, federal limits on interstate tax competition through the federal tax-and-spend power. Finally, the GATT contains prohibitions on subsidies which may affect interjurisdictional tax competition.

A: The Commerce Clause

The proliferation of tariffs burdening trade among the states prompted in part the Constitutional Convention of 1787. Fearing enmity among the states, economic inefficiency and even armed conflict, the framers adopted Article I, §8 of the Constitution, the Commerce Clause, which prohibits economic protectionism. Tariffs, much like bidding for jobs through tax incentives, are rational from the individual state's point of view. Both tariffs and incentives favor an individual state's economy. Yet, both are detrimental to the national economy as they injure relations among the states and distort markets.

The Commerce Clause states, "The Congress shall have power...to regulate commerce with foreign nations, and among the several States..."⁶⁵ The powers of Congress under the Commerce Clause have been interpreted to include not only an affirmative power to legislate but also a negative or dormant power which prohibits states from encroaching on Congressional power by enacting laws which discriminate against out-of-state competitors.⁶⁶

⁶⁵U.S. Const. art. I, §8.

⁶⁶*West Lynn Creamery Inc. v. Healy*, 114 S.Ct. 2205, 2211(1994).

The Supreme Court has used this dormant aspect of the Commerce Clause to strike down state legislation which heavily resembles typical incentive programs. For example, in *Bacchus Imports, Ltd. v. Dias*, the Supreme Court invalidated a scheme to encourage consumption of Hawaiian liquors by exempting locally produced alcohol from the state's liquor tax. The exemption discriminated on its face against liquor produced outside Hawaii and thus violated the Commerce Clause.⁶⁷ Similarly in *Westinghouse Electric Corp. v. Tully*, New York devised a complicated franchise tax for a type of export company called a domestic international sales corporation (DISC).⁶⁸ The scheme attempted to encourage the location of such corporations in New York by granting New York-based DISCs a credit which lowered their effective rate of taxation. A Pennsylvania corporation that did business in New York brought suit alleging in part that a tax credit offered only to New York DISCs violated the Commerce Clause. The Supreme Court agreed noting that two otherwise similar corporations would receive different treatment under the scheme merely because one located a greater percentage of its shipping activity in New York.⁶⁹

Most recently, the Court addressed an incentive-like scheme favoring local business in *West Lynn Creamery Inc. v. Healy*.⁷⁰ In that case, the Massachusetts Department of Food and Agriculture issued a pricing order which required premium payments from all of the state's milk dealers. Though in-state and out-of-state dealers paid on an equal basis, the revenue collected was disbursed solely to Massachusetts milk producers. As a result, Massachusetts producers could lower prices and enjoy a greater demand for their milk. The state justified the scheme as a way to preserve the state's failing dairy industry and make sure Massachusetts consumers had a stable supply of fresh milk. Likening the premium payment system to a tariff imposed only on

⁶⁷ *Bacchus Imports Ltd. v. Dias*, 104 S.Ct. 3049 (1984).

⁶⁸ *Westinghouse Electric Corp. v. Tully*, 104 S.Ct. 1856 (1984).

⁶⁹ *Id.* at 1863.

⁷⁰ *West Lynn Creamery Inc. v. Healy*, 114 S.Ct. 2205 (1994).

out-of-state producers, the Court nevertheless found it to be unconstitutionally discriminatory against interstate commerce.⁷¹

The Supreme Court has never directly addressed whether a traditional incentive measure such as a tax abatement violates the Commerce Clause by offering assistance solely to firms which locate in-state. In *West Lynn Creamery*, the majority decision acknowledged that it had neared but never confronted this fundamental question. The court noted its prior ruling that “[d]irect subsidization of domestic industry does not ordinarily run afoul” of the Commerce Clause. Further, the Court rather blandly stated “it is undisputed that states may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education or low taxes.”

An analysis of whether state development incentive policies such as tax abatements violate the Commerce Clause is beyond the scope of this thesis. Obviously, many state policies look very much like those struck down in *Bacchus*, *Westinghouse Electric* and *West Lynn Creamery*. For example, when a state offers a property tax abatement solely to firms which relocate and make a specified dollar level of investment in the state, the state is clearly favoring enterprises on the basis of whether or not they locate within the state. Several pieces of legislation reviewed below raise issues under the Commerce Clause, which will be noted as they occur. As incentive programs proliferate, one may expect further definition from the Court on which incentives are closer to those “creating an environment conducive to economic activity” and which are mere schemes to favor local interests.⁷²

⁷¹ *Id.* at 2212.

⁷² Recently, the Corporation for Enterprise Development has called on attorneys at trade union and legal services to challenge incentives based on the Commerce Clause. Schweke, Rist and Dabson, *supra*, note 13 at 66.

B. Conditions on the Use of Federal Funds

When federal dollars will be directly involved in shuffling jobs from one part of the country to another, the federal government has intervened. There are two immediate motives for such action. First, Congress has to some extent realized the national economy does not benefit when taxpayer's dollars are used merely to shuffle firms from one region to another. Second, constituents angry when federal funds have subsidized industrial flight have demanded such legislation.⁷³

Federal funds under the Job Training Partnership Act (JTPA) and the now defunct Urban Development Action Grants (UDAG) include limitations on using funds to poach jobs from another state. Section 1551 of the JTPA states:

- (1) No funds provided under this Act shall be used or proposed for use to encourage or induce the relocation, of an establishment or part thereof, that results in a loss of employment for any employee of such establishment at the original location.
- (2) No funds provided under this Act shall be used for customized skill training, on-the-job training or company specific assessments of job applicants or employees, for any establishment or part thereof, that has relocated, until 120 days after the date on which such establishment commences operations at the new location, if the relocation of such establishment or part thereof, results in a loss of employment for any employee of such establishment at the original location.
- (3) If a violation of paragraph (1) or (2) is alleged, the Secretary shall conduct an investigation to determine whether a violation has occurred.
- (4) If the Secretary determines that a violation of paragraph (1) or (2) has occurred, the Secretary shall require the State, service delivery area, or substate grantee that has violated paragraph (1) or (2) to--
 - (A) repay to the United States an amount equal to the amount expended in violation of paragraph (1) or (2)....and

⁷³Interview with Jack O'Meara, legislative assistant to Congressman Tom Barrett (October 5, 1994).

(B) pay an additional amount equal to the amount required to be repaid under subparagraph (A), unless the State, service delivery area, or substate grantee demonstrates to the Secretary that it neither knew nor reasonably could have known (after an inquiry taken with due diligence) that it provided funds in violation of paragraph (1) or (2).⁷⁴

Similarly, UDAG legislation prohibited the use of funds for projects facilitating the intermetropolitan relocation of industrial or commercial plants unless the Secretary of Housing and Urban Development found such relocation did not "significantly and adversely affect the level of unemployment or the economic base of the area from which such industrial or commercial plant or facility is to relocated."⁷⁵

In 1994, anti-poaching language similar to that in the UDAG statute was passed in the House of Representatives for the Community Block Development Grant program. While bipartisan support for the language was quite strong, the bill to which it was attached died in the Senate. The legislation did have bipartisan support, and proponents hope to win passage in a future session.⁷⁶

A remaining question is how greatly such language can affect the downside of interjurisdictional competition and run-away shops. At this point, the anti-poaching provisions in the JTPA statute are too recent to have instigated any reported legal action. The language of the JTPA statute, while specific about remedies, suggests the Secretary of Labor alone will have authority for enforcing that act's anti-poaching provisions. Thus, the impact of the statute depends entirely on the vigilance of a department which may have other priorities.

⁷⁴21 U.S.C. §1551.

⁷⁵42 U.S.C. §§ 5301-20 (1988).

⁷⁶Interview with Jack O'Meara, *supra*, note 73.

C. The Call for Other Federal Action

To stop the race to the bottom as states try to outbid each other for the promise of jobs and dollars, commentators have long advocated federal action beyond the Commerce Clause. No such legislation has passed, but, generally, these proposals invoke Congress's tax-and-spend power and to tie a restriction on bidding to some form of federal assistance.⁷⁷ Congress has already restricted the states' ability to issue industrial revenue bonds. Because the federal government paid the tab, IRBs were formerly a favorite form of offering assistance to business. To encourage cost effectiveness, Noto has suggested federal restrictions on the use of subsidies much like those imposed on IRBs and other tax-exempt bonds.⁷⁸

There are several counterarguments to this call for federal action. Significant among them is the improbability of such legislation making its way through Congress. (At this point, it appears no actual legislation has even been proposed by a member of Congress.) The federal government had a financial self-interest in limiting industrial revenue bonds (foregone revenue) which is not apparent in the case of local subsidies. Indeed, given foreign competition, the federal government may be interested in the continuation of interjurisdictional competition to attract business to the United States by lowering operating costs.

Parallels are strong with the debate over corporate chartering. Pointing to a "race to the bottom" in state legislation, advocates of federal action recommended federal incorporation or, at the least, a Federal Corporate Uniformity Act prescribing a

⁷⁷See, e.g. Mark Taylor, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 Tex. L. Rev. 417 (1994).

⁷⁸Nonna Noto, *Trying to Understand the Economic Development Official's Dilemma*, in COMPETITION AMONG STATES AND LOCAL GOVERNMENTS 251, 255, (Daphne Kenyon & John Kincaid, eds., 1991).

floor for corporate law.⁷⁹ On the other side of the debate were arguments readily applicable to federal action on development incentives. Primary were the "genius of federalism" arguments: the importance of interjurisdictional competition as an antidote to monopoly in trade, the states' rights to compete and the conception of the states as laboratories of experiment. In addition, critics, much like advocates of incentives, questioned whether states were heedlessly racing to the bottom or were merely making rational decisions in order to lure business.⁸⁰ Ultimately, no federal corporation legislation passed; that fate seems likely for federal legislation on development incentives.

D. Subsidy Prohibitions in GATT

Finally, the increasingly global marketplace may force change in incentive policy. Though its impact is not clear at this point, the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) does contain policies which could substantially affect the ability of state and local government to grant incentives. GATT generally attempts to eliminate subsidies and their distorting effects. Among the subsidies described in the Agreement are "government-provided benefits to a specific industry or firm [which] may take the form of grants, loans, equity, loan guarantees, forgiveness of taxes otherwise due, the provisions of goods and services other than infrastructure, or government purchase of goods at non-market prices or income or price supports to benefit a firm. GATT groups subsidies in three categories: prohibited (red) subsidies, actionable (yellow subsidies) and nonactionable (green subsidies). Prohibited and actionable subsidies include subsidies which displace or impede exports from

⁷⁹W.L. Carey, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale Law Journal 663,701 (1974)

⁸⁰*See, e.g.,* Albert Breton, *supra*, note 31 at 45.

another country. Thus, it appears most development incentives would violate GATT. A newly created Dispute Settlement Body of the World Trade Organization will enforce these policies and judge complaints about trade policy.⁸¹ The NGA has already warned members that GATT may force individual states to alter their incentive policies.⁸²

⁸¹Kayne and Shonka, *supra*, note 9 at 2.

⁸²*Id.*

II. Cooperation: Negotiated and Legislated

A second strategy for curbing the excesses of development bidding is the establishment of voluntary non-competition compacts among states. Compacts are not a new idea. Michigan Governor William Milliken called for a "SALT pact" in the 1970s and several midwestern governors attempted a regional truce in 1988 that ultimately failed.⁸³ In August of 1993, the National Governors' Association, published its "Statement on Economic Growth and Development Incentives." Recognizing the pressures which cause government to offer subsidies in the form of development incentives and business to readily take them, the NGA called for "mutual cooperation" not just among states but between business and government as well to curb the excesses of the practice.⁸⁴

There is at least one real example of a non-competition compact. In October, 1991, Connecticut, New Jersey, and New York signed a pact agreeing to end advertisements bad-mouthing their neighbors and attempts at luring business from the other states.⁸⁵ In the past, often in the face of blatant violations, the states claimed the truce continued. In 1994, however, the agreement appeared dead as Swiss Bank announced it would pull 1300 employees out of Manhattan to Stamford, Connecticut after that state offered it a \$120 million package of tax breaks. New York responded with threats including those from one city official who vowed to fight back, stating "New Yorkers are not widely considered to be patty-cakes."⁸⁶ Nevertheless, thus far, New York has taken no legal action; indeed, it is unclear what action it could take.

⁸³Guskind, *supra*, note 50.

⁸⁴Kayne and Shonka, *supra*, note 9 at Appendix A.

⁸⁵Tom Redburn, *New Flare-Up in Region's Border War Kills an Oft-Ignored Truce*, New York Times, Oct. 16, 1994, at 37,42.

⁸⁶*Id.*

As demonstrated by the New York-New Jersey-Connecticut compact, the difficulty of maintaining such agreements is their primary shortcoming. In particular, compacts between states may be difficult to maintain in the constantly changing political world as new governors, mayors, and economic development officials go in and out of office. Further, unless the compact is extremely explicit, conflicts are likely to result over what actions constitute violation of the agreement. For example, is cutting the tax on manufacturing equipment or improving education an attempt to lure industry from other states? Regardless of these complications, states may be reluctant or unable to enforce a compact. Such suit would require action against a neighbor with whom, one assumes, the complaining state would have other amicable and interdependent relationships. In addition, judicial enforcement of such compacts is untried.⁸⁷

A different approach to the regional compact is the proposed Multistate Industrial Retention Commission (MIRC) legislation. The proposal for such legislation is a product of the 1991 National Conference of State Legislatures' labor issues conference. The purpose of such a commission would be to assist states in avoiding the harms caused by firms relocations.

Implementation of the MIRC requires passage of the legislation in a minimum of five states. After passage, a commission is created with representatives from each state. The commission then investigates any significant business closing or workplace relocation. The commission determines whether the relocation or closing is detrimental. If it is determined that a relocation is detrimental, the commission recommends actions to the states against the employer including barring the employer from receiving economic development assistance or incentives.

⁸⁷Potential legal problems with compacts include the Compact Clause of the Constitution, Article I, Section 10, which prohibits compacts among the states absent Congressional approval and the authority of governors to enter into such arrangements on behalf of a state.

While the MIRC legislation does create a concrete forum for interstate cooperation in economic development, it suffers from several flaws. Most notably, crucial language concerning what is a "detrimental" relocation appears quite ambiguous and broad, a characteristic unlikely to appeal to state legislators considering the legislation. The proposed legislation reads:

For the purposes of this act, an employer shall be regarded as responsible for a detrimental net relocation of employment if the commission finds that:

(1) Employment lost from the establishment was transferred or is being transferred to one or more other locations, including any transfer by means of outsourcing or contracting out of production, and that employment loss is not the result of the employer reducing or discontinuing entirely its sale or use of the product line or lines produced at the establishment and

(2) The transfer of employment to other locations has contributed or will contribute to an undermining of labor, health, environmental, human rights, civil rights or other standards, based on a diminishment of the pay and conditions of employees, of the funding of education or other public services required for the general welfare, or of other conditions affecting employees and their communities, which diminishment is demonstrable by comparison of conditions where the establishment is located and conditions at the other locations.

One wonders what relocation wouldn't violate some of these standards. Further, the power of the commission is only to make recommendations. A government can simply ignore the commission advice. These flaws may be the reason no state has passed MIRC legislation.

III. Litigation Strategies

In the face of business renegeing on explicit or implicit agreements to remain in a location after receiving an incentive, several cities have turned to litigation as a more unilateral approach to penalize business. In some cases, a litigation strategy in combination with a broader organizing campaign has brought favorable results. For

example, Chicago settled a suit with Playskool after the toymaker attempted to close a plant for which it had received city-sponsored low-interest loans. A broad campaign included not only the suit itself but organizing around the toymaker's heartlessness in giving pink slips to workers right before Christmas. The settlement terms included an emergency fund for displaced workers, a job placement program and redevelopment of the abandoned facility.⁸⁸

Nevertheless, litigation itself has not garnered very favorable results for government. While there are few actual reported decisions, the cases which do exist suggest government cannot rely on tacit promises. In some cases, a city or state may find relief if the court discovers explicit contractual or legislated agreements. I review these cases below.

In February of 1992, General Motors announced that it would close its Willow Run facility in Michigan and transfer the operations to Arlington, Texas. The township of Ypsilanti sued GM claiming the company had entered into agreements with the township in order to obtain twelve-year tax abatements on its property in 1984 and 1988 and that, by relocating production to Arlington, the automaker would violate the terms of those agreements.⁸⁹ General Motors' abatement was granted under section 207.551 of the Michigan statutes. The section authorized tax abatements to industrial facilities which "will...have the reasonable likelihood to create employment, retain employment, prevent a loss of employment, or produce energy in the community in which the facility is located."⁹⁰ There is a two-step abatement process. First, the municipality in which the facility will be located must create an industrial development district after a public hearing considering the abatement application. Municipalities may approve abatements for a term of up to twelve years. Upon approval by the municipality, the State Tax

⁸⁸Robert Mier and Robert Giloth, *Democratic Populism in the United States: The Case of Playskool and Chicago*, in SOCIAL JUSTICE AND LOCAL DEVELOPMENT 135 (Robert Mier, ed. 1993).

⁸⁹*Charter Township of Ypsilanti v. General Motors Corp.*, *supra*, note 8.

⁹⁰*Id.*

Commission must review the application, principally to ensure the municipality has not overextended its resources in granting the abatement. The Circuit Court opinion noted that the State Tax Commission had never rejected an abatement on such grounds.⁹¹

After finding the Michigan statute under which General Motors' abatement was granted offered no contractual language or remedies upon which the township could recover from General Motors, the Circuit Court ruled the township had established a promissory estoppel claim. Under Michigan law, the elements of promissory estoppel are: "(1) a promise that the promisor should reasonably have expected to induce action of a definite and substantial character on the part of the promisee, (2) which in fact produced reliance or forbearance of that nature, (3) in circumstances such that the promise must be enforced if injustice is to be avoided."⁹² The Circuit Court found statements made by General Motors representatives at the public hearing for its 1988 abatement application constituted such a promise. Specifically, General Motors representatives stated that subject to "favorable market demand," the automaker would "continue production and maintain continuous employment" at the Willow Run plant.⁹³ This promise induced the township to forego over \$2 million in local taxes. Finally, the court found "[t]here would be a gross inequity and patent unfairness if General Motors, having lulled the people of the Ypsilanti area into giving up millions of tax dollars which they so desperately need...is allowed to simply decide that it will desert 4500 workers and their families because it thinks it can make these same cars a little cheaper somewhere else."⁹⁴ The court enjoined General Motors from closing its plant at Willow Run.

⁹¹*Id.*

⁹²*Id.* at 11.

⁹³*Id.* at 11.

⁹⁴*Id.* at 13.

Though hailed as a triumph by labor activists and some academic commentators⁹⁵, the Michigan Court of Appeals quickly poked holes in the victory by reversing the Circuit Court's decision.⁹⁶ In particular, the Court of Appeals found that there had been no promise on the part of General Motors. Statements the Circuit Court found to be promises were nothing more than the statements General Motors needed to make in order to qualify for an abatement. GM was under no obligation to make good on such statements. "[T]he fact that a manufacturer uses hyperbole and puffery in seeking an advantage or concession does not necessarily create a promise."⁹⁷ Indeed, the Court of Appeals pointed to discussions among Township Supervisors during the abatement hearing in which members expressed their concern that the automakers, ultimately, had made no promise to stay.⁹⁸

Similarly, in 1988, the United States Court of Appeals for the Second Circuit found the City of Yonkers had no actionable claims against Otis Elevator when the company closed a factory for which the city had given development assistance.⁹⁹ The city advanced claims of breach of contract or quasi-contract, fraud and equitable estoppel. Much like the Michigan Court of Appeals, the Second Circuit Court of Appeals found statements made by Otis as it negotiated land acquisition and development deals were "goals" rather than "commitments." As in the Michigan case, the court pointed to evidence that Yonkers officials were quite aware that Otis had made no promises. For example, the Project Director of the Yonkers Community Development Association, upon reviewing the letter of intent between the city and Otis Elevator commented:

⁹⁵See, e.g. John Borsos, *The Judge who Stood Up to G.M.*, THE NATION, April 12, 1993, at 488; Fran Ansley, *Standing Rusty and Rolling Empty: Law, Poverty and America's Eroding Industrial Base*, 81 Geo. L.J. 1757 (1993).

⁹⁶*Charter Township of Ypsilanti v. General Motors Corp.*, 506 N.W. 2d (Mich. App.) 556 (1993), *aff'd* 443 Mich. 879 (1993).

⁹⁷*Id.* at 559.

⁹⁸*Id.* at 561.

⁹⁹*City of Yonkers v. Otis Elevator Co.*, 844 F.2d 42 (1988).

Has Otis gone any further than stating it is their goal to remain in Yonkers? There appear to be a great number of sanctions against the City should it fail to meet up to its part of the obligation but no similar sanctions against the Otis Elevator Company.¹⁰⁰

Two unreported plant closing cases show similar results. In West Virginia, Anchor Hocking announced that it would close an eighty-seven year old glassmaking plant after a hostile takeover by the Newell Corporation. Anchor Hocking had been the recipient of several development incentives including \$3.5 million in low-interest loans from the West Virginia Economic Development Authority, tax abatements and job training funds. The governor of West Virginia brought suit originally in federal court on breach of oral contract grounds claiming Anchor Hocking had committed to assist him in finding a new owner for the plant and in keeping the plant operating. When re-filing in state court, the governor added claims of breach of express and implied contract based on the incentives given, breach of good faith and fraud. The court found in favor of the defendant Anchor Hocking. The loan documents allowed Anchor Hocking the right to retire debt early and no specific commitments to remain open existed. The tax abatements were generally available to all similar firms in the state regardless of any promises to remain in the state.¹⁰¹

A suit by the city of Norwood, Ohio against General Motors after an announced plant closure suffered a similar fate. Though the town had granted the automaker numerous concessions during its sixty year tenure in Norwood including, according to the town's complaint, "the building of an underpass at Forest Avenue...vacating several streets in and around the GM plant...assisting General Motors in the purchase...of property...assisting with traffic problems and, in general doing anything that General

¹⁰⁰*Id.* at 47.

¹⁰¹Fran Ansley, *supra*, note 95 at 1819-1820.

Motors requested," the court dismissed all counts save a nuisance claim that General Motors had not properly disposed of hazardous wastes at the site.¹⁰²

In contrast, litigation strategies have succeeded when there is more explicit contractual or statutory language. In *In re: Indenture of Trust dated as of March 1, 1982, Re: City of Duluth \$10,000,000 Industrial Development Revenue Bond*, the Minnesota Court of Appeals considered a suit by the city of Duluth against the Triangle Corporation. Triangle received a \$10 million industrial development revenue bond from the city to acquire and modernize a local tool and horseshoe company and then used part of the financing to purchase equipment which it transferred to a South Carolina plant.¹⁰³ Within five years, Triangle reduced the workforce at the Minnesota plant by 200 workers.¹⁰⁴

The Minnesota Municipal Industrial Development Act authorized bonds "to prevent the emergence of chronic unemployment and further economic deterioration through encouragement of industrial growth." A mortgage secured the bond with Triangle's property and equipment at the Diamond plant as collateral. The mortgage limited the circumstances under which Triangle could transfer those assets to two situations: (1) if the equipment became obsolete or (2) if the fair market value of the equipment were under \$500,000 and Triangle reimbursed the mortgagee for the costs of the equipment. On the basis of this language and the statute, the court prohibited Triangle from removing equipment which would "materially impair" hand tool operations at the Minnesota plant.¹⁰⁵

¹⁰²*Id.* at 1823 citing *City of Norwood v. General Motors Corp.*, No. A8705920 (Ct. Common Pleas Hamilton County, Ohio filed Aug. 7, 1987).

¹⁰³*In re: Indenture of Trust dated as of March 1, 1982, Re: City of Duluth \$10,000,000 Industrial Development Revenue Bond*, 437 N.W.2d 430 (1989)

¹⁰⁴*Id.* at 433.

¹⁰⁵*Id.* at 436.

While the record of litigation to address the issue of plant closings in the wake of government assistance is sparse, several points do emerge. First, over the long run, courts have been unwilling to enjoin a firm from closing or to award damages without clear, usually written indications of a contract. Second, from the records in some of the above actions, government officials do not appear completely blameless when business relocates after taking advantage of incentives. While towns have attempted to portray themselves as reasonably--albeit perhaps naively--relying on promises from business that they would stay, the debate at the Ypsilanti hearing and the letter from the official in Yonkers indicate government knows full well it is giving a hand-out with very few strings attached when granting incentives.

Finally, the dearth of successes, particularly in litigating promissory estoppel claims, has changed the emphasis of the strategy for curbing the misuse of incentives. The *Township of Ypsilanti v. General Motors* decision and subsequent publicity demonstrated that government had to get real promises and attach real strings. Had Ypsilanti prevailed, one might expect to see an explosion in promissory estoppel litigation. Instead, there has been an explosion in state level legislation using accountability mechanisms. That new emphasis on legislation will be the focus of the next three chapters.

CHAPTER THREE--THE USE OF ACCOUNTABILITY LEGISLATION

As described earlier, accountability mechanisms aim to make business responsible for tax breaks and other development concessions received from local or state government. Like the strategies described above, they attempt to remedy the ill-effects of interstate competition. Accountability mechanisms come in a variety of forms. Generally, these measures may be grouped into four categories:

Evaluation requirements mandate inquiry into the impact of and need for an incentive. Typical mechanisms include cost/benefit analysis of a proposed incentive, a "sorting" inquiry attempting to determine whether the firm is actually induced to locate in the area by the incentive and/or is looking at other sites, measurement of how many jobs/how much investment an incentive will spur and determination of a minimum length of time that an enterprise is expected to remain in the state.

Business quality standards mandate inquiry into or require specific wage rates, benefits, or levels of environmental compliance for firms receiving incentives.

Compliance/Sanction procedures provide a process for inquiry into whether a firm lives up to its promised benefits and/or a process for enforcing compliance. A common mechanism is the clawback, a statutory or contractual requirement¹⁰⁶ that, should a business not live up to its promises, it will refund all or part of the benefits it has received. In conjunction with or in place of clawbacks, a state may withhold funds until an incentive recipient makes good on job creation or other commitments.

¹⁰⁶While the focus of this thesis is statutory accountability mechanisms, state government also attempts to create a bargain for development incentives through the use of contractual language. For example, Indiana has used clawbacks in its agreement with United Airlines concerning an airline maintenance facility. Indiana's agreement with United Airlines casts the deal in contractual terms including language requiring reimbursements in the event that the project does not live up to its projected project costs or job creation levels. Specifically, should United fail to provide the promised 6300 jobs by 2004 or fail to make the promised project investments by 2001, the air carrier will reimburse Indiana for benefits it received in proportion to the amount of projected jobs or investment it did not create. (Agreement Section 6.02 between State of Indiana and United Airlines on file with author.)

Procedural notice and hearing requirements are public participation requirements which mandate a process by which stakeholders are informed of an application for an abatement, credit or other incentive and have an opportunity for input.

Below, I first distinguish accountability mechanisms from the strategies described in Chapter 2, next briefly review early legislation in the area and then describe the measures employed in recent state-level legislation.

Why Use Accountability Mechanisms?

Accountability measures appear a natural progression from the litigation described above but quite distinct from the more systemic strategies outlined earlier. First, unlike federal action and compacts, accountability mechanisms are not a regional or national approach. Individual states or even local governments pass accountability mechanisms unilaterally. In some ways, this makes such legislation quite appealing; local interest groups concerned about smokestack chasing may not be able to influence national politics or induce their state into a compact but can organize around the issue on a more local level and push for rational economic development policy employing accountability mechanisms.

Second, unlike a strategy employing federal legislation to ban bidding altogether, accountability mechanisms assume such competition will continue. Given the history of regional competition in this country (and one could say our fundamental dedication to it), they are a pragmatic approach. However, based on some of the theoretical arguments above and empirical evidence, an approach which justifies the use of incentives is arguably more counterproductive than beneficial in the long run.

Finally, what unites accountability mechanisms is not a similarity of form--the legislation varies a great deal--but the similarity of their overall approach. The guiding principal behind such legislation is not to eliminate incentives or interjurisdictional

competition. Interstate competition pressures (and the lack of a federal mandate to cease) dictates that states will continue to offer incentives. Thus, the goal of accountability mechanisms is to provide at least some basis for choosing whether or not to award an incentive to a particular firm.

In more "traditional" economic development bidding, a state's incentive package mimics that of another, often adjacent state. The guiding question is what amount must the state offer to lure a relocating business away from competitors or keep an existing enterprise in-state. With accountability mechanisms the focus changes. The question becomes what a state will get in terms of a real return for its investment of public funds such as jobs, tax revenues, a firm complementary to the state's economy, etc. With the more sophisticated mechanisms, the question also becomes how well the business will ensure that it will deliver on its promises.

Early Legislation

To understand the significance of recent legislative developments, one should compare conventional incentive legislation which has no accountability component and some of the early local accountability legislation. There are numerous examples of weak protections in enabling legislation for development incentives. One representative piece of legislation is Section 207.551 of the Michigan Code which provides tax abatements to industrial facilities which "will...have the reasonable likelihood to create employment, retain employment, prevent a loss of employment, or produce energy in the community in which the facility is located."¹⁰⁷ This language appears to impose some restrictions on what sort of business can receive an abatement, but its meaning is fairly hollow. There is no prescribed procedure for how one might determine whether

¹⁰⁷Mich. Comp. Laws §207.551.

the business will, for example, create or retain employment. There is no mechanism for sanctioning an abatement recipient who fails to do so. Indeed, as described above, when the township of Ypsilanti attempted to rely on Section 207.551 in its suit against GM, the generally sympathetic trial judge declared the state legislature did not intend to create any contractual rights between the local government and subsidized firm.¹⁰⁸

Beginning with the wave of plant closures in the 1980s, several cities and a few states passed legislation injecting accountability into their economic development process. One of the earliest examples is a New Haven, Connecticut city ordinance passed in 1985 which requires recapture of benefits given to manufacturing facilities that relocate.

The language of the ordinance is straightforward:

If the city directly grants a tax abatement, tax assessment deferral or other tax benefit to an industrial or commercial entity for the purpose of locating, maintaining, rehabilitating or expanding this manufacturing facility in New Haven, and the entity relocates its manufacturing facilities from New Haven in whole or in part during the term of any such benefits, the tax benefits for the remainder of the term shall automatically be canceled, and the tax benefits effected shall be repaid within 30 days to the City of New Haven together with interest from the date the benefits accrued, such interest to be at the prime rate on the date of cancellation, and such industrial or commercial entity must notify the City of New Haven six months prior to its relocation.¹⁰⁹

During the 1980s and early 1990s, several other communities passed similar legislation. For example, an organizing campaign culminated in the passage of a 1990 Hammond, Indiana city ordinance which mandated (1) evaluation of economic development proposals through a cost benefit analysis (called a Statement of Benefits); (2) a public notice and hearing process; and (3) compliance review through a hearing before City Council should a business granted an abatement deliver less than 80% of its

¹⁰⁸*Charter Township of Ypsilanti v. General Motors Corp.*, *supra*, note 8 at 9.

¹⁰⁹NEW HAVEN, CONN., ARTICLE VII, § 21-39 (1985).

promised benefits.¹¹⁰ Further, reflecting roots in the 1980s movement for plant closure protections, some local legislation and earlier state legislation included requirements that recipients of development incentives promise to give employees early warning of an impending plant closure.¹¹¹

Current State Level Legislation

In the last few years, there has been widespread passage of state-level accountability legislation. A brief description of legislation from nineteen states may be found in Appendix I. In addition, Appendix II offers a quick summary of legislation by the type of accountability mechanism employed.

In contrast to the meaningless protections of Michigan's Section 207.551, much of the recent state legislation is quite explicit about what is expected from firms which receive incentives: mandatory wage levels, provision of health insurance, the creation of a specific number of jobs, benefits to the state which outweigh costs, promises to repay incentives, etc. In addition, state legislation has relied much less on the public participation required in early local ordinances. Below, I further describe the types of accountability mechanisms outlined above, breaking them down into the more specific categories used to summarize the legislation in Appendix II.

¹¹⁰HAMMOND, IN., CODE § 90-33-C (1990).

¹¹¹*See, e.g.* Vacaville, California City Ordinance *quoted in* Greg LeRoy, *supra*, note 9 at 82.

Categories of Accountability Mechanisms

I. EVALUATION REQUIREMENTS

A. Sorting

As noted by Wolkoff, government officials have difficulty determining whether a firm requesting an incentive is actually considering relocation or is merely bluffing.¹¹² In addition, even advocates of interstate economic competition would argue it is inefficient for states to offer an incentive greater than the costs avoided by locating in another state.¹¹³ Sorting mechanisms attempt to address this problem by sorting firms which have true relocation prospects from those that do not. For example, Illinois requires business applying for its Credit for High Impact Businesses to demonstrate that there is an alternative site outside that state which would receive the project if it were not given incentives in Illinois.¹¹⁴ In addition, some states require that there exist a disparity between a project's projected costs in the state and the costs elsewhere. Indiana requires its Economic Development for a Growing Economy Board to grant tax credits only if "a significant disparity is identified, using best available data, in the projected costs for the applicant's project compared to the costs in the competing state, including the impact of the competing state's incentive program."¹¹⁵

The sorting mechanism offers a rational approach to granting incentives; only those firms with real prospects to locate elsewhere are given assistance. Nevertheless, this policy clearly raises constitutional issues. Firms are given assistance explicitly because they choose to locate in one state rather than another. This type of mechanism seems ripe for a challenge under the Commerce Clause.

¹¹²Wolkoff, *supra*, note 51.

¹¹³Note, however, the argument that it is economically counterproductive overall to offer incentives in order lure business away from locations where they can produce goods at lower costs or with greater efficiency.

¹¹⁴20 I.L.C.S. 655/5.5.

¹¹⁵Ind. Code §6-3.1-13-15(4).

B. Cost/Benefit Analysis

The National Governors' Association has recommended use of cost/benefit analysis to determine first whether a state's investment in a business (through an incentive) provides a positive return and second that the return is greater than would have been gained from alternative investments.¹¹⁶ While states have not passed legislation that requires a consideration of opportunity costs, as suggested by the NGA, several states have mandated cost/benefit analysis weighing positive and negative effects of offering incentives. For example, the Indiana budget agency must determine that awarding a tax credit will result in a positive fiscal impact before the Economic Development for a Growing Economy board may grant a tax credit.¹¹⁷ Similarly, Oklahoma requires projects granted premium payments under its Oklahoma Saving Quality Jobs Act have a positive net direct state benefit. The net direct state benefit is defined as tax revenues from new jobs less the direct state costs in terms of education of children of new residents, costs of public health and safety, and costs of other state services.¹¹⁸

C. Job Creation/Minimum Investment Goals

Several states require incentive recipients produce a minimum level of jobs or invest a minimum level of dollars in the state. A very common approach is to allow credits only for business providing a specified (and usually large) number of jobs or amount of investment.¹¹⁹ Other states, realizing the potential benefits of job creation by small businesses, require minimum job creation and investment levels but peg standards

¹¹⁶Kayne and Shonka, *supra*, note 9 at 13.

¹¹⁷Ind. Code §6-3.1-13-15.

¹¹⁸Okla. Stat. tit. 68, §3701.

¹¹⁹*See, e.g.* S.D. Codified Laws Ann. §10-45B-1 requiring a minimum investment of \$20 million.

to both large and small businesses. For example, both small businesses providing at least 5 jobs and larger businesses providing at least 50 jobs are eligible for New Jersey's Job Investment Tax Credit.¹²⁰ (As described below, some states also tie these standards to sanctioning components which punish a recipient's failure to make good on commitments.)

D. Scaling

Several commentators including Bartik and Ledebur and Woodward have endorsed incentive policies which tie the assistance given to the amount of benefit received.¹²¹ Several pieces of legislation attempt to do this by scaling positive impacts with the amount of an incentive. For example, Connecticut's New Jobs Tax Credit offers credits based on a percentage of exempted corporate taxes which increase as the number of a business's employees and amount of square footage it occupies rise.¹²²

II. JOB QUALITY STANDARDS

A. Wages and Benefits

A number of states seek to ensure incentives are targeted to businesses which provide quality jobs. The most common job quality standard is a requirement that incentive recipients create jobs that offer a specified wage level or wages which exceed the area median. New Jersey requires firms receiving its New Jobs Investment Tax Credit provide jobs with a median compensation of \$27,000.¹²³ Other states require benefits such as health insurance.¹²⁴

¹²⁰N.J. Stat. Ann. 54:10A-5.3.

¹²¹See Bartik, *supra*, note 32; Ledebur and Woodward, *supra*, note 49.

¹²²Conn. Gen. Stat. §12-217(m).

¹²³N.J. Stat. Ann. §54:10A-5.3.

¹²⁴See, e.g. Tenn. Code Ann. §67-4-908.

B. Requirements for a Minimum Length of Operation

As demonstrated by the litigation in *Township of Ypsilanti v. General Motors* and *City of Yonkers v. Otis Elevator Co.*, government often grants development incentives only to watch businesses relocate soon thereafter, claiming there was no agreement about how long the business was required to remain. Several states have passed legislation making explicit the length of time an incentive recipient is required to stay. In Arizona, for example, businesses which have claimed credits under the state's Credit for Construction Costs of Qualified Environmental Technology must remain in the state for five years or face recapture of credits taken.¹²⁵

III. SANCTION/COMPLIANCE PROCEDURES

A. Withholding

In order to guarantee incentive recipients provide the requisite number of jobs or amount of investment, several states have passed legislation instructing the appropriate agency to withhold part of the incentive until the recipient has demonstrated that it has met performance standards. Commonly, this type of accountability measure is used with job training tax credits to ensure an employer retains an employee after the worker is trained. The Texas Smart Jobs Fund Program gives grants to business for funding skills training with new jobs. Twenty-five percent of a grant is withheld until ninety days after a training program is complete. If all employees have been retained, the

¹²⁵Ariz. Rev. Stat. Ann. §43-1080.

funds are disbursed. Alternatively, the grant is reduced for any employees who are not retained.¹²⁶

B. Recapture/Clawbacks

When an incentive recipient relocates or reduces operations in a state, several states require that the business refund all or part of the incentive received. Typically, recapture occurs on a sliding scale; the longer a business remains in the state, the less will be recaptured. Vermont's New Jobs Income Tax Credit mandates recapture if an employer who has benefited from the credit reduces its workforce to less than 50% of the number of workers it employed in the state in 1993 (the year the tax credit passed the legislature.) Repayment is on a sliding scale: 100% if employees are reduced within two years of receiving a credit; 50% for between two and four years and 25% for between four and six years.¹²⁷

IV. PUBLIC PARTICIPATION

Several of the early local initiatives on accountability used public participation to regulate the incentive process.¹²⁸ This approach has been less prevalent with state-level legislation reflecting perhaps the difficulty of inviting a statewide public to become involved in the economic development process. Nevertheless, Wisconsin has provided at least the potential for public participation in its incentive process through voter referenda and notice to stakeholders. First, a petition signed by the requisite number of a municipality's voters may block industrial development revenue bonding

¹²⁶Tex. Gov. Code Ann. §481.151.

¹²⁷Vt. Stat. Ann. §58.1-439.

¹²⁸See descriptions of Indiana ordinances above.

for a specific firm until it is approved by a majority of voters in a general or special election.¹²⁹ In addition, legislation relating to both industrial development revenue and economic development bonds in Wisconsin requires that businesses seeking financing notify any collective bargaining unit in the state with which they have a collective bargaining agreement.¹³⁰

¹²⁹Wis. Stat. §66.521.

¹³⁰Wis. Stat. §66.521 and §234.65(2)(a).

CHAPTER FOUR--EVALUATION OF TWO RECENT CASES

The inclusion of accountability mechanisms in so much incentive legislation, as described above, is encouraging. It appears that states are listening to academic commentators and groups like the NGA in designing more rational economic development legislation. Yet, the impact this legislation will have is unclear. Much of the state-level legislation is too recent to have had a history of implementation and enforcement. Unfortunately, the record of enforcement from early state and local efforts is less than encouraging¹³¹. For example, New Haven's ordinance, now nearly ten years old, has never been used to recapture benefits from a relocating business. According to advocates involved in its passage, an ordinance in St. Paul in 1989 (see below) has gone unused.

Why hasn't government used existing accountability legislation? It is possible that the opportunity has not arisen, yet given the amount of early legislation in a variety of places, this seems unlikely. In order to discover what has and has not worked in the area of accountability legislation, I examined two cases for which I was able to collect adequate information: Louisiana's experiment with an environmental scorecard linking the amount of tax exemptions to environmental compliance and St. Paul's experiment with a Jobs Impact Statement requiring a cost benefit analysis. From those cases, I draw lessons for policymakers designing current state legislation.

Introduction: Case Studies in St. Paul and Louisiana

¹³¹For additional examples of local legislation, see LeRoy, *supra*, note 9.

A detailed study of attempts to use accountability mechanisms in St. Paul and Louisiana offers a useful comparison for recent state-level legislation. First, initiatives in St. Paul and Louisiana are old enough that there is a trail of what happened after legislation passed. Second, both initiatives have been touted in the literature as exemplary forms of accountability legislation. The Louisiana Scorecard even won several awards, including one from The Center for Policy Alternatives which named it one of the ten most innovative state programs of 1990.¹³² Finally, the two initiatives are similar types of accountability with different design. Both principally rely on ex ante evaluation of applicants for incentives. However, the initiatives contrast significantly in how they are designed; St. Paul's ordinance is cast in permissive and somewhat vague terms while review in Louisiana employed much more specific mandates.

CASE STUDY: ST. PAUL

In 1989, the St. Paul City Council and Mayor's Office approved a city ordinance mandating that the city not acquire property for redevelopment purposes if such acquisition would lead to a decrease in employment or a plant closing in the city. In addition, the ordinance required all city development projects to assess their job creation/job elimination potential through the use of a Jobs Impact Statement. This case illustrates several points. First, the case demonstrates that public participation is not adequate to regulate the economic development incentive process. Second, the case demonstrates that the language of legislation may over time become less meaningful such that the legislation does not provide the accountability its proponents expected. Finally, the St. Paul case does show that even less-than-perfect legislation may nonetheless influence political dynamics.

¹³²Thomas Hilliard, *Report Card on Louisiana's Environmental Tax Scorecard*, 92 State Tax Notes 23-13 (1992).

Background

Blunders by the cities of St. Paul and Minneapolis provided much of the impetus for the Jobs Impact ordinance. In the late 1980s, Minneapolis constructed a large downtown convention center and parking ramp. Among the buildings it purchased for land acquisition was the site of Continental Baking Company. Continental had 160 well-compensated union workers, most of whom were city residents. Forty percent of the employees were women and 40% people of color. The city made no efforts to relocate the bakery assuming it would find a new site in Minneapolis. Instead, the bakery chose to close its Minnesota operations entirely and now ships its product into the state from Illinois.¹³³ One organizer familiar with the situation stated, "The city in effect eliminated jobs it would normally give its eye-teeth for."¹³⁴

At the same time, St. Paul began land acquisition for a large riverfront redevelopment area. The city bought out the Harvest States Co-op grain elevator resulting in the elimination of 11 jobs. The least senior employee had worked sixteen years at the facility, and all employees were over 50 years old.

The two incidents led to extensive campaigns around the cities' economic development policies and the lack of benefits for displaced workers. The combined efforts of church and labor groups garnered a benefits package of health, child-care and educational benefits for the displaced Continental Bakery workers. Organizers also pushed for legislation that would require the cities to consider the impact of development efforts on employment. The Minnesota Working Group on Economic Dislocation began drafting an ordinance that would become the Jobs Impact Statement

¹³³Telephone interview with Dennis Dorgan, Minnesota Working Group on Economic Dislocation (September 29, 1994) and Minnesota Working Group on Economic Dislocation, Public Accountability Project Grant Proposal, (1993)(on file with the author).

¹³⁴*Id.*

ordinance. Dennis Dorgan drafted the original version which would have required the city evaluate the employment impact of a project as soon as the city began considering redevelopment or offering development incentives. No incentives or assistance could be offered until it was shown that the jobs created would exceed area median wage. Further, under the original proposal, projects that would create job loss would not receive approval for assistance or would receive approval only if they provided full health care coverage for employees.¹³⁵

The initial proposal met opposition, particularly from the St. Paul Office of Planning and Development. The office wanted more flexibility in working with business or redevelopment projects. Ultimately, the Working Group agreed to support the present version but planned to carefully monitor compliance and organize around any failures by the city to enforce the ordinance.¹³⁶ The City Council passed the ordinance in 1989.

The Jobs Impact Statement

The St. Paul ordinance first requires a Jobs Impact Statement be completed for any proposed development receiving financial or technical support from St. Paul, including federal funds administered by the city, revenue bond financing, planning assistance, tax increment financing, tax levies or any other form of assistance. Procedurally, the Statement must be submitted for review and comment to workers who may be displaced, labor unions which represent them, the local district planning council and affected or interested community organizations. Further, the Statement must go through a public hearing before a development project may be approved.

¹³⁵*Id.*

¹³⁶*Id.*

The Jobs Impact Statement must identify the following: 1) the number and type of jobs to be created/eliminated; 2) the wage and benefit rates for the jobs; 3) any indirect job loss attributable to the project such as job loss to suppliers; 4) the total projected costs of redevelopment assistance; 5) demographics of the affected workforce; 6) skill levels for jobs created/lost; 7) the likelihood that displaced workers will find jobs with comparable pay and benefits; 8) the developer or employer's record for meeting job creation projections; and 9) a public monitoring process for insuring compliance with job creation projections. In addition, the ordinance requires that displaced workers receive benefits including retraining funds, preferential hiring, health insurance benefits of up to one year and supplemental unemployment insurance payments as well as other benefits.¹³⁷ Apparently, the benefits listed in the ordinance are a laundry list of benefits already offered by the state and city.¹³⁸

Implementation and Impact

Despite the Minnesota Working Group's expectations that the Jobs Impact Statement would provide a process to make the city of St. Paul and businesses receiving development incentives accountable, sources agree the ordinance has been largely ineffective. The Jobs Impact Statement is used mainly with applications for commercial loans from the city. Currently, the city uses a three phase process for complying with the Jobs Impact Statement. In the first stage, a project requesting assistance gives a brief description of its proposed development and lists the number of jobs to be retained, created or eliminated. According to a staffperson at the St. Paul Department of Planning and Economic Development, no applicant has ever projected

¹³⁷1989 St. Paul Ordinance, see Appendix III.

¹³⁸Telephone interview with Wayne Young, Planner, City of St. Paul, Workforce Development Division (October 10, 1994).

that it would eliminate jobs. If an applicant did forecast job elimination, the Department would, hypothetically, make further inquiry in the second phase. The third phase, which occurs after the project is completed, requires assistance recipients to report the number of jobs created.¹³⁹

During the three-stage process, the Department relies entirely on figures from business; it does no independent investigation. Department staff reports, however, that a project's forecasts are carefully reviewed. Experienced city project managers look out for projects where job creation promises are unrealistic given other indicators such as projected square footage and payroll. In addition, scrutiny is now largely left to Department staff. Drafters of the ordinance expected the mandate of a public monitoring process would mean review by City Council. Instead, the Department now apparently interprets the language to merely require monitoring from a public body, the Department itself.¹⁴⁰ Finally, a source in St. Paul city government reports that the Jobs Impact Statement now receives more attention as an early estimate of what jobs may be created by a project. That information is passed on to the city's labor training department where staff searches for jobs for JTPA students.¹⁴¹

Early proponent of the Jobs Impact Statement ordinance now complain that there has been no enforcement and that no project has ever been denied assistance on the basis of a Jobs Impact Statement.¹⁴² In addition, no Jobs Impact Statement has become the focal point for an organizing campaign as the drafters expected. Instead, the statement has become perfunctory, a formality in the process of granting incentives which must be complied with but need not be taken seriously.

¹³⁹Interview with Katherine TerHorst, St. Paul Department of Planning and Economic Development (November 8, 1994).

¹⁴⁰*Id.*

¹⁴¹Young interview, *supra*, note 138.

¹⁴²Dorgan interview, *supra*, note 133.

Dorgan, the drafter of the original version of the ordinance, believes the ordinance's lack of impact is due to its design. Enforcement is entrusted to a city department that is in the business of creating deals to attract business. Dorgan notes:

The antipathy to this legislation runs deep. At best, they'll be lukewarm. The people are dealmakers and expeditors. Enforcement must be separate from the deal-making division. If put together, it's doomed.¹⁴³

Another source within the planning department attributes the lack of effectiveness to the lack of a vocal advocate demanding continued scrutiny of development deals. He states:

It is just one of those things like the way organizations work. All the people on City Council are gone and the staff has turned over four times. People forget it exists.¹⁴⁴

Dorgan does note, however, that the Jobs Impact Statement has had some incidental effect. The city increasingly emphasizes assistance for projects with higher wages and is educated enough about the ramifications of its economic development policies that it has not supported another incident like the purchase of the Harvest States grain elevator.

The original proponents of the ordinance are now calling for a different strategy relying on public participation rather than bureaucratic review. In an attempt to revive accountability in the economic development process, the Minnesota Working Group has been seeking to fund a Public Accountability Project. The Project would research the results of publicly supported development initiatives, create a manual offering the average citizen a guide to public finance and develop guidelines for public financial support, targeting public support and accountability. Overall, the objective of the Project is to create public awareness of and dialogue about publicly financed economic

¹⁴³*Id.*

¹⁴⁴Telephone interview with Staff, City of St. Paul, Planning Department (October, 1994).

development strategies. While the Jobs Impact Statement might be used, the Project would not rely on a process that hinges on the vigilance of the Department of Planning. Instead, the hope is that the public will become a watch-dog bringing more scrutiny to the process and improving the public's return for investment of its resources. Thus far, the project has not been funded.¹⁴⁵

CASE STUDY: LOUISIANA

For a single year, Louisiana attempted a valiant feat, linking its 50 year old business property tax exemption to a firm's environmental compliance. Several factors make this an interesting case. First, in many senses, the effort, the Louisiana Environmental Scorecard (the "Scorecard"), was quite successful. Toxic emissions in the state were reduced, and the Scorecard was touted nationwide as innovative policy. Yet, the Scorecard became a focus of political opposition to the state's governor. After Governor Edwin Edwards was elected in 1992, his first act was to abolish the Scorecard. The Louisiana initiative thus illustrates that politics are extremely influential. Nevertheless, even in a politically hostile climate, linking a tax exemption to an evaluation component and job-quality standard is possible and even quite productive.

Background

Since the 1930s, Louisiana has included in its constitution a ten-year property tax exemption (five initial years plus five additional) for new and expanding plants. The exemption covers state, parish and municipal property taxes on buildings,

¹⁴⁵Dorgan interview and Grant Proposal, *supra*, note 133.

equipment, machinery and improvements to land. Authority to grant the exemption rests with the Board of Commerce and Industry (the "Board.") However, in a twist which proved significant for the Louisiana Scorecard, the governor has final approval over the exemption, and the exemption may be granted "on such terms and conditions as the board, with the approval of the governor, deems in the best interest of the state."¹⁴⁶

The Board granted approvals and renewals routinely. In 1982, for example, only one of 559 exemption applications was denied. In 1983 and 1984, no applications were denied, and in 1985, of 430 applications for exemptions, only three were denied.¹⁴⁷ Consequently, Louisiana parishes and towns suffer significant losses of tax revenue. In 1989, for example, the Louisiana Coalition for Tax Justice estimated \$275 million in property taxes were exempted for manufacturing industry.¹⁴⁸ The Department of Economic Development estimated the average annual figure to be lower at approximately \$143.7 million per year.¹⁴⁹ Either figure is certainly significant in a state which ranks among the lowest in the nation in terms of per capita income and which has suffered several huge budget shortfalls in the last decade.¹⁵⁰

While the constitutional tax exemption has been called "the closest thing to a sacred cow in Louisiana" and "the ball game" in terms of economic development policy in the state,¹⁵¹ it has not been without opponents. In particular, critics have focused on some of the bigger recipients of the state's exemption policy: large refineries and producers in the chemical, petroleum and paper industries.¹⁵² Because these firms are capital intensive, they capture large savings from the exemption. At the same time,

¹⁴⁶LA. CONST. art. VII, @21(F).

¹⁴⁷Oliver Houck, *This Side of Heresy: Conditioning Louisiana's Ten-Year Industrial Tax Exemption upon Compliance with Environmental Law*, 61 Tul.L.Rev. 289, 296 (1986).

¹⁴⁸Stephen Farber, Robert Moreau and Paul Templet, A Tax Incentive Tool for Environmental Management: An Environmental Scorecard 5 (1994)(Ecological Economics, forthcoming)(manuscript on file with author).

¹⁴⁹Hilliard, *supra*, note 132.

¹⁵⁰*Id.*

¹⁵¹Houck, *supra*, note 147 at 292, 294.

¹⁵²*Id.*

Louisiana has a poor record of environmental enforcement. In 1989, the state ranked second highest in a nationwide EPA ranking of toxic discharges. The same year the state Department of Environmental Quality reported industry in the state produced 27.4 billion pounds per year of hazardous waste, over two tons for every resident of Louisiana.¹⁵³

Organizers investigating large polluters often discovered these firms were among the biggest recipients of state largesse from tax exemptions. For example, Baton Rouge citizens attempting to block a PCB incineration plant planned by a corporation with a long record of environmental violations discovered the plant had applied for \$2.5 million in tax exemptions. In an unprecedented move, the governor and the Board deferred and then blocked the exemption application in 1984.¹⁵⁴

Early attempts to link environmental compliance and the exemption in legislation had mixed results. In 1982, a state representative from New Orleans introduced legislation to condition the exemption on compliance with environmental laws; the proposal died in committee.¹⁵⁵ In 1986, Oliver Houck, a professor at Tulane, published an article advocating a statutory link between environmental compliance and assistance from the board. The article emphasized the state's poor record in environmental enforcement and the board's lack of interest in environmental compliance as it exempted millions of dollars in tax revenue.¹⁵⁶

While Houck's article prompted no action in the state legislature, sentiment against the exemption continued to grow. Advocates of a link between environmental compliance and economic development took advantage of political opportunities in the late 1980s to establish the Scorecard. Internally, Paul Templet, director of the Department of Environmental Quality (DEQ) began pushing a proposal which became

¹⁵³Hilliard, *supra*, note 132.

¹⁵⁴Houck, *supra*, note 147 at 291.

¹⁵⁵*Id.*

¹⁵⁶*Id.*

the Scorecard.¹⁵⁷ Externally, Robert Kuehn of the Public Law Center and Tulane Environmental Law Clinic put pressure on the Department of Economic Development by filing a rulemaking request. Kuehn and the public interest groups he represented believed their previous strategy of opposing individual applications to the Board had only limited effect. More systemic reform was needed. The request asked that the DED impose environmental scrutiny of tax exemption applications on the basis of a provision in the state constitution requiring that the state's resources be "protected, conserved and replenished." The section had been interpreted by the Louisiana Attorney General to mean state agencies had an affirmative duty of environmental protection.¹⁵⁸ The original rulemaking request proposed a system using an "all or nothing approach" closer to that proposed in Oliver Houck's article than to the form of the Scorecard ultimately adopted.¹⁵⁹

As pressure mounted, then Governor Buddy Roemer stepped in, instructing the Board to promulgate rules for environmental review of exemption applicants. The Board stalled, and the Governor asked a task force including Templet to draft rules. After the Board refused to act on the proposal and approved 111 exemption applications at its next meeting, the Governor flexed his muscle to push the Board. Roemer refused to approve all 111 exemptions unless the Board approved the Scorecard proposal.¹⁶⁰

Negotiations ensued as the proposal was modified to address some concerns of industry and the Board.¹⁶¹ In particular, industry bristled at the Scorecard's proposed retroactive effect back to 1988 and the "entire program's bias against industries which

¹⁵⁷Telephone interview with Paul Templet, former Secretary, Louisiana Department of Environmental Quality (October 5, 1994).

¹⁵⁸Interview with Robert Kuehn, Tulane Environmental Law Clinic, November 8, 1994.

¹⁵⁹*Id.*

¹⁶⁰J. Andrew Hoerner, *Uniting Environment and Development: The Louisiana Tax Scorecard*, (case study prepared for the International Institute for Sustainable Development, June, 1994, on file with author) at p. 3.

¹⁶¹Templet interview, *supra*, note 157.

make up the state's economic base."¹⁶² Despite the opposition, in December of 1990, a rule was adopted that implemented the Scorecard.¹⁶³

The Scorecard System

Generally, the Scorecard graded applicants for tax exemption on the basis of four elements: a firm's record of environmental compliance, a jobs-per-emissions factor, bonus points for various activities and penalty points for specified hazardous activities. The applicant's score corresponded with the percentage of the tax exemption to which the firm would be entitled. For example, a firm scoring 88 would receive 88% of what its full tax exemption would have been.

First, applicants could score a maximum of 25 points for their environmental compliance history. Only final actions no longer subject to appeal were considered. Points were subtracted from the maximum of 25 according to the table below.

<u>Violation fine</u>	<u>Points subtracted</u>
\$0-\$3000	1
\$3001-\$10,000	5
\$10,000-25,000	10
\$25,000 & up	15
Criminal/Felony Violations	20 ¹⁶⁴

The Scorecard further weighted points depending on the age of the violations. In addition, incentives were created to settle penalties. Any polluter which voluntarily

¹⁶²*Governor Signs off on Heavily Revised Scorecard*, Louisiana Industry Environmental Alert, Vol. 6, No. 5 (May, 1991).

¹⁶³*Louisiana Board of Commerce of Industry Backs Proposal to Tie Tax Breaks to Pollution*, State Tax Notes (Jan. 11, 1991).

¹⁶⁴Robert Moreau and Paul Templet, Louisiana's Environmental Scorecard, (excerpt from Master's Thesis of Robert Moreau on file with author) at p. 3.

agreed to a settlement with the DEQ would receive a 50% reduction in the points subtracted from its grade on the Scorecard.¹⁶⁵

The second component of the Scorecard was a Emission-per-Job Ratio worth a maximum of 25 points. The numerator of the ratio, emission, was calculated based on Environmental Protection Agency data showing company's emissions of toxic and criteria air pollutants in the past year. Criteria air pollutants were weighted at one-tenth their total while lead emissions were valued at 100%. The denominator was the number of jobs provided. This number was calculated based on total payroll dollars (data from the Louisiana Department of Revenue) divided by \$25,000. Once the pounds of emissions per job was calculated, the Scorecard awarded points based on the table below:

<u>Pounds of Emissions per Job</u>	<u>Points Awarded</u>
0-500	25
501-1000	20
1001-2500	15
2501-5000	10
5001-10000	5
10000 & up	0 ¹⁶⁶

An applicant could also take advantage of bonus points awarded according to the following table:

<u>Activity</u>	<u>Points Awarded</u>
Designing an Emissions Reduction Plan	15 maximum
Use of closed loop recycling	5 maximum
Companies primarily engaged in recycling	10 maximum
Jobs in High Unemployment Areas	15 maximum
Diversification (industry which diversifies the state economy)	10 maximum ¹⁶⁷

¹⁶⁵*Id.* at 4.

¹⁶⁶*Id.*

¹⁶⁷*Id.* at 4-5.

Finally, the Scorecard heavily penalized certain activities. Tax exemptions were reduced by 50% for any facility where the total product of emissions was comprised of more than 20% banned or designated-to-be-banned materials. Importers of hazardous waste also faced heavy penalties. The Scorecard disallowed exemptions for companies which imported more than 15% of their total hazardous waste product from out of state for disposal or incineration in Louisiana.¹⁶⁸

Implementation and Impact

The Board used the Scorecard to review 382 applications for a tax exemption.¹⁶⁹ Interestingly, applicants did not rank as low as one might expect. Scores ranged from 67.5 to 100. Twelve firms which initially scored low increased their scores by committing to an emissions reduction plan that would further reduce pollutants by 141.8 million pounds.¹⁷⁰ According to DEQ, the average firm received 94.9% of its requested exemption.¹⁷¹

The DEQ estimated a tax savings of \$5.4 million over ten years as a result of reductions in exemptions for firms scoring less than 100.¹⁷² Additional benefits have been noted. Proponents of the Scorecard have written about it extensively and credit it with prompting planned reductions of nearly 180 million pounds of various pollutants.¹⁷³ In addition, proponents stress the improved business behavior that the

¹⁶⁸*Id.* This penalty for importation of out-of-state waste has potential Commerce Clause implications, but was never challenged. See, e.g., *Chemical Waste Management v. Hunt*, 112 S.Ct. 2009 (1992); *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

¹⁶⁹Moreau and Templet, *supra*, note 164 at 5.

¹⁷⁰Hoerner, *supra*, note 160 at 10.

¹⁷¹Hilliard, *supra*, note 132.

¹⁷²*Id.*

¹⁷³Farber, Moreau and Templet, *supra*, note 148 at 13.

Scorecard generated. Because the Scorecard itself offered a single, easy-to-understand index of how a firm was performing in terms of its environmental record and economic development payoff, public attention focused on the issue of linking those concerns. Industry began competing for a better score.¹⁷⁴ Finally, the Scorecard changed perceptions. Local government became aware of how much revenue the Board excluded from its coffers. Publicity about the Scorecard generated skepticism about the constitutional tax exemption generally. Even after the Scorecard's demise, there has been some interest in the state legislature in abolishing the ten year exemption altogether.¹⁷⁵

Reaction

Whatever its impact, the Scorecard was less successful in weathering opposition both from environmentalists and industry. Environmentalists complained its criteria were conciliatory towards industry and became especially vocal after amendments to the rule further softened the Scorecard. In April, 1991, Robert Kuehn, the attorney who first requested rule-making linking the tax exemption to environmental compliance filed comments with the Board supporting the Scorecard concept but demanding standards be toughened.¹⁷⁶ Another early proponent offered more piquant criticism stating:

These companies don't come to Louisiana for the tax break to begin with: they come for the low wages, because we're close to the Mississippi River and the Gulf, but not to get tax breaks. So the 10-year exemption is just ice cream for them. You can't change a company's behavior by taking away five percent of their ice cream.¹⁷⁷

¹⁷⁴Hoerner, *supra*, note 160 at 12.

¹⁷⁵Kuehn interview, *supra*, note 158.

¹⁷⁶*Id.*

¹⁷⁷*Id.*

Within government, opponents described the difficulties the Scorecard posed as the state struggled to attract business. A spokesman at the Department of Economic Development noted the "layer of uncertainty" the Scorecard created. In addition, several opponents criticized the link between environmental record and economic development claiming the DEQ and DED should remain in their separate spheres.¹⁷⁸

Finally, industry complaints about the Scorecard emphasized an unfair bias throughout the Roemer administration against the biggest business in the state and castigated an overreaching DEQ. Speaking after the Scorecard was abandoned, the president of the Louisiana Chemical Association, Dan Bourne, called it "a discriminatory attempt to penalize the petrochemical industry." He added, "It [the Scorecard] tried to depict our jobs as dirty jobs. It tried to discourage that type of investment. It belongs exactly where it is, in the graveyard."¹⁷⁹ Further, Borne criticized the DEQ as acting as though it had expertise beyond its bailiwick stating:

My perception of the previous administration was that the DEQ felt it had more expertise in economic development than the DED [Department of Economic Development]; that it has more expertise in Health than the Department of health and that it had more expertise in taxation than the Department of Revenue and Taxation. I suggest to you that it didn't. But there were statements and sometimes inferences coming from DEQ that exhibited that it was the repository of all that was good, fair and positive in the state.¹⁸⁰

One commentator attributes the opposition the Scorecard encountered to industry's view of the ten year tax exemption as a right never previously denied them.¹⁸¹

Most importantly, the Scorecard became a major target for attack during the 1992 Louisiana governor's race. Ultimately, the Scorecard died along with the administration that created it. Governor Roemer was defeated in the gubernatorial

¹⁷⁸*Id.*

¹⁷⁹*Roundtable: Business and the Environment*, The Greater Baton Rouge Business Report, (April 7, 1992).

¹⁸⁰*Id.*

¹⁸¹Kuehn interview, *supra*, note 158.

primary. Three-time governor Edwin Edwards defeated David Duke in the general election. Two days after his inauguration as his first official act, Edwards announced he would get rid of the Scorecard citing the "mixed signals" it sent as the state tried to attract industry.¹⁸² In addition, Edwards appointed Kai Midboe, a lawyer who had represented oil and gas firms, as Secretary of the Department of Environmental Quality. Midboe quickly expressed opposition to attempts to revive the Scorecard and instead promised his department would work with business early in the development process to ensure environmental compliance.¹⁸³

Lessons from St. Paul and Louisiana

One could say the attempts to make the incentive process more rational in Louisiana and St. Paul are hardly heartening. One attempt sowed the seeds of resentment which destroyed a political administration. The other attempt has been largely ineffectual. However, the success or failure of these measures is difficult to measure. As noted earlier, it is not the goal of accountability legislation to entirely eliminate incentives. Rather, the intention is that a process be used to evaluate the benefits of investing public money in a given enterprise. At the very least, measures in both St. Paul and Louisiana changed the way government approached giving incentives. In addition, the case studies point out several issues crucial for policymakers designing current accountability mechanisms and interested in avoiding some of the problems which confronted St. Paul and Louisiana. Those issues are summarized below.

A. Design Matters

¹⁸²Hoerner, *supra*, note 160 at 5.

¹⁸³Roundtable, *supra*, note 179.

First, the experiences in Louisiana and St. Paul demonstrate that design matters. As shown with the legislative summaries in Appendix I, accountability mechanisms come in a variety of forms; there are a number of tools from which policymakers may choose. Not every tool is as useful as the next, however. More important, it matters who reviews and approves requests for assistance. Second, it matters what data are used. Third, it matters whether the review is couched in mandatory or permissive language.

In St. Paul, organizers believed a Jobs Impact Statement would allow the city to protect the public's interests when assisting development projects by sifting out projects that had negative impacts. In fact, the review is now perfunctory. As pointed out by Dorgan, parties with an interest in expediting deals now "evaluate" them.

Second, the data sources for evaluation of a project in St. Paul and Louisiana are quite different. In St. Paul, the city relies on figures from developers, conducts no independent inquiry and has no real process for sanctioning businesses that do not meet their promises. The city reports that it has never received an application from a developer projecting job loss. Given that simply projecting job creation is enough to pass muster and that applicants are not penalized for not performing, this is hardly surprising.

In contrast, Louisiana computed much of its Scorecard on the basis of numbers that could not be fudged and that were compiled by entities impartial to whether or not a particular business got a tax break. The jobs-per-emissions ratio, for example, used information attainable entirely from independent government sources.

Third, whether legislation is couched in mandatory or permissive language certainly matters. Some parts of the Scorecard were not discretionary. Businesses which imported a high amount of hazardous waste were excluded from the exemption entirely. In addition, the evaluation of applicants for the exemption was principally performed on the basis of real data rather than projections. This left the Board of Industry and Commerce, which had been hostile to a link between economic

development and the environment, little room to skirt administrative rules. In contrast, the St. Paul ordinance mandated a review of a project's projected impact. It did not force any particular levels of job creation, job quality, etc. Those standards were left to the discretion of the city Planning Department.

B. Sunshine is Important but not Enough

Much of the early city ordinances relied principally on public participation in the economic development process to improve policy. The thinking was that the sunshine of public attention would cure a sick system. Indeed, organizers in St. Paul believed, no matter the final form of the Jobs Impact Statement ordinance, they would force accountability by monitoring city practice. In reality, given a lack of funding and competing needs, proponents have been unable to devote attention to keeping tabs on the city.¹⁸⁴ Early organizers in Louisiana also organized around public participation and information, calling attention to individual blunders by the Board of Industry and Commerce. However, leaders chose to pursue a broader strategy at the same time, pushing for rulemaking at the Board. While the result of that process, the Scorecard, is now defunct, its success demonstrates the impact of advocating policy change at higher levels of government.

No doubt, greater public participation in and education about economic development would improve the process. In addition, organizing may provide the groundwork for more systemic change, and noisy interest groups keep policy alive. Yet, on its own, public participation it is not likely to be a sufficiently strong or reliable force for accountability. In addition, the recent emphasis at the Minnesota Working Group on public education suggests that the public's lack of understanding for what is often a complicated process lessens its ability to scrutinize economic development policies.

¹⁸⁴The Calumet Project which pushed for accountability legislation mandating public participation in three Indiana cities and before the Indiana State Legislature similarly reports that, due to lack of staff, it has been unable to monitor compliance with any of the legislation for which it lobbied. Interview with Staff, the Calumet Project (November, 1994).

C. Perceptions Matter

The perceptions of stakeholders in the economic development process matter. What interest groups perceive they are losing is crucial. Business in Louisiana believed it was losing a near right to the ten year tax exemption. Had that tax break not been so deeply ingrained in the state's economy by years of virtual rubber-stamping from the governor and Board of Industry and Commerce, opposition to the Scorecard might not have been so strong. In addition, the petrochemical business was especially inflamed by what it perceived to be the DEQ singling it out as a target for new state policies on economic development and the environment. Reform of the tax exemption that did not so directly impinge on this single (and powerful) industry might have survived.

D. Politics Matter

As academic commentators like Wolman acknowledge, politics is very much a part of economic development. If pleasing interest groups (especially business) were not a concern of government, one might expect economic development policy long ago would have reflected academic findings. Instead, the Louisiana Scorecard, which some commentators describe as a truly mild stopgap, met with enormous opposition and became a major campaign issue. While the entitlement-like stature of the tax exemption, discussed above, may have made business especially irate, the Louisiana experience clearly demonstrates that policymakers cannot approach incentives unaware of politics. Similarly, as reported by Planning Department staff, changes in the St. Paul City Council affected the Jobs Impact Statement because there was not a clear advocate for its use.

At the same time politics are dynamic and do not demand perpetual catering to business. The perception that the public wants business to be held accountable may alone change dynamics. This may well be the greatest legacy of accountability mechanisms in St. Paul and Louisiana. In St. Paul, actual legislation is largely ineffective. Yet, one should not label the effort a failure. Even critics of what the Jobs Impact Statement has become acknowledge that the city and business are at least more

attuned to understanding development incentives as a reward for good projects rather than an entitlement for any applicant.

Similarly, even after its demise as official policy, the Scorecard continues to have some effect in Louisiana. With increased citizen awareness of the potential for using the tax incentives as a tool for other policy goals, the ten-year exemption is perhaps less of a sacred cow. While Louisiana industry no longer receives a grade for its environmental compliance that affects its incentive from the state, it can no longer assume an outright entitlement to that tax break.

CHAPTER FIVE: CHANGING DESIGN AND CHANGING ATTITUDES

In the four preceding chapters, I have outlined the case supporting use of accountability mechanisms, reviewed recent state legislation, and looked at some design and implementation issues based on two case studies. Overall, the picture shows promise. States are increasingly following the long-held academic wisdom on development incentives and are attempting to be rational when granting incentives.

Of course, states have certainly not stopped granting incentives altogether. A 1994 legislative review found 83% of states approved new development incentives in that year alone.¹⁸⁵ Additionally, it is not obvious that states intend to be vigilant about enforcing the accountability mechanisms now on the books. In a recent advertisement in *Site Selection*, a magazine aimed at business and real estate executives involved in relocating businesses, Oklahoma touted its Quality Jobs Program, as a "money back guarantee...your pencil pushers can really sink their teeth into."¹⁸⁶ (See Fig.2.) Oklahoma did not mention that after year three of "guaranteed cash back", a business must verify that its payroll for new jobs exceeds \$1,000,000. (See Appendix I.) One wonders how likely Oklahoma will be to enforce that part of the legislation if it is, as the ad suggests, simultaneously bending over backwards to be business-friendly.

In addition, assuming tax incentives are, as much of the literature suggests, misguided economic development policy, accountability mechanisms arguably at best offer a minor ray of hope in the midst of an otherwise misbegotten game. At worst, accountability mechanisms are actually a form of co-optation. By making bad policy (chasing business with incentives) seem rational (because a cost/benefit analysis is performed or recapture is possible), accountability mechanisms perpetuate the ill-effects

¹⁸⁵Venable, *supra*, note 45.

¹⁸⁶Advertisement from *Site Selection*, June, 1994.

of interjurisdictional competition. Interest groups which might otherwise organize against incentives instead fight the battle for accountability mechanisms and, consequently, lose the war.

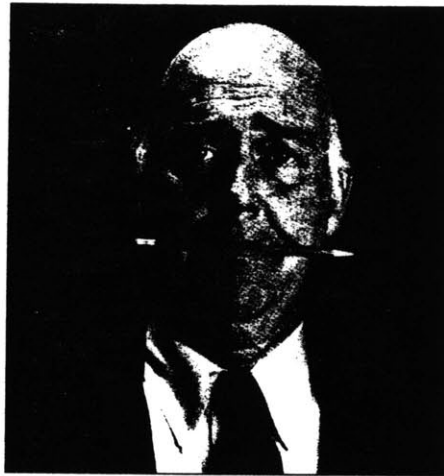
While abandonment of incentives altogether might eliminate the problems of interstate bidding for business, it is not likely to happen. States will not unilaterally disarm. The federal government does not appear likely to force a truce. Thus, accountability mechanisms do offer an improvement from today's deadlock. In addition, better design could alleviate some of the problems already mentioned such as the reluctance of government officials to enforce legislation. Further, if this change in policy were accompanied by a more distinct change in rhetoric about incentives, attempts to make business more accountable might better succeed.

In the paragraphs below, I make recommendations for improving both the design of accountability mechanisms and their political context. To understand what would be an optimal strategy for making business accountable for development incentives, I discuss an analogy to traditional lending. Further, because I believe it is simplistic to argue that government should act like a lender, I also discuss changes in rhetoric and perception necessary to improve the politics that surround economic development policy.

Devising an Optimal Accountability Policy

There exists a ready analogy against which current accountability mechanisms might be judged. That analogy is lending and, specifically, construction lending. In the paragraphs below, I suggest optimal policy using accountability mechanisms would most resemble the way financial institutions approach often risky lending for construction.

Oklahoma's Money Back Guarantee is something your pencil pushers can really sink their teeth into.



You'll get money back when you move your business to Oklahoma. Guaranteed. Which could make you and a lot of people in your company very happy.

And we aren't talking about "potential" profits. (Although we can give you the names of hundreds of companies that have found Oklahoma a very profitable place to be.)

We're talking cash. Money. The stuff your accountants' dreams are made of. And lots of it. Coming to you in regular quarterly payments that can add at least a million dollars to your bottom line.

It's all part of Oklahoma's Quality Jobs Program.

And the way it works is simple. Since so many companies have found that our work force is as much as one-third more productive than the rest of the nation's, we're confident our workers will do a Quality Job for you, too.

So confident we'll guarantee you'll get money back, if your company qualifies.

The Quality Jobs Program/Money Back Guarantee pays your company based on a percentage of your total payroll in

Oklahoma. You'll get direct cash payments of up to 5% of your total payroll, every quarter for up to ten full years.

You pay our workers, we pay you back. It's that simple.

So simple in fact, that if you give us 24 hours, we'll give you a cost/benefit analysis on how much money you can expect. We'll also tell you about

Oklahoma's other advantages. All free.

And all you have to do is call (also free). We'll give you the numbers.

You give them to your accountants.

And then you can watch as the feeding frenzy begins.



1 - 8 0 0 - 5 8 8 - 5 9 5 9



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CIRCLE #297

Fig. 2

To understand the analogy, I begin with a development project in State A. Company X wishes to locate a plant in State A and approaches the state about what assistance it might offer. X also expects to borrow \$10 million for construction costs and approaches Lender B. Despite protestations by the NGA and academics alike, one can expect that A will offer incentives of some sort, probably with an eye to what other states might offer. It would be irrational for a state to offer more in incentives than it will receive in return for its investment; however, A still may do just that. First, A is not even aware of what return it wants--beyond vague goals like "jobs"--or what return it might actually receive or whether that return justifies spending state resources. Second, feared or real competition from other states may drive up the incentive package. Third, the incidental yet politically beneficial effects of attracting business may cause public officials in State A to offer more in benefits to business than it will receive back for the public. In a separate blunder, A is unlikely to take steps to evaluate the riskiness of the assistance or to try to ensure its return. A probably will not attach real strings to the money or insist on a process that makes X pay up if it reneges on the deal.

Assuming X is creditworthy, Lender B would also like to have X's business. But the conversation between B and X will be quite different from that between X and State A. First, B would expect that by lending to X, it can generate a rate of return competitive with or better than other projects. B will have a clear idea of the return it wants. In addition, B will consider how likely it is to receive that return and how it can improve the odds by scrutinizing the risk associated with X's project. B will consider if there are assets that might secure the lending. B will look at X's past performance history and the projections for this project. Ultimately, B will offer terms and conditions on the financing that will reduce the lender's risk. For example, the interest rate itself takes into account the project's risk. In addition, the lender will typically

disburse payments to the borrower as it demonstrates that it has completed phases of work on the project. Ideally, the borrower in a construction loan never "gets ahead" by drawing more funds than the value of the property which secures the loan. In this manner, the lender will avoid risk to its return.¹⁸⁷

If State A behaved like Lender B, prudently investing its money in X in order to garner a desired return, its interaction with X would be quite different. First, State A would think about the return it wants for a given amount of investment through an incentive. The return will not be as straightforward as in lending; there will not be some percentage rate of interest generated. Rather, government should expect a return for its investment in terms of benefits to the community such as job creation, increased tax revenue, stimulation of other business, etc. Like a lender, government should quantify the return it wants--number of jobs created, amount of tax revenue derived, etc.--given the amount of the public's money it invests. Several of the statutes listed above begin to explore this area as they demand to know how many jobs the project will actually generate and the quality of those jobs in terms of benefits and wage rates. The legislation might be pushed even farther by scrutinizing projects in light of a planned economic development strategy for the state.

Second, State A must concern itself with the safety of its return and the risk it is willing to undertake. Risk varies among types of projects. For certain projects, added risks may be worthwhile. For example, an incentive for a riskier project in a growing industry or an industry well matched to the state's economic base may be justified by a higher return in terms of economic growth.

Third, State A must take steps to guarantee the return for the public's investment. Some of the accountability mechanisms discussed above attempt to do this. An

¹⁸⁷This discussion is drawn principally from William Brueggman and Jeffrey Fisher, *REAL ESTATE FINANCE AND INVESTMENTS*, (1993). Note that one typical aspect of construction lending, a take-out loan which pays off the construction lender and provides permanent financing is not mentioned here as it is not relevant to the analogy.

especially popular option is the use of recapture of credits if a firm leaves or fails to reach its job creation/investment goals. While recapture is certainly an improvement over traditional policies that left communities like Ypsilanti without any recourse, it falls short of the construction lending model. Too often, recapture becomes discretionary because it is left to a public official to enforce. In the construction lending model, the lender ideally never releases more funds than it can recover from the asset. A borrower would never expect a lender to release all funds up front and bear the entire risk of the project's completion. Similarly, a state should not release funds until its return--in terms of jobs, investment, etc.--has accrued. By putting the burden on the firm to show that it has, in fact, qualified for its incentive, public officials are stripped of the discretion of choosing whether or not to enforce accountability mechanisms like recapture. Further, accountability becomes mandatory rather than permissive.

Changing Perception and Politics

Simply stating that states need to act more like lenders is not adequate. Obviously, states aren't lenders and are subject to concerns private actors don't confront. Any state taking the initiative in passing meaningful accountability measures is likely to suffer at least initially in terms of its "business friendliness" rating. Incentives have become a deeply ingrained part of the way states vie for economic development. As the Louisiana case study demonstrates, many business interests now expect incentives like tax breaks and battle fiercely if attempts are made to curtail them.

Thus, states also need to change the way the game is perceived both by business and the public. Government officials need to refocus the rhetoric around incentives when dealing with business. States should abandon any incentive that looks like an entitlement. If firms deserve assistance at all, it is not because they simply locate in the state. Rather, firms deserve assistance based on the value they add to the state's

economy. Second, instead of justifying any incentive package as what is necessary for bagging new industry at untold costs to the taxpayer, states should focus on the particular rewards of the deals into which they enter. On behalf of the public, government officials are investors. When offering incentives, they infuse the public's money into firms with the expectation of a return. The deal should be couched in those terms when negotiating with business. States should not act as if they can gamble any more freely than would a private investor.

Finally, in order to justify accountability to the public, accountability mechanisms should be placed within the larger context of changing the way government operates. The recent wave of accountability legislation has coincided with two curiously similar trends in politics. First, there are increasing calls to "make government more like business." Candidates for public office in the 1994 Congressional elections specifically cited their background in business as experience relevant to government.¹⁸⁸ Second, states increasingly call upon the poorest recipients of government assistance, families on AFDC, to be "responsible" for the benefits they receive.¹⁸⁹

The recent wave of legislation using accountability mechanisms might be a distant cousin of the two trends described above. Moreover, whether or not one agrees with the arguments for making government more like business or reforming welfare, one can use the rhetoric to defend accountability mechanisms. Increasingly, the public voices an expectation of a return for public spending. Certainly, it should demand a concrete return from GM if it expects one from women and children on welfare.

¹⁸⁸In a debate during his senatorial campaign, candidate Mitt Romney, a venture capitalist, claimed he knew how to create jobs in government due to his "skills and experience in the private sector." R.W. Apple, *Kennedy and Romney Meet, and the Rancor Flows*, *The New York Times* (October 26, 1994) at A1.

¹⁸⁹For a review of several state welfare reform proposals and critique of their effectiveness see Lucy Williams, *The Ideology of Division: Behavior Modification Welfare Reform Proposals*, 102 *Yale L. J.* 719 (1992).

The pressures on cities and states to enter into incentive battles remain strong. At the same time, there is mounting public pressure to link public spending to tangible results. To put more sanity into the economic development process, communities cannot wait for the federal government to intervene or states to form non-competition compacts. They also cannot rely on judicial enforcement of implicit promises from business. If government officials and activists want to make development incentives into serious exchanges with efficient outcomes, the onus is on them to create the processes and design the legislation that will lead to that result. The onus is also on them to defend that legislation as necessary to satisfy the public's growing interest in rational economic development policy.

APPENDIX I—SUMMARY OF RECENT STATE LEGISLATION

(Note: The legislation described here was gathered in the following manner. First, I researched legislation described in Greg LeRoy's NO MORE CANDY STORE. Second, I read through the last several years of STATE TAX NOTES. Finally, I performed several on-line legislative searches using keywords and phrases related to this type of legislation.)

ALABAMA

Alabama has attached job quality standards to financing from its industrial development authority. Section 41-10-44 of the Alabama Code describes the powers of the Alabama Industrial Development Authority (AIDA). AIDA offers loans and credits enhancements to firms and approves companies on the basis of creditworthiness, the number of jobs which will be created, the type of jobs to be created and their quality. Specifically, jobs must provide pay of at least \$8 per hour or total compensation for all full-time employees must be \$10 per hour. For agricultural jobs, a variation of 10% is allowed from the standard.

ARIZONA

The Arizona Credit for Construction Costs of Qualified Environmental Technology Facility, §43-1080 of the Arizona Revised Statutes, grants a credit against corporate income tax for the construction of environmental technology, manufacturing, processing or production facilities. The credit is worth 10% of the amount spent during a taxable year to construct the facility (including site acquisition, building improvements, etc.) up to a maximum of 75% of income tax owed. The legislation authorizing the credit requires minimum job creation levels, sets a minimum length of operation for the facility and includes a recapture component.

To qualify for credit, the taxpayer must enter into a memorandum of understanding with Department of Commerce stating employment goals and the taxpayer's understanding that the department may stop, readjust or recapture all or part of the tax incentives provided to the taxpayer. If the taxpayer abandons the facility in less than 5 years, the taxpayer will be forced to repay foregone taxes in an amount depending upon the length of time the project was in operation. For example, if the project was placed in service at least two years but less than three years before ceasing operations, 60% of the credit must be refunded.

CONNECTICUT

New Jobs Tax Credit

Connecticut recently passed a New Jobs Tax Credit codified at §12-217(m) of the Connecticut General Statutes which includes job creation standards, scaling of benefits received to the project's impact and a recapture procedure. The credit is taken against corporate taxes and is directed at large scale business. The amount of credit increases with the size of the facility and number of employees according to the table below.

<u>Type of Facility</u>	<u>Qualifications</u>	<u>Amount of Credit</u>
Class I	occupies 250,000 square feet and has 1000 new employees	10%
Class II	occupies 500,000 square feet and has 2000 new employees	15%
Class III	occupies 750,000 square feet and has 3000 new employees	21.5%
Class IV	occupies 1,000,000 square feet and has 4000 new employees	25%

The Commissioner of Economic Development requires taxpayers to submit annually information to determine the amount of occupancy and number of employees. If it is determined that the project has not meet the space and employment requirements listed above, the credit ceases.

Recapture of the credit is also possible. If it is determined that, (1) there are fewer than 750 employees at the project for any period of more than 60 days during the six years following certification for the credit, (2) those employees are not replaced by in-state employees and (3) the employer has relocated operations from the new facility out of state, that employer has relocated facility outside state, the state will recapture a percentage of the credit granted. The recapture amount varies with the length of time the employer kept employment above 750 employees.

Connecticut Economic Development Authority

In other legislation at §32-5(a) of the Connecticut General Statutes, the Connecticut Economic Development Authority requires, as a condition of receiving financial assistance, that businesses agree 1) not to relocate outside the state for ten years after receiving such assistance or during the loan or guarantee, whichever is longer, unless the financing is repaid plus a 5% penalty and 2) that if the business relocates within the state, it will offer employment at the new facility to employees from its original location.

ILLINOIS

Recapture of improvements to real property

Illinois has clawback legislation effective January 1, 1992 codified at 740 ILCS 30/5. If at the written request of business, a state agency or unit of municipal government, acquires, constructs, improves or modifies any real property to induce business to locate or remain in the state and that business closes down or terminates operations within 2 years, the business is liable to the state agency or unit of government for damages. Damages are the cost of acquiring, constructing, improving or modifying the property.

Credit for High Impact Businesses

In addition, the state requires proof of possible job loss and employs a sorting mechanism by demanding proof of competition for site location when granting its Credit for High Impact Businesses. In order to receive the Illinois Credit for High Impact Businesses codified at 20 ILCS 655/5.5, an existing business must submit a plan showing 1500 full time jobs would be eliminated if the business were not designated. A proposed new facility must provide proof of alternative non-Illinois sites which would receive the project if it were not designated. If it is later determined that a business would have retained or created jobs without the designation, the statute instructs that the Revenue Department shall begin proceedings to recover all wrongfully exempted taxes

Illinois Training Grants and Loans

Finally, the Illinois Training Grants and Loans have a withholding component. These training grants, codified at 20 ILCS 4020/17, are made to employers who are expanding, relocating, or introducing more efficient technology. Twenty-five percent of the grant is withheld until the trainee has been retained in employment for 90 days after the end of the training, unless failure to retain the employee is due to medical disability or death. For occupations where 90 consecutive days of employment is not customary, retention during a probationary period of at minimum 500 hours is permitted.

INDIANA

In 1994, Indiana passed the Economic Development for a Growing Economy Tax Credit as part of a package of tax incentive legislation codified at Ind. code §6-3.1-13. The credit may be used against any state tax liability imposed on the taxpayer and includes mandatory cost-benefit analysis as well as sorting, scaling and sanctioning provisions. A credit-seeking business must apply for a credit through the Economic Development for a Growing Economy board. The board may enter into an agreement with the applicant if it determines all of the following conditions are met: 1) the project will create new jobs not previously performed by the applicant's Indiana employees; (2) the project is economically sound and will increase opportunities for employment; (3) the applicant verifies that there is at least one other state being considered for the project; (4) using best available data, there exists a significant disparity between the project's projected

costs in Indiana as compared with costs in another state (after including the impact of the other state's incentives; (5) political subdivisions have committed local incentives; (6) the tax credit is a major factor in the applicants decision and withholding the credit will result in the applicant not creating jobs in Indiana; and (7) the budget agency determines awarding the tax credit will result in an overall positive fiscal impact.

If an applicant passes muster, the board must determine the amount of the credit and enter into a tax credit agreement. The amount of the credit is determined on the basis of several factors including the magnitude of the cost differential between Indiana and a competing state, the potential economic impact and costs of the project and the amount by which average wages paid by the applicant exceed the average wage in the county where the project will be located. The tax credit agreement must include several provisions including a method for determining and reporting the number of new jobs created by the project, a requirement that the taxpayer maintain operations at the project site for at least two times the number of years as the term of the tax credit and any other performance measures deemed appropriate by the board.

Finally, Indiana includes a sanctioning procedure. If a tax credit recipient's reports show that it has not lived up to the terms of its tax credit agreement, the director of the Commerce Department may notify the department of noncompliance and request an assessment against the taxpayer, which may not exceed the sum of the credits allowed under this section.

IOWA

Iowa Community Economic Betterment Program

In 1992, Iowa passed its Community Economic Betterment Program, codified at Iowa Code § 15.313, which supports mainly rural businesses with debt and equity financing. Financial assistance from the program is given after the Department of Economic Development ranks applicants. The ranking factors include job quality analysis. For example, more points are awarded when the jobs which will be created are full-time and have a higher wage scale, better health benefits and lower turnover rate than other jobs. In addition, the department considers the impact on the state including whether the business will have in-state suppliers, its potential for future job growth, its prospects for diversifying the state's economy and the extent to which it will give preference for hiring state residents. Finally, certain businesses are disfavored. Business with a record of legal violations must be given the lowest ranking. While there is no sanctioning mechanism, the statute does mandate an evaluation of the program's record in job creation and retention through data collection from employers receiving assistance.

Iowa New Jobs and Income Act

In 1994, Iowa passed H.F. 2180, the Iowa New Jobs and Income Act. The Act includes an array of job quality provisions and a sanctioning component. To receive benefits, a business must first demonstrate that it 1) has not closed or reduced operations in one area of state to relocate in another; 2) will provide at least eighty

percent of the cost of standard medical and dental care for all full-time employees; 3) will pay a median wage for full-time hourly, nonmanagement jobs of \$11 per hour or 135% of county median wage, whichever is higher; 4) will make an investment in the state of at least \$10 million dollars; 5) will be in environmental compliance and 6) will agree to create at least 50 (or in some cases 75) jobs for a period negotiated with the department of at least 5 years.

In addition, business must do at least three of the following: 1) offer a pension or profit sharing plan; 2) produce high value-added good or services or be in one of 10 specified industries (most of which are high-tech); 3) make day care services available to employees; 4) invest no less than 1% of pretax profits from the Iowa facility in research and development in Iowa; 5) invest no less than 1% of pretax profits in worker training; 6) have an active safety improvement program involving worker participation or 7) occupy an existing facility of at least 20,000 square feet that is formerly vacant.

After a business qualifies for a credit, it may be subject to a penalty for noncompliance if it fails to meet its job creation or other commitments. If business has not met more than 90% of its job creation requirement, it repays a percentage of its incentives in proportion to how many jobs it did create. If the business does not meet its wage level commitments or commitment based on any of the three selected criteria from the list above, it must meet that commitment in the following year or forfeit incentives

KENTUCKY

The Kentucky Tax Incentives for Economic Development legislation, codified at K.S. 144.130, was created as part of a package for Delta Airlines. The tax credit, which is available only to air carriers, is partially forfeited if the carrier does not increase meet project scope or investment projections of at least \$300,000,000.

MICHIGAN

The Michigan Abandonment of Business Act, M.C.L. 445.601, dates from 1970 and states that any company doing business in the state may not abandon any factory, workshop, machine shop, repair shop, office, or agency without repaying all money bond, lands and other property granted as inducement for the location or operation of business. Restoration includes payment with interest. Violation of the Act is a misdemeanor punishable by fines, penalties, forfeitures, injunctions and imprisonment. Recapture does not apply to businesses which receive inducements for maintaining operations for a specified length of time and comply with those conditions.

NEBRASKA

The Nebraska Employment and Investment Growth Act, Neb. Rev. Stat. §77-4103, gives various tax credits against sales and use taxes and personal, partnership or corporate income taxes for businesses in specific industries. The legislation requires a

minimum amount of job creation or investment and includes a recapture component. The business must either (1) invest \$3 million in qualified property and hire at least 30 new employees, (2) invest \$20 million in qualified property or (3) invest \$10 million and hire at least one hundred employees at one or more projects.. The taxpayer must then enter into an agreement specifying the employment and investment levels required by the act, the time period by which those levels must be meet and the documentation the taxpayer will supply when claiming an incentive. The Act requires recapture of credits as an underpayment of taxes if a project does not meet job or investment projections.

NEW JERSEY

New Jersey New Jobs Investment Tax Credit Act

N.J.S.A. 54:10A-5.3 provides a credit against corporate business tax. The credit includes job quality standards, minimum levels of job creation, scaling to the number of jobs created and a clawback component. To qualify, an enterprise must create 5 (small business) or 50 (all other) jobs with a median compensation among all jobs of \$27,000 per year, adjusted for inflation. The credit is scaled to the number of jobs created. If the taxpayer ceases operations or employs fewer than the required number of people, the taxpayer must reconcile the credit taken with the shorter term of operation and/or lower level of employment.

OKLAHOMA

Oklahoma Quality Jobs Program Act

In 1994, Oklahoma passed as part of HB 2093 the Quality Jobs Program Act to be codified at 68 § 3601. The Act creates a premium payment fund for high impact projects with annual gross payrolls for new jobs projected to be between \$1,000,000 and \$2,500,000 within three years after receiving an incentive payment. Those projects may receive quarterly incentive payments of 2.5% of gross payroll for new direct jobs for up to six years. For the first three years, incentive payments are granted irrespective of whether the minimum payroll amount is achieved. To qualify for payments after year three, the project must verify that its gross payroll for new jobs exceeds \$1 million.

Oklahoma Saving Quality Jobs Act

In addition, in 1994, Oklahoma passed as part of HB 2093 the Saving Quality Jobs Act to be codified at 68 Sec. 3701. The Act creates a premium payment program for businesses (1) which save at-risk jobs (jobs that may be lost due to business relocation) and create new jobs in the state or (2) are engaged in an industry strategically important to the state. Payments are based on the net direct state benefits which is equal to the net direct state benefit (tax revenues) from the new jobs less the direct state costs (ex. education of new resident children, costs of public health and safety, and costs of other state services.)

SOUTH CAROLINA

Effective in 1993, the South Carolina Corporate Income Tax Credits for Corporate Headquarters, S.C. Code §12-7-1245, permits a tax credit of 20% of the real property costs of preparing corporate headquarters (ex. design, construction, lease carrying costs, etc.) The legislation includes job creation and quality standards. To be eligible, the project must create at least 75 new full-time jobs performing headquarters related functions or research and development. The jobs must have an average cash compensation level of more than one and one-half times the per capita income of the state.

SOUTH DAKOTA

The 1994 South Dakota Tax Refunds for Construction of Manufacturing, Agricultural and Power Generating Facilities, S.D. Codified Laws Ann. §10-45B-1, allows a tax refund for contractor's excise taxes and sales/use taxes for the construction of projects exceeding \$20 million in costs. Ten percent of the tax refund is withheld until the recipient completes project and meets investment projections.

TENNESSEE

The Tennessee Job Tax Credit, Tenn. Code Ann. §67-4-908, permits a tax credit of \$2000 against a taxpayer's franchise tax. The statute includes some job creation and quality standards. Businesses must increase employment by 25 or more jobs in a year and make the requisite capital investment in Tennessee. The credit is only available for the creation of full time jobs (at least 37.5 hours per week) that carry minimum health care benefits.

TEXAS

The Texas Smart Jobs Fund Program, codified at Gov. § 481.151, makes grants to businesses funding skills training for job creation. The legislation includes job quality, incentive withholding and recapture components. Grants may be awarded only to businesses certifying the starting wage for a new job funded by the program will be greater than 66 2/3 percent of the state average weekly wage and that, after the training program is over, the wage will be at least 10% more than the original wage or 75% of the state weekly wage, whichever is greater. These requirements may be modified for an employer which has been "required to reduce or eliminate...work force because of reductions in overall employment within an industry or a substantial change in the skills required to continue the employer's business..." In addition, 25% of a grant is held until 90 days after completion of the training project. If all trained employees have been retained in employment, all funds are disbursed. The amount of the remaining funds is reduced for any employees not retained. If this results in a negative balance, the employer is liable for that amount and must repay the state.

VERMONT

In 1993, Vermont passed a New Jobs Income Tax Credit. The credit includes job quality standards and a clawback component. The credit is only available for jobs with a salary of at least \$20,000 per year. In addition, recapture of the credit occurs if any employer ceases to employ in Vermont at least 50% of the number of individuals it employed in Vermont on 1/1/93. The employer must both surrender any unused carryforward credits and repay up to 100% of the credit previously taken. The amount of credit recaptured depends on the number of years between the time the credit became available and the time employment fell below 1993 levels.

VIRGINIA

The Virginia Investment Credit, codified at Va. Code Ann. §58.1-439 for taxable years after January, 1995, allows a credit against various taxes for companies establishing or expanding a major business facility. The legislation includes job creation standards and a recapture component. The taxpayer must create at least 100 full-time jobs. The credit is recaptured entirely if the number of qualifying full time jobs at a facility falls below 100 within five years after a credit is taken. If, during the five years after the credit is taken, the number of full-time employees falls below the average number of full-time employees during the credit year, the credit is recalculated based on the decreased number of full-time employees.

WEST VIRGINIA

West Virginia at W. Va. Code §11-13C, the Business Investment and Jobs Expansion Credit, allows a credit of up to 80% of the business and occupation tax, severance tax, carrier tax, telecommunications tax, business franchise tax, corporate income tax, sales and use tax or personal income tax of eligible business. The legislation includes job creation standards, scaling and a sanctioning component. The amount of job creation required depends on the type of project. Credits for locating corporate headquarters requires employment of fifteen West Virginians. Credits for most other projects require at least fifty jobs be created. Small businesses may create as few as ten new jobs to qualify.

For non-headquarters or non-small business projects, the amount of the credit is determined based on the project's "new jobs percentage" multiplied times the amount of qualified investment it has made. The "new jobs percentage" ranges from a high of 90% for the creation of 1,000 jobs to a low of 50% for the creation of 50 jobs. In addition, this credit is recaptured fully when the number of new jobs created falls below 50 and the taxpayer removes qualified investment property from service in the state. Partial recapture occurs if job levels stay above 50 but below the amount upon which the taxpayer's "new jobs percentage" was based.

WISCONSIN

The process for Industrial Development and Economic Development Bonds in Wisconsin includes a mild cost-benefit analysis, a reporting requirement and public participation. Section 66.521 of the Wisconsin Statutes states a municipality may not enter into a revenue agreement for a bond with a business unless the business submits a form estimating whether its project would eliminate, create or maintain jobs at the site or elsewhere in state and estimates of the number of jobs to be eliminated, created or maintained. The business must submit a similar form two years after the bond is financed or 12 months after the project is completed listing the number of jobs actually eliminated, created or maintained. The form goes both to the Department of Development and any collective bargaining agent with which the business has an agreement.

For Economic Development bonds and loans, as described at §234.65 of the Wisconsin Statutes, the Wisconsin Economic Development Authority may only finance loans after considering a) the extent to which a project will maintain or increase employment; (b) the extent to which a project will contribute to the state's economic growth and (c) whether project will be located in an area of high unemployment or low income. As with industrial bond financing, businesses must make similar projections of jobs to be eliminated, created or maintained and submit actual numbers twelve months or two years later.

Wisconsin also prescribes public participation. Applicants for either industrial or economic development bonds must notify agents for parties with whom they have collective bargaining agreements. In addition, a petition by voters may block industrial development revenue bonds for a specific enterprise unless a majority of a municipality's voters approve the financing.

APPENDIX II

LEGISLATION	Sorting?	Cost/ Benefit?	Job Creation/ Minimu m Invest- ment Goal?	Scaling?	Wage/ Benefit Quality?	Min. Length of Opera- tion?	With- holding?	Recapture?	Public Participa- tion?
Alabama Powers of the Ala. Industrial Development Authority Ala. Code §41-10-44					X				
Arizona Credit for Construction Costs of Qualified Environmental Technology Facility Ariz. Rev. Stat. Ann. §43-1080			X			X		X	
Connecticut New Jobs Tax Credit Conn. Gen. Stat. §12-217(m)			X	X				X	
Connecticut Conditions on Relocation Conn. Gen. Stat. §32-5(a)						X		X	
Illinois Community Investment Recovery Act 740 ILCS 30/5						X		X	
Illinois Credit for High Impact Businesses 20 ILCS 655/5.5	X		X					X	
Illinois Training Grants and Loans 20 ILCS 4020/17							X		

LEGISLATION	Sorting?	Cost/ Benefit?	Job Creation/ Minimum Invest- ment Goal?	Scaling?	Job- Quality?	Min. Length of Opera- tion?	With- holding?	Recapture?	Public Participa- tion?
Indiana Economic Development for a Growing Economy Tax Credit Ind. Code §6-3.1-13-1 et seq.	X	X	X			X		X	
Iowa Community Economic Betterment Program Iowa Code §15.313					X				
Iowa New Jobs and Income Act 1994 Iowa H.F. 2180			X		X	X		X	
Kentucky Tax Incentives for Economic Development Ky. Rev. State Ann. §144.130			X					X	
Michigan Abandonment of Business Mich. Comp. Laws §445.601								X	
Nebraska Employment and Investment Growth Act Neb. Rev. Stat. §77-4103			X					X	
New Jersey New Jobs Investment Tax Credit Act N.J.Rev. Stat. §54:10A-5.3			X	X	X	X		X	
Oklahoma Quality Jobs Program Act Okla. Stat. tit. 68, § 3601			X						
Oklahoma Saving Quality Jobs Act Okla. Stat. tit. 68, §3701		X		X					

LEGISLATION	Sorting?	Cost/ Benefit?	Job Creation/ Minimu m Invest- ment Goal?	Scaling?	Job- Quality?	Min. Length of Opera- tion?	With- holding?	Recapture?	Public Participa- tion?
South Carolina Corporate Income Tax Credits for Corporate Headquarters S.C. Code Ann. §12-7-1245			X		X				
South Dakota Tax Refunds for Construction of Manufacturing, Agricultural and Power Generating Facilities S.D. Codified Laws Ann. §10-45B-1			X				X		
Tennessee Job Tax Credit (Franchise Tax) Tenn. Code Ann. §67-4-908			X		X				
Texas Smart Jobs Fund Program Tex. Gov. Code. Ann. § 481.151							X	X	
Vermont New Jobs Income Tax Credit Vt. Stat. Ann. tit. 32, §5929					X			X	
Virginia Investment Credit Va. Code Ann. §58.1-439			X					X	
West Virginia Business Investment and Jobs Expansion Credit W.Va. Code Ann. §11-13C-5; §11-13C-8a			X					X	

LEGISLATION	Sorting?	Cost/ Benefit?	Job Creation/ Minimu m Invest- ment Goal?	Scaling?	Job- Quality?	Min. Length of Opera- tion?	With- holding?	Recapture?	Public Participa- tion?
Wisconsin Industrial Development/Economic Development Bonds Wis. Stat. §66.521; §234.65			X						X