

A Comparison of Growth Rates of Firms With and Without Tax Abatements

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INTRODUCTION

Arguments about the wisdom of granting tax abatements to firms often get lost in the fear of city officials that if abatements are not offered, firms will select other venues where they are offered. In the effort to respond to demands for abatements, local economic development officials, city councils, county commissioners, and others rarely question, or are in a position to question, the promised gains from the proposed abatements. Rarely are checks made to determine if the promised jobs materialized. Moreover, if new jobs do materialize, few city officials would be in a position to determine if they are a result of the abatement or the result of other factors, like a robust economy.

This study takes a step toward examining the usefulness of tax abatements as an economic-development tool in one community by comparing the job performance of firms receiving abatements with a matched set of firms that did not. The city of Toledo, Ohio, has a list of all of the manufacturing firms that have received tax abatements by year, since 1985. The actual changes in the number of jobs comes from the ES-202, from the Ohio Bureau of Employment Security. This data set provides employment levels for each of the firms receiving an abatement can be traced over this time period. A set of control firms, matching those with abatements by size and Standard Industrial Code (SIC) has been drawn from the ES-202 data set.

Toledo is an industrial city historically linked to the auto industry in neighboring Detroit. But it is more than a blue-collar, industrial town. Until the 1980s, when it was hard-hit by recession and the merger mania that was typified by the leveraged buyouts of that decade, Toledo was home to six Fortune 500 firms, and there were two Fortune 500 firms nearby—a large number for a city of about three hundred and fifty thousand at the time. The rough economic times subsequently led to a number of economic development initiatives in Toledo, including significant use of tax abatements.

BACKGROUND ON TOLEDO ABATEMENT POLICY

Ohio has an enterprise zone act which authorizes municipalities to designate low-income areas for special tax treatment. Under the program, the city council can grant businesses a ten-year tax exemption for real and personal property taxes on the value of the new investment (which has to equal at least 5 percent of the existing value of the facility). The program is available in designated areas of the city.¹ The cost falls principally upon the school districts (which have no legal voice in the decision) because municipalities in Ohio depend upon the municipal income tax for the major share of their general revenues. Thus, the City Council decides the abatement but feels no financial pain for the decision.

Disenchantment with the abatement policy led, in November, 1986, to the creation of the “Manager’s Tax Abatement Policy Committee,” composed of individuals involved in economic development from the governmental and private sector as well as representatives from academia and neighborhood organizations. The committee voiced

¹ Actually, the city was persuaded that this program would boost economic development throughout much of the city and during the hard times of the recession, much of the city met the economic hardship criteria to be eligible for designation. Thus, much of the city is now an enterprise zone.

many serious criticisms with the tax abatement programs. It noted that “the City of Toledo has opted to participate to the maximum extent possible in all state tax incentive programs and to grant to businesses the maximum abatement available under those programs.”² It heard testimony from small businessmen who received tax abatements. One testified that his ten-year abatement was not necessary—his need was for “up-front” assistance. Another businessman said the “key” for him in deciding to go into the enterprise subzone was subsidized land and help in obtaining financing—not tax abatement.³ The committee criticized the Tax Incentive Review Council for not performing its legally mandated function “to determine whether a business has lived up to its [job creation] agreement with the City,” and for not circulating “findings to Review Council members, and [for making] no recommendations to City Council.”⁴

The Toledo city council responded to some of the recommendations of the City Manager’s Tax Incentive Policy Review Committee with an ordinance that created a series of changes in the abatement policy.⁵ Some changes were straightforward. For example, the ordinance limits enterprise zone abatements to manufacturing firms. It provides that proposed abatement agreements be submitted to each affected governmental entity (such as school districts) at least 14 days before City Council action. The Tax Incentive Review Council is to review and monitor abatements and submit a report to the city council on an annual basis.

² City Manager’s Tax Incentive Policy Review Committee, Final Report, (Toledo, June 29, 1987), p.2. (One of the authors of this study served on this committee.)

³ Manager’s Tax Incentive Committee, Meeting, January 7, 1987 (Toledo).

⁴ City Manager’s Tax Incentive Policy Review Committee, op. cit., p. 10.

⁵ Toledo City Council, “Enterprise Zone Tax Policy,” Resolution 250-87.

The ordinance creates an administratively complicated program. For example, “Twenty-five percent of the new employees hired as a result of the Enterprise Zone Agreement must meet at least one of the following criteria at the time of their employment.” And six conditions follow, including “Residents of Lucas Co. who have been unemployed for at least six months”.

In addition to being administratively complicated, the ordinance is difficult to interpret as when it states that an “abatement shall be made in accordance with the following formula:”

$$\frac{\text{New investment}}{\text{Existing investment}} \times \frac{\text{Jobs after investment}}{\text{Jobs before investment}}$$

Not surprisingly, the data collection, review and monitoring aspects of the ordinance was handled poorly. An investigative report in late 1996 by the local newspaper revealed that stated mandated monitoring of abated companies, which involved sending form letters to abated firms requesting data on how many jobs have been created, frequently go unanswered. Abated firms have gone out of business without the city, or the Tax Incentive Review Council, school and other area government officials, and private citizens who review the abatements, knowing about it. Numerical information on reports from abated firms is not verified by the city.⁶

DATA

Data for this study come from two sources: the City of Toledo’s information on firms granted a tax abatement and the ES-202.

⁶ Sam Roe, “Tax breaks often fail to produce new jobs: Toledo investing millions in broken corporate promises,” *The [Toledo] Blade*, September 1, 1996.

Abated Firms

The City of Toledo's Economic Development Department maintains the records on the firms that have been granted property-tax abatements by the City Council. From their records, for all firms receiving abatements between 1985 and 1996, we obtained the length of the abatement, the employment at the time of abatement, usually a promise of new or retained jobs, and occasional information from follow-up reporting for all firms receiving a tax abatement between 1985 and 1996.

Because of the lax reporting and monitoring, city records are seriously incomplete. Another source for employment information is necessary.

ES-202

Employers in all states are required to report the number of their employees and wages to Unemployment Compensation offices, except for certain exclusions including sole proprietorships, churches and small agricultural enterprises.

The University of Toledo's Urban Affairs Center is participating in the Ohio Urban University Program's (UUP) ES-202 project. The data set comes from the Ohio Bureau of Employment Security, conditioned upon our acceptance of confidentiality agreements. Information about individual firms cannot be revealed.

The data set, as received by the UUP, has two shortcomings. The first involves reporting. Multi-establishment firms are supposed to report their employment and wages by establishment. Unfortunately, many firms continue to report from a single central location. To correct for this problem, the Ohio university units participating in the ES-202 project are "cleaning" the data, or assigning the employment and payroll to the proper establishments and correct addresses. The second shortcoming, discovered in

cleaning and in efforts to link firms in this data set to firms in other data sets, is that a small number of covered firms do not report, or report in ways that we cannot identify. The inability to locate all firms receiving abatements in the ES-202 data set hampers analysis. Our way of dealing with the missing data favors the performance of the abated firms, as described below.

Whatever the shortcomings, this data set allows us to move from aggregate-level analysis down to individual firms. This allows for powerful analysis in tracking changes in size of individual firms.

METHODOLOGY

This study provides a comparison of the employment record of each abated firm with the averaged record of two to five matches.

Firms report their employment on a quarterly basis for the ES-202. For the first year of the abatement, the quarterly employment figures are averaged to obtain an annual figure. The ES-202 database was searched to find the five firms closest in size to each of the abated firms, within the same three-digit SIC code. A considerable amount of time was spent examining each of the matches. Some matches were excluded because the dominant activity was far different from the abated firm, even though the two firms shared the same three-digit SIC code. In several of these cases, alternative databases listed different SIC codes for the firms.

When searching for firms closest in size with the same three-digit SIC code as the abated firm, frequently firms that came up as controls had either earlier or subsequently obtained an abatement. This led to a selection criterion that no control firms will be

among those receiving abatements during our study period. Although this rule made sense to us, it did increase the difficulty of finding controls for certain firms. It turns out that in some SIC categories, a substantial number of firms have received abatements.

With the ES-202, great difficulties are encountered when tracking firms over a period of time. They move; they are bought and sold; they change names; and they go out of business. In the case of abated firms, moving out of the region or going out of business would result in a termination of the abatement, which city records would sometimes indicate. These firms were dropped from the analysis. Thus, the abated firms in the analysis stayed in existence in Toledo and had identifiable ES-202 data for the study period. The situation is quite different for the control firms. In numerous cases, employment in control firms would “zero” out. Different kinds of searches were conducted to determine the cause. In some cases, it was as simple as a name change; these firms stayed in the study. As many as possible of the originally selected control firms were kept in the study. In several cases, firms that “zeroed” out in fact went out of business; they stayed in the sample. In other cases where employment “zeroed” out, the disposition could not be determined. Although some of these firms could have been taken over by others or are otherwise continuing in business, they are treated in our study as having gone out of business. Thus, the study results are biased in favor of the abated firms.

Abated firms in the 371 SIC category (371 = motor vehicle and passenger car body manufacturing) had no matches of comparable size; they are excluded from the analysis.

Abated firms were dropped from the analysis if fewer than two matches were found.

ES-202 data have been cleaned through 1996. For that reason, the study includes abatements granted through 1996. Between 1985 and 10\1996, the city of Toledo granted a total of 135 abatements. Twenty-five of the abatements were abatement number two for a firm, five of them were number three, and one abatement was number four for a firm, for a total of 31 duplicate abatements. Twenty-one abatements were dropped from the analysis because the firm either went out of business, no record of the firm can be found in any of our databases, or the city records show that the abatement was terminated. A total of 83 abatements between 1985 and 1996 appear in the analysis, except where firms with one abatement are compared to those with multiple abatements. Excluding the 21 abatements that involved firms going out of business, had the abatement terminated, or for which no information can be found results in findings more favorable to the performance of the abated firms compared to their controls.

FINDINGS

For five size categories, Table 1 presents a comparison of the job-creation performance of firms that have received tax abatements with the matched control group that have not after three years from the date of the abatement and for the period stretching from the date of abatement to 1996, the ending date for the employment data. The table also shows the number of jobs promised for the firms receiving the tax abatements.

Table 1⁷

Actual and Promised Job Growth, by Size of Firm,
after 3 Years and for the Whole Period

Size	Promised Jobs	After 3 Years		After Whole Period		N
		Abated	Controls	Abated	Controls	
1-19	31.6	24.9	-1.7	6.8	-2.4	23
20-49	23.5	15.8	-1.1	10.9	-1.7	26
51-99	79.2	-2.3	-5.6	9.3	0.4	14
100-499	54.6	58.8	4.8	52.4	17.1	14
Over 500	293.7	56.2	61.1	254.4	12.1	5

For all the comparison except one, the job-creation performance of the abated firms exceeds that of the control firms. The one exception is for the largest category of firms for the three-year period. Three years after the abatement for firms of 500 employees or more, the abated firms had added an average of 56.2 employees while the control firms added 61.1 employees on average.

In some cases, both the abated firms and the control firms lost employment, as in the case of the firms in the 51-99 size category for the three-year period. Here, the abated firms lost 2.3 workers on average while the control firms lost 5.6.

Although the abated firms clearly outperform the control firms, for most categories they do not perform at the level that they promised. For example, the fourteen firms in the 51-99 size category promised an average of 79.2 additional jobs, but actually

⁷ City of Toledo, Department of Economic Development, "Enterprise Zone Breakdown by Type of Investment 1983 thru 1997 Program Activity"; ES-202

lost an average of 2.3 jobs in the three-year period. For the whole period, these firms added an average of 9.3 jobs.

Perhaps the most interesting aspect of Table 1 is the inconsistencies in job change across periods and across size categories. In the smallest size category, the abated firms average an increase of 24.9 jobs after three years; this drops to 6.8 jobs across the whole period. In the 51-99 category, the firms average a loss of 2.3 jobs after three years; this increases to 9.3 jobs for the whole period.

In numerous cases, the city of Toledo granted a second and sometimes a third abatement to the same firm. The above analysis deals only with the first abatement for the firms that received multiple abatements. A firm's second and third abatements were ignored. Similarly, no new control group was created for a firm's second or third abatement. But the firms that receive only one abatement should be compared to the firms that receive multiple abatements. If the city is proceeding on the assumption that an abatement is going to lead to a certain amount of job growth, should it not be assuming that a second or third abatement will lead to even greater job growth?

Table 2 presents a comparison of the performance of firms that have received one abatement with those which have received multiple abatements, along with the promised jobs for each group. Size categories have been collapsed to avoid the possibility of identifying individual large firms. For the smaller two size categories, firms receiving single abatements promised more jobs than the firms receiving multiple abatements. With regard to the actual jobs, the picture is mixed. Over the shorter, or three-year time period, the firms with 51 through 99 employees receiving a single abatement created many more jobs on average than the counterpart firms with multiple abatements. For the

three-year period, all categories of firms except the largest category receiving multiple abatements failed to live up to the promised new jobs. For the largest size categories, the firms receiving multiple abatements outperformed those receiving single abatements in both time periods. For the entire period, the firms receiving multiple abatements performed better across all size categories. In two of the three size categories for the entire period, the firms receiving multiple abatements outperformed their promised new jobs.

Table 2⁸

Comparison of Job-Creation Performance of Firms with One Abatement and with Multiple Abatements, after Three Years and for Whole Period

Size	Promised Jobs				After 3 Years		After Whole Period	
	Single Abate.	(N)	Multiple Abate.	(N)	Single Abate.	Multiple Abate.	Single Abate.	Multiple Abate.
1-49	29.5	(40)	20.4	(8)	8.9	9.8	14.65	43.7
51-99	114.5	(9)	24.8	(6)	18.7	-2.5	-3.8	6.7
Over 100	58.6	(11)	243.6	(8)	12.3	246.9	-217.6	245.6

The extreme variability in job creation and loss is dramatized in Table 2. For the firms over 100 employees, firms with one abatement dropped an average of 218 jobs over the entire period while the large firms with multiple abatements added an average of 246.

From 1992 on, the city listed the property taxes saved by each of the companies receiving abatements. This sums to \$55,975,980. Table 3 presents the promised and actual job performance for abated firms for the period 1992-94 and 1992-95 along with

⁸ City of Toledo, Department of Economic Development, "Enterprise Zone Breakdown by Type of Investment 1983 thru 1997 Program Activity"; ES-202

the sum of the property taxes saved from the abatements for the years. For comparison purposes, Table 3 also includes the job growth of the control firms for the two periods. For the 1992-95 period, 38 of the 50 abated firms promised 2,398 new jobs (the city shows no record of promised jobs for 12 firms); they show an actual growth of 1,790 new jobs in comparison to the 415 new jobs for the control firms. If the abatements can be credited with the difference in job growth between the abated firms and the control firms, then the cost to Toledo citizens of creating 1,127 additional jobs in Toledo was the \$21,191,883 in property taxes saved for the abated firms and the tax advantage to Toledo citizens was an additional \$1,367,100 in payroll taxes for the net increase in jobs ascribed to the abatements (actual job growth of abated firms minus job growth of control firms), assuming generously that each new manufacturing job paid \$35,000.⁹

Table 3¹⁰

Promised and Actual Job Growth, Property Taxes Saved and Additional Payroll Tax for Abated Firms, 1992-1994 and 1992-1995

	Job Growth			Property Taxes	New Payroll Taxes (\$35,000)
	Promised	Actual	Controls	Saved	Actual - Jobs of Controls
1992-94	2031*	1519	392	\$21,191,883.00	\$986,125.00
1992-95	2398**	1790	415	\$29,630,056.00	\$1,566,250.00

*8 of 35 firms did not promise new jobs

**12 of 50 firms did not promise new jobs

⁹ In May, 1997, the Toledo City Council debated the wisdom of offering abatements to two firms that planned to create jobs paying from \$6.00 to \$10.00 per hour. Jeffrey Cohan, "Tax abatements considered by city council," *The [Toledo] Blade*, May 14, 1997.

¹⁰ City of Toledo, Department of Economic Development, "Enterprise Zone Breakdown by Type of Investment 1983 thru 1997 Program Activity"; ES-202

CONCLUSIONS

Comparing the performance in job creation by firms receiving tax abatements with the change in jobs of a set of control firms seems like a straightforward approach to assessing the value of tax abatements. Unfortunately, data problems abound, and many are extremely difficult to solve. Firms often fail to report information to the city that is required by the abatement ordinance. In some cases, firms also fail to report, as required by law, to the state under the ES-202 system. Information reported to the city does not always square with the information reported to the state. Some businesses are extremely difficult to track over time because of name changes, mergers, buyouts, going out of business, etc. A firm may use one name when reporting to the city and another when reporting to the state.

Developing matches for each of the abated firms proved difficult. The set of matches for a particular firm frequently contained firms that subsequently received abatements. In some cases, their employment zeroed out over time; if a name change or being bought out by another firm could not be verified, the firm was treated as if it went out of business. But it is possible that some of these firms are still around in another form; hence the job-creation of the control firms is understated. Contrariwise, a significant number of the firms receiving abatements are dropped from the analysis, which means that the job-creation performance of the abated firms is overstated.

There are additional factors that would be interesting to explore. It takes a certain knowledge and aggressiveness on the part of those in firms to seek out, make application, and receive an abatement. Are firms that seek abatements more aggressive in expanding than firms that do not seek abatements? That is, is seeking and obtaining an abatement more a measure of the aggressiveness or competitiveness of those in a firm than of a cause of the enhanced job creation?

The variability in job-creation performance of both the abated firms and the controls demonstrates the difficulty of picking winners and losers.

Whatever the methodological biases of the approach, the job-creation performance of the abated firms was, overall, greater than that of the control firms. However, when the analysis is extended to the finances, the costs to Toledo citizens in property taxes abated are far greater than the advantages from the enhanced payroll taxes to the city from the additional jobs.