A Better Deal for Illinois:

Improving Economic Development Policy

By
Good Jobs First
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Though we draw from many sources, all conclusions and any errors are our own.
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Good Jobs First is a national resource center promoting corporate and government accountability in economic development. GJF provides research, training, model publications, consulting, and testimony to grassroots groups and public officials seeking to ensure that subsidized businesses provide family-wage jobs and other effective results. Good Jobs First is also active in the smart growth movement, bringing development subsidies and labor unions into the sprawl/smart growth debate.

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The Center for Tax and Budget Accountability ("the Center") is a bi-partisan organization that provides a voice for the working poor who frequently are not represented in the decision-making processes which affect their incomes and opportunities. The Center is committed to ensuring that tax, fiscal and spending policies in Illinois are fair and just, promote economic growth for all Illinoisans and achieve revenue collection thoroughly but simply.

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Executive Summary

This report begins with a 25-year historical narrative of Illinois' economic development policies and deals, following the Department of Commerce and Community Affairs (DCCA) through the past three gubernatorial administrations. Two case studies of costly tax-based subsidies follow: Economic Development for a Growing Economy (EDGE), and Single Sales Factor (SSF). We then provide five deal-specific case studies: Diamond-Star Motors in Bloomington-Normal; the Sears headquarters relocation from Chicago's Loop to Hoffman Estates; Motorola's cell-phone plant in Harvard; Ford Motor Company's supplier campus on Chicago's southeast side; and the Boeing Headquarters relocation from Seattle to downtown Chicago.

Our analysis reveals:

Big-Business Favoritism - the state's policies and practices have cumulatively favored big businesses over small ones.

Shift to Unaccountable Tax Spending - Illinois has made a long-term shift towards tax expenditures for economic development (as opposed to appropriations), and tax spending is growing more than twice the rate of the state's economy. Tax-based spending is unaccountable, because it is rarely audited, evaluated, or sunsetted. And as a corporate entitlement, it denies the state budget control.

A Failed Windfall for Big Manufacturers - one especially costly new tax incentive – Single Sales Factor – mostly favors a small number of big manufacturing companies, fails every measure of accountability, and is clearly not working.

Overpayment - Illinois very likely overpaid for high-profile deals such as Diamond-Star and Boeing, failing to recognize the imbedded value of its many "business climate" assets.

State-Subsidized Sprawl - the state has repeatedly subsidized suburban sprawl, causing enormous wasteful costs for duplicative infrastructure, exacerbating regional inequality, reducing transit choice for workers, harming air quality, and fueling consumption of open space and farmland.

Perversion of Well-Intended Programs - especially in the cases of tax increment financing, enterprise zones and Economic Development for a Growing Economy, the state has repeatedly taken programs with laudable original intentions and so loosened their rules as to make them semi-automatic "gimmees."

We also find serious recurring *procedural* problems, including:

A lack of transparency **-** poor record-keeping, incomplete annual reports and public statements, no tax expenditure budgeting before 1993, and selective withholding of basic information requested under the state's Freedom of Information Act.

Vital Negotiating Skills Missing **-** Despite recurring allegations of overspending, DCCA has failed to develop the ability to perform cost-benefit analysis.

Failure to Recapture Misused Monies **-** Despite having enacted "clawback" safeguards on some programs, the state has been inconsistent in demanding repayment when deals fail to deliver promised benefits.

As we detail in our narrative and case studies:

- State policy as exemplified by the actions of DCCA has gyrated from aggressive "smokestack-chasing" first ramped up by Gov. James R. Thompson to drastic spending cuts and a national call for restraint by Gov. Jim Edgar back to aggressive deal-chasing under Gov. George Ryan. Most of the bad systemic trends began under Thompson, but Edgar signed Single Sales Factor after then-candidate Ryan came out strongly for it.

- Tax increment financing (TIF), a diversion of property taxes that was deregulated by the state as part of the Sears deal, has mushroomed and now dwarfs other tax-based subsidy programs.

- The EDGE program has already drifted from a selective "tip the scales" subsidy to a nearly-automatic component of major deals that lacks clear cost-benefit analysis. DCCA's annual EDGE report is missing basic information required by law, and DCCA has even redacted job-creation information in a Freedom of Information Act response on an EDGE deal.

- In just three phase-in years, Single Sales Factor has already cost the state treasury $192 million. But instead of creating new factory jobs, several major Illinois firms that reportedly lobbied for SSF have instead announced plant closings or mass layoffs, and other manufacturers that presumably got big income tax cuts have also laid off workers.

- Illinois very likely overspent for Diamond-Star Motors in what was then the costliest auto “transplant” deal in U.S. history. Although direct assembly jobs have exceeded original projections, the state’s rosy forecast for supplier jobs – which it used to justify the package – has proven woefully inaccurate.

- Illinois’ massive subsidies for the Sears headquarters relocation are a textbook case of state-subsidized suburban sprawl, causing massive new and inefficient costs for roads and other infrastructure and adversely affecting many incumbent Sears employees, especially those from Chicago’s South Side and South suburbs.

- Motorola’s Harvard plant, now shutting down, is another case of state-subsidized sprawl. It also demonstrates the dangers of putting a lot of eggs in one basket. A risky taxpayer investment in a volatile high-tech product went sour when the company misjudged consumer preference and new technology.

- Ford’s supplier campus, while no bargain, stands out positively as a well-rounded project that will benefit numerous occupants, enhances the long-term prospects for Ford’s Torrence Avenue assembly plant, will help revitalize a truly needy area, and has addressed community concerns including environmental reclamation.

- Despite evidence that incentives mattered little to Boeing, Illinois offered far greater sums than Dallas or Denver. The state used a study by the now-disgraced accounting firm of Arthur Andersen to justify the package; incredibly, it projected ripple effects 1,150% greater than those DCCA claimed for Sears. But now DCCA refuses to divulge the study; its refusal is being appealed.

Positive Solutions

To remedy the recurring policy problems found in our investigation, we offer eight positive solutions based on best practices in other states:

Unified Development Budget - an annual report to the legislature that aggregates *all* forms of economic development spending so that legislators have a full, objective picture of the state’s real priorities and spending trends. In Illinois’ case, it would underscore the magnitude and very high growth rate of tax expenditures.

Annual, Company-Specific Disclosure - public reporting about deals, including costs and benefits, covering both appropriated subsidies and tax credits, collected and published annually on the Web for the duration of the subsidy. If necessary, an amendment to

Illinois' Freedom of Information Act to clearly cover consultant studies and make the subsidy-negotiating process fully transparent.

Location-Efficient Subsidies - a state amendment to all its incentive programs to require that when a project is proposed for a metro area, the project site must be transit-accessible. This would make economic development and transit spending more efficient by encouraging their integration, increase commuter choice, create more opportunity for low-wage workers and improve air quality.

Reinstate a Three Factor Formula for Corporate Income Tax - a return to the traditional consensus three factor formula that apportions taxable income based on property, payroll and sales would mean companies that have a large presence in the state – and which therefore create large public-system costs such as roads, schools and safety – would pay their fair share.

Install Basic TIF Safeguards - Illinois can make TIF more efficient and effective by reinstating eligibility criteria that restrict TIF to areas that are truly blighted and need public-sector reinvestment to spur the return of private capital. Numerous other safeguards are recommended, including cost-benefit analysis, annual deal disclosure, property-tax disclosure of TIF diversions, job quality standards, a performance audit focusing on sunset "triggers," and improved public-participation rules.

Eliminating or Capping Big-Company Subsidies; Redirecting Monies to Skills and Infrastructure that Benefit All Employers - across the board eliminations of or caps upon the state's big-company subsidies would preserve a great deal of revenue. There are many compelling arguments for redirecting dollars from private deals to public goods, especially America's growing skilled-labor crisis.

Fully-Transparent Cost-Benefit Analysis - seventeen years after it was criticized for overspending on Diamond-Star, DCCA still cannot determine when or if taxpayers will break even on a subsidy deal. With a small investment in software and training, Illinois can obtain the capability to weigh deals objectively, bargain more smartly, and deter waste driven by politics or favoritism.

Standard Clawbacks in All Contracts - a state rule mandating clear recapture language in every subsidy agreement – including EDGE and TIF – would ensure that taxpayers are made whole when deals fail to deliver.

Using these best practices, Illinois can make more effective use of its economic development resources and win a better deal for communities, taxpayers and workers.

Introduction: Why Economic Development Deserves Scrutiny

Like most other states since the late 1970s, Illinois has enacted a raft of new economic development subsidies intended to help the state attract new business projects or encourage incumbent employers to stay or expand in Illinois. These subsidies include: corporate income, sales, and property tax breaks; training and other grants; infrastructure aid, and low-interest loans and loan guarantees. It has also assembled several large, multi-subsidy deals for specific "high impact" situations.

Illinois' budget records are so incomplete, especially before 1993 when the state did not even publish a tax expenditure budget, they make it difficult to estimate how much the state has been spending for economic development. (The appendix to this report summarizes some of the key information that is available.) Yet it is clear the trend in Illinois is consistent with patterns seen elsewhere: a large, long-term increase in both the number and value of subsidies given, and especially a surge in *tax* spending (i.e., tax expenditures such as corporate income tax credits and sales tax exemptions) compared to appropriated spending (e.g., training grants).

The state's major economic development subsidies include:

- **High Impact Business Program**

Created as part of the Illinois Enterprise Zone Act, it makes enterprise-zone type tax breaks available to companies locating *outside* enterprise zones that are investing at least $12 million and creating 500 full-time jobs, or $30 million while retaining 1,500 full-time jobs.

- **Enterprise Zone Program**

These include a variety of state sales, individual, and corporate income tax breaks for companies locating in one of 93 zones approved by DCCA. To qualify as an enterprise zone an area must satisfy at least one of four criteria for economic distress, or be the location of a project with high job creation and investment potential ($100 million or more). Local tax abatements may also be offered. The number of Illinois businesses receiving subsidies under this program mushroomed from 98 in 1984 to 1,837 in 1999.[1]

- **Tax Increment Financing (TIF)**

Now numbering nearly 800 in Illinois, TIF districts are areas in which incremental increases in property tax revenues that result from new development or redevelopment are diverted to pay for infrastructure improvements or other incentives. From FY 1980 through FY 1999, nearly $2.4 billion in tax revenue was diverted into TIF, away from education, public safety and other services supported by property taxes. The revenue stress created by TIF was originally justified by its original purpose as an anti-poverty tool. However, beginning with the designation of a Hoffman Estates TIF district in the Sears deal, TIFs have become more and more an all-purpose economic development tool.[2]

- **Economic Development for a Growing Economy (EDGE) Tax Credits**

This corporate tax credit program was created as part of the 1999 Illinois Jobs through Competitiveness Act (SB-40). See Chapter 2 for a detailed discussion of EDGE.

- **Single Sales Factor Apportionment for Corporate Income Tax**

Rather than a tax credit, Single Sales Factor (SSF) is a way of calculating corporate income tax that favors large Illinois manufacturers that sell their products nationally. Advocates lobbied for it by calling it an economic development incentive. See Chapter 3 for more on SSF.

Other subsidy programs include:

- Large Business Development Program (Grants/Loans)
- Illinois First infrastructure assistance
- Corporate Headquarters Relocation Act

A Growing Share of the Budget "Pie"

While it is impossible to sum up trends in state spending over the past 25 years, it is documented that economic development spending is taking up a growing share of the state budget "pie." According to the Illinois Comptroller's most recent Tax Expenditure Report,[3] economic development tax expenditures – corporate income tax credits granted for business capital investment, research and development, employment and job training – grew at an annual rate of nearly 7% between 1995 and 2001. That is more than twice the rate of state personal income growth or gross state product growth, and much faster than all tax expenditures (4.7% annually). Appropriated expenditures by

DCCA also grew rapidly in this period, increasing nearly 9% per year – almost *triple* the growth rate for state spending as a whole.

With the state facing an estimated FY 2003 budget deficit of $1.2 billion, scrutinizing parts of the budget with such high growth rates is obviously prudent. But the state's spending for economic development deserves close examination not only for its immediate budget costs, but also for its long-term impact. That's because one of the primary goals of economic development is to improve the state's tax base. This is critical because there is no such thing as free growth: if the state succeeds in attracting and growing more jobs, the resulting population increase means more public-system costs for schools and teachers, roads and sewers, public safety and corrections, higher education and social services.

This is a core issue of government competence and fairness. If Illinois is not smart at the "game" of economic development, if it grants unnecessary subsidies, if it encourages sprawl and inefficient utilization of infrastructure and land, if it distorts the tax code in favor of one group of employers at the expense of many others, or if it fails to sustain adequate funding to grow the skilled labor base that is now and will remain the leading site location advantage in America, then it will undermine the state's prosperity in the 21st century.

The Structure of this Report

This report begins with an overview of Illinois' economic development policy over the past 25 years and then examines in more detail two of the key tax incentive programs: EDGE tax credits and the Single Sales Factor method of calculating corporate income tax liability.

We then present five case studies of company-specific subsidy deals:

- the Diamond-Star automobile plant in Bloomington-Normal;
- the relocation of the headquarters of Sears, Roebuck to Hoffman Estates;
- the Motorola cell phone manufacturing plant in Harvard;
- the Ford Motor Co. supplier campus in Chicago; and
- the relocation of Boeing Co.'s headquarters to Chicago.

Of course, a few case studies cannot tell the whole story of 25 years of state policy, but these cases are high-profile, high-cost episodes that commanded the attention of governors and top DCCA officials. In total, they cost state and local governments in Illinois more than $600 million. Together, they reveal the state's very uneven record in playing the incentives game.

Chapter 1. Twenty-five Years of Economic Development Policy in Illinois

For almost a quarter of a century, the Department of Commerce and Community Affairs (DCCA) has been at the center of economic development policies and deals in Illinois. Other state agencies like the Illinois Development Finance Authority and the Illinois Department of Transportation have had an important role, as have tax and budgetary policymakers. Nonetheless, DCCA has been the leading vehicle by which Illinois governors have tried to shape the state's economic future.

While the agency has multiple functions, it is DCCA's role as dispenser of state funds to attract new corporate projects and to retain existing ones that is the subject of this report. We examine DCCA's history through the administrations of the state's last three governors.

DCCA and Subsidy Policy Under Governor James R. Thompson (1977-1990)

Governor James R. Thompson created DCCA and transformed Illinois from a state with a conservative, low-spending approach into one of the most aggressive states in the Midwest. By pursuing tax-cutting and deregulatory policies, Thompson put Illinois squarely into what has been called "smokestack-chasing" and the "war among the states." He led the way in creating a slew of tax-based subsidies and engineered what was then the largest auto plant deal in U.S. history as well as the highly controversial retention deal for the headquarters of Sears, Roebuck & Co.

Thompson formed DCCA in 1979 by merging the Department of Business and Economic Development and the Department of Local Government Affairs with the Governor's Office of Manpower and Human Development. Under the Thompson Administration, the part of DCCA's budget funded by state general revenue funds (as opposed to federal funding) quadrupled from $150 million in FY 1979 to $600 million in FY 1986.[4]

Several factors motivated the creation of the new agency, including the 1973-1974 recession and increased competition for business from Southern states. Business and political leaders called for a new, more aggressive approach to "selling" the state. Gene Graves, former head of the Illinois Board of Economic Development, said: "We were late compared to some of the states. The South relaxed environmental laws. Illinois was the 43rd state to offer industrial revenue bonds. Southern governors came up here on raids offering [property] tax abatements. Our hands were tied because we couldn't offer the same things."[5]

In response to criticism that Illinois had become less attractive to companies seeking to relocate, expand, or launch new operations, Thompson's DCCA pursued companies aggressively, launched high-profile overseas missions seeking foreign direct investment, and sought changes in tax and regulatory policies perceived as making the state uncompetitive. These included a phase-out of the sales tax on machinery and equipment,[6] a sales tax exemption for rolling stock (any transport vehicle for hire) and hefty tax breaks for companies whose operations were designated as "high impact" (read big) or were located in enterprise zones. The Thompson era also saw the enactment of "Build Illinois," a $2 billion-plus initiative for building new infrastructure and improving the state's image as a place for tourism and business investment.

Thompson's tenure was also marked – some thought marred – by its no-holds-barred pursuit of high-profile subsidy deals, in which Illinois competed with other states in a continually escalating battle to attract new manufacturing projects planned by U.S. and Japanese companies. In the early 1980s, Illinois unsuccessfully bid for a new Chrysler assembly plant, and in 1985, it sought GM's coveted Saturn plant.[7] Finally, in 1985, Illinois landed the Diamond-Star auto assembly plant, originally a joint venture of Chrysler and Mitsubishi Motors. The state and localities provided subsidies of $243 million, then the biggest incentive package yet offered for an auto assembly plant[8] (See Chapter 4 for more details.) Midwest governors, including Thompson, sought to deter "job piracy" within the region, but Indiana Gov. Robert Orr undermined such efforts.

In pursuing additional subsidies to win the Diamond-Star deal, Thompson won legislation creating corporate income investment tax credits, with five-year carry-over rights, for any company locating in an enterprise zone and creating 2,000 or more jobs[9]; he also won state utility tax exemptions. It was an early example, repeated in several subsequent subsidy deals, of giving preferential treatment to large companies.[10]

This approach was quite evident in the Thompson Administration's response to the 1989 announcement by Sears that it planned to abandon its famous skyscraper in downtown Chicago and move its headquarters, perhaps to another state. DCCA and other state agencies paid handsomely to prevent Sears from leaving the state, but still the retailer shifted its headquarters to Hoffman Estates, a distant suburb northwest of Chicago, in a move that contributed to suburban sprawl. The Thompson Administration's push to qualify wealthy Hoffman Estates for a TIF district for Sears perverted a tool designed to promote redevelopment in poor urban areas.

The Sears deal was so egregious, *Crain's Chicago Business* editorialized:

> In retrospect, it's clear that the checkbook economic development practiced in the 1980s by Governor James R. Thompson and other

> governors was bad policy. It was unfair to thousands of less powerful companies… and it overshadowed the less flashy, essential government strategies that can really foster long-term economic growth, like wisely investing in public education, job training, technology and infrastructure.[11]

In summary, the Thompson Administration saw the creation of and aggressive funding for the state's first unified agency for economic development, the granting of what was then the nation's most costly auto assembly-plant deal, a very costly and sprawling corporate headquarters retention deal, the perversion of TIF, tax cuts that mostly benefited large corporations, and a general policy shift in favor of costly, high-profile, company-specific deals.

The First Detailed Analysis of Economic Development Subsidies in Illinois

The first in-depth critique of DCCA's high-cost deals came from within state government near the end of Thompson's Administration. In 1989, Illinois Auditor Robert G. Cronson issued a stinging performance audit of DCCA, accusing the agency of awarding subsidies to companies that didn't need them, inflating job retention or creation figures, failing to follow program guidelines for company eligibility and exceeding the allowable maximum subsidy per job.[12]

The audit also criticized DCCA's failure to protect the state's interest in some loans, to employ effective collection procedures, or to do cost-benefit or economic impact studies, even in deals involving millions of state dollars.[13] Complaining that the Diamond-Star Manufacturing (DSM) project was exempted from normal state application procedures and subsidy limits, the audit report also found it remarkable that DSM did not have to hire any specific number of employees or remain in operation for any stated time period.

The Auditor General also called for greater openness and accountability: "The General Assembly may wish to consider amending the confidentiality provisions in the economic development program statutes to require firms accepting public funds to make public such data as are needed to establish (1) their eligibility for the subsidy, and (2) their compliance with the conditions of the loan or grant."[14]

DCCA accepted some of the audit's recommendations, but the agency rejected the suggestion that financial aid be restricted to companies with inadequate internal rates of return, saying that the Diamond-Star deal would have been impossible with that criterion.

DCCA and Subsidy Policy under Governor Jim Edgar (1991-1998)

Faced with a sluggish state economy and fiscal constraints associated with the 1991 recession, Governor Jim Edgar put his own stamp on DCCA and state policy, swinging sharply away from Thompson's practices. In his first term, he became a nationally prominent advocate for restraint in the use of incentives, to the point of leading a pro-accountability caucus of governors. He also signed clawback legislation to recapture subsidies from failed deals. But Edgar eventually strayed from his principles, granting large subsidies to a Motorola plant that is now shutting down. Worse, late in his administration, he signed a controversial tax-formula change – Single Sales Factor – that contradicted everything he had earlier advocated.

Edgar moved quickly to reshape DCCA; in 1991, he cut its budget by 68% and its staff by 37%.[15] These moves were designed to respond to business criticisms of the agency, summed up in the sarcastic remark of one business leader: "I don't know why you would say we were critical of the old DCCA just because it became a patronage dumping ground."[16]

Under Edgar, DCCA's role was redefined to be an intra-governmental advocate for business, including support for changes in workers' compensation that were strongly opposed by organized labor. DCCA's mission was also refocused on retention, expansion, and industry-wide concerns, instead of smokestack-chasing and incentives competition.[17] In 1991 DCCA Director Jan Grayson said that the new focus would be on industrial "clusters," or concentrations of interdependent businesses engaged in related industries.[18] In another interview, Grayson said that the Edgar Administration would probably not have given Sears its huge subsidy package: "I doubt if we would do that. I would not expect it."[19]

A 1992 report by the SRI Center for Economic Competitiveness and Data Resources found that Illinois was not keeping pace with neighboring states in capturing high-wage jobs. This reinforced the Edgar Administration's view that a new approach was necessary.[20]

Edgar himself spoke out against interstate bidding wars in a 1992 speech to the National Governor's Association (NGA). Noting the dilemma faced by states, he said: "We all favor disarmament, but no one wants to do it unilaterally."[21] In 1993, Edgar led a pro-restraint caucus of governors in a nationally televised debate. The governors did not disarm, but they did agree on a non-binding resolution full of enduring wisdom:

> States will always be in competition [but] this competition should not be characterized by how much direct assistance a state can provide to individual companies. …The competition should be judged on factors such

> as improvements in education, transportation, telecommunications, state fiscal conditions, tax policies, business regulation, and the provision of quality public services. …Public subsidies should benefit and be available to all businesses… Public subsidies should be in the form of investments in people, resulting in a better-educated and skilled workforce, and in communities, by developing the physical and social infrastructure… The business community has an obligation to deliver the promised benefits (e.g., investment, jobs and payroll) in return for state development subsidies. The state owes it to its citizens to ensure that all development agreements include provisions for recouping subsidies when businesses fail to meet this obligation."[22]

Within a year of the NGA meeting, the Edgar Administration's subsidy restraint disappeared. In 1994 the state granted $36 million in infrastructure improvements and tax credits for Motorola's ill-starred cellular phone manufacturing plant in the distant Chicago exurb of Harvard. The plant, now scheduled to close completely in 2003, is a textbook example of a poorly conceived economic development project. (For more details on the Motorola deal, see Chapter 6.)

The Edgar Administration did, however, seek to establish effective subsidy recapture provisions if companies failed to deliver on their commitments. In 1991, Illinois enacted a broad clawback plan, the Community Investment Recovery Act, which covered assistance provided by any state agency or unit of local government to build, improve, or modify real property for projects designed to attract or retain jobs. The law required that if a company terminates operations at the site within 24 months of starting (or 24 months after receiving the subsidy at an ongoing site), the company must pay back the state the full value of the assistance.

Monitoring compliance was another matter. It took a 1995 whistleblower lawsuit by the United Paperworkers International Union to get the state to recapture more than $3 million in various tax breaks from the A.E. Staley Manufacturing Co. Required to maintain at least 1,000 employees to qualify for the breaks, Staley had fallen below the threshold after a highly-publicized labor dispute at its Decatur corn-milling plant.[23] The Decatur dispute and subsequent downsizing were widely known; a routine review of the company's unemployment insurance filings would have easily revealed the job shortfall.

In 1997 Illinois was ranked 4th by *Site Selection* magazine in an assessment of state policies related to business relocations and expansions.[24] While citing recent "pro-business' measures like an unemployment insurance tax cut, the publication said companies moving to or expanding in Illinois were attracted by "strong financial resources, an educated workforce and sophisticated technology resources," as well as competitive energy prices and abundant water.[25]

Despite getting high "business climate" marks for strengths other than subsidies, Gov. Edgar the next year signed a controversial corporate income-tax formula change called Single Sales Factor (SSF) apportionment. Edgar had vetoed SSF in 1997, but signed it into law in 1998 after then-candidate George Ryan came out strongly for it. Touted as an economic development boon, SSF was actually a huge windfall to the state's biggest manufacturers without any guarantee it would boost factory jobs. As detailed in Chapter 3, some of the companies that lobbied for or benefited from the tax-law change subsequently cut Illinois jobs instead.

Edgar's signing of the Single Sales Factor was a sad coda to his administration, for it contradicted everything he had advocated in the National Governors Association exchanges. It was a highly selective subsidy that primarily benefited a very small share of the state's employers. As a tax-formula change, it could not incorporate any recapture provisions if those beneficiaries failed to deliver, i.e., if factory jobs failed to grow. It included no incentives for improving workforce education or skills. And it has deprived the state of large sums that could have been used to sustain quality public services and improve infrastructure.

DCCA and Subsidy Policy under Governor George Ryan (1999-2002)

In its approach to economic development, the Ryan Administration showed two faces – one looking forward with some novel initiatives, the other looking back toward the heavy use of company-specific subsidies. Upon her appointment as Ryan's DCCA Director, Pam McDonough unabashedly stated: "We're going back to a Thompsonesque [style of] economic development."[26]

The Ryan Administration launched some innovative if controversial programs. The Illinois Tomorrow initiative included the pilot Balanced Growth Capacity-Building Program, a modest program that gave local governments grants to do comprehensive planning for smart growth.[27] The $12 billion Illinois First infrastructure program was criticized for its notorious member initiatives – discretionary funds for legislators that often seemed like pork-barrel spending – but still managed to address some important needs. Another small program, the $30 million Prime Sites program, was intended to give more development resources to poor urban areas. Just before the high-technology bubble burst, Illinois announced VentureTECH, a five-year, $1.9 billion program to invest state resources in health sciences, biotechnology and information technology.

A cornerstone of the Ryan Administration's approach was the Economic Development for a Growing Economy (EDGE) Tax Credit Act, which was inspired by, and created to counter, a similar program in Indiana. The credit gives companies investing at least $5 million and hiring 25 or more employees a corporate income tax credit that can go as high as the personal income taxes paid by newly hired or retained employees. The credit is not an entitlement, however; it is awarded at the discretion of the DCCA director with the consent of a Business Investment Committee.

The need for Illinois to match incentives offered by neighboring states was a recurring theme sounded by Ryan. During the Thompson and Edgar administrations, northwest Indiana lured some Illinois manufacturers in search of lower taxes.[28] Ryan's response to this competitive threat, whatever its true magnitude, was to promise even bigger incentives than neighboring states.[29] As time went on, almost every large deal included EDGE credits, and the state's success in landing most deals was attributed to them. According to DCCA, EDGE supposedly allowed Illinois to triple its "business attraction rate" from 16% to 45% by Spring 2001. However, since DCCA doesn't keep a unified and public deal list, it is impossible to know if this is a credible or meaningful figure.[30] EDGE credits formed the bulk of the state's subsidies in the 2001 Boeing headquarters deal. The EDGE program has accelerated the trend toward tax-based subsidies.

Despite its renewed heavy use of deal-specific subsidies, the Ryan-era DCCA generally opposed efforts to increase corporate accountability. A broad reform advocated by the Illinois AFL-CIO died in committee in 1999. Two years later, Gov. Ryan vetoed clawback legislation that passed both houses after subsidy recipient Motorola announced mass layoffs. The governor and DCCA claimed that new laws weren't necessary, given the performance standards contained in the enabling legislation of particular subsidies.

The problem is that these so-called "performance-based incentives" assume that recipients will voluntarily report accurate information. Even if the reporting is honest, the information is revealed in confidential documents (i.e., corporate tax returns) rather than reports that are widely available to policymakers and the public.

There's also the question of whether the state will enforce existing rules. Two examples from the final months of the Ryan Administration suggest the state remains unable or unwilling to recapture subsidies when companies close plants. When the City of Springfield recently attempted to recover a $150,000 grant (part of a nearly $5 million local/state package) from Illini Technology after it closed its new plant, neither the State Treasurer's STEP program nor DCCA would attempt to recover state subsidies, saying that the company had met program guidelines.[31] And despite Maytag's October 2002 announcement that it will close its heavily subsidized Galesburg plant in 2003, DCCA has yet to announce if it will penalize the company for closing the refurbished plant.

Political Geography: Springfield vs. Cook County

Development policy in Illinois has been shaped to a great degree by the political geography of the state; specifically, the divide between Republican governors in Springfield and Democratic-controlled Chicago and Cook County.

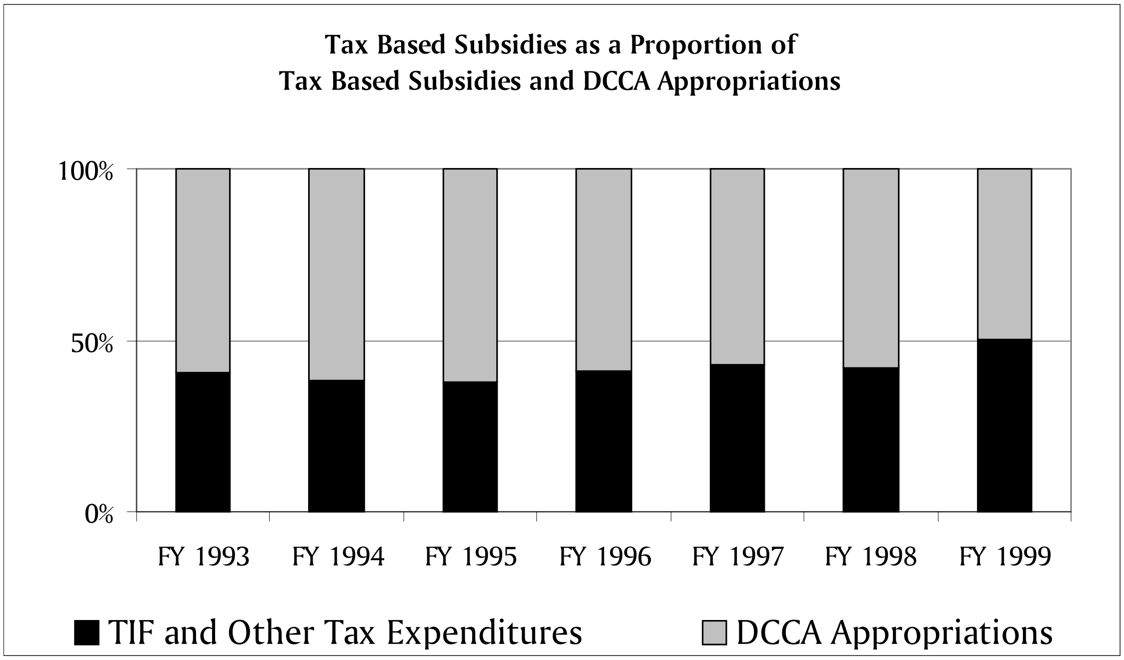
During the Thompson Administration, the tension was obvious. Chicago's greatest need was for industrial retention, but Thompson was busy opening foreign trade missions and chasing the Diamond-Star deal for Bloomington-Normal. Chicago Mayor Harold Washington's administration bootstrapped its Local Industrial Retention Initiative and partnered with a network of non-profit community development corporations to try to stem the tide with an early warning system.

Thompson helped Mayor Richard M. Daley find a compromise site for the Sears headquarters near O'Hare, perhaps to try to compensate for the Diamond-Star project; but ultimately, Thompson lavishly subsidized Sears' move to distant Hoffman Estates. The state occasionally helped the city in specific retention deals, but broader programmatic and policy help was missing. The Chicago Economic Development Commission paid for a study of family-owned manufacturers at risk of closure, but the state never acted on the findings.[32]

During the Edgar Administration, the perception that Chicago was being neglected was reinforced by the state's heavy support for Motorola's plant in far-exurban Harvard. Again the city bootstrapped policy, as Mayor Daley became one of the nation's most outspoken advocates for brownfield reclamation, especially during his 1996 term as president of the U.S. Conference of Mayors. The state did provide land for a major industrial park on the northwest side of Chicago,[33] but other Edgar-era deals tended to favor the suburbs over Chicago. For example, the state pledged $700,000 in grants and financial incentives for Ameritech and IBM's joint customer-service center in Arlington Heights.

In the first years of the Ryan Administration, DCCA apparently remained indifferent to Chicago's needs. In 2000, Mayor Daley and suburban mayors called for a restructuring of DCCA on a regional basis to make sure the greater Chicago area got its fair share of economic development dollars.[34] This may help explain an unusual degree of bipartisan cooperation that has evolved between Ryan and Daley. Other recent examples of city-state cooperation on economic development include the Boeing headquarters deal and the Ford supplier park and Solo Cup projects on Chicago's southeast side. But DCCA remained active outside Cook County as well, with deals such as the DuPage Technology Park, which is seen even in the business community as a sop to suburban Republican leadership.[35]

Tax Spending: The Bottom of the Iceberg



Tax-based subsidies represent a very significant share of all Illinois economic development spending, averaging approximately 40% between 1993 and 1998. By 1999, tax-based subsidies accounted for half of all economic development spending. Tax-based subsidies include TIF and other economic development tax expenditures.

Because tax expenditure data is not yet available for years since 1999, we cannot derive such comparisons for more recent years. However, we do know that both tax expenditures and DCCA appropriations have continued to rise since 1999. Added to the tax expenditures will be growing TIF property-tax diversions, increased EDGE credits claims and more than $200 million in revenues lost to Single Sales Factor. Gov. Ryan has also won increased DCCA appropriations since 1999.

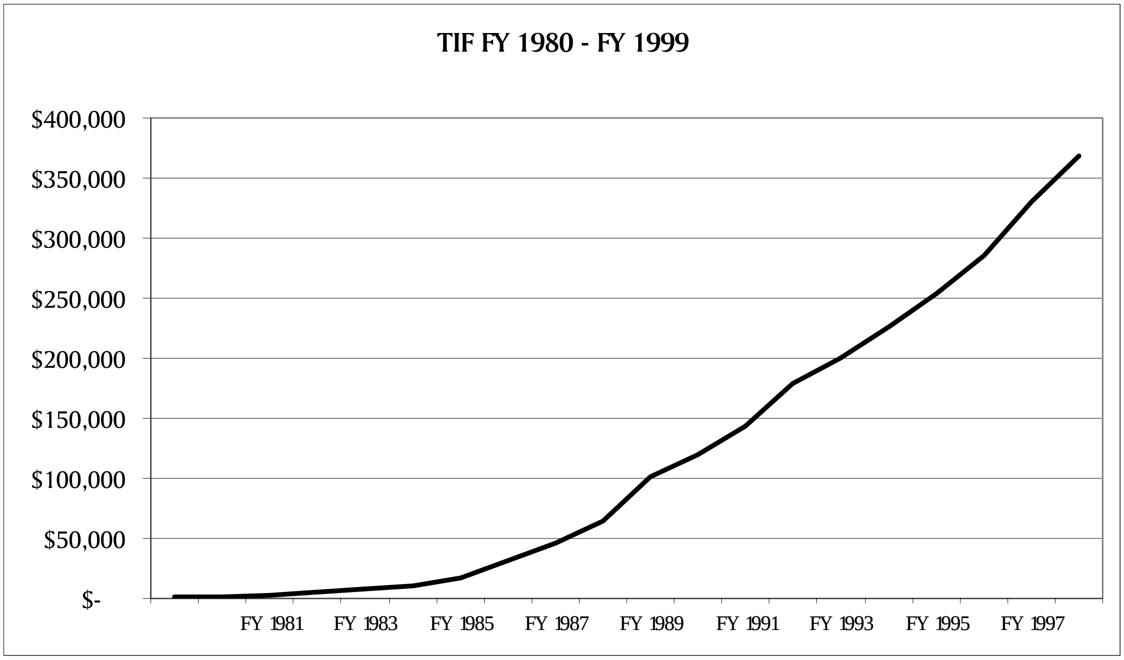
As we detail in our policy conclusion, when states experience budget deficits, appropriations are usually better scrutinized and more likely to be reduced than tax expenditures (despite the fact that tax expenditures are far less likely to have been audited or evaluated for effectiveness). If Illinois were to adopt a Unified Development Budget, legislators would have a full and accurate picture of all state spending for development to help determine budget priorities.

TIF: Triples in the 1990s to Become the Largest Tax Expenditure

The next two charts show the rapid rise in TIF spending and how dominant TIF has become as Illinois' largest single tax expenditure. The state now has approximately 780 TIF districts, including more than 100 in Chicago alone. The amount of revenue captured by TIF districts more than tripled in the 1990s.

By 1999, TIF districts were diverting $368 million in property taxes a year – *and the amount of revenue captured by TIF districts exceeded the value of 23 other economic development tax expenditures combined*, including:

- Assembling and Equipment Exemption
- Building Materials within EZ Exemption
- Coal Research Investment Credit
- Coal, Oil Distillation Machinery and Equipment Exemption
- Designated Tangible Personal Property within EZ Exemption
- Enterprise Zone and Foreign Trade Zone High Economic Impact Business Exemption
- Enterprise Zone and High Economic Impact Interest Subtractions
- Enterprise Zone Revenue Exemption
- EZ and Federal Trade Zone
- EZ and Foreign Trade Zone Dividend Subtractions
- EZ Investment Credit
- Graphic Arts Machinery and Equipment exemption
- High Economic Impact Business Investment Credit
- Income Tax Credit
- Investment Tax Credit
- Job Training Contribution Subtraction
- Jobs Tax Credit
- Manufacturer's Purchase Credit
- Research and Development Credit
- Rolling Stock Exemption
- Tech Prep Youth Vocational Program Credit
- Training Expense Credit


TIF FY 1980 - FY 1999
$400,000
$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
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FY 1981
FY 1983
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FY 1993
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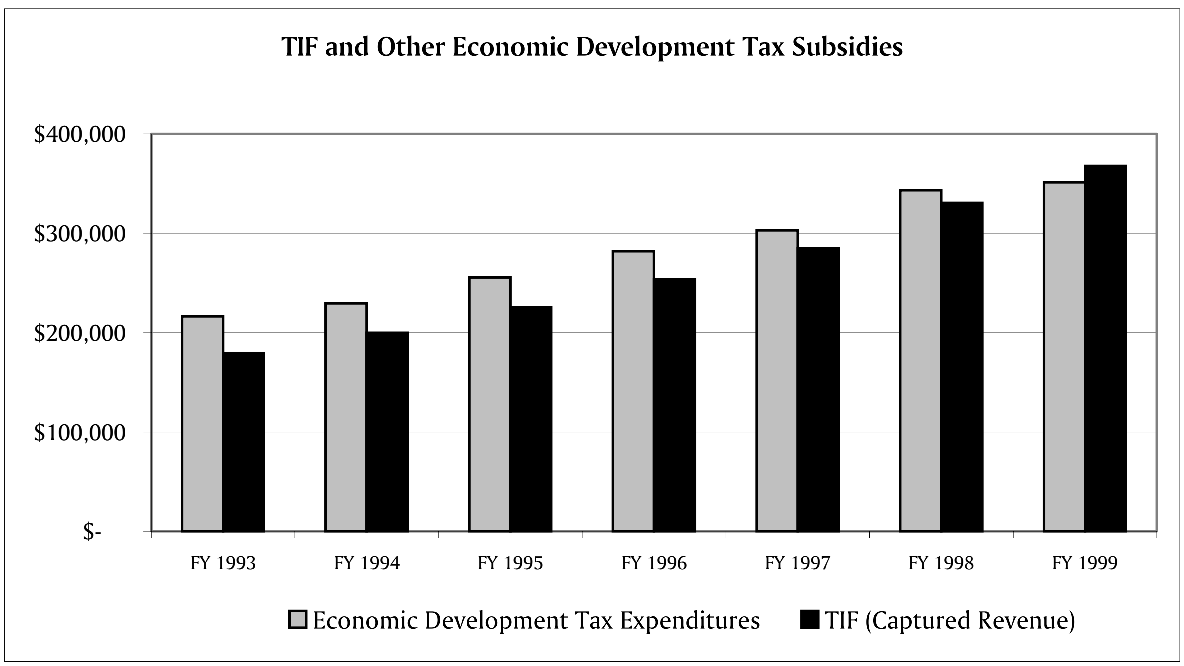
FY 1997


TIF and Other Economic Development Tax Subsidies
$400,000
$300,000
$200,000
$100,000
$-
FY 1993
FY 1994
FY 1995
FY 1996
FY 1997
FY 1998
FY 1999
Economic Development Tax Expenditures
TIF (Captured Revenue)

Chapter 2. EDGE: A Scalpel Becomes a Broadax

During his 1998 campaign for Governor, George Ryan promised to "create a new tax incentive program that would help Illinois better compete with neighboring states and capture a larger number of businesses looking to expand or relocate."[36] Accordingly, the state legislature enacted the Economic Development for a Growing Economy (EDGE) Tax Credit program as part of the 1999 Illinois Jobs through Competitiveness Act (SB-40).

The EDGE program provides corporate income tax credits up to the value of personal income taxes paid by newly hired or retained employees in qualifying projects. EDGE credits are a form of "gap" subsidy, designed to fill the gap between costs in Illinois and purportedly lower costs of doing business in competing states. Subsidies offered by other states are included in these competing costs, so that Illinois is, in effect, challenged to match them with subsidies and credits of its own.

The program is not automatic. Companies must apply and present evidence that their key business costs are or would be lower in a competing state. Further, they must attest that "but for" the credits, they would not locate the project in Illinois or that credits are at least a major consideration. EDGE credits comprised most of the state's share of the Boeing deal.

EDGE credits are supposed to be reduced if minimum job creation goals are not met. However, our analysis of the program finds serious problems, including the potential for overuse and misuse, inadequate disclosure and accountability, and insufficient public input. While the EDGE tax program has some modest safeguards, it still has important defects that could be costly to Illinois taxpayers. And like other Illinois economic development programs, its original, targeted justification has faded as it becomes an all-purpose subsidy.

DCCA has credited EDGE with increasing the state's "win rate" – the share of companies that actually relocate or expand in Illinois from among those who consider it – from 17% to 60% in the first half of FY 2001.[37] But as stated before, because the records behind this claim are not public, it is impossible to know if it is credible or significant. The EDGE tax break program helped Illinois become a favorite of the site location press, exemplified by the state's receiving *Site Selection* magazine's Governor's Cup in February 2001. Even if EDGE does give Illinois a leg up, shortly after it was created, the Illinois Comptroller predicted a self-defeating outcome: "Much of the proliferation of incentives is the result of efforts to keep pace with competing states. Evidence indicates that new programs are quickly copied in other states so that any advantage gained from new programs is short-lived."[38]

Despite this caution, EDGE credits are now a standard feature of larger DCCA deals. Between December 22, 1999, and June 30, 2002, DCCA approved 116 EDGE applications and signed 74 agreements – an average of 46.4 deals yearly. Another 50 applications for the credit were pending.[39] Although DCCA apparently posts only a fraction of press releases related to these deals on its website, those that are there show a rapid increase in the use of EDGE credits – 9 in 2000, 13 in 2001, and 18 in 2002 (January through November).

The Fine Print on the EDGE Tax Credit

Like the High Impact Business Program and several Enterprise Zone tax breaks, EDGE provides corporate income tax credits. The program allows eligible companies to deduct from their income tax an amount based on incremental payroll increases generated by new or retained employees. Current guidelines:[40]

- The size of the EDGE tax credit is determined on a case-by-case basis and may be lowered to reflect other state subsidies.

- The tax credit can equal but not exceed the state personal income taxes paid by new or retained employees at eligible projects. The credit can be reduced to reflect other state aid to the company.

- In general, EDGE credits are limited to 10 years. However, companies with annual sales of $25 billion that relocate headquarters with at least 250 employees can get EDGE credits for up to 15 years. In this case, credits are capped at 60% of the maximum credit theoretically available for that period.

- Applying companies must present evidence of key cost differentials, including those due to subsidies, between Illinois and other states competing for the project.

- Applying companies must claim that "but for" the credits, they would not locate the project in Illinois, or that credits are a "major factor" in their decision.

- Companies receiving credits are expected to maintain the project, with the related jobs and investment, for a period of 10 years. They are also required to maintain a specific minimum number of jobs in order to remain eligible for any EDGE tax credits, as well as the expected number of created or retained jobs that is the basis of the award.

EDGE Guidelines, Continued

- Credits cannot exceed the firm's state income tax liability. Credits are non-refundable (i.e., companies can't get a refund if their tax liability is negative), but unused credits can be carried forward for as many as five years.

Whether they are proposing an expansion at an existing location or a new plant or headquarters, companies applying for the EDGE credit must:

- Be in an industry that adds to the export potential of Illinois. Examples are manufacturing and assembly, agricultural or other processing, warehousing and distribution, research and development and office industries. Non-export service industries – such as health, retail and retail food, and professional services – are explicitly excluded.

- Create at least 25 jobs (excluding recalls, transfers, etc.), and invest at least $5 million in Illinois, or create 50 jobs and invest $2.5 million.

- Create at least 25 jobs in low-income areas (or locations serving such areas), or hire 25 low-income workers, in which case the minimum capital investment requirement is waived. However, relocating corporate headquarters of companies (like Boeing) with annual sales of $25 billion or more, and 250 or more employees are also eligible, even if their employees are transferred.

- Meet individual investment and job creation, and/or retention requirements as set forth by DCCA.

The DCCA Director can authorize credits for companies not meeting these job and investment requirements provided there is a "substantial economic benefit." Such benefits include preserving a key source of area employment, locating in an area with low economic development potential or higher than average unemployment, or having high growth or spin-off potential. In other words, the program gives the DCCA director a great deal of discretion.

EDGE Compared to Other States

The EDGE program was originally supposed to offset similar subsidies in neighbor states, like those offered by Kentucky's Rural Economic Development Act, Wisconsin's Enterprise Development Zone Program, Iowa's New Jobs and Income Program, Indiana's own EDGE program, and the Missouri Building Incentive Program.[41]

Comparing Illinois's EDGE program with other states, DCCA's 2002 report claims "it is distinctly more attractive than those offered by Iowa and Missouri in the restrictions placed on the minimum number of jobs created, the length of the commitment, and the minimum investment needed to qualify." [42] In other words, Illinois competed with Iowa and Missouri by setting lower eligibility standards. For example, Missouri's program requires a minimum $15 million investment compared to Illinois' $5 million, and 100-full-time jobs compared with Illinois' 25. However, the Illinois EDGE program does have specific investment and job creation minimums, while the Kentucky, Indiana, and Wisconsin programs do not.

But some of those states also have other tougher eligibility requirements. Wisconsin's program is "reserved for larger projects where there will be significant positive impacts on a community that has higher unemployment rates or declining property values."[43] Kentucky requires investment to last at least 15 years, versus 10 in Illinois.

When the EDGE tax credit was created to counter similar tax subsidy programs in neighboring states, the Illinois Comptroller's Office found evidence suggesting the limited effectiveness of such programs. From information provided by the Quad City Development Group, they noted that while neither Illinois nor Iowa had a clear advantage in tax incentives, economic growth on the Illinois side of the river had consistently exceeded Iowa's.[44] But official justification for EDGE credits soon went beyond the need to compete with neighboring states. DCCA Director Pam McDonough said getting good jobs for Illinois meant finding ways to offset the negative impact of the state's corporate income tax: "Currently 22 states have either a lower corporate income tax or no corporate income tax."[45]

However, several studies suggest corporate income tax rates generally have negligible impact on business location.[46] What's more, Illinois's shift to Single Sales Factor in determining corporate income tax liability is already giving enormous tax cuts to multi-state corporations with substantial Illinois property and payroll.[47] In fact, corporate income tax revenue as a share of Illinois' general funds revenue fell from 5.2% to 3.7% in just three years after SSF was enacted, from FY1999 to FY2002.[48]

Ryan Administration officials also claimed that EDGE subsidies really are no cost to the State, since the projects would not have been located in Illinois without them. For example, in the 2001 Boeing deal, in which EDGE credits made up the bulk of state incentives, Gov. Ryan maintained that the state government would "only use a small portion of the anticipated long-range economic benefits the company and its employees will bring to the state to leverage economic benefits."[49]

A 2002 Arthur Andersen paper on the EDGE tax breaks considered them small change, with the revenue loss to the state offset by increased tax revenues from new or retained employees. Citing the EDGE legislation, the Andersen study claimed:

> Since these are employees that would not be working at these jobs in Illinois were it not for the EDGE credit, the "incremental income tax" limitation alone would appear to secure the state from being "out of pocket."[50]

This argument assumes that without the EDGE credit a project would not locate or expand in Illinois – a claim presumably validated by the EDGE program's "but for" or "major factor" requirements. However, this argument requires taking at face value statements that are made by companies trying to qualify for the credit.

As noted in Chapter 8 on the Boeing deal, one unusual argument in defense of EDGE credits was that they might be effectively canceled by other tax breaks. Referring to Illinois' adoption of the Single Sales Factor apportionment for corporate income tax,[51] DCCA spokesman Brian Reardon noted that Boeing might not even owe taxes in Illinois, with or without EDGE credits.[52] But Boeing and other EDGE credit recipients can carry unused EDGE credits forward for five years.

Evaluation of EDGE Tax Credits

On paper at least, the EDGE program marks an improvement over previous subsidy programs, for the following reasons:

- It requires clear goals for minimum job creation, and makes continuation of the credit contingent on maintaining them. Since the size of the credits can't exceed the increased personal income taxes paid by employees hired for the new operation or expansion, there is a cap on the credits a company can get for each project.

- It requires companies relocating within Illinois to provide evidence as to why their current location is inadequate. This could prevent companies from getting state assistance to run away from a unionized workforce.

- It allows DCCA to adjust credits downward to reflect other state assistance.

However, the EDGE tax credit program also falls seriously short in several ways:

EDGE tax credits can be over-used. For example, the Dutch bank ABN-AMRO was offered EDGE tax credits for its U.S. headquarters even though all the sites it considered were in Chicago.[53] In addition, companies that already plan to relocate or expand in Illinois might solicit competing offers from other states simply to justify getting EDGE credits. As the Progressive Policy Institute recently noted, in subsidy negotiations "the state doesn't know if the business is bluffing in its decision to move, or what the bottom line number is that will influence its decision."[54] A nationally prominent site location consultant, Dennis Donovan, confided that he advises clients: "Negotiate incentives for the new project in two or three finalist locations, preferably in different states. Generally speaking, spend most of the time negotiating in the preferred location. Use offers from the alternate areas for leverage."[55]

The fact that the site location consulting industry has had a role in creating and justifying the EDGE program undermines its credibility. EDGE's enabling legislation cites a survey by Deloitte & Touche purportedly showing that subsidies influenced almost one half of all business investment decisions. To quote the firm's website:

> State and local tax credits and incentives can be a tremendous bonus. The challenge is to choose from the many opportunities available. If you want to make a thoroughly informed decision – one that aligns with your business goals and strategies – call on the credits and incentives team at Deloitte & Touche.[56]

But Deloitte & Touche is hardly an objective source on this topic, since its Fantus division is the "granddaddy" of site location consultancies. (Fantus was founded in Chicago in the 1930s and was later acquired.) Many site location consultants get paid at least in part on commissions derived from the subsidies they win for their corporate clients. As early as 1986, Fantus Corp., then an independent firm, produced a report for DCCA urging the state to adopt tax incentives.[57]

T*he EDGE program so far lacks reliable or publicly available cost-benefit analysis.* When one company received EDGE tax credits for its expansion, DCCA Director McDonough said: "We expect a quick return on this investment in the form of higher payroll and other taxes generated by the new jobs." [58] But it is not clear how or if DCCA verifies or quantifies such benefits, or if increased revenues from other taxes will offset the new costs created by EDGE-subsidized growth. As noted in Chapter 8 on the Boeing headquarters relocation, DCCA refused to release the entire Arthur Andersen study that DCCA cited to justify that package; most of the state portion was EDGE credits.

*Overall, EDGE has the appearance of accountability without the substance. T*he EDGE enabling legislation requires DCCA to list and describe new projects (and provide an update on existing projects), along with their expected revenue impact, in an annual report to the legislature.[59] However, this information is omitted in the 2002 report.[60] DCCA's EDGE press releases state projected jobs, but not jobs required to maintain the EDGE credits; most omit the projected value of the credits as well.

DCCA also makes incomplete responses to Freedom of Information Act requests. For example, when Service Employees International Union Local 1 made a FOIA request to see the state's $30 million EDGE agreement with Tellabs Inc. for its new Naperville headquarters, the union received a copy in which the company's minimum job creation requirement was blacked out.[61] This did not deter Local 1, which has made a public issue of the fact that, despite receiving the EDGE credits, Tellabs was laying off workers. Faced with these protests, Tellabs has withdrawn from the EDGE program, saying that depressed economic conditions have made it impossible to reach the promised job level.[62]

Good Jobs Illinois' FOIA requests for the estimated value of EDGE credits for particular deals, and the revenue lost to the state, have so far gone unfilled despite several requests. Our August request for the 2002 EDGE annual report was answered promptly. However, when in September we asked for information that is required by law but was not included in the 2002 report, the EDGE program manager phoned to say that further requests for information would have be submitted under FOIA. Good Jobs Illinois submitted this FOIA request on November 1. DCCA's November 12 response invoked a provision extending the time it may take to answer. As this report goes to press in late December, no further reply from DCCA has yet been received.

The problem of inadequate accountability is also found in the approval process. Although the allowable maximum credit is set by statute, DCCA decides the actual size of the credits individual companies receive. However, it is the Business Investment Committee (BIC) of the Illinois Economic Development Board that sets guidelines for determining what types of company projects are eligible for credits; it also makes recommendations on specific projects.[63] Except for the DCCA Director and a representative from the Department of Revenue, five of the seven committee members are businesspeople.[64] The most prominent is Christopher Galvin, CEO of Motorola, recipient of a subsidy deal that is now failing.

Finally, the mechanism for the state's recovery of EDGE credits from companies that completely fail to meet job goals or other conditions is unclear. The DCCA Director is supposed to report such non-compliance to the Department of Revenue, but how recovery proceeds after that is not evident in the legislation. While companies that fail to maintain promised minimum employment levels may be denied future EDGE tax credits, it is not clear that companies that repeatedly fail to maintain promised minimum employment are subject to effective clawback provisions for EDGE credits previously received.

Created as a fine-tuning scalpel to help "tip the scales" for Illinois, EDGE has already turned into a blunt broadax, a near-automatic "gimmee" that lacks clear cost-benefit analysis and that fails basic accountability yardsticks.

Chapter 3. Single Sales Factor Formula: A Failed Windfall for Big Manufacturers

In July 1998, Gov. Jim Edgar signed HB 2363, which established Single Sales Factor (SSF) as the method by which companies with multi-state operations determine how much of their income is apportioned to Illinois and therefore taxed there. The net effect of SSF was to give a small number of large Illinois manufacturers a huge corporate income tax windfall.

Traditionally, most states used three factors to apportion net income for determining corporate tax liability: the shares of a company's property, payroll and sales that occur in the state. Some states weight those factors one-third each, while others give extra weight to sales, so that sales account for 50% of the formula, with property and payroll accounting for 25% each.

The theory behind such formulas is intrastate fairness. If a company has a large physical presence in a state (i.e., a lot of property and payroll), this means it creates a lot of public-sector costs in that state (such as schools, roads and safety), and should therefore pay more taxes there. And if all states use the same formula, then all corporate income gets taxed somewhere.

But with the SSF approach adopted by Illinois (and eight other states), the only measure is sales; property and payroll are no longer factored in at all. Manufacturers and other companies with large amounts of property and payroll in Illinois, but mostly out-of-state sales, ended up with a huge reduction in their state corporate income tax bill, along with a decrease in taxes paid to the Personal Property Tax Replacement Fund for Illinois local governments.[65]

Say a consumer products manufacturer with $10 million in profits has 50% of its property and payroll in Illinois, and it makes 4% of its sales there (roughly Illinois' share of the U.S. population). Here is how the company's taxes would be calculated under the two systems:

Scenario #1: Traditional Three-Factor Formula (With Double-Weighted Sales)

Three Factors	Illinois Share	Times Weight	Equals	Share of $10 Million in Profits Taxed by Illinois
Sales	4%	X 50%	2%	$200,000
Property	50%	X 25%	12.5%	$1,250,000
Payroll	50%	X 25%	12.5%	$1,250,000
Total Income Subject to Illinois Corporate Income Tax				**$2,700,000**

Scenario #2: Single Sales Factor

Single Factor	Illinois Share	Times Weight	Equals	Share of $10 Million in Profits Taxed by Illinois
Sales	4%	X 100%	4%	$400,000
Total Income Subject to Illinois Corporate Income Tax				**$400,000**

If the company were paying Illinois' corporate income tax rate of 4.8% (that is, assuming it had no other tax breaks), its tax bill would plummet from $129,600 to just $19,200 – a tax cut of more than 85%!

Some of Illinois's biggest companies were quite aware of the potential benefits of this seemingly arcane rule change. The Illinois Manufacturers Association (IMA), whose members include many of the state's biggest companies, pushed for the change. The *Chicago Tribune* reported Caterpillar and Motorola as presumed major beneficiaries and named Ameritech, Abbott Laboratories, Deere & Company, Duchossois Industries, Kraft USA, Nalco Chemical and Quaker Oats as lobbying for SSF.[66]

Business interests claimed that Illinois would benefit from the change, as companies with sales mostly outside the state would have an incentive to expand operations in the state. An IMA-financed study by a professor at the University of Chicago School of Business predicted 285,000 new jobs would be created by a change to SSF, 155,000 of them in manufacturing.[67]

Illinois Department of Revenue officials reportedly described these figures as "so absurd it's laughable."[68] Opponents – especially the AFL-CIO and the American Federation of State, County, and Municipal Employees (AFSCME) – predicted that SSF would seriously reduce state revenues for public services without producing compensating economic or employment gains. Opposing an earlier version of the bill, AFSCME cited Department of Revenue figures showing that just six Illinois companies – Archer Daniels Midland, Caterpillar, R.R. Donnelly, John Deere, Motorola, and Amoco – would reap 60% of the tax cuts, *without having to create a single new job*.[69]

Illinois House Republicans nonetheless boosted SSF as a way for the state to keep existing companies and recruit new ones. They also argued that SSF would cause Illinois companies to hire new workers, since employment would no longer be a factor in determining tax liability.[70]

After the final version was enacted, the Illinois Comptroller's Office projected that, based on 1995 tax returns, 7,014 corporations would get tax breaks totaling $217 million each year. However, five Illinois companies would get $60 million of that, or nearly 28%. [71]

SSF has clearly provided a major tax cut for at least some companies already. Gov. Ryan, a vocal supporter of the change, said last year that the three-year phase-in of SSF apportionment has already provided Illinois companies "tax relief" totaling $192 million, including $96 million in FY 2001 alone;[72] the grand total through FY 2002 is likely to be a quarter-billion dollars or more.

SSF Revenue Loss and Factory-Job Loss

Far from experiencing the boom predicted by SSF proponents, manufacturing employment in Illinois has been falling since the new system took effect.[73]

Fiscal Year	Revenue loss Due to Single Sales Factor	Illinois Manufacturing Job Loss	Percentage Decline in Manufacturing Jobs by Fiscal Year
FY 1999	$32 million	20,000	2.0%
FY 2000	$64 million	6,400	0.7%
FY 2001	$96 million	45,500	4.8%

As the Center for Tax and Budget Accountability noted recently, "There is no compelling evidence that the change in how Illinois apportions the income of multi-state corporations for tax purposes resulted in any economic growth. In fact many of the companies benefiting from the change have laid off thousands of Illinois workers and/or have been purchased by out of state or foreign-owned companies."[74]

Maytag Corporation's October 2002 decision that it will transfer its Galesburg, Illinois operations to Mexico by 2004, laying off 1,600 workers in the process, is only the latest example of major factory layoffs since the adoption of SSF. Maytag's announcement came only seven years after the Galesburg facility received a $10 million state-county-city subsidy package to renovate its operations to meet new U.S. Department of Energy efficiency standards.

The following table shows job cuts in Illinois at companies identified with SSF:

Job Cuts at Companies that Reportedly Lobbied for or Likely Benefited from Single Sales Factor [75]

Company/ Layoff Date	Jobs Lost	Type of layoff	Operation	Location	Reason
Abbott 10-10-02	200	Mass layoff; permanent	Headquarters	Abbott Park	restructuring
SBC Ameritech 10-1-002	750	Permanent mass layoff	48 administrative, 702 technicians	Downers' Grove, statewide	Poor economy; regulators
SBC Ameritech 5-23-02	250	Attrition, then mass layoff	Construction, installation, service	189 in Chicago, downstate	Not specified
Kraft 4-24-02	300 possibly	Permanent mass layoff	Manufacturing	Chicago (South Side)	Not "cost-effective"
Motorola 4-16-02	850	Permanent Mass layoff	Distribution	Harvard	Market Conditions
SBC Ameritech 5-5-02	60	Closing	Customer Service	LWIA 20-Springfield	Not given
Motorola 4-7-02	2,500	Permanent Mass layoff	Electronic parts manufacturing	Harvard	Not given
Nalco 5-23-02	145	Mass layoff	Chemical manufacturing	Chicago/ Bedford Park	Not given
John Deere 3-5-02	200	Permanent mass layoff	Electronics	Springfield	Consolidation, Outsourcing
SBC Ameritech Before 11-01	300, lots more likely	Mass layoff		Illinois and Indiana	Lost market share, profits
Motorola 3-3-00	310	Closing	Manufacturing	SO8 Arlington	Bankruptcy*
Motorola 6-29-99	139	Closing	Manufacturing	SO1-Libertyville	Consolidation
Motorola 10-19-99	1,019	Closing	Manufacturing	SO1-Libertyville	Relocation, consolidation
BP/Amoco 2-5-99	1,500	Permanent mass layoff	Headquarters	Chicago	Merger

* The reference to a Motorola bankruptcy appears in the State of Illinois Monthly WARN Activity Listing for Cook County for March 2000. We find no indication that Motorola or any of its subsidiaries have filed for bankruptcy.

SSF and Declining State Corporate Income Tax Receipts

While revenues from corporate income taxes in Illinois fluctuate with economic conditions, their share of overall state tax revenues has dropped sharply in recent years, and is projected to fall further. SSF is accelerating that decline.[76]

Year	Corporate Income Tax Revenue ($ millions)	Total General Funds Revenue ($ millions)	Share of Total General Funds Revenue from Corporate Income Tax
FY 1999	1,121	21,674	5.2%
FY 2000	1,237	23,250	5.3%
FY 2001	1,036	24,106	4.3%
FY 2002 (est.)	900	24,350	3.7%
FY 2003 (est.)	950	24,830	3.8%

SSF's Economic Development Track Record: Failure

Illinois' experience is not unique; the experience of other states with SSF shows that it is a costly economic development tool. Citing a *Site Selection* magazine survey, the Washington-based Center for Budget and Policy Priorities reports that between 1995 and 2000, only 6 out of 51 new production facilities valued at $700 million or more went to states using SSF.[77]

When the Oregon Center for Public Policy compared growth in manufacturing employment and in gross state product (GSP) for all states between 1995 and 2000, it found that only one of the states using SSF, Texas, ranked in the top ten for even one of those measures (9th for GSP.)[78] Using data from its state's Legislative Revenue Office, the Oregon Center concluded that SSF would have a miniscule positive economic impact on Oregon itself. But it would cut state revenues $100 million in 2003-2005 alone.[79]

A study by the Washington, DC-based Institute on Taxation and Economic Policy underscores the irrationality of SSF as a competitive weapon: "The unhappy result of this 'race to the bottom' is that states offering the Single Sales Factor pay all of its costs in the form of reduced corporate income tax revenues, but enjoy none of the locational incentives Single Sales Factor is said to offer."[80]

SSF: Reconsidered?

The state budget crisis that hit Illinois in late 2001 reopened the debate on SSF. The Center for Tax and Budget Accountability, a bi-partisan organization working for fair fiscal policy, called for repeal of the SSF to help prevent drastic budget cuts in education and essential social services.[81] Later, when the Center helped organize the Emergency Campaign for a Fair Budget, a coalition of 200 organizations from around the state, repeal of SSF was made a major plank in its platform.

In Spring 2002, AFSCME District 31 and the Illinois AFL-CIO, long-time opponents of SSF, backed House Bill 4901which would have suspended SSF until 2007. At a rally of 10,000 people at the State Capitol in April 2002, Illinois AFL-CIO President Margaret Blackshere described SSF as the latest variant of "trickle-down" economics.[82]

This opposition, plus the intractable budget crisis, eventually prompted Gov. Ryan in the spring of 2002 to propose that legislative leaders consider repeal of SSF as one of several possible "revenue enhancers." However, the Illinois Chamber of Commerce, the Illinois Manufacturers Association, and House Republicans vigorously defended SSF, and repeal never came to a formal vote.[83] The Chamber of Commerce defended the system in the following terms:

> Adoption of Single Sales Factor was a tremendous win for the Illinois economy because it encourages job creation and capital investment in Illinois. Those who propose to repeal Single Sales Factor apportionment fail to recognize this basic economic reality and focus instead on estimates of state revenue loss that do not take into account increased economic investment and that cannot be backed up with actual data. [84]

In fact, there is no credible data on SSF's contribution to increased economic investment or job growth in Illinois.

Chapter 4. Diamond-Star: A Deal on Wheels – or Low Mileage?

Essential Facts
Year: 1985
Location: Bloomington-Normal, Illinois
Total state and local subsidies: $249.3 million (initial state share: $83.3 million[85])
(the State Auditor General later estimated the state's share at $146 million.)
Original direct jobs projection: 2,900
Subsidy per job: $85,965 (total); $28,724 (initial state share only)

> [On] my second trip to Japan to meet with [Mitsubishi President Toyoo] Tate, I recall very vividly pulling out a big Illinois road map, putting it on the floor of his office, and getting down on my knees and pointing out how Route 51 would run from Rockford to Bloomington. I thought at first that President Tate might think I was violating the normal rules of reserve governing Japanese business relationships by crawling around his floor. Yet I wanted him to see that we really cared about their plant, our highway and our state.
>
> – Gov. James Thompson, recounting his
> Diamond-Star recruitment efforts[86]

Illinois' 1985 victory in the six-state competition for the $680 million Diamond-Star Motors plant, which began as a joint venture between Mitsubishi and Chrysler and is now owned by Daimler Chrysler, was a key event in the Midwest wars for Japanese auto investment and in Gov. James Thompson's economic development efforts. But the deal also embodies the key issues about "smokestack-chasing": Did the state pay too much? Were the deal's "ripple effect" benefits overestimated?

Our analysis suggests that the state did overpay, justifying massive subsidies by overestimating the ripple effects in new parts supplier jobs (a common flaw in auto-subsidy justifications). The deal has played out oddly; although supplier jobs have lagged projections, assembly jobs have often exceeded projections, and the plant remains dependent upon imported drive trains, unlike many other foreign-owned assembly plants.

Project Subsidy Package

A comprehensive 1995 study of the deal by university researchers Margaret L. Chapman, Arun P. Elhance, and John D. Wenum, catalogued the various federal, state and local subsidies over 10 years.[87] They included:

- $40 million in job training funds over five years;
- $14.5 million in state and local funds for construction of water and sewage mains and treatment plant improvements;
- Up to $11 million in Build Illinois funds for site acquisition and preparation activities;
- $17.8 million in highway improvements.

State and local governments provided $160 million in tax abatements over 10 years by virtue of the plant's being located in a newly created enterprise zone. This included:

- A ten-year, 50% property tax rebate from McLean County, Dry Grove Township, the cities of Bloomington and Normal, and the local airport authority;
- A ten-year, 25% property tax abatement from the local sanitary district; and
- A 50% property tax abatement from schools, ending in 1995.

Local governments also provided nearly $6 million in infrastructure support,[88] while the federal government provided $29.7 million in subsidies (in the form of reduced import duties) by giving the plant foreign trade zone status.

Projected Benefits of the Project

To justify the generous subsidy package, which initially included $83.3 million from the state, Gov. Thompson and other state officials cited huge projected benefits[89]:

- 2,900 direct new assembly jobs.

- 11,000 to 14,000 new "ripple-effect" jobs, including "upstream" supplier jobs and "downstream" retail and service-sector jobs.

- $515 million in tax revenues from new jobs ($303 million federal, $110 million state, and $102 million local over 10 years), with revenues from direct new employment alone paying for the subsidies package.

Public officials dwelled more on projections than they did on requiring Diamond-Star to make explicit performance commitments. The state did, however, require that the company pay part of the land preparation costs if the plant didn't create the expected number of jobs. If the plant closed, the land would revert to the state. And tax credits linked to the plant's enterprise zone status required a minimum employment level of 2,000 workers.

Thompson's Aggressive Deal-Making

Besides getting down on his knees before Mitsubishi's president, Gov. Thompson pulled out all the stops in creating the conditions for a broad subsidy package for Diamond-Star. As analyst Nancy Lind has written, this included getting various levels of government to work together:

> Three primary means used to develop the incentive package for presentation to Diamond-Star – the Illinois Enterprise Zone Act, the home rule provisions of the Illinois Constitution which permitted the development of a metro zone, and the Build Illinois Act – all required intergovernmental cooperation.[90]

To make the Diamond-Star deal possible, the legislature enacted new subsidies. These included an investment credit (which could be carried over five years) for all companies locating in an enterprise zone and creating 2,000 or more jobs, as well as a requirement that local utility tax exemptions be provided when there are state exemptions. A related bill provided a $500 tax credit for every dislocated worker hired in an enterprise zone. In other words, the bid for the Diamond-Star deal was the occasion for expanding Illinois' arsenal of subsidies.

The state Department of Commerce and Community Affairs (DCCA) advised local officials as early as November 1984 to create an enterprise zone as part of the subsidy package for the Diamond-Star project. This spurred the local county and city governments to cooperate to find an eligible site, hold public hearings during the Christmas holidays (minimizing public input and possible opposition), and get state approval by December 31st.[91]

Illinois officials justified their aggressive moves by suggesting that Illinois was competing with half a dozen other states for the Diamond-Star plant. This position ignored evidence that Japanese car companies did not want to locate a new Japanese assembly plant (or joint venture) in a state that already had a "transplant."[92] The Japanese feared that the U.S. would enact domestic content legislation, requiring as many as 90% of a company's cars sold in the U.S. to have American labor and parts. The U.S. House of Representatives passed domestic content legislation in 1983 and the U.S. Senate debated it in 1984.[93]

To fend off protectionist legislative proposals, the Japanese automakers spread the transplants one to a state, to gain favor with the maximum possible number of U.S. senators.[94] Beginning with Honda in Ohio in 1982, Nissan in Tennessee in 1983, Diamond-Star in Illinois in 1985, Mazda in Michigan in 1987, Toyota in Kentucky in

1988, and Subaru-Isuzu in Indiana in 1989, Japanese automakers fanned out across the Midwest. This meant that Illinois actually faced fewer than six competitors, since states like Tennessee and Ohio had already landed Japanese transplants or joint ventures.

The need for extensive subsidies was also mitigated by the fact that Mitsubishi was apparently focusing on other factors that worked in favor of Illinois. For example, the company was drawn to the Bloomington-Normal area because of the access it would provide to local universities and those in Chicago.

Mitsubishi officials also placed great emphasis on the attitude of the local community to the plant. When Normal Mayor Richard Godfrey asked the company's representative who was examining the Illinois site what the deciding factor would be, he reportedly replied, "How we will be received." Bloomington-Normal's existing sister city relationship with the Japanese city of Asahikawa apparently paid dividends at a reception for the same representative. According to a newspaper account:

> Among the guests… were two high school girls, exchange students from the sister city in northern Japan. Godfrey suggested that the Mitsubishi representative speak to them privately. Later, the representative told Godfrey the girls loved the area, adding: 'I decided that evening that this was where we were going to locate.'[95]

Writing about Japanese transplants, Robert Perucci has argued that state and local commitment to a close partnership with the locating company was more important than the actual value of financial incentives.[96] Comparatively inexpensive gestures, like Gov. Thompson's pledge to create a Japanese language school for children of Mitsubishi managers, had a disproportionate impact.[97]

In a 1989 *Chicago Tribune* op-ed, professors Norman Glickman and Doug Woodward, who described the Diamond-Star's subsidy package as "largely a waste of the taxpayers' money," said that foreign-owned companies set up operations not where they get special breaks from state and local governments but where they have good access to markets, a well-trained work force and other factors. They cited a survey that showed that tax incentives ranked dead last in a list of 10 factors considered by foreign companies when deciding where to locate their plant.[98]

This is not to say that Diamond-Star was not interested in subsidies. In an interview with the *Chicago Tribune*, Gov. Jim Blanchard of Michigan made it clear that his state dropped out of the running because of what he considered the excessive demands for subsidies made by Mitsubishi, particularly for job-training funds. Blanchard said he thought Mitsubishi always intended to locate the plant in Illinois but used Michigan to "whipsaw" Illinois into increasing its offer. [99]

Perhaps most revealing were comments by Robert Ady, then executive vice president of Fantus Corp., who helped Chrysler and Mitsubishi negotiate their subsidy package. Illinois "could not have bought" the Chrysler-Mitsubishi plant with its incentives, he said: "The economics just absolutely had to be there…"[100]

Clearly, both Illinois and Bloomington-Normal had characteristics that made them strong contenders for the Diamond-Star plant – characteristics that in theory should have kept the need for subsidies to a minimum. Instead, both state and local governments became willing partners in an expensive game in which Mitsubishi and Chrysler held most of the cards.

Backlash from Existing Illinois Manufacturers

Not long after Diamond-Star began operations, various parties began to realize the drawbacks of the deal's generosity. Some existing Illinois manufacturers complained that they could not get subsidies either from their own state or from the Japanese government. One company, Gates Rubber, howled when the state gave a $3 million subsidy package to a Diamond-Star supplier, Mitsuboshi, that Gates feared would soon compete for Big 3 business. The Illinois Manufacturers Association (IMA) complained the state was doing little to help existing suppliers get Diamond-Star business. By comparison, Indiana, which had provided a much smaller subsidy package ($55 million), won a guarantee from the Isuzu-Subaru joint venture to use Indiana firms for half of its supply contracts.[101]

These protests prompted Senate Senator Joyce Holmberg to introduce a bill requiring detailed economic analyses of the impact of subsidies to foreign firms, followed by a vote of the whole legislature on the proposed subsidy packages. DCCA and Gov. Thompson managed to get the language watered down, but Thompson still vetoed the weakened bill. Ironically, DCCA reportedly denied that its subsidies brought Mitsuboshi to Illinois, saying the company's $35 million investment meant it already had business in the state – a theory that might apply to many other deals.[102]

A broad critique of the Diamond-Star deal appeared in a July 1989 report by state Auditor General Robert G. Cronson. He took DCCA to task for not setting an upper limit to the subsidies it would offer, and for not calculating the deal's long-term costs. The report estimated the actual value of the Diamond-Star subsidy package at $456.4 million, including federal subsidies; the state's share was put at $146 million.[103]

The report also criticized DCCA for ignoring its own guidelines on job creation and for failing to include any performance requirements – for number of jobs, production levels, or local purchasing – in its contract with the company.

The Disappointing Record on Supplier Jobs

One of the main selling points for the big Diamond-Star subsidy package was the promise of a large number – 8,000 was the figure frequently cited – of "ripple-effect" jobs in supplier companies.

Ironically, it appears that a significant number of those jobs were created not in Illinois, but rather in Michigan. The 1995 study by Chapman, Elhance and Wenum discovered that only 23 of Diamond-Star's main production suppliers were located in Illinois, compared with 81 in Michigan. They were able to document only 400 supplier jobs in McLean County, Diamond-Star's home county, far less than the 1,100 expected.[104]

In a study for the Council of Great Lakes Governors, Carnegie-Mellon Professor Richard Florida tried to explain why Michigan had apparently gained the most auto supplier jobs: "Diamond-Star is not a conventional, centralized mass production plant. Rather, it is the center of a network of firms, including tool and parts makers, engineers, electronic component manufacturers, and marketers, linked tightly in a region-wide research, design and production network."[105]

More recently, an economist at the Chicago Federal Reserve confirmed this geographical concentration in the auto supply industry at the regional level: "I find that having suppliers in the immediate vicinity of the assembly plant is not necessary to maintain a system of tight linkages and low inventories… This suggests a clustering of economic activity at the regional rather than the local level."[106]

These analyses indicate that the original projections about the number of auto supplier jobs that Diamond-Star would create in Illinois were based on hasty and inaccurate assumptions. State officials need to develop a more accurate and honest analysis of secondary job benefits.

Second Helpings: Mitsubishi's Later Quest for Additional Subsidies

Although Mitsubishi did not regard subsidies as the central factor in its original site location decision, the company grew accustomed to tax breaks. Once the plant was up and running, Mitsubishi sought more.

In 1992, despite the large abatements it had already received, Diamond-Star successfully contested its local property tax assessment in court. This reduced local property tax revenue an additional $5 million annually, forcing some local authorities to refund taxes already collected.[107]

As time passed, local authorities became increasingly unwilling to give more subsidies. In 1998, when property tax breaks for Mitsubishi were set to expire, local boards voted not to renew them. One city official said, "We were looking forward to the day when those [tax breaks] would expire…. It was a good deal for the state and the city in 1985 - but we no longer want to participate."[108]

Local governments, however, had no problem extending Diamond-Star's *state* tax breaks, which they were able to do because the plant was located in an enterprise zone. This did not sit well with some state legislators. State Senator Chris Lauzen (R-Aurora) demanded: "Why should the state participate in any project that the local community doesn't participate in?"[109]

The state, however, made no protest, since Mitsubishi had fulfilled the zone requirement to employ at least 2,000 full-time workers. DCCA Executive Director Fred Kimble officially admitted that a fear of possible job loss was also involved:

> I'm not saying they [Mitsubishi] ever said that (they were leaving), but I'm saying it's an implicit assumption you can make whenever you talk to companies …We have had situations where companies have said, 'If you don't extend those tax benefits, we'll consider leaving.' And then it's up to the community and the state to determine whether they are serious about that. If you call their bluff, and the company leaves, well, then it's a tough situation.[110]

Conclusion: Too Many Subsidies, Too Few Parts Jobs

Despite blemishes such as a prominent sexual harassment scandal in 1996, and productivity problems that caused Mitsubishi to consider closing the plant in 1998,[111] the Diamond-Star project has some significant achievements. The plant – which, like other transplants with some U.S. ownership, did not fight unionization – reached an employment level of 4,000 in 1995. That has since slipped to about 3,100 workers, but this is well above the original employment projections. Investment in the plant also remains strong, with a new assembly line expected to open in 2003.

These positive factors, however, are not enough to call the state's involvement in Diamond-Star a success. Specifically:

First, it is difficult to avoid the conclusion that Illinois simply paid too much for the deal. A more hardnosed analysis of Diamond-Star's likely behavior – realizing, for example, that states with a transplant were not likely to land another – might have led state officials to negotiate more confidently.

Second, Illinois did not do enough to protect its investment. The state did retain the right to recover infrastructure costs if Mitsubishi abandoned the site. However, apart from requiring employment levels of 2,000 – only two-thirds of the projected jobs linked to enterprise zone breaks – the state did not insist on provisions that would allow it to recoup its massive investment if Diamond-Star didn't produce the number of jobs expected. Illinois was lucky that direct employment so far has exceeded expectations.

Third, the state was not realistic about the number of in-state secondary jobs Diamond-Star would create. Early projections of 8,000 to 11,000 were either based on an incorrect analysis of how close Diamond-Star's suppliers would have to be to the plant or on deliberately inflated projections to justify the huge subsidies. While some factors affecting job creation might have been hard to predict, there is no evidence that the state really weighed such questions, or that it has tried to monitor actual secondary job creation since then.

Despite its ripple effect miscalculations in Diamond-Star, Illinois never developed the internal capacity to perform such analysis, outsourcing a ripple-effect study of the Boeing deal in 2001.

Chapter 5. Sears' Headquarters Relocation: State-Subsidized Sprawl

Essential Facts
Year: 1989
Location: Hoffman Estates, Illinois (relocation from downtown Chicago)
Total state and local subsidies: $178 million (state share: $66 million - including $25 million in roads to handle traffic congestion in Hoffman Estates.)
Original projection of jobs to be retained in state: 5,400
Subsidy per job: $33,000 (total); $12,200 (state share only)

In 1989, retail giant Sears, Roebuck & Co. announced plans to abandon its corporate headquarters in the Sears Tower in downtown Chicago and move to another site, possibly outside Illinois. After reportedly considering 50 sites in various states, Sears chose Hoffman Estates, a wealthy suburb about 29 miles northwest of the Loop. The decision came after Illinois offered the company the largest retention subsidy package in state history.

The Sears package is also one of the most controversial deals in Illinois history, for it exemplifies many of the main negative features of economic development policy over the last quarter-century: corporate exploitation of the economic war among the states, favoritism towards large companies, giving preference to suburbs over cities and thereby promoting sprawl, and the perversion of programs that were originally intended to address poverty and blight. Another questionable feature of the deal was that Sears was not simply building a new headquarters. The company also wanted to act as the real estate developer for a major business park in Hoffman Estates.

Sears described the move as part of a strategy to become more competitive, both by cutting costs, and improving internal communication.[112] In the view of the company's top management, the downtown Sears Tower had become too expensive, and the arrangement of its offices inhibited creative exchanges among employees.[113] The move was seen as a way for the old-line retailer to meet the challenge posed by aggressive discounters, especially Wal-Mart, and specialty retailers like the Gap.

From the state's point of view, losing the Sears headquarters would have dire economic consequences. Illinois officials claimed that the state would lose $411 million in personal income taxes and $19.4 million in state and local taxes. Besides the 5,400 headquarters jobs, it was projected that 2,200 related jobs would also be lost through a negative ripple effect.[114]

Yet it often appeared that the real concern was about something less tangible than the economic impact. As two writers in *Illinois Issues* observed: "Politically, no elected official would be willing to risk losing a company like Sears. And they have measured winning by its euphoric psychological effect, not by a ledger sheet." The writers quoted Gov. Thompson as saying that, if Sears moved out of state, "We would have lost a symbol of what Illinois has been." [115] The Thompson Administration made it clear that the state was prepared to give the retailer just about anything it wanted. After the company made its decision, the governor declared: "Everyone is a winner…We would have no more let Sears leave Illinois than we would let the White Sox leave Chicago."[116]

The $178 million package

The State of Illinois contributed $66 million directly to the Sears package.[117] Equally important, it passed special legislation allowing affluent Hoffman Estates to establish a tax increment financing (TIF) district.[118] This was a major deregulatory change in Illinois' TIF program, which had originally been created to bring private reinvestment to blighted areas.[119] The TIF changes made it possible for Hoffman Estates to provide Sears with 786 acres of land by issuing $112 million in low-interest TIF bonds, the principal and interest on which was to be repaid out of property taxes paid by Sears.[120]

The State of Illinois' direct contribution consisted of:

- $30.7 million for site preparation and improvements;
- $2.3 million in public infrastructure, including the extension of sewer service;
- $1.1 million industrial training grant;
- $1 million interest-free loan to build a child care center on site;
- $25 million for highway improvements from the Illinois Department of Transportation; and
- Enterprise Zone status for the project, which would cut Sears' sales and income tax payments by about $6 million. This included a $4 million state sales exemption on construction materials, $1.025 million in investment tax credits on $205 million in building and equipment costs, and $1 million ($100,000 annually for 10 years) in state utility tax exemptions.

What Did Sears Commit To?

The agreement between Sears and Hoffman Estates has a "hold harmless" provision that requires Sears to make up any shortfalls in the property tax revenue generated by its business park, if it has fewer tenants than expected, to guarantee the future incremental property taxes needed to pay off the TIF bonds. Sears also agreed to complete a two million-square-foot office complex and to apply for a certificate of occupancy by the end of 1992. Sears also promised not to sell its property for 10 years.[121] There were no employment requirements in the deal, though the state reportedly had sought a commitment that at least 5,400 jobs would be retained.[122]

Impacts of the Deal: Jobs and Tax Revenues Lag, Sprawl Worsened, TIF Perverted

Jobs and Tax Revenues: Despite the concerns expressed by state officials about retaining the 5,400 Sears headquarters jobs, the new facility in Hoffman Estates did not reach that level until 1998. In the early 1990s there were only about 4,000 employees at the new headquarters, plus around 600 who remained in Chicago.

The business park in Hoffman Estates, known as the Prairie Stone complex, was also slow to develop. A decision by Northern Illinois University to build a classroom center at the site was a big boost, bringing in 2,500 regular students and 2,000 workshop/seminar participants a year.[123] Overall, however, Prairie Stone failed to attract the number of tenants and related tax revenue that Sears and local officials had hoped for.

In the first two years after the complex opened, Hoffman Estates had captured only $273,000 in new revenue, compared with $1.5 million generated by the nearby Ameritech headquarters in its first taxable year.[124] In 1998, Sears had to pay Hoffman Estates $1.2 million to make up a deficiency in the property tax revenues used to service the TIF bonds.[125] Richard Dye, an economist at Lake Forest College and the University of Illinois-Chicago, said the shortfall "really points out the risk to communities that are led into these deals by developers, who say there's no risk."[126]

In 2001, with much of the business park still vacant, Sears had to pay $5.1 million to cover yet another shortfall in projected property tax revenues.[127] An executive at the company responsible for marketing Prairie Stone told a reporter that he was considering soliciting tenants engaged in light manufacturing.[128] Overall, the promises of a development boom in Hoffman Estates as a result of the Sears deal have yet to materialize.

Sprawl impact. The Sears deal is a textbook case of government funds promoting the transfer of economic activity from a central business district to a remote suburb, thus contributing to the problem of suburban sprawl.

As the maps on the two adjoining pages indicate, when Sears was in the Loop, commuters came from all over Chicago and its older suburbs to work there, including substantial numbers from the City's predominately African-American South and West Sides and adjoining suburbs. Given the quality of rail and bus service to the Loop, most Sears workers presumably came by public transit. By contrast, before Sears relocated to Hoffman Estates, that suburb drew most of its commuters from adjoining suburbs and from further northwest. Given the lack of transit to the area at the time, virtually all of them must have commuted by car. Changes in the way 2000 census commuting data was reported precludes an analysis of Hoffman Estates' commuting patterns since Sears arrived.

Sears employees who were transferred to the new facility in Hoffman Estates in most cases could no longer take public transportation to work and had to use their cars. Those who did drive would add to the mass of reverse commuters already using Northwest Tollway and Kennedy Expressway. To reduce traffic congestion due to the Prairie Stone development, the state provided about $25 million in road improvements, adding interchanges at Beverly Road and Illinois 59, and widening Barrington, Higgins and Beverly roads and Illinois 59.

Of course, such expenditures are the essence of state-subsidized sprawl: take 5,400 jobs that are well served by a century of public transit investments, relocate them off of that grid, and put them in a sprawling suburban campus setting that requires massive new infrastructure investments for an auto-dominated destination. The net effect is to take traffic away from the transit system and create duplicative transportation capacity that is also less efficient. The relocation also exacerbated regional inequality by removing jobs from the urban core, harmed air quality by forcing more people to drive to work, and fueled the consumption of open space and farmland as more workers relocated to large-lot suburbia to be closer to their jobs.

Recognizing that this would not solve the problem, local officials joined with Sears to encourage employees to use public transportation. By late 1991, Pace, the suburban bus agency, was seeking nearly $2 million from the Regional Transportation Authority to start five bus routes to prevent gridlock. It also was negotiating with Sears to split the costs of a transit center.[129] Pace provided 13 subscription-service buses for 660 employees, while another 50 workers arranged for their own subscription bus service.

By 1994, Sears had persuaded 34% of its headquarters workforce to participate in mass transit or car pools.[130] Raising that number will be difficult, given that current plans for expanding the CTA Blue Line do not extend as far northwest as Hoffman Estates.[131] The sprawl effects of the Sears project are also being felt by neighboring communities. Don Klein, former executive director for Barrington Area Council of Governments and a sprawl critic, has complained: "Suddenly you're plunking down a huge development in the middle of the cornfields… They [Hoffman Estates] courted Sears and they got it, regardless of the impacts on the towns surrounding them."[132]

Apart from the environmental and traffic aspects, the decision by Sears to move so far out had a dramatic impact on its headquarters workforce. Initial indications were that more than two-thirds of the workers didn't plan to move their residences to be closer to the new headquarters.[133] While some workers liked the new Prairie Stone development, others faced one and a half or two-hour commutes each way.[134] For the many Sears employees living on the South Side and south suburbs, "Hoffman Estates might as well be Beijing," quipped one article.[135]

The sharply higher housing costs in the Hoffman Estates area were also an issue. One worker who did move complained of having to take out a mortgage three times as large as her old one. And while Sears helped people find discount movers, employees bore the cost of the move themselves.[136]

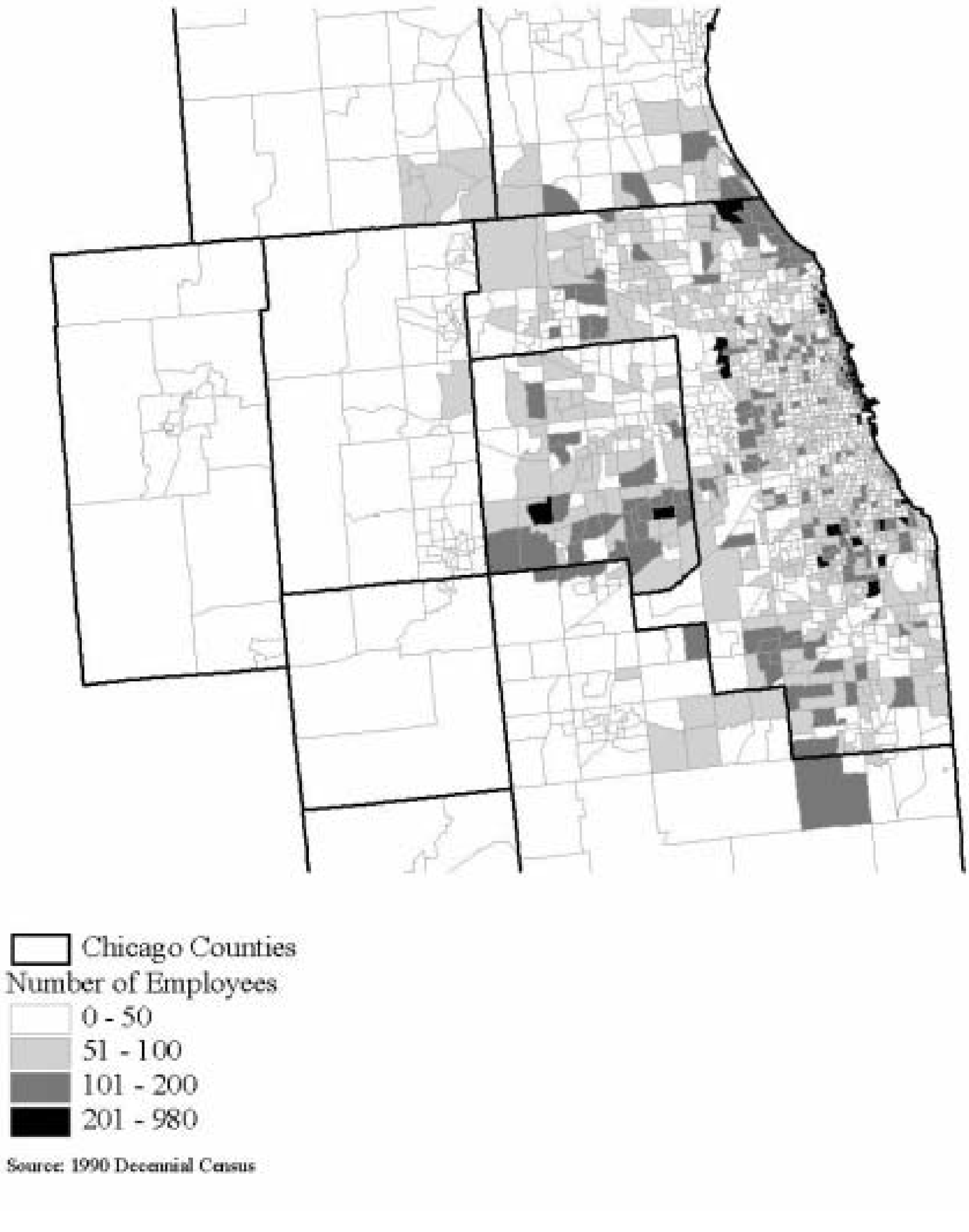
Ironically, Sears is among the signatories to the "Metropolis Principles" upheld by Chicago Metropolis 2020, a business-civic association promoting smart growth. The 104 corporations endorsing these principles agreed to expand or relocate only in areas with public transit access and affordable housing. If Sears were relocating today, a move to Hoffman Estates would likely violate such principles.[137]

Some employees regarded the company's decision to move as an indirect way of reducing its headquarters workforce. One worker told the *Chicago Tribune*: "They'll lose a lot of people, and that's what they want… We're too fat, too top-heavy and the executives know they can get rid of a lot of excess just by moving somewhere inconvenient."[138]

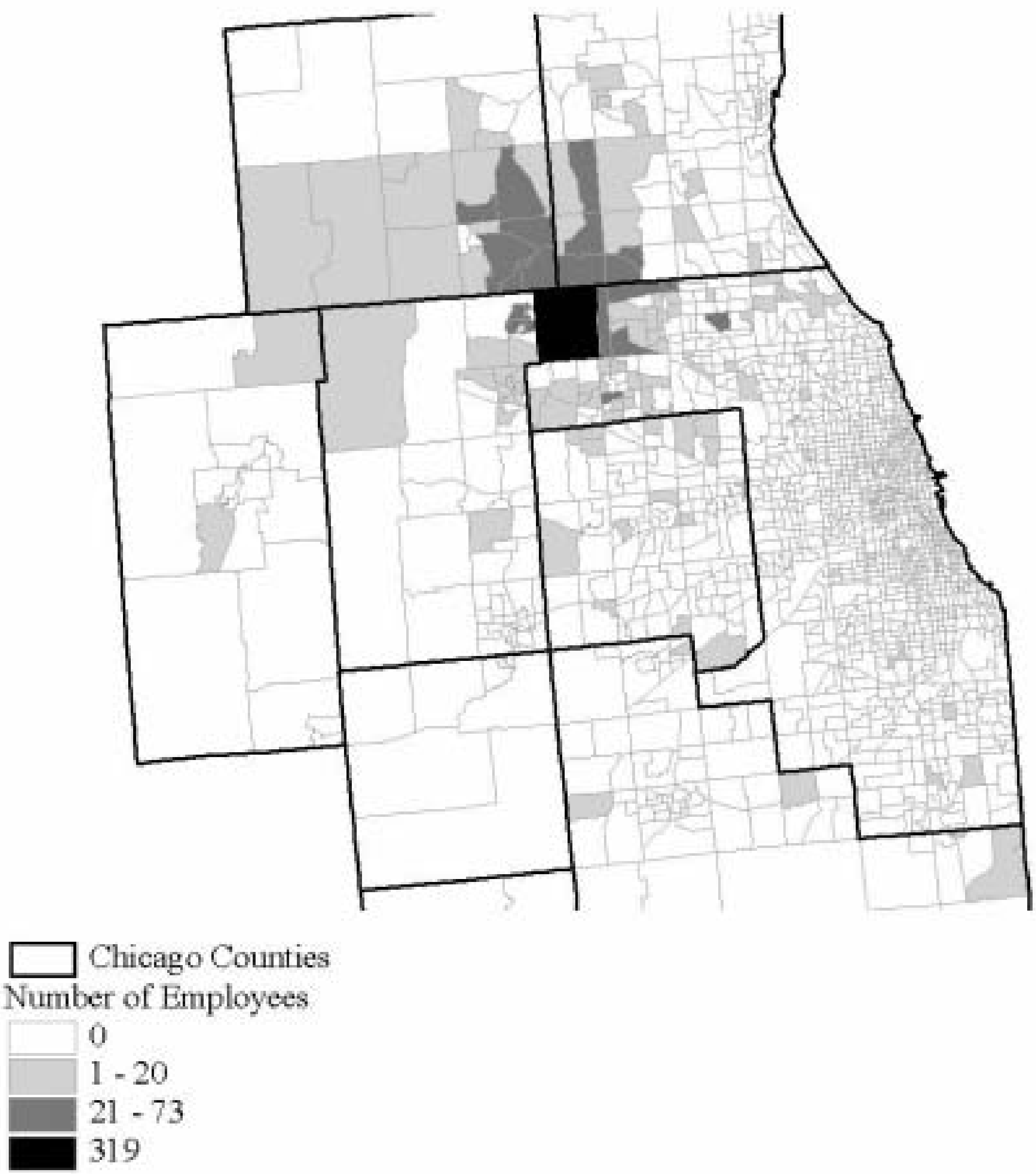
Other critics accused Sears of moving in order to shed minority workers living in Chicago's South Side and south suburbs – a charge Sears denied. Wim Wievel, a professor at the Center for Urban Economic Development at the University of Illinois-Chicago, warned that Sears would have to make a special effort to retain and recruit minorities if it wanted to maintain a diverse workforce. Rev. Jimmie Daniels of Operation Push and the Leadership Council for Metropolitan Open Communities complained that the company didn't respond to offers to help find affordable housing near the new headquarters for minority workers.[139]

TIF perverted. The policy and fiscal impacts of the Sears project go far beyond the

Where Workers Lived in the Sears Tower Census Tract Before the Relocation



Where Hoffman Estates Workers Lived Before Sears Relocated There



Source: 1990 Decennial Census

immediate terms of the deal. To make the TIF-based deal possible, the Thompson Administration had to arrange for a change in the law so that tax increment financing could be used in a dramatically different way from how it was originally intended. The change allowed a program designed to help revitalize poor urban communities to be used to subsidize the construction of a corporate headquarters and business park in an affluent community located in a remote suburb.

This raised concerns that other companies would seek to take advantage of TIF to flee older areas. Anthony Young, a State Representative from the West Side of Chicago who was one of 14 House members who voted against giving the suburbs incentives to attract businesses, said: "It's a double slap in the face…Sears could have gotten the same kind of incentives on the West Side without any legislation. Now anybody who talks about leaving Illinois will be coming for a tax break."[140]

By loosening the TIF district eligibility criteria, the Thompson administration set the stage for TIF's controversial status in Illinois today, especially Chicago with more than 100 TIF districts. Lake Forest, another affluent suburb north of Chicago, is believed to be the only U.S. city with both a TIF district and a Ferrari dealership.

Chapter 6. Motorola's Harvard Cell-Phone Plant: the Wrong Number

Essential Facts

Year: 1994
Location: Harvard, Illinois
Total state and local subsidies: $43 million (state share: $36 million)
Original direct jobs projection: 2,500
Subsidy per job: $17,000 (total); $14,000 (state share only); Subsidy per Illinois job: $23,000 (total); state share: $19,200

If you walked into a bank and held them up, you'd go to jail.
But if you're a multi-national and take (millions) from
the taxpayers, we say, "Thank you very much."

- State Representative Jack Franks, responding to
Motorola's 2002 announcement that their
Harvard plant would be completely shut down. [141]

The failings of Illinois' subsidy policies are perhaps most evident in the sad saga of the Motorola cellular telephone manufacturing plant in the rural community of Harvard. Only a few years after state officials praised the Harvard deal as a boon for the economy of Illinois, Motorola announced that it was shutting down the facility and moving the operations to Texas and Mexico.[142]

Even while the plant was open, Illinois did not enjoy the full benefit of its $36 million investment of state funds. The plant's location 70 miles from Chicago near the state's northern border meant that at least 25% of the jobs went to residents of Wisconsin, which did not have to offer any incentives to Motorola.

Ironically, this most disappointing of high profile Illinois deals occurred in the Edgar Administration, which generally avoided company-specific subsidies and the smokestack-chasing of the Thompson years. As detailed in Chapter 1, Gov. Edgar was for a while an outspoken critic of the excesses of costly interstate bidding wars that became all too evident in the Motorola deal.

The Harvard Package

The state provided the following support for Motorola's Harvard plant:

- $30 million in road and infrastructure improvements, including funds from the Build Illinois Public Infrastructure program;

- $5 million in High Impact Business tax credits; and

- $1 million for job training

The town of Harvard spent $4.6 million (including a $2.5 million state Business Development Public Infrastructure grant from DCCA) on a water tower, water mains, and a sewer system. It also gave $3 million in local property tax abatements.[143]

Promises and Projections: High Tech Boom Foreseen

Announcement of the new plant was accompanied by optimistic projections for new employment, investment, and state and local tax revenues. Gov. Edgar initially said that the project would create as many as 3,000 jobs and involve an investment of more than $100 million.[144] However, in later discussions with DCCA Motorola asked that the job creation projection be adjusted downward to 2,500.[145]

The governor's press announcement for the project predicted that the plant would produce $11 million in net state revenue annually and $8.7 million in net local taxes, based on personal income adjusted for the cost of education and government services.[146]

Helping to finance Motorola's new cellular phone manufacturing plant seemed like a good idea to state officials in 1994. Motorola, then leading the global market for cell phones, was at its zenith, hailed by the business press as "a big company that sizzles," "a nimble giant" and an "icon of innovation."[147]

At the announcement in Harvard's Village Hall, Motorola executive Robert N. Weisshappel said: "We are seeing explosive growth for cellular in Japan, India, China, Latin America and the United States…That's why we're building this plant."[148] He added: "The city of Harvard met the attributes that were most important to Motorola during our search, including that the location be within a reasonable distance to our Libertyville plant and that Harvard offers the flexibility for growth that the cellular marketplace continues to demand."[149] This flexibility included an option to buy 300 more acres.

In a reference to the other state that was bidding for the Motorola plant, Weisshappel added, "There are many winners in both Illinois and Wisconsin. In fact, 40% of our labor force is expected to come from Wisconsin."[150] In other words, Wisconsin was to reap a large share of the benefits of Illinois' subsidy package without the costs. At the same time, some observers suggested that the choice of Illinois was driven not so much by the size of its subsidy package as the fact that its corporate tax rate was about 2 points lower than Wisconsin's.[151]

Except for promises to create 2,500 jobs to receive public infrastructure funds, and meet High Impact Business tax credit requirements (500 jobs and a $12 million investment), Motorola made no other public commitments.[152] However, now that the plant is closing, Motorola is obligated to find a new occupant.[153]

The Sprawl Effect

Like the Sears deal in Hoffman Estates, the Motorola project in exurban Harvard was a case of government subsidies being used in a way that contributed to sprawl. Motorola was no stranger to this process; in the 1970s, the company moved its headquarters from Chicago to suburban Schaumberg.

The selection of Harvard was a more drastic step. About 70 miles from Chicago (though linked by rail service) and only 6 miles from Wisconsin, Harvard was a small community whose economy was previously dominated by dairy farming. Referring to Harmed, the fiberglass symbol of the town's dairy industry, one Harvard official noted happily: "What we've got is Motorola's high-tech image next to Harvard's downtown cow."[154] (Harvard is also the birthplace of Motorola founder Paul Galvin, a fact that may have helped it land the plant.)

Not everyone was thrilled by the contrast. In choosing Harvard, Motorola executives reportedly said they wanted a site away from suburban sprawl. But groups like the McHenry County Defenders and the Fox Valley Foundation worried that the manufacturing plant would instead make Harvard like Schaumberg,[155] a suburb so sprawling it was commonly the butt of stand-up comic's jokes. There was also concern that the project would shrink the amount of land devoted to farming.

The plan also did not sit well with many urban dwellers. Dennis Byrne of the *Chicago Sun-Times* expressed this discontent when he wrote: "What they're doing in DuPage, as well as in Lake, McHenry, Will, and Kane counties, is hurting Chicago. Chicago has a right to say stop. The explosion of the suburbs at the expense of the city increases pollution, drains jobs from Chicago, isolates the poorest of its residents from employment, adds to the infrastructure costs, kills inner city property values and tax base, etc., etc."

Byrne added: “To ‘lure’ Motorola to Harvard, the state (a lot of which is Chicago) will cough up $36 million in incentives, including worker training and road improvements. That’s because the site is just a little short of skilled workers and 19 miles away from the nearest interstate. What interest does it serve for Chicago taxpayers to contribute to this kind of diffusion of the metropolitan area?”[156]

Death by Degrees

As it turned out, the Harvard project did not have lasting sprawl effects – but mainly because the plant did not create lasting jobs. Economists have noted that the life cycles of high-tech products tend to be more volatile and shorter than “old economy” products like cars, and Motorola’s cell phone history bears that out.

For a while, it appeared that job promises would be fulfilled. The plant was almost entirely spared when Motorola cut 24,000 jobs worldwide in1998, the year Nokia surpassed it in cell phone production. By September 1999, employment reached 4,400, with promises of an additional 2,000 hires.[157]

Employment reached 5,000 the following year, but that turned out to be the peak. From that point onward, the Harvard plant died by degrees.

In January 2001 2,500 manufacturing workers were permanently laid off, but research, distribution, engineering and marketing positions were unaffected. After this first round of cuts, Harvard officials asked Gov. Ryan to seek a pledge from Motorola to keep the Harvard plant open.[158] Motorola spokesperson Sue Frederick was quoted in the *Rockford Register-Star* as saying only that the company “remains committed to Harvard” but was continuing to evaluate its workforce needs there.[159]

In March 2001 all manufacturing was discontinued at Harvard plant. By the beginning of 2002, a total of about 4,000 workers had been laid off. The permanent layoffs have continued since then, and the company has indicated that the entire operation will be shut down by Spring 2003.

For Harvard itself, the fact that the Motorola project collapsed so quickly made the economic impact less dramatic. As the *Chicago Tribune* noted, “Harvard never boomed the way many envisioned, and so it isn’t busting in anything like the same proportions as Harvard itself.” [160]

Before the layoffs, Harvard was actually growing more slowly than nearby towns like Crystal Lake and Algonquin. Motorola’s workers weren’t sure that job security was good enough to move to Harvard. For many, their commute was tolerable.[161] Harvard City Administrator David Nelson acknowledged: “people [working at the plant] didn’t stop and shop…They were all commuters – in and out." Commercial development related to the plant was limited to a 60-unit hotel, a video store and a Taco Bell.[162] The anticipated housing boom also never materialized, with only 15% of homes in three new subdivisions actually built in the four years after the plant opened.

Despite the property tax abatements provided the plant, schools reportedly had been getting $1 million in annual tax revenue from project, the city $250,000.[163] Losing the Motorola plant hurt local public finances.

The Autopsy

The early demise of Motorola's Harvard plant can be attributed to the company's market misjudgments over the commodification of cheap cell phones and the rise of superior digital technology. While high technology product life cycles are notoriously volatile, it is not clear the plant should have been built, much less subsidized.

When Motorola officials began shutting down operations at the Harvard plant, they blamed world market conditions and local production costs. The *Chicago Daily Herald* reported: "Company officials explained that a global surplus of cellular phones combined with high manufacturing costs is forcing the company to either make its products overseas or hire overseas firms to do the manufacturing."[164]

Mike Zafirovski, then president of Motorola PCS (now president and chief operating officer of the whole company) acknowledged that the Harvard plant had improved quality and cut costs in 2000. But, he claimed, "We cannot competitively manufacture products [in Harvard] when there is surplus global capacity at Motorola's lower cost sites."[165]

Industry analyst Herschel Shosteck believed Motorola and other cell phone makers had, in fact, grossly overestimated 2000 sales: "We think they are so absurdly high that it was a political effort to motivate manufacturers to rack up component sales to maintain share."[166] However, another company official said the production shutdown was not in fact a reaction to excess capacity but part of a long-term strategy to raise supply chain efficiency.[167]

But neither justification explained how Motorola had allowed its chief competitors, Nokia and Ericsson, to erode its share of the cellular market. A leader in the analog cellular phone revolution, Motorola had apparently taken too long to grasp the potential of digital-phone technology and made costly mistakes when it did.[168] Some analysts thought Motorola had also underestimated the market for inexpensive cell phone models.[169]

One Motorola executive, Dennis Sester, seemed to agree with this perspective: “Cell phones have become a commodity. In the kinds of volume that we deal with in cell phones, a 50-cent difference can be a huge difference over the whole volume.”[170] And Chicago investment researcher Joseph Correnti thought Motorola could make cell phones abroad at one-third or one-quarter of the costs at the Harvard plant. [171]

Months after the initial massive layoffs, the *Chicago Tribune* argued that the 1.5 million square foot factory was a white elephant that never should have been built: “Its high cost structure, out-of-the-way location and huge capacity all reflect how Motorola’s vision of the future failed to live up to reality… Still-shiny manufacturing equipment in the 5-year-old facility awaits shipment to a Motorola plant in Mexico or other disposition.”[172] What seemed like a sure thing seven years earlier now seemed like an obvious mistake.

Public Sector Reactions: Clawbacks Versus Marketing

After the initial round of layoffs at Harvard, State Rep. Jack Franks introduced “clawback” legislation to force companies that receive subsidies and then don’t deliver on their promises to repay at least part of the money. As Franks put it: “Taxpayers should not have to foot the bill for corporations that don’t want to keep our workers employed because they’d rather pay workers in Mexico less money. We have an obligation to our workers, our families and tax payers to hold these corporations accountable.”[173]

The clawback bill passed both the House and Senate, but it was vetoed by Gov. Ryan. State officials also did little to use existing laws and regulations to recoup funds from Motorola. Even after the initial layoffs, DCCA remained optimistic. In July 2001 an official of the agency said: “You have to look long-term as far as economic development projects go. It is still a rather young facility. I think you can look at it as an anchor out there.”[174]

By Spring 2002, such illusions could no longer be maintained. Motorola gave up its utility tax exemptions for the previous year, but it sought to avoid repaying the state for the costs of road and infrastructure improvements, claiming they would still benefit the public.[175] DCCA gave Harvard $1 million of the $3 million the state got back from Motorola, and the city used the money to assist laid-off workers and finance an effort to find a new tenant for the facility.[176] Local legislators sought more money for the effort.[177]

But short-term prospects seemed dim. A partner with a Rockford architectural firm said, “In five years, Harvard and Huntley are going to be hot properties as the suburbs fill up... Right now, companies in Chicago aren’t looking to move this far west. It’s seen as too remote."[178] In other words, the ability of Harvard to regain any advantage from the Motorola deal may have to wait for more sprawl to develop.

Policy Lessons

The Motorola Harvard project's failure reveals key deficiencies in state policy and programs, especially with regard to abetting sprawl, overusing tax incentives and failing to use aggressive measures to recover funds given to an underperforming project.

The state's willingness to help Motorola locate its plant far from population centers showed the same passivity that characterized the Sears deal five years before. It was Motorola's decision to make such a move, but the state didn't have an obligation, or even a self-interest, to support it with substantial subsidies, especially in light of the fact that the company made it clear that many of the workers it planned to hire would be from Wisconsin.

Changed markets and unexpected competition turned Motorola from market leader into market laggard in a few years. This probably could not have been predicted, but it provides a cautionary and expensive lesson on state aid to company-specific projects in an increasingly volatile global economy. If nothing else, the state should have employed some aggressive clawback safeguards.

The Harvard plant's closing after barely six years of operation also exposes the ineffectiveness of Illinois' much-touted Single Sales Factor apportionment method. When SSF legislation was being considered in the legislature, Motorola was one of several large Illinois companies that reportedly stood to gain greatly from the change.[179] Yet when it came to the situation at Harvard, business basics trumped SSF.

Chapter 7. The Ford Motor Co. Manufacturing Campus: A Better Type of Deal

Essential Facts
Year: 2000
Location: Chicago, Illinois
Total state and local subsidies: $95 million[180] (state share: $52 million)
Original direct jobs projection: 800 (not including 200 construction jobs)
Subsidy per job: $119,000 (total); $65,000 (state share only)

> We have always seen large developments that we haven't been part of. It's nice to be involved and to see something here.
>
> - Hegewisch neighborhood resident[181]

While costly on a per job basis, the Ford Motor Company supplier campus on Chicago's Southeast Side has positive features not present in most other high-profile subsidy deals in Illinois. In contrast to the Sears and Motorola projects, it is bringing family-wage jobs to an urban area that had suffered from industrial decline. In doing so, the project's planners have communicated with the community and have tried to address the needs of community groups, labor unions and environmentalists.

The 155 acre, 1.5 million square-foot campus will assemble about 11 top suppliers of critical auto components only a half mile from Ford's Torrence Avenue assembly plant, one of Illinois' largest industrial assets, which currently makes the Mercury Sable and Ford Taurus.[182]

There have been reports that the deal, the final details of which are still being negotiated, may include a provision requiring Ford to repay at least part of the city and state's infrastructure expenditures if employment goals are not met.[183] Moreover, rather than relying on dubious secondary job creation projections to justify the high costs, the Ford deal promises to directly stabilize a large number of existing Chicago-area jobs at the Torrence Avenue Ford assembly and Chicago Heights Ford stamping plant. While the ultimate outcome of the deal remains to be seen, the Ford project provides a positive model for more prudent and accountable subsidy use and fruitful city and state collaboration.

The Ford Package

State funds for the project include:

- $41.2 million for road improvements, including moving Torrence Avenue ½ block east onto a former railroad line, relocating and extending 126th Street between Torrence Avenue and Avenue O, and making both adequate for heavy trucks.[184]

- $4.8 million from the Illinois FIRST program to restore a brownfield site.

- $6.1 million for Industrial Training grant programs at Ford's new Chicago Heights Technical Training Facility. The facility also received up to $12 million from Ford and the United Auto Workers for state of the art robotics and machinery. [185]

The City of Chicago is providing:

- $11 million in TIF assistance for land acquisition and preparation.

- $7.6 million from the Mayor's Office of Workforce Development.

- $2 million from the Department of Environment (from a Commonwealth Edison fund) to install technology to improve energy efficiency in both the new facility and Ford's existing assembly plant, supplemented with $500,000 from DCCA; and

- $22.2 million from the Department of Transportation for road improvements.

What Ford Promised and Other Expectations

- 800 permanent jobs and 200 related construction jobs are projected for the supplier park.[186] According to one article. Ford is expected to create at least 500 full-time jobs by the end of 2006 and maintain them through 2010. The company is reportedly subject to subsidy clawback provisions if full-time jobs fall below 500.[187]

- Ford must create at least one million square feet of building space.[188]

- According to reports of an unreleased PriceWaterhouseCooper study, the supplier park is projected to increase city, county and state revenues (from taxes and fees) by over $160 million annually over the next ten years.[189] DCCA projects that Ford's investment will add $1.3 billion to Chicago's economy over the next 10 years.[190]

The Ford Motor Company Fund is making a $6 million donation to the Chicago Environmental Fund to develop a comprehensive plan for the Calumet region and to establish the Calumet Environmental Center.[191] An extraordinary natural habitat on the southwestern edge of Lake Michigan, the Calumet region was also the victim of massive dumping of steel industry waste through the 1970s.[192] Ford is also donating $3 million to Northwestern University to establish the Ford Motor Co. Center for Global Citizenship, which will focus on environmental and corporate responsibility.[193]

The Deal and Its Background

In September 2000, after lengthy negotiations,[194] Gov. Ryan and Mayor Daley offered nearly $95 million in subsidies to land Ford Motor Company's automotive supplier manufacturing campus. Set for completion in 2003, it will be the first such campus in North America, following the siting of similar parks in Spain, Germany, Belgium, and Brazil.[195] Located a half mile from the Ford's southeast Chicago assembly plant, it will be built on a site that was in part formerly occupied by LTV Steel. The campus will assemble key "Tier One" suppliers to deliver pre-assembled components to Ford's plant, using an overhead conveyor for just-in-time or in-sequence delivery, thereby cutting inventory costs.[196]

State and city officials initially predicted that the 155-acre manufacturing park would create 1,000 permanent new jobs and make over 4,500 existing jobs at Ford's assembly plant on Torrence Avenue and its Chicago Heights stamping plant more secure.[197] More recent reports project 800 new jobs. Ford, its suppliers and its development partner, CenterPoint Properties, are expected to invest more than $400 million in the project during the next several years.

The new supplier park will support production of two new Ford models, the Ford Cross Trainer and the Ford Five Hundred, which will replace the Ford Taurus and Mercury Sable currently produced at the Chicago assembly plant. The CrossTrainer, a combination SUV-sedan, will be the catalyst for Ford's move to fully integrated, flexible, just-in-time production.[198]

Although industry sources told the *Chicago Tribune* that Chicago was the only serious competitor for the project,[199] Ryan and Daley claimed that Atlanta and a city in Michigan were in the race. Dismissing charges of "corporate welfare," Ryan maintained that both the city and state will recover their investment and insisted the subsidies were essential: "If it weren't for the incentives that we provided – the Mayor and I, city and state – we wouldn't be here today. You'd be reading about it in another state…Better the governor of Georgia receive that condolence call."[200] Daley added: "It is not welfare for corporations. This is a vision for the future of the Southeast Side."[201]

Intense competition and rapid technological innovation in the global car industry set the context for Ford's decision to build its Chicago supplier campus. In early 2002, the company announced that it would cut its annual production capacity by 1 million cars and trucks.[202] As part of its restructuring, Ford said it would close or sell other plants in Ohio, Michigan, and elsewhere. Illinois was much luckier.

Plant Sites and Parks, a site location magazine, wrote of the Chicago project: "By integrating logistics, inventories, supplier manufacturing operations and sequencing of manufacturing schedules, the plant and supplier manufacturing campus will be able to respond more quickly and efficiently to changes in customer demands."[203] The magazine quoted Jim Padilla, a Ford vice president for global manufacturing:

> This project is an evolution in automotive manufacturing and a way to address competing trends toward globalization and demands for local flexibility to meet customer needs… This is an important step in Ford's drive to boost customer and shareholder value.[204]

Another Ford executive said that "By moving suppliers together near the plant, Ford wants to cut inventory, reduce transportation costs, improve quality and reduce order to delivery times." The supplier park "allows one set of tooling to build multiple vehicle configurations."[205]

Chicago-based location consultant Geoffrey Kasselman said supplier parks like the one in southeast Chicago let suppliers work with developers to build specialized facilities. Suppliers can also cooperate to get fiber-optic networks, deregulated power, and other benefits.[206] Auto industry analyst Jim Gillette predicts Ford's park will be a model for similar parks throughout the manufacturing sector.[207]

The Ford supplier park contrasts markedly with the Mitsubishi Diamond-Star project. State expectations that Diamond-Star suppliers would locate in large numbers near the plant (or elsewhere in Illinois) seem not to have been fulfilled, at least on the scale predicted. The difference in models is perhaps due to the close interaction Ford wants to have with key suppliers, as part of its version of flexible manufacturing. Dr. David Cole of the Center for Automotive Research says "Close relationships between manufacturers and suppliers is part of the new flexible business model."[208]

Project Impacts

Community. The announcement was clearly a boost for a number of struggling neighborhoods, such as Hegewisch, in southeast Chicago near the Indiana state line. One neighborhood resident told a reporter: "Hegewisch went through some real brutal times when the [steel] mills collapsed."[209] Another resident commented, "We have always seen large development that we haven't been part of. It's nice to be involved and to see something here."[210]

Representatives from Ford, along with state and federal environmental officials, have met with community groups and local environmental organizations to assure them that there would be minimal air and water quality impacts from the project, which is being built on a reclaimed brownfield site.[211]

In addition, the City Department of Environment is working with Ford to improve and restore the natural habitat around the Calumet River, Indian Creek and Wolf Lake areas. The campus will use natural methods like curb cuts, planted ditches and native plantings to drain storm water in ways that reduce runoff and require little new infrastructure.[212]

Labor. Ford won United Auto Workers (UAW) support for the supplier park when it agreed to require suppliers to remain neutral towards union organizing drives. In addition, Ford promised that suppliers would not work on its assembly plant floor (a practice that occurs in Ford's offshore plants), and little work would be transferred from the assembly plant to subcontractors.[213]

Local union leaders look forward to the opportunities presented by the park. Paul Korman of UAW Region 4, a project supporter, said "history will tell you at some point we will organize all the plants in that industrial park." He added: "Material handling, shipping costs, maintaining quality, on-time delivery – you can eliminate almost all those problems… The success of this project will probably determine how we build automobiles in the future." [214] Richard Clay, president of UAW Local 551, saw a key role for labor in this future. "I think we will be able to adapt to whatever is necessary to build this new product." [215]

Conclusion: A Better Model

Overall, the prospects for the Ford project seem promising. By May 2002, 85% of the park was leased or reserved by letter of intent.[216] The park is expected to be in full operation by 2004. Key constituencies such as neighborhood groups, labor unions and environmental organizations appear to be pleased at the steps Ford has taken to address their concerns. The supplier park deal is also an example of effective city-state cooperation. Mayor Daley has said: "If I decided to do this on my own, it would never have happened."[217] Like the nearby Solo Cup project, the Ford supplier park project has the potential to be a model for future efforts that revitalize industrial infrastructure, neighborhoods, and ecosystems.

The main accountability flaw of the project is that the job creation and retention requirements could have been tougher, especially in light of the considerable amount of subsidies being provided.

The contrasts between the Ford Manufacturing Campus and the Mitsubishi Diamond-Star plant are important to keep in mind, particularly in regard to the supplier question. Ford already had an assembly and a stamping plant to draw suppliers, and Ford's manufacturing strategy clearly involves both interaction with and even pressure upon its key suppliers. By contrast, the Diamond-Star plant in Bloomington-Normal does not even have an adjoining engine plant. Despite the fact that the expected Diamond-Star supplier jobs failed to materialize in the quantities expected, the plant has produced more assembly jobs at the plant itself than expected. Both deals were very expensive.

While the final verdict on the Ford campus deal won't be in for some time, it does suggest that a pro-urban, pro-environment, pro-community, anti-sprawl approach development is possible. The rumored job retention requirements, if accurate, could be tougher, given the deal's expense. But the project still contrasts favorably with another manufacturing project, Motorola's Harvard plant, where sprawling subsidies ultimately led nowhere.

Chapter 8. The Boeing Headquarters Relocation: An Overpriced Trophy

Essential Facts

Year: 2001
Location: Chicago, Illinois
Total state and local subsidies: approx. $56 million (state share: $30 million)
Original direct jobs projection: 500
Subsidy per job: $110,000 (total); $60,000 (state share only)

> As we looked at the total cost issues, it [the state-city incentives package] became an irrelevant point.
>
> - John Warner, the Boeing executive who ran the headquarters search[218]

The 2001 Boeing headquarters deal clearly demonstrates that Illinois has failed to learn the lessons of previous high-profile subsidy deals. Although Boeing executives made various statements indicating that subsidies would not be the main factor in their decision, state and city officials piled on the incentives. In the end, these subsidies did not mean much to a company the size of Boeing, but they contributed to the fiscal difficulties of a state now struggling with a severe budget crisis.

The Boeing deal has also been marred by the use of dubious ripple-effect estimates derived from an Arthur Andersen study that the state refuses to make public.

The Boeing Package

State subsidies included:

- $17 million in EDGE corporate income tax credits up to 60% of the personal income tax revenues Boeing employees generate for the next 15 years[219]
- High Impact Business sales tax exemption worth $1 million[220]
- Coverage, worth $8.6 million, of 50 percent of Boeing's relocation expenses[221]
- $2 million in job training grants[222]

- $1.5 million from DCCA's Large Business Program and Tech Challenge Grants, for technology and capital improvements[223]

Subsidies from the City of Chicago included:

- A 20-year, $16 million property tax abatement, even though Boeing planned to lease rather than purchase its new headquarters[224]

- Reimbursement to Boeing of $4.3 to $6 million for any taxes paid to the county, the Chicago Park District, local community colleges, and the Metropolitan Water Reclamation District over the next 20 years[225]

- A $2 million energy grant

- $1 million to buy out the lease of the previous tenant in Boeing's building

- An unspecified amount for improvements at Midway Airport to accommodate travel for Boeing executives using the company's 20-jet fleet

- A downtown heliport for Boeing and other firms for executives flying in and out of Chicago

- A waiver from a city ordinance prohibiting company logos on the top of buildings

An Unusually Public Site-Location Auction

In March 2001, after 75 years of being based in Seattle, Boeing held a press conference in Washington, D.C. to reveal that it planned to move its headquarters to another part of the country. Boeing reportedly wanted a neutral place, without any major Boeing operations, to announce the move. The site also symbolized Boeing's plans to reinvent itself as a global high technology company, with a new headquarters distant from its Seattle plants and other major operating units.[226]

Breaking with the usual practice of site location searches being conducted virtually covertly, Boeing also announced at the outset that three metropolitan areas – Chicago, Denver, and Dallas-Ft. Worth – were already finalists in the search. This provoked an intense, nationally publicized competition, with the three candidate areas mobilizing to land a trophy deal.

Dallas recruited sports celebrities to contact Boeing CEO Phil Condit to argue the merits of their city. The governor of Colorado and the mayor of Denver organized the

"Boeing 100," enlisting Broncos quarterback John Elway, beer magnate Pete Coors, and former United Airlines chief Gerald Greenwald in the effort.

In Illinois, Gov. Ryan promised an aggressive, coordinated promotion by the state and the City of Chicago:

> The combination of Illinois' highly skilled and productive workforce, strong infrastructure, strategic location, attractive financial incentives, and world-class cultural attractions gives us an edge over the competition… we have everything Boeing is looking for, and we'll make sure the company fully understands our assets."[227]

World Business Chicago (WBC), a private-public partnership funded in part by the city, led the marketing campaign. Arthur Andersen provided Illinois and Chicago with an analysis of the expected economic return and job creation benefits.[228] A Chicago media consultant remarked: "You wouldn't think we would get this crazy for a big company. I haven't seen this kind of excitement in the Chicago media since the Bulls won their last championship."[229]

While intense, the competition was short. On May 11, 2001 Boeing announced it had chosen Chicago. Paul O'Connor, director of WBC, described the victory as Chicago's first step in reversing recent headquarters losses such as Amoco, Ameritech, and Waste Management. Comparing the Boeing deal with the strategy used to land the Ford supplier park in 2000, O'Connor added:

> That strategy is to win every point, give them your best shot right out of the box, and create such a wave of momentum that the competitors will be overwhelmed… That strategy paid off."[230]

Overwhelming competitors was costly. Even after the legislature scaled back the $41 million state subsidy package sought by the Ryan Administration by $11 million, the $56 million total city/state subsidy package still dwarfed Denver's reported $18 million bid and Dallas/Ft. Worth's $14 million offer.[231] And it apparently far exceeded the modest package that Governor Ryan originally considered.[232]

Behind Boeing's Decision

Boeing's selection of Chicago reflected basic changes in its corporate strategy more than the power of state and local subsidies, as the comments of both aerospace industry and business relocation analysts suggest. While retaining its focus as a master lobbyist for and recipient of federal contracts, Boeing's perspective is increasingly one of a global company, with no sentimental ties to an area but with highly specialized technical, financial, and service needs that only a few cities, including Chicago, can satisfy.

Seattle University business professor Barbara Parker saw Boeing's headquarters relocation away from its Seattle manufacturing base as part of a larger detachment from any region or even nation: "My sense of what is going on is they are trying to transition to a more global firm that is less oriented toward any one single nation."[233] Boeing Chairman and CEO Phil Condit said as much. "We're continuing to transform our company with a focus on long-term growth and value creation. Our new corporate architecture – with a leaner headquarters located separately from our major business units – is a fundamental element of our business strategy."[234]

Labor observers in Seattle viewed the move as part of a broader Boeing trend toward disinvestment of Seattle-area production. They noted that Boeing's board was increasingly composed of non-Seattle-area residents, and that Boeing's acquisition of McDonnell-Douglas increased outsourcing activity. The company's condition has also been seriously affected by airline woes; since the September 11th, 2001 terrorist attacks, Boeing has announced 30,000 layoffs nationwide.[235]

Site Selection, the leading business location magazine, noted that Chicago had "the global business environment necessary to support Boeing's strategy, including a diverse business community, unparalleled business services sector, superior air service, world-class cultural and recreational amenities and quality residential communities and educational opportunities."[236]

Chicago Crain's Business noted that a move to Illinois would help Boeing attain its federal lobbying goals, since Boeing would become a constituent of House Speaker Dennis Hastert and of Illinois Sen. Richard Durbin, who serves on the defense and transportation subcommittees on appropriations. By moving to Chicago, *Crain's* said, Boeing got access to "a major financial market that's pro-business, centrally located and equipped to propel Boeing's diversification as part of major downsizing and decentralization."[237]

Aerospace industry analysts agreed. Paul Nisbet at JSA Research in Rhode Island said: "There's a different milieu in Chicago…It's just way more cosmopolitan." Another aerospace analyst, John Rogers, noted that Boeing "will have access to all of the support systems a major corporation needs."[238] Both *Crain's* and *Business Week* also noted the importance of both the quality and diversity of Chicago's workforce in the company's decision. After having been hit with lawsuits alleging discrimination, Boeing could now more easily make use of minority service contractors.

How Important were Subsidies to Boeing's Decision?

This close fit between Chicago's assets and Boeing's needs strongly suggests that the state-city subsidy package had a small role, if any, in Boeing's decision. Several important statements from Boeing executives bear this out.

Site Selection magazine quoted John Warner, the Boeing executive who ran the headquarters search, as saying that the "pro-business" attitude in Chicago meant much more than the financial subsidies. Warner also cited the ability of state and local leaders to work together to facilitate Boeing's move. Financial incentives, it seems, were less important in themselves than they were as a sign of that pro-business attitude.[239] A few months later, a *Harvard Business Review* interview with Warner listed subsidies as one of *19* equally important factors considered by Boeing.[240]

But Warner and other Boeing executives elsewhere gave subsidies more importance, perhaps because they were mindful that certain subsidy programs required recipients to state that the project would not happen without the subsidies. Thus in the magazine *Business Facilities,* Warner was quoted as saying that the state-city subsidy package was "an important factor in building a business case for the region."[241]

Company spokesman Lawrence L. McCracken covered both bases by saying that Boeing wanted to be close to Chicago's top engineering and business colleges and world-class amenities, but state and city subsidies were also needed to offset Chicago's "world-class cost of living and tax structure."[242]

Another Boeing explanation is telling: "In terms of economic incentives, they were certainly one of the things the company was looking at, and a*ll three cities provided what we would characterize as appropriate packages*. We weren't making our evaluation based on which package was the biggest." [emphasis added][243] Since the subsidy packages offered to Boeing ranged from $10 million to $56 million, this statement strongly suggests that the Illinois package was unnecessarily large.

Despite the initial euphoria over the Boeing deal, some observers in Illinois also suspected that the city and state were overpaying. Some of the sharpest criticism came from *Business Week's* Chicago bureau chief Joseph Weber. Early in the competition for Boeing, he argued that Chicago's many amenities and air transportation connections would be decisive, not state or local subsidies.[244]

Boeing's EDGE

Some of the most dubious justifications of the subsidy package came from public officials defending the state's extensive use of EDGE tax credits. Those officials stressed that Boeing had to meet minimum job creation and investment goals to remain eligible for the EDGE credits. When asking for additional tax breaks for Boeing, City Deputy Planning Commissioner Robert Kunze told Cook County Commissioners that Boeing's state and local tax breaks would be reduced proportionately if headquarters employment fell below 500.[245]

In a letter to Senate Republican staff, DCCA Director Pam McDonough argued that Boeing would be held accountable for maintaining a minimum number of jobs at the new headquarters:

> The first difference [from previous state subsidies to companies] is that the vast bulk of the financial incentives offered to Boeing – i.e., relocation grants and EDGE tax credits – not be advanced to the company. Instead, Boeing will be able to receive these benefits incrementally on an annual basis…the principle of 'benefiting while they stay' is embodied in these two incentives…[246]

Gov. Ryan himself credited the EDGE tax subsidies for having a key role in Boeing's decision and promised more deals like it: "In the future, we expect these types of incentives will also help level the playing field for Illinois as it competes with other states for new corporate headquarters."[247] DCCA Director McDonough said EDGE credits offset the competitive disadvantage supposedly created by Illinois' corporate income tax.

But the Boeing deal itself belies this claim. Responding to Texans touting that state's lack of a corporate or personal income tax, Boeing executive John Warner reportedly said such taxes were "not an overriding issue."[248]

State officials also claimed that EDGE tax breaks have no real cost to the State, since, they claim, the relocation would not have occurred without them. In his quarterly newsletter, Gov. Ryan said: "State government will not divert any existing resources to Boeing, but only use a small portion of the anticipated long-range economic benefits the company and its employees will bring to the state to leverage economic benefits."[249]

However, Ryan's statement may well have been driven by a legal technicality. State law governing the EDGE program requires companies to certify that a project would not occur "but for" the EDGE credits, or that the credits were a "major factor" in the decision. This legal requirement may have caused Ryan and others to publicly claim that EDGE credits were in fact decisive and so had "no cost" to the state.

But the state's bizarre "no cost" argument was undermined by a DCCA admission that because of Illinois' use of the Single Sales Factor for apportioning corporate income, Boeing might not take full advantage of all the EDGE credits available. A Wisconsin paper quoted a DCCA spokesman as saying: "Given the way Illinois calculates corporate income tax liability… it's possible Boeing would not even owe taxes in Illinois, with or without EDGE credits."[250] Hence a paradox in the official line: the EDGE credits were purportedly essential to land Boeing, but may actually be meaningless.

The Andersen Economic Impact Study: Pumping the Numbers?

In legislative testimony and responses to critics of the Boeing deal, state officials relied heavily on an economic impact study the state commissioned from the consulting arm of the now-disgraced accounting firm Arthur Andersen. Gov. Ryan repeatedly cited the study's claim that five "high end" new jobs would be generated for each job at Boeing, and that the area economy would gain $4.5 billion over the next 20 years.[251]

Alluding to the study, the Illinois Manufacturers' Association described the tax subsidies as a "modest $2 million [annual tax break] investment for an annual return of about $220 million or approximately a 10,000 percent return." Chicago city officials also cited the Andersen figures when calling on Cook County to grant Boeing additional tax breaks.[252]

The claim of five additional jobs for every one at Boeing headquarters is far out of line with standard economic impact projections. Recently, the National Association of State Development Agencies found that for most single-county regions, 1.5 indirect jobs are generally created by each of a project's new hires.[253] Libertarian columnist Amity Shlaes ridiculed the five-for-one claims:

> Such high claims make the old "multiplier effect" concept seem too tame; perhaps we should speak instead of the "exponential effect"? Is Mr. Ryan referring to the maids and interior decorators who will service executive mini-mansions in suburbia? [254]

The DCCA claims blatantly contradict the Department's own figures about the Sears headquarters when the state projected that the loss of 5,400 direct jobs would cost the state another 2,200 jobs. That is, in the Sears case, DCCA claimed a ripple effect of 0.4 jobs; in Boeing it claimed 5, or a difference of 1,150%!

Independent assessments of Andersen's optimistic projections have been hampered by the fact that, except for a one-page executive summary, the study has not been made public. For over a year, DCCA has denied Freedom of Information Act requests for the publicly funded study's release on the grounds that it is based upon a "proprietary" model.[255] A citizen's appeal of a trial court decision backing DCCA is pending before the Illinois Appellate Court.

Apart from the disputed legality of keeping the report secret, critics of the deal have raised the issue of the legitimacy of the firm that produced the study. Andersen did the Boeing work for Illinois before the revelation of Andersen's firm's improper actions in auditing the books of Enron Corp. Found guilty of federal obstruction of justice charges, Andersen is no longer engaged in auditing or consulting, and what remains of the firm is little more than a team of lawyers handling lawsuits brought by Enron shareholders.

Yet even at the time of the Boeing study, Andersen was well known for its role in helping companies seek out the largest possible subsidy packages when they were planning new facilities or relocating existing ones. Dan Malachuk, then an Andersen partner in charge of its site location services, spoke approvingly of Boeing's staging a public auction: "If you wanted to create an incentive sweepstakes, you create the potential political climate for doing that." Malachuk hinted that an earlier subsidy competition he designed – where 10 to 12 cities had been pre-selected to compete for headquarters of the NCAA – was the model for the Boeing strategy. [256]

Inflated Claims, Inflated Subsidies: Lessons from the Boeing Deal

For the corporate relocation consulting industry, Boeing's public auction may presage a new model for getting public subsidies. A New York consultant said: "If this works for Boeing and they get a healthy incentive package and they end up being in a place that really works for them, this could change the whole corporate site location landscape."[257] However, Fortune 100 headquarters relocations are comparatively rare events. A public auction for a 400-worker clutch plant would not likely create such a frenzy.

As for Chicago and the rest of Illinois, the success in attracting the Boeing headquarters will have some economic benefits – and it represents a shift from state-subsidized corporate migrations to remote suburban locations (though with less than a tenth of the jobs taken out by Sears). Yet the cumulative evidence strongly suggests that Illinois and Chicago overpaid for the Boeing deal.

Equally important, the Boeing deal exemplifies particularly negative trends in subsidy policy. It aggravates the trend toward off-budget expenditures, exemplified by the EDGE credits, which are even more unaccountable than direct subsidies. As Ralph Martire, Director of the Center on Tax and Budget Accountability, has put it:

> Governor Ryan insists that all public money we give to Boeing now will more than come back to the state later... The problem is, there is no way to know whether the governor's evaluation is on the mark. Why? Because Illinois is giving Boeing its cash subsidy in the form of a “tax expenditure.”[258]

The Boeing deal was touted as reversing Chicago’s loss of key corporate headquarters in recent years. But the causes and cures for this trend have little to do with subsidies. James Carlini, a local management consultant and Northwestern University professor, argues that Chicago’s loss of headquarters has been due more to slow adoption of new information technology rather than a poor business climate or lack of subsidies.[259]

Some observers, like economist Brian Wesbury, question whether Chicago’s headquarters “name drain” due to buyouts, mergers and other economic trends has been as devastating as claimed: “Business underneath these 100 large companies is still very active. We have new replacing old, and old wearing out. It’s creative destruction.”[260]

Raiding headquarters from other cities, or chasing footloose companies like Boeing regardless of cost, may not be the best strategy for Illinois or Chicago. *Business Week* has argued that cities and states should respond to “corporate nomads” like Boeing with public investment more than tax giveaways:

> Metropolitan areas should invest in basic public goods, such as airports and universities, and pursue policies that ensure plenty of telecom bandwidth and an adequate housing stock. These investments don’t move, and at the same time they do attract the kind of entrepreneur that creates future corporate behemoths.[261]

Finally, one prominent Chicago executive argues that the key to the city’s progress is improving its “access to transportation and, therefore, trade. Economic growth follows infrastructure.” The executive? Boeing CEO Phil Condit.[262]

Conclusion: Policy Problems and Positive Solutions

The missteps chronicled here are hardly unique to Illinois, and the purpose of this study is not to assign any blame for the past. Our only intention is to examine the state's history through the lens of best practices, with an eye to improving future policies. In that spirit, we see the following policy problems and offer positive solutions from other states:

Policy Problem #1: A Shift Towards Tax Spending Instead of Appropriations

Using tax expenditures (such as EDGE, Single Sales Factor, and all the various enterprise zone and High Impact tax credits) for economic development is problematic for many reasons. Unlike direct appropriations, tax spending is seldom audited, evaluated, or sunsetted. (State revenue departments are in the business of collecting revenue, not program evaluation.) Tax incentives get debated just once, then become imbedded in the tax code, eroding revenues year after year, rarely scrutinized to see if they are effective. Because tax-based subsidies are entitlements due to any company that performs a specified act, they deprive the state of budget control over spending levels. And when recessions come and budget deficits appear, tax-based subsidies are usually less well examined than appropriated budget lines.

Positive Solution #1: Unified Development Budget

As pioneered by Texas, a Unified Development Budget (UDB) is an annual report to the legislature from the state comptroller or treasurer that aggregates *all* forms of spending by the state for economic development: all tax expenditure programs (TIF, income, sales and utility), training programs, extension and modernization services, vocational education, infrastructure, small business assistance, industrial revenue bonds and other loans and loan guarantees. With such a document, legislators have a full, objective picture of the state's real priorities and spending trends. In Illinois' case, it would underscore the magnitude and very high growth rate of tax expenditures.

Policy Problem #2: Poor Transparency and Record-Keeping

Illinois' economic development programs are truly opaque. The state did not publish a tax expenditure budget until 1993. By its own admission, DCCA does not keep many records of its activities for more than three years. DCCA's press releases on deals often omit critical details, including taxpayer costs. And the Department's annual EDGE report is missing basic information required by law. Researching the deals covered in this report was made easier by the fact that they received extensive media coverage, but there are hundreds of deals per year that don't get such publicity. Finally, DCCA is currently refusing, in Freedom of Information Act litigation, to release a controversial Arthur Andersen study that was used to justify the $52 million Boeing subsidy; the study's ripple effect claims are questionable.

Positive Solution #2: Annual, Company-Specific Disclosure

Nine states, most notably Minnesota, Ohio and Maine, now provide some form of annual, company-specific disclosure about deals. The best disclosure reports include costs (which program the subsidy came from and how big a subsidy the company received) and benefits (how many jobs have been created and what wages and benefits are provided). In the cases of Minnesota and Ohio, the disclosure is compiled electronically and published on the state commerce or tax department's website.[263] Disclosure should cover both appropriated subsidies and tax credits; we recommend that disclosure be maintained annually for the duration of the subsidy (e.g., for the length of the loan or the tax credit). By making every deal visible for all to see, the state can deter favoritism and encourage more civic engagement in the process.

Policy Problem #3: State-Subsidized Sprawl

As documented in the Sears and Motorola case studies, Illinois has provided large company-specific subsidies that effectively moved or expanded economic activity into distant exurban areas. Such deals have created enormous and wasteful taxpayer costs for duplicative new infrastructure, exacerbated regional inequality, reduced transit choice for workers, harmed air quality, and fueled the consumption of open space and farmland. The state effectively controls this subsidized sprawl process two ways: by where it agrees to assist individual companies and by its regulatory control of locally-administered subsidies such as TIF.

Positive Solution #3: Location-Efficient Subsidies

To reduce such waste in the future, the state could amend its incentive programs to require that when a project is proposed for a metro area, the project site must be transit-accessible (typically defined as less than a quarter-mile and definitely no more than a half-mile from regular bus or train service). This would have at least four positive effects. First, it would make economic development and transit spending more efficient by encouraging their integration. Second, it would steer more new-job development onto regional transit grids, giving more commuters a choice and improving air quality. Third, it would increase job opportunities for workers who cannot afford to own a car. Fourth, it would likely create more popular support for better transit service in suburban areas.

Some states' "smart growth" laws, such as Maryland's, effectively say to companies: if you wish to build a new project inside a Planned Development Area (i.e., an area that already has infrastructure), we can assist you with our economic development toolkit. But if you insist on building outside such areas, we cannot help you, and you will have to bear all of the new costs – including infrastructure – yourself. Such rules have effectively prompted companies to reinvest in existing communities, making far more efficient use of taxpayers' historic investment in public systems.

Policy Problem #4: The Failure of Single Sales Factor

SSF stands out negatively because it is so expensive, because it favors so few companies, because it fails every measure of accountability, and because it clearly is not working, as factory shutdowns and mass layoffs continue. As well, SSF is inherently unfair to most non-manufacturing businesses and to small businesses that sell little outside the state, because they don't receive SSF's windfall tax cuts.

Positive Solution #4: Reinstate a Three-Factor Formula for Corporate Income Tax

The traditional consensus three-factor formula which apportions taxable income based on property, payroll and sales (or the variation that double-weights sales) is the fairest way for Illinois to tax corporate income. As it did until 1998, a three-factor formula would mean that companies that have a large presence in the state – and which therefore create large public-system costs such as roads, schools and safety – would pay their fair share.

Policy Problem #5: The Deregulation of TIF

In deference to voluminous research by other groups, this report has not covered TIF in depth, except to note the critical role of the Sears deal in loosening TIF standards in ways that have since led to TIF's rapid proliferation. But our brief attention is in no way intended to dismiss the significance of the problem. By allowing TIF districts to be created in prosperous areas and by omitting basic accountability safeguards, Illinois has created yet another tax expenditure that dwarfs other tax-based subsidies, diverting revenue that is critically needed for education and other core public services.

Positive Solution #5: Install Basic TIF Safeguards

As Good Jobs First will document in a forthcoming study, some states have moved in recent years in the opposite direction of Illinois, making TIF even more targeted and selective to ensure that it is serving truly needy areas. Illinois can make TIF more efficient and effective by reinstating eligibility criteria that restrict TIF to areas that are truly blighted or distressed and need public-sector reinvestment to spur the return of private capital.

Numerous other safeguards would improve TIF in Illinois, including: annual TIF cost-benefit disclosure as part of the state system in solution #2 above; annual disclosure by county tax assessors to property taxpayers of how much of their taxes are going into local TIF districts (as is already done in at least one Illinois county); market-based job quality standards to preclude subsidized companies from paying poverty-level wages; a rigorous state performance audit focusing on the feasibility of setting sunset "triggers" in TIFs before the end of their 23-year lives; and improved public-participation rules, especially before deals are finalized.

Policy Problem #6: Big-Deal Chasing at the Expense of Small and Existing Businesses

As documented in most of the case studies, Illinois policy and practice has repeatedly favored large businesses, especially with tax-based subsidies such as High Impact and Single Sales Factor. But when tax systems are considered to be inequitable, those who feel cheated resent paying taxes and lose faith in government's even hand.

Positive Solution #6: Eliminating or Capping Big-Company Subsidies; Redirecting Monies to Skills and Infrastructure that Benefit All Employers

Across the board eliminations of or caps on the state's big-company subsidies would preserve a great deal of revenue. By caps, we mean restricting job-based tax credits to, for example, the first 500 jobs. Property tax abatements could be capped, for example, at 50% and restricted to the first $100 million of assessed value. There are many compelling arguments for redirecting dollars from private deals to public goods, especially America's growing skilled-labor crisis. With the aging Baby Boom generation nearing retirement, the U.S. labor force's growth rate is plummeting and will remain depressed for at least the next half-century; those states with the most skilled labor will be the economic development winners of the 21st century.

Policy Problem #7: Lack of Cost-Benefit Analytical Capacity

Seventeen years after it was criticized for overspending on Diamond-Star, Illinois still cannot determine when or if taxpayers will break even on a subsidy deal. Is the ripple effect of a corporate headquarters job 0.4 additional jobs, as DCCA said about Sears, or is it 5, as it said for Boeing? The Department invites suspicion when it releases such disparate figures.

Positive Solution #7: Fully-Transparent Cost-Benefit Analysis

As has been documented by survey research published by the U.S. Department of Commerce, there is a substantial body of public and private-sector expertise in doing cost-benefit analysis.[264] With a small investment in software and training, Illinois can obtain the capability to weigh deals more objectively, bargain more smartly, and deter waste driven by politics or favoritism.

Policy Problem #8: Failure to Recapture Wasted Subsidies

Although the state does have clawback language attached to some of its development programs, many programs still lack this basic safeguard, and the state's use of "discretion" in applying the concept does not seem uniform. Inevitably, ambiguity in such matters leads to perceptions of unfairness.

Positive Solution #8: Standard Clawbacks in All Contracts

A state rule mandating that standard recapture language be included in every subsidy agreement – including EDGE and TIF – would eliminate ambiguity and ensure that taxpayers are made whole when deals fail to deliver.

Appendix : DCCA Appropriations, TIF, and Economic Development Tax Expenditures

	DCCA Appropriations	TIF (Captured Revenue)	Economic Development Tax Expenditures
FY 1980	$173,430	$771	
FY 1981	$295,478	$1,659	
FY 1982	$277,130	$2,717	
FY 1983	$256,716	$5,495	
FY 1984	$41,524	$7,756	
FY 1985	$574,573	$10,367	
FY 1986	$606,112	$17,360	
FY 1987	$738,401	$31,203	
FY 1988	$577,708	$46,353	
FY 1989	$628,103	$64,702	
FY 1990	$871,938	$100,924	
FY 1991	$815,005	$119,173	
FY 1992	$646,052	$143,350	
FY 1993	$582,090	$179,368	$216,275
FY 1994	$698,458	$199,843	$229,343
FY 1995	$787,457	$225,772	$255,561
FY 1996	$776,294	$253,747	$281,892
FY 1997	$778,650	$285,198	$303,052
FY 1998	$931,627	$330,733	$343,310
FY 1999	$718,092	$367,934	$351,364
FY 2000	$1,359,641		$439,198
FY 2001	$1,894,069		$361,914
FY2002	$2,128,244		
FY 2003	$2,172,141		

Notes: Data not available for TIF after 1999. Data not available for tax expenditures 1980-1992.

Sources: State Budget Books (FY 1980-FY 2002); Tax Expenditure Reports, Office of the Comptroller; Illinois State Budget: the Thompson Years; 1999 Illinois Property Tax Statistics, Illinois Department of Revenue. Budget book summaries FY 1989-2001 provided courtesy of Taxpayers Federation of Illinois; tax expenditure data FY 1993-FY 1996 provided courtesy of Office of the Comptroller.

Notes

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[183] These commitments, cited by Dr. Joan Fitzgerald in an article cited below, could not be confirmed independently, since both the State and City of Chicago are still finalizing some agreements. However, the city's not yet finalized agreement makes the stages of obtaining TIF financing for the project contingent on attaining 750 jobs.

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[216] "Ford Supplier Park," PR Newswire, May 29, 2002.

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[220] Testimony of Pam McDonough, DCCA Director, House Revenue Committee, May 23, 2001.

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[248] "Boeing flies through tour: Three-team approach allows fast area survey," *Dallas Morning News,* April 25, 2001, www.westlake-tx.org/history/MorningNews/042501.htm.

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Illinois.… For our modest investment of $2 million a year in state tax credits on new revenue, Boeing will have an impact of more than $220 million a year on the Chicagoland region. That is a return on our investment of 110 to one. That's not bad." Ryan Radio Report #13, May 12, 2001, http://www.state.il.us/gov/press/rreport/transcripts/13-05-12-01.htm.

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