The Research Bureau

Promoting Business Growth in Worcester: Do Tax Incentives Provide the Incentive?

The *Telegram & Gazette's* pre-election poll of Worcester voters ranked "economic development/jobs" and "fiscal management" as the two issues most important to them. These polling results are reflected nationally as well, and should come as no surprise to public officials when government spending seems out of control and the nation is in one of the worst economic downturns since the Great Depression.

When city council candidates were asked how they would address Worcester's fiscal crisis, they emphasized the need for economic development and expansion of the City's tax base. While obviously a much more attractive option than raising taxes and/or reducing services, it is also extremely difficult to achieve, especially during a recession.

Many factors affect Worcester' prospects for economic growth, including the quality of its public education system and infrastructure, but the most direct way the City can strengthen its economic competitiveness is through tax policy. The Research Bureau and others have often criticized the City's current policy of taxing businesses at more than twice the rate of residential property owners and argued that the best way to promote economic development in Worcester would be to adopt a single tax rate. This would enable Worcester to compete with nearby towns where the commercial/industrial tax rate is often one-third of Worcester's.

Others, partly out of frustration with the seeming political impossibility of adopting a single tax rate, have urged the development of new tax-incentive programs to stimulate growth in Worcester. There is no question that tax incentives are an important piece of the puzzle. Last winter, The Research Bureau published a report on downtown in which we surveyed the various large projects completed over the past decade. Almost all were backed by some form of "creative financing," that is, funds from a few different sources, including non-profit organizations and Federal, state, and local government sources, and tax-incentive programs such as Tax-Incentive Financing (TIF). Although for-profit development backed purely by unassisted private financing may ultimately be preferable, it remains elusive in Worcester. This will likely continue to be the case for the foreseeable future, and so the question is how to come up with the fairest and most intelligent tax-incentive policy.

Two new tax incentive programs have recently been proposed. The first is H. 2702, "An act to promote economic development in the Gateway Cities," which is currently under consideration by the state Legislature. The intention of this legislation is to provide Worcester and the other old, formerly industrial "Gateway" cities with an array of new tax incentives tailored to their unique strengths and weaknesses. It would lift the cap on historic tax credits in the Gateway Cities, thus helping to stimulate more interest in their many old buildings. It would also provide tax incentives for market-rate housing. (Because Worcester has abundant affordable housing-14%, well above the 10% benchmark-it would be redundant to require developers to include affordable housing in their projects as most programs currently do.) The bill also would provide corporate income tax credits for job creation, which could be helpful in attracting businesses that just need office space, and for which existing tax incentives for capital improvements, such as the TIF program, hold little appeal.

The second proposal is the Philadelphia Abatement Plan, a program advocated by Worcester Citizens for Business, which has attracted the attention of a number of City Councilors and government officials. Under this proposal, the City would "lock in" predevelopment assessments of commercial and industrial properties for a ten-year period. During that time, property owners would not have to pay taxes on any increased valuations that resulted from their investments, thus encouraging new development as well as improvements and renovations to existing properties. This program, too, would require approval by the state Legislature.

Both the Philadelphia Plan and the TIF program provide tax incentives for capital investments, but they differ in a few important respects. The Philadelphia Plan offers a total tax abatement for capital investments, whereas under the TIF, the city negotiates with the business owner how much of the increased valuation will be taxed. The TIF also qualifies the property owner for an additional 5% abatement on the state corporate income tax. The TIF includes a job-creation requirement, which the Philadelphia Plan does not, and the TIF is meant primarily for commercial and industrial development, whereas the Philadelphia Plan applies to all types of development, including residential. (In Philadelphia, the plan led more to high-end residential development than it did commercial development. The Worcester Citizens for Business advocate limiting it to commercial development.) Under the Philadelphia Plan, in other words, the city sacrifices more in tax revenues than under the TIF.

All those who are concerned about Worcester's future want to see economic growth that results in an expansion of the tax base. When evaluating these two proposals and the tax incentive programs currently available to Worcester, a few considerations should be weighed. First, because both the Philadelphia Plan and the TIF program favor new development, they do nothing to alleviate the tax burden of existing businesses that are just trying to survive. What can we do for these businesses? Second, since a successful tax incentive program should lead to an overall increase in tax revenues, it makes no sense for the state and municipalities to subsidize businesses for doing something they would have done anyway. A tax incentive program authorizes the government to make bets on what industries, companies or areas have the brightest prospects for growth. How confident are we in the government's ability to pick winners and losers? The Philadelphia Plan would give developers a 100% property tax rebate for ten years on any new improvements they undertake or even any new building they construct. Are we sure this is a good bet? Finally, we must always be aware of what public-policy scholars refer to as the law of unintended consequences. Tax incentive programs, like all public policies, often produce consequences that are unforeseen at the time of their adoption that may also be undesirable. The TIF is a case in point. Although originally intended to help close the cost difference between locating in an economically-depressed area and in a wealthy suburb, the TIF has been utilized by Williamstown and Westwood as well as Worcester. If the TIF can be applied to all communities, then Worcester loses the advantage of the incentive.

Having raised these questions, The Research Bureau believes that these proposals deserve serious consideration. We also believe that a good tax policy is a fair and simple one, and that the fairest and simplest "tax incentive policy" would be to phase in a single tax rate over several years. This would lower taxes for all businesses: old and new, big and small alike. It would be the fairest way for Worcester to promote economic development. It would not require the approval of the state Legislature, and it is the option least likely to result in unintended consequences.

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