

## **The Economics and Politics of *Smokestack Chasing***

During the past twenty years, there has been a marked resurgence of interest in “local economic development.” In these local wars for jobs and dollars, local governments openly compete with their neighbors for jobs associated with business locations or relocations to their locality. Cities in the DFW region have become increasingly aware of the intense competition from their neighboring cities that give developer incentives. As a result, local government officials are beginning to question all past practices used to stimulate economic development.

This essay situates this dilemma within the urban policy and urban economics literature and outlines briefly two alternative policies that cities have used to capture or stimulate business development. It then provides a discussion on some of the major political and economic issues arising from the use of these policies, including the implications and desirability of competition from a local and regional perspective. The essay concludes with a description of alternatives to these initiatives that have become increasingly asserted in the urban policy literature and provides a discussion of the implications of developing long-term sets of policies and programs that may lead to limiting or terminating public investment in private projects.

### ***Locating the Dilemma***

Traditionally, the United States has been regarded as a place of limitless land and resources (Freilich & Stuhler, 1981). The dominant sociopolitical context that “growth is good” encourages economic policies that will permit unfettered growth. To generate demand, for example, reflationary policies are put into effect. To boost productivity, on the other hand, supply-side policies are put into play. In fact, numerous federal programs initiated in the post-WWII period to aid cities (urban renewal, 701 planning grants, the War on Poverty, and Model Cities), accelerated the suburbanizing process through various housing, taxation, and transportation policies (Freilich, 1999). Incentives for the construction of low-density, detached single-family housing were provided by federally insured mortgage money and the many tax advantages of home ownership (Freilich, 1999). The interstate highway system provided access to suburban areas where land was cheaper for residential, industrial and commercial uses.<sup>1</sup>

Against this national ideological, political and economic backdrop emerge local economic development policies to buy growth. As early as the 1940’s and 1950’s, local governments were competing for businesses. Southern cities competed fiercely for northeastern manufacturing plants. They enticed these businesses by offering “low wages, lack of unions, low taxes, supporting infrastructure, southern hospitality, and warm weather” (McDonald, 1997). This enticement strategy was later coined “smokestack chasing” and is often used to describe the contemporary context of local economic development efforts to capture and stimulate business development.

Economic development policies are shaped fundamentally by municipal government’s reliance on property taxes, sales tax revenues and local charges and fees. This creates a powerful incentive for local governments within an urban area to compete against one another for commercial and industrial development rather than invest in economic development strategies and policies that may increase the growth in the entire urban area (McDonald, 1997). This has resulted in intense competition among municipal governments to provide the more attractive grab-bag of incentives for businesses than that offered by their neighbors. Yet, Cullingsworth (1997) argues that competition by incentives is a zero-sum game that accomplishes only a shifting of jobs from one part of the country to another. However, Wolman (1988) argued that there is a political imperative for municipal governments to offer these incentives, even when they counteract the efforts of their neighbors. Regardless, this competition is perpetuated and aggravated through public policy drivers.

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<sup>1</sup> Freilich (1999) argues that, in fact, the Federal Aid Highway Act provided preferential federal highway expenditures for motor vehicle traffic and discouraged transit or multimodal uses. The new interstates and ring roads were instrumental in linking the country with a usable and dependable interstate highway system, which also resulted in a surge of suburban employment centers. These highways decimated neighborhoods and made previously undeveloped land developable.



Mondale and Fulton (2003) argue that growth is shaped in large part by at least three different sets of public policy tools: (1) infrastructure investment policy (including sewer, water, and transportation); (2) open space protection programs and public land ownership; and (3) local land-use planning policies. These three sets of policies play a major role in shaping urban growth patterns. In particular, these theorists argue that the location and size of infrastructure investments creates a pull factor that attracts urban growth to areas where capacity exists. On the other hand, Mondale and Fulton (2003) note that publicly owned land and protected open space put into effect a push factor that averts growth from locations where it is desirable. Specific policies that drive these push and pull patterns include a variety of tax subsidies, abatements and increment financing; land use zoning, *e.g.*, special districts such as BID, school, Enterprise Communities and Enterprise Zones; strip annexations along transportation corridors in extraterritorial jurisdictions; development cost charges and transfers of development rights, among many others. These policy drivers distort market processes.

The problem, argues Brueckner (1997), is that cities' intense competition to attract business (and thereby jobs and productivity) results in local tax systems that require developers to pay only a fraction of the infrastructure costs associated with their projects. This makes development look artificially cheap and encourages urban expansion. Moreover, state actions exacerbate local competition and reinforce local tax systems that are development friendly. Knaap, Talen, Olshansky and Forrest (2003) note that many states offer grants or loans for constructing sewer and water treatment plants if they can be shown to foster economic development. Indeed, they lower the municipal costs for urban expansion and promote and perpetuate municipal competition.

Over time, the net effect of these and other policies have manifested in urban spatial structures that reflect housing, employment and population decentralization; edge cities and suburban subcenters that dwarf central cities; and persistent, discontinuous or leapfrogged development. Municipal governments have become hopelessly gridlocked in intense competition with one another to buy growth. Consequently, a vast number of central cities are burdened by severe housing, educational and environmental problems and depleted natural resources. Consumer lifestyle choices and cities' decreasing fiscal solvency exacerbate these conditions. The substantial out-migration of commerce and industry from the central city—and the spiraling costs of rebuilding the deficient infrastructure left in its wake—have resulted in a pervasive inability to cope with this modern trend of urban demographics and economics. This has led local government officials to question all past practices used to stimulate economic development.

### ***Municipal Policy Alternatives to Capture or Stimulate Business Development***

Sources of urban economic growth fall into the following general categories: export demand and import replacement; private and public capital; labor; education and training; technical change; entrepreneurship; amenities; and static and dynamic agglomeration economies (McDonald, 1997). When one or more of these areas of growth begin to decline and pull on the city coffers, municipal officials seek policy interventions to correct for market failures. Often, they look toward strategies and policies that will entice businesses to the area. Two local economic development tools that are widely used to capture and stimulate business development are property tax abatements (Walzer & P'ng, 1995) and tax increment financing (Mann & Rosentraub, 1998).

#### Property Tax Abatements

Property tax abatements are a commonly used economic development policy used to entice businesses to the city. Mikesell (2003) describes them as negotiated contracts between the municipality and a parcel holder under which some share of assessed value will not be taxed for an agreed-on period of time. However, the share is intended to vary over time such that the parcel will be brought back into the tax system (Mikesell, 2003). The property tax abatement is employed primarily when economic development officials seek to entice businesses to develop a particular location for a particular economic activity that is believed that, without the abatement, will not be developed. Where commercial and industrial activities are already in place, property tax exemptions are offered to stimulate further economic activity. The exemption for a parcel may be granted permanently or for a specific period of time. This tool may also be



used to exempt portions of the parcel, such as pollution-control equipment or solar-energy equipment. Some areas also provide special exemption for rehabilitated property (Mikesell, 2003).

#### Tax Increment Financing

Tax increment financing (TIF) is used primarily when municipalities wish to make public improvements to a specific area. Typically, the choice for the TIF is based on the assumption that private redevelopment will not occur without stimulative actions. The areas to be redeveloped are often those areas that have presented a fiscal strain on the city through a declining tax base and increasing blight. To attract businesses to the area, the city promises to freeze the tax base at the pre-development level for a specified period of time. This period is typically set by state statutes and can be up to 30 years. While the property taxes continue to be paid, the taxes derived from the increase in the assessed values of the new development are designated toward special uses. Often, cities will use these funds to retire the bonds issued to launch the development or they will leverage the funds against future planned development within the TIF district.

To establish a TIF district, the city adopts a redevelopment plan and draws the geographical boundaries of the area. The property within the area is then assessed at the present value and the taxing jurisdictions continue to receive these revenues at the predevelopment assessed value. However, taxing jurisdictions may increase their gross tax revenues during the increment period by increasing their millage rates (Minter, 1991). Once the TIF time period has expired, the taxing jurisdictions receive the revenues based on the post-development assessed value.

#### ***Political and Economic Implications***

Local Implications of Property Tax Abatements. Mikesell (2003) argues that the research shows that accessibility to markets, resource availability, transportation networks, economies and diseconomies of agglomeration, and environmental amenities are more significant draws for commercial and industrial facilities than property tax abatements. Given this, the expected return on the investment is much lower than economic developers project. However, as Mikesell argues further, the more significant problem is the effect on the existing property in the area when the incentive actually works. New industries create a demand for public services and the influx of population subsequent to the development results in an even higher demand for services. However, the residential tax base is not robust enough to cover the cost of the additional services. Similarly, Wassmer's (1992) research showed that property tax abatements offered moderate increases in property tax base, but simultaneously decreased home values and increased property tax rates. Interestingly, as Reese (1999) notes, despite a large body of literature that suggests that tax abatements are not successful in attracting industry, work only at the margins, and result in significant costs to cities, municipal governments, nonetheless, continue to rely very heavily on them (McCalley & Silman, 1982; Kale, 1984; Ambrosius, 1985; Ahlbrandt & DeAngelis, 1987; Eisinger, 1988).

Local Implications of Tax Increment Financing. On the whole, research shows that TIF has been successful in revitalizing blighted areas. Its unique advantages over other economic development tools are the possibility for new taxes and the local autonomy it affords. However, tax increment financing presents two substantive political challenges: first, on the merits of municipal capacity to commit its citizens to debt liability outside normal decision-making structures; and second, the removal and insulation of elected officials from the decisions about how the public funds will be used. Too, tax increment financing has led to significant interjurisdictional conflict between local governments and school boards for local property tax share (Huddleston, 1984). Another drawback for local governmental use of TIFs, and particularly the TIF district, is the creation of another level of local bureaucracy which may or may not be attractive politically given the risk of loss of control over a governing board. Finally, borrowing against projected TIF revenues is a risky financial investment of public funds.

Regional Implications of Municipal Economic Development Policies. Local governments are hopelessly gridlocked in a competition with their neighbors to buy growth. A zeitgeist that "growth is good" and "jobs, jobs, jobs" compels local governments to compete for tax revenues that perpetuate poorly planned



development. This exacerbates the already discontinuous, inefficient, and fiscally burdensome patterns of development throughout the metropolitan landscape. Cities expend more monies on roads, sewer and water, school, open space, transportation, refuse collection, police and fire protection, postal services, administrative facilities, health care, library services, and operating costs for infrastructure to compete against their neighbors in providing the most attractive package of economic development incentives. The cities that lose their footing in the competition can do little to stabilize themselves.

The effects of this competition fall disproportionately among economic actors and give rise to grave concerns of efficiency and fairness. The polarized landscape is a manifestation of the push of concentrated poverty and the pull of concentrated resources throughout the metropolitan region (Orfield, 1997). Public services needed to support new development often result in highways and roadways that disseminate lower-income, minority, tightly-knit communities. Frequently, the result of a successful development project necessitates a reduction of services to the remaining population. Low density redevelopment tends to inflate housing costs with concomitant loss of scale economies and exacerbates middle-class movement toward the periphery. Scarce resources are allocated toward new infrastructure rather than to maintaining existing infrastructure. The unintended negative consequences and economic externalities are perpetuated through this economic and political arena of vigorous municipal competition and are exacerbated by a “deeply entrenched resistance of local governments to sharing any of their authority over land use” (Downs, 1994). These externalities do not heed political boundaries. Rather, they sprawl over the entire metropolitan landscape. Orfield (1997) summarizes in question and answer form the central regional implication: “Who pays? We all do.”

### ***Policy Alternatives***

Given the political and economic issues described above, two distinct sets of policy alternatives have emerged in the literature to address contemporary economic development efforts. The first set of policies focuses on alternatives to growth. An example of some of the policy recommendations that address this alternative are presented in Anthony Downs’ (1994) *New Visions for Metropolitan America*. The second set of policies focuses on alternatives to government involvement. An example of one of these policy recommendations is presented in Michael Porter’s (1997, 1995) *New Strategies for Inner-City Economic Development* and *The Competitive Advantage of the Inner-City*.

#### Alternatives to Growth

In Rusk’s categorization of elastic and inelastic cities, he notes that metropolitan growth occurs predominantly inside economically healthy, elastic cities but outside inelastic cities, which are surrounded by suburbs. From this framework, he recommends policies that would encourage states to allow cities to expand. Downs (1994) argues, however, that while Rusk’s argument may be logically sound, it is not politically sound. Cities do not support metropolitan government. In theory, it is well; in practice, it is rare. Instead, Downs offers seven alternative policies to cope with the growth-related problems described above. These policies call for voluntary cooperation among local governments; the exercise of state agencies’ jurisdictional authority and structural capacity to create cooperative arrangements for uniform zoning and building codes among local governments; establish public-private coordination to influence public policy; the creation of functionally specialized and federally-rooted regional agencies; the creation of a federal incentive for regional institutions; and to embed municipal land use authority into a broader framework established by state government. Of these policy alternatives, Downs argues that two have the greatest potential: regional agencies to coordinate federal funding and state mandates requiring local governments to participate in comprehensive planning within a state-established framework.

Implications of Developing a Long-term Set of Downsian Type Alternatives to Growth. Although Downs calls for a significant role for government in his policy recommendations, it is feasible that, over time, these policies could lead to limiting or terminating public investment in private projects. However, scope and authority of local, state and federal governments, together with the creation of a regional entity would rely heavily on statutory authority to govern and guide growth. The most likely mechanism through which this political power may be demonstrated is eminent domain. As such, the most probable implication of



Downsian-style economic development alternatives is the likelihood of widespread Constitutional challenges to planned growth efforts.

There is a “taking” of property when government action directly interferes with or substantially disturbs the owner’s use and enjoyment of the property. To constitute a taking, within Constitutional limitations, it is not essential that there be physical seizure or appropriation, and any actual or material interference with private property rights constitutes a taking. Taking of property is triggered if application of zoning law denies a property owner of economically viable use of his or her land, which can consist of preventing best use of land or extinguishing fundamental attribute or ownership. The takings issue most triggers Fifth Amendment (just compensation) and Fourteenth Amendment (equal protection of the laws) challenges. As such, the case law has evolved into requiring timing and sequencing to correspond with Constitutional principles of due process, equal protection, substantive due process, and the Takings Clause. In relation to urban growth and growth policies, the takings issue is essentially the challenge posed to government to meet the legal requirements of “reasonable use” over a “reasonable period of time” when prohibiting development. Meeting the tests of reasonable use and reasonable period of time are posed against other legal tests.

Reasonableness is determined against the substantial advancement test which balances government interests and the economic impact of the regulation. Upon determining the weight of the government interest, this weight is then tested against the nature of the government’s actions and the “reciprocity of advantage” conferred by the ordinance. The lesser the relationship of the required facilities to public health or safety, the lesser the deprivation allowed before the regulation is invalidated.

The determination of whether a landowner has been deprived of *all* reasonable use of his or her property focuses on the economic impact of the regulation and the extent to which the landowner’s distinct investment backed expectations have been defeated. If the landowner is not deprived of *all* use of his or her land, then there is *remaining use*. Whether remaining use is reasonable or unreasonable is set against yet another test: economic impact of regulation *versus* the extent to which the landowner’s distinctive investment-backed expectations have been defeated. Therefore, the takings issue is a reflection of the reasonableness of time (duration), the reasonableness of scope (purpose), and the reasonableness of use (land value). If there is no taking, then “just compensation” is not due.

#### Alternatives to Government

Porter (1997) argues that economic development policies aimed at revitalizing central cities have been framed in social rather than economic terms. Given this, local and state governments have crafted and implemented a variety of social programs and heavy subsidies to counter the effects of poverty, blight, crime, and the absence of businesses and jobs in the inner-cities. He notes that these policies and programs have consistently failed to remedy these problems and, in fact, create fiscal distortions and externalities that exacerbate and perpetuate inner-city problems. Rather than craft yet another breed of policies for governmental intervention and public investment, Porter (1995, 1997) suggests that economic development be approached from the competitive perspective within which it actually exists. He calls for a new set of policies that are based on genuinely profitable business opportunities and argues that inner cities will prosper only when they are successfully integrated into the regional and national economy.

To this end, he states, “the private sector must play the leading role in inner-city business development, motivated by self-interest instead of charity.” In a sense he argues that the government should let the dead bury the dead: social programs should play a central role in meeting human needs and improving education but no role in revitalization efforts. From his perspective, a sustainable economic base can only be created “through private, for-profit initiatives and investment based on economic self-interest and genuine competitive advantage” (Porter, 1997).



Implications of Developing a Long-term Set of Porterian Type Alternatives to Government. The striking implication of corporate-led growth and economic development is the degree to which these policies may perpetuate what Tawney (2001) described as an acquisitive and functionless society. Tawney argues that, over time, the means and ends of man and society have been inverted. Where industry existed for man, man now exists for industry. Social obligations, he argues, bind men to one another to provide social *functions* rather than to assert individual *rights*. His argument challenges habits of thought that have calcified over time through the invocation of doctrines of individual rights and property (the cornerstones upon which society has been organized) and economic rights (the cornerstone of Porter's argument) that are anterior to and independent of economic functions. Tawney would dispute the validity of the Porterian implication of isolating production and allocation from the larger social processes in which they are embedded. He contends that *rights* which contribute to social purpose are valid; whereas mere privileges serve no such social function. Tawney argues that, where there is no obligation, there is no transgression. The Porterian model speaks to no *obligation*. Corporate-led economic development does not obligate corporations to any social purpose. Instead, it advances self-interest and corporate profits.

Thus, in the strictest sense, the implications of developing a long term set of Downsian-style reforms that can lead to terminating public investment in private projects is that citizens and corporations will be placed at the mercy of government-controlled economic development. Conversely, in the strictest sense, the implications of developing a long term set of Porterian-style reforms that can lead to terminating public investment in private projects is that citizens and government will be placed at the mercy of corporate-controlled economic development. In either case, the implication is, perhaps, best embodied in Lord Acton's notion that "power tends to corrupt; absolute power corrupts absolutely." Regardless, this essay has captured the seeming Catch-22 of local economic development policies and illustrates more sharply the dilemma of the economics and politics of smokestack chasing.

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