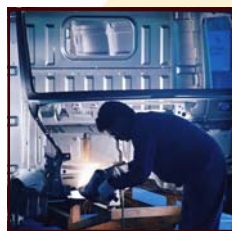


CURRENT PRACTICES AND POLICY RECOMMENDATIONS CONCERNING PUBLIC ACT 198 INDUSTRIAL FACILITIES TAX ABATEMENTS

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POLICY BRIEF

Linking Science with Decision Making

CURRENT PRACTICES AND POLICY RECOMMENDATIONS CONCERNING INDUSTRIAL TAX ABATEMENTS UNDER PA 198

By

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This policy brief summarizes the analysis and findings of a research report entitled “Industrial Facilities Tax Abatements under Public Act 198: Current Practices and Policy Recommendations.” Financial support for this research was provided by the Land Policy Institute at Michigan State University using a variety of university and W. K. Kellogg Foundation funds. Interested readers are encouraged to review the full report, which is available to download from www.landpolicy.msu.edu. The full report examines how past use of tax abatements has affected the economic health of local governments (especially larger and distressed cities) across Michigan. It offers recommendations for improved state tax abatement legislation and local tax abatement criteria based on best practices in those communities where use of tax abatements has been effective.

Introduction

For more than three decades, local governments across the state of Michigan have sought to promote economic development by granting tax relief to manufacturing firms that invest in their communities. Any investment in real or personal property, whether for a new industrial facility or for rehabilitation and updating of an existing facility, is eligible for a tax abatement, so long as the investment adds or retains jobs. Under Michigan PA 198 of 1974, the Plant Rehabilitation and Industrial Development Districts Act, billions of dollars have been invested in the development or rehabilitation of industrial plants across the state. Tax abatements granted under this program have affected hundreds of thousands of jobs.

Academics and policy analysts have frequently questioned the merits of property tax abatements as economic development tools. But while the results and conclusions of these studies are debated in academic circles, government policy makers continue to make liberal use of incentives to attract investment and jobs. The debate over the effectiveness and merits of tax incentives is beyond the scope of this report. Our concern is not whether jobs have been created or whether there has been a change in overall economic well-being. Rather, we assume that incentives are likely to continue to be widely available and just as widely employed. The relevant questions here are how has past incentive use affected cities across the state and how can existing incentives (in particular PA 198) be used most efficiently and effectively?

Public Act 198 & Local Economic Health

Public Act 198 has been popular with both firms and local governments. From 1980 through 2001, 721 (40%) of Michigan’s 1,773 cities, villages and townships (referred to hereafter as “local governments”) granted one or more PA 198 tax abatements (see Table 1). Over this 21-year period, 137 municipalities granted just one industrial facility property tax abatement; an additional 72 provided only two abatements. At the other extreme, the city of Grand Rapids granted 522 abatements, an average of one new abatement every two weeks. The top five Michigan communities in terms of total abatements granted (Grand Rapids, Holland, Holland Township, Detroit and Wyoming) were responsible for 13.5% of all abatements. The 25 communities granting the most abatements provided almost 5,000 abatements, nearly 36% of the total.

Most of the abatement activity occurred in the State’s metropolitan areas, primarily Grand Rapids (with ten communities in the top 25) and Detroit (with six). The majority of the top 25 are suburban municipalities. Only three small non-metropolitan cities—Cadillac, Coldwater and Sturgis—are among the top 25.

Table 1: Top 25 PA 198 Certificate Granting Municipalities

Municipality	# of Certificates	Metro Area
Grand Rapids	522	Grand Rapids
Holland Township	478	Grand Rapids
Holland	373	Grand Rapids
Wyoming	261	Grand Rapids
Detroit	258	Detroit
Clinton Township	226	Detroit
Kalamazoo	216	Kalamazoo
Kentwood	187	Grand Rapids
Walker	186	Grand Rapids
Battle Creek	182	Kalamazoo
Fraser	173	Detroit
Jackson	167	Jackson
Grand Haven	158	Grand Rapids
Auburn Hills	158	Detroit
Cadillac	149	—
Norton Shores	146	Grand Rapids
Sterling Heights	145	Detroit
Midland	134	Saginaw
Coldwater	132	—
Spring Lake Township	128	Grand Rapids
Muskegon	125	Grand Rapids
Benton Township	124	Benton Harbor
Portage	123	Kalamazoo
Chesterfield Township	121	Detroit
Sturgis	118	—

Has the use of PA 198 contributed to the economic health of those communities that have made frequent use of abatements? The concept of “*economic health*” used here is measured by the health of individual households in the community, a criterion employed in much past research. The measure, average health index score, was constructed from a factor analysis of census variables and includes median family income, percent of households in poverty, and unemployment.

Initially, municipalities that were to become frequent users of industrial property tax abatements had the highest average health index score (see Table 2). Their use of abatements during the next two decades was accompanied by a sharp drop in their mean health index score. Communities that have been occasional users of PA 198 also experienced a decline in their health index, but one that was much less severe. By 2000, the average health index score for occasional users was marginally higher than for frequent users.

Table 2: Change in Average Health Index Score 1980-2000

	Average Health Index Score		
	1980	1990	2000
Frequent Users	0.48	0.23	0.11
Occasional Users	0.29	0.22	0.12
Nonusers	-0.22	-0.14	-0.08

Communities that did not grant any PA 198 abatements started the period with the lowest average health score. (It should be noted that for many of the municipalities non-participation was not a policy choice but rather because they have never been asked for an abatement.) The non-user group was the only category that recorded an increase in mean health score over these two decades. Thus, it appears that the use of abatements has not, on average, led to improvements in health; and not using them has not resulted in declines.

Data on the number of PA 198 certificates issued by individual communities from 1980 to 2001 *fail to show a clear, consistent relationship between abatement activity and change in economic health*. It is apparent that there are other causes of changes in economic health besides use of tax incentives. Among the 25 communities experiencing the greatest community health declines seven granted no abatements at all; several—Kalamazoo, Sturgis, Midland, and Portage—made extensive use of abatements. Nine of the 25 municipalities with the largest gains used few or no tax abatements, while three—Coldwater, Battle Creek and Bay City—each granted more than a hundred.

Relationship to Sprawl

An examination of abatement activity in Michigan’s two largest urban areas, Detroit and Grand Rapids, provides a different perspective on the effects of tax abatements on community well-being. Table 3 summarizes abatement activity in the two large cities, distressed suburban municipalities, and rapidly growing townships within their respective tri-county areas.

Table 3: Detroit and Grand Rapids Area Abatement Activity 1991-2001

	Detroit			Grand Rapids		
	City	Older Suburbs	Newer Suburbs	City	Older Suburbs	Newer Suburbs
Abatement	107	323	252	221	575	506
Per 1,000 People	0.1	0.34	1.05	1.2	2.90	13.68
Investment	\$4.54b	\$6.26b	\$1.47b	\$0.31b	\$1.66b	\$1.23b
Per 1,000 People	\$4,412	\$7,780	\$6,282	\$6,282	\$8,396	\$3,324
Jobs	27,252	46,558	23,790	15,470	51,625	5,974
Per 1,000 People	26.5	56.8	61	81.9	260.7	101

The suburban municipalities in both metro areas were much more active in granting abatements than their respective central cities. When abatement activity is standardized to account for differences in population, the central cities lag in all categories. To the extent that PA 198 abatements shift investment and jobs away from core cities, they appear to be contributing to the widening economic gap between older urban centers and their suburbs.

A frequent criticism of property tax abatements is that they do not create investment and jobs but rather effect the location of investment and jobs that would have occurred even without tax breaks. There seems little doubt that the granting of abatements has encouraged the continued dispersal of employment and economic activity farther from these older city centers. The revitalization of the State's older cities is not explicitly one of the objectives of PA 198; but, it is one of the overarching concerns of State policy that appears not to be well served by PA 198.

Impacts of Abatements on Economic Health

Over the decade of the 1990s, most of these municipalities recorded improvements in measures such as income, poverty rate, unemployment, and State Equalized Value (SEV). Suburban municipalities, particularly the newer, growing townships, showed less relative improvement than their respective central cities in their unemployment and poverty rates (see Table 4). In part, this is because the central cities had more room for improvement; for example, their poverty and unemployment rates were substantially higher at the beginning of the period. At the end of the period, the central cities had higher unemployment and poverty rates (as well as lower incomes and SEV growth) than their suburbs.



Photo by Mike Forsyth

Table 4: Change in Outcome Measures 1990-2000

	Detroit			Grand Rapids		
	City	Older Suburbs	Newer Suburbs	City	Older Suburbs	Newer Suburbs
Income	57.4%	48.1%	61.7%	38.9%	38.2%	39.7%
Poverty Rate	-6.0%	-1.2%	-0.3%	0.0%	-3.7%	2.3%
Unemployment Rate	-5.9%	-2.9%	-2.1%	-1.0%	-1.5%	1.1%
SEV	94.0%	67.7%	198.5%	69.3%	108.1%	177.7%

It is not certain that tax abatements bear much responsibility for the gains, however. Suburban communities, comparable to those included in Table 4, that chose not to grant abatements during this period enjoyed gains in prosperity measures similar to communities that did grant abatements (see Table 5). The selected communities that did not grant tax abatements had consistently higher income growth and more favorable unemployment trends. The results for SEV growth and poverty rates are mixed, however. The granting of abatements is clearly not a guarantee that these health measures will improve more than in similar communities that did not grant abatements.

Table 5: Change in Outcome Measures for Users and Nonusers 1990-2000

	Detroit				Grand Rapids	
	New Users	New Non-users	Older Users	Older Non-users	New Users	New Non-users
Income	61.7%	62.8%	48.1%	53.8%	39.7%	50.7%
Poverty Rate	-0.3%	0.3%	-1.2%	-0.8%	2.3%	-0.8%
Unemployment Rate	-2.1%	-2.4%	-2.9%	-3.4%	1.1%	0.7%
SEV	198.5%	178.0%	67.7%	71.5%	177.7%	146.2%

Relationship to Restructuring of Manufacturing

Has the widespread use of PA 198 contributed to the restructuring of Michigan’s manufacturing industries, leading to a diversification away from traditional auto to more high-tech industries? To assess this question, Michigan manufacturing employment was divided into five broad categories (see Table 6). The first two, Transportation Equipment and Heavy Manufacturing, represent Michigan’s traditional strengths. The High Tech category includes Pharmaceuticals, Computers and Electronics, and Aerospace Manufacturing. With the exception of Transportation Equipment, all of the broad categories experienced employment declines during the 1990s; the State as a whole lost more than 140,000 manufacturing jobs.

All industrial categories have benefited from tax abatements. Taken at face value, the data in Table 6 suggest that almost nine out of ten manufacturing jobs were associated with the granting of tax abatements. If firms receiving PA 198 abatements had not created any of the promised new jobs in Michigan, the total number of manufacturing jobs would have been about 573,000 in 2002, rather than 736,000. If all of the manufacturing jobs “retained” through PA 198 abatements would have left the state as well, there would have been fewer than 60,000 manufacturing jobs left in the state by 2002.

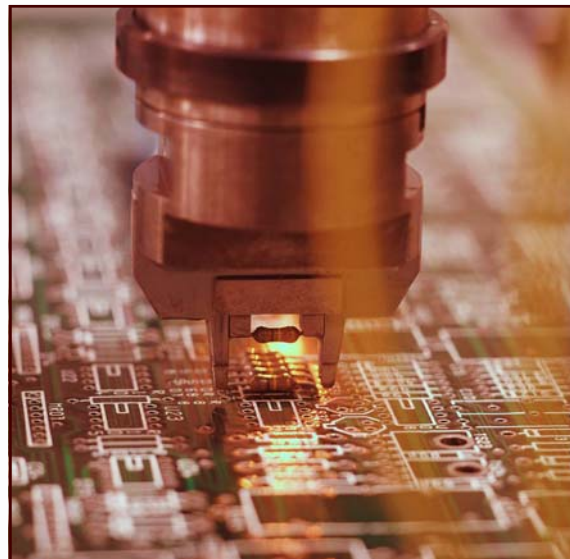
This reasoning overstates the importance of abatements, however. Because individual manufacturers (especially Transportation Equipment firms) received multiple abatements, jobs in these plants have, in effect, been retained multiple times. Some of the jobs attracted by tax abatements might have materialized anyway, perhaps in a neighboring jurisdiction. Nevertheless, it would appear that PA 198 has had a significant impact on the number of jobs.

PA 198 has had the greatest employment impact on Transportation Equipment manufacturing, where a total of 239,000 new and retained jobs were associated with abatements. This is roughly equal to the actual number of Transportation Equipment jobs in 2002. In contrast, only half of the total Heavy Industries jobs could be associated with PA 198 abatements.

Table 6: Michigan Employment by Industry and Abatement Activity 1992-2002

	1992 jobs	PA 198 Retained	% Retained	PA 198 New	2002 Est.	2002 Actual	Est. as % of Actual
Transportation Equipment	202,697	194,901	96.1%	44,143	239,044	238,731	100.1%
Heavy Industries	263,381	71,524	27.1%	30,173	101,697	213,618	47.6%
High Tech	44,957	71,534	158.9%	35,376	106,910	36,950	289.3%
Consumer Goods	57,361	58,337	101.6%	15,003	73,340	37,499	195.6%
Other	308,328	94,197	30.5%	38,931	133,128	209,461	63.6%
Total	876,724	490,493	55.9%	163,626	654,119	736,259	88.8%

Abatements have promised a substantial number of new jobs in High Tech manufacturing industries with growth potential (Florida, 2005; Fulton & Grimes, 2005). High Tech industry jobs represent 21% of the *new* jobs attributed to abatements, while *retained* High Tech jobs represent 15% of all employment retained through tax abatements. Based on the projected jobs, both new and retained, covered by tax abatements, Michigan should have had almost 107,000 High Tech jobs in 2002. The actual figure was less than 37,000, almost 70,000 fewer than were promised in the abatement applications. Tax abatements appear to have been more effective in attracting and retaining jobs in Michigan's traditional manufacturing sectors and have done little to diversify the economy.



Key Observations

The following key observations were gleaned from this analysis:

1. Despite billions of dollars in foregone property tax revenues, manufacturing jobs have declined in Michigan in almost every category.
2. Transportation Equipment was the only category where employment increased.
3. In the High Tech category alone, some 70,000 promised jobs never materialized or left the state anyway; for Consumer Goods, the shortfall was almost 36,000.
4. Michigan local governments have used tax abatements to preserve (at least temporarily and most certainly repeatedly) jobs in dying industries; efforts to attract new jobs in new industries have produced few lasting benefits.
5. Overall, there appears to be little relationship between abatements granted and improvements in local economic health.
6. Abatements for new jobs and real property investment have clearly favored growing suburbs, rather than central cities and their older suburbs.
7. Abatements have largely been directed at retaining existing jobs, often multiple times, rather than fostering new jobs creation in new industries.

Best Practices

Best practices communities are those that have written guidelines or criteria for issuing abatements, regularly place performance conditions on firms (such as hiring goals/quotas), and evaluate the costs and benefits of abatements after the fact (for example, tracking the number of jobs retained or created).

Many municipalities report having explicit guidelines governing the granting of tax abatements; in 31% of the communities these guidelines are formally codified. Another 40% of municipalities report that they have informal or unwritten guidelines, while 30% have no guidelines at all. Among communities with written guidelines, it is common to automatically grant the maximum twelve year abatement for real property investments and a shorter period for personal property investment (for example, Kentwood abates personal property taxes for eight years, Muskegon for six years). Some municipalities (i.e. Muskegon, Blackman Township) employ a "point" system that allows for a longer abatement period, depending on the number of jobs and/or level of investment. Charlevoix and Hillsdale both use a similar point system to determine if any abatement will be granted.

The use of many best practices is still not widespread, however. Almost one-third of municipalities have never placed any conditions on abatements. When conditions are imposed, communities seldom focus on the quality of the jobs or the proportion of local residents hired. In addition, nearly nine out of ten communities report that abatement requests are seldom or ever rejected. The ease with which abatements can be obtained suggests that the conditions imposed may not be effective. Furthermore, those communities most likely to use best practices are municipalities prosperous enough to devote necessary resources and personnel to their economic development activities.

Recommendations for Improved Policy

Abatements could be more effective if there were significant policy changes at the State and local levels. A number of policy changes that local communities could adopt might make the use of abatements more efficient, without eliminating them entirely. Some of these changes might include:

- Granting abatements for less than the maximum period of twelve years.
- Limiting the number of times a single firm can be granted an abatement or requiring a number of years between abatement requests.
- Limiting the number of times the same job can be credited to abatements.
- Limiting abatements to new investment or jobs.
- Limiting abatements to particular targeted industries or sectors.

It is also recommended that local communities devote greater attention to the activity of firms, once abatements have been granted. Requiring performance guarantees for recipients—including tenure after the abatement, investment and job creation levels, and hiring targets for residents of the community granting the abatement—might be imposed. Even for communities not inclined to impose *clawbacks* on firms receiving abatements, more careful monitoring and evaluation of the results of abatements granted might provide a more rational basis for assessing future abatement requests.

New state legislation requiring that local communities grant abatements only on demonstration of necessity (so-called “*but for*” requirements), or that abatements be tied to minimum levels of investment or employment, could encourage communities to be more selective in their abatement activity.

Another possible legislative change would be to increase the targeting of property tax abatements, focusing on communities that have demonstrated that they face difficulty in retaining and attracting jobs. Presently, some of the economic development programs in Michigan give preference to designated “*core*” communities that exhibit high levels of distress. In an effort to focus investment in areas already served by infrastructure, the Michigan legislature has proposed creation of *commerce centers*, which may provide an alternative list of communities that could be targeted to enhance urban revitalization and reduce urban sprawl.

It appears likely, however, that most communities, particularly those that are highly distressed or have limited resources, are unlikely to adopt and effectively utilize best practices. If the state pursues the adoption of new targeting criteria, this might provide an opportunity to institutionalize best practices, especially by incorporating technical assistance programs to support these efforts.

Most of the Industrial Facilities Tax Abatements granted in Michigan over the past two decades have involved relatively small investments. There have been a number of large-scale investments that clearly have had an impact on the regional and perhaps even the State’s economy. The responsibility for granting property tax abatements for these large projects might be reserved to the State, rather than delegating it to local governments. The burden of monitoring and evaluating these larger projects would then rest with the State. For investments below some threshold amount, monitoring and evaluation could remain a local concern. Setting the threshold at \$10 million in total projected investment would have given the State responsibility for evaluating fewer than 1,000 (less than 7%) of the abatements granted between 1980 and 2001; a minimum project size of \$5 million would have involved just 11percent of all abatements granted during this period. A policy change of this sort would ensure that at least larger tax expenditures (forgone taxes) are assessed and monitored rather than being left to the vagaries of inter-municipal competition.

In a perfect world, there would be little need for property tax abatements or other economic development incentives to increase equity and efficiency. Given the complexities of economic development in metropolitan markets in Michigan and elsewhere, it seems likely that tax abatements and other incentives will continue to be used extensively. **This review of the Michigan industrial tax abatement program suggests that, even if incentives continue to be widely used, modest changes could be made to increase their effectiveness and efficiency. State policies that encourage best practices at the local level are needed to reduce inter-municipal competition and expensive local government outlays, which often result in little economic benefit.**

See full report for citations on references, available at www.landpolicy.msu.edu.



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