



## **Government as Developer: Why MAPS for Fish is a Bad Idea**

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Oklahoma City's proposal to build a Sportsman's Center for Bass Pro Shops is unwise public policy. As a matter of principle, government should not be in the development business. Taxing some citizens to give someone a service at less than the market price is not a legitimate function of government in a free society. What's more, the Bass Pro proposal is unlikely to pay for itself, will benefit a handful of property owners at the expense of small and start-up businesses, and will foster a politicized, anti-business climate.

Oklahoma City's proposal to build a Sportsman's Center for Bass Pro Shops in Bricktown raises a number of issues relating to the proper functions of government. Should government effectively go into the development business, picking which enterprises to bestow subsidies upon? Is local economic development a public good? What constitutes a pro-business local environment? Both moral and economic arguments can be made against the project. In this paper, I consider both the case against government as developer generally and specifics concerning whether the Bass Pro project will pay for itself.

### **Should Local Government Subsidize Business?**

In a free society and market economy, government should be limited to protecting people and their property while undertaking for people beneficial functions they cannot perform themselves. government should provide for citizens what markets cannot readily supply. Thus government often provides public goods which markets would under-supply. Taxing some citizens to simply to give the money to another citizen, or equivalently to give someone a product or service at less than the market price, is not a legitimate function of the government in a free society.

Oklahoma City is currently negotiating a lease with the Bass Pro Shops company and thus the terms are yet to be finalized. The report on project revenues prepared by PGAV Urban Consultants estimates that Bass Pro Shops will pay \$610,000 per year in gross rent.<sup>1</sup> The City will be responsible for maintenance at the site, so PGAV estimates net rent of \$449,000, or about \$4/square foot, which is below the market rate for retail space.<sup>2</sup> Although the company will not receive tax dollars directly from the City, below-market rent is equivalent to a subsidy.

Can the Bass Pro project be justified on public goods grounds? Bass Pro sells sporting goods, boats and outdoor equipment; these products are and will continue to be available whether or not Bass Pro locates in Oklahoma City. Clearly the project does not address a shortage of fishing tackle in Oklahoma. Most retailers build their facilities using their own funds. Retailers with an economically sound project can raise the funds necessary for the capital investment of a new building. The project cannot be justified on the grounds that the private sector is failing to provide sufficient space for Oklahoma retailers.

Project proponents argue that the Sportsman's Center will contribute to economic growth in Oklahoma City through sales of merchandise at the store, spending by the store's employees, and the spillover economic activity at businesses around the Sportsman's Center in Bricktown. PGAV's economic impact study estimates that the Center will generate annual sales of \$38 million, 220 jobs in the store itself, about 700 other jobs, and produce direct tax revenues for the City of \$17 million over 15 years. The

spending associated with the Bass Pro store does not constitute growth for the U.S. economy; rather it is totally diverted from other activities in the economy. Most of the sporting goods sold would be purchased elsewhere, mainly at other stores either locally or throughout the region. If sales of goods increase, consumers will reduce spending on other items to compensate. The ancillary spending associated with the store meals in Bricktown restaurants, stays in area hotels, visits to the planned theater complex are also diversions of consumer spending. The people employed at the Bass Pro store would have held jobs elsewhere in the economy.

The availability of one more retail outlet does not constitute growth for the economy. Bass Pro Shops contributes to the economy by offering a new type of retail option, a very large-scale sporting goods and outdoor equipment store. New types of retailing like Wal-Mart Superstores and e-commerce reduce transaction costs. The Bass Pro Shops' business strategy relies on consumers traveling long distances to patronize their regional superstore. Is their plan sound? As an academic economist, providing such assessments is beyond my area of expertise. One can easily question whether consumers in the e-commerce era will still drive 50 or 100 miles or more to purchase goods retail, even high-value goods like boats. This, however, is exactly the kind of question that the market economy answers. The market functions when entrepreneurs either risk their own money or convince investors to risk their own money on their business idea, on whether they can offer consumers quality products at competitive prices and still make a profit. If the owners of Bass Pro Shops think they have a better way to retail sporting goods and outdoor equipment, they should be willing to risk their own money in the venture and build a store without tax dollars. They will earn the profits if correct and will bear the losses if wrong. Of course, a lot of ideas suddenly look like good investments if funded by tax dollars. Taxpayers end up bearing the risk but do not share in the profits if the venture is successful.

Although it does not matter for the national economy where expenditures occur, residents and local politicians do care about the location of spending. City leaders will want economic activity to occur within the city's borders. Retail sales in Oklahoma City will increase if Bass Pro locates a store in Bricktown, even though the sales are diverted from elsewhere in the region. This benefits Oklahoma City, but not all residents of the city benefit from the increase in sales. Sales at the Sportsman's Center benefit the company. The spillover tourist dollars will be concentrated at restaurants, shops, theaters, and hotels near Bricktown. Yet this spending does not benefit the average resident of Oklahoma City, and may not even benefit people who work in, supply to, or even own these establishments. An increase in demand does not benefit all resource suppliers.

To see this, suppose the state legislature passed a law making it much easier for patients to sue their doctors and HMOs, and this leads to a medical malpractice litigation explosion in Oklahoma. Suppose litigation requires two inputs lawyers and yellow legal pads. Many companies produce legal pads (assume they sell in the market for \$1 each) and production of pads can double or triple without increasing the cost of production. On the other hand, the number of lawyers in the state is fixed in the short run, and the number of persons who have the ability and interest in attending law school is limited. Doubling the number of lawsuits in the state would raise lawyers' salaries, even in the long run.

Who benefits from the litigation explosion? Lawyers, yes, but not the suppliers of legal pads. The paper companies make only a competitive return on legal pads, the same return the companies could earn making Post-It notes or loose leaf paper, and the same return the companies' stockholders could make investing elsewhere in the economy. In general, the owners of inelastically supplied inputs the lawyers benefit from an increase in demand, not the suppliers of elastically supplied inputs the legal pads.

The increased economic activity due to the Bass Pro project will primarily benefit the owners of land in Bricktown. Bass Pro will hire sales staff, but these persons could work at similar jobs for similar wages elsewhere in the Oklahoma City metro area. Bricktown restaurants will have more customers, but even the restaurant owner might not benefit from this. Longer lines and higher prices for meals at these establishments could simply result in correspondingly higher rent, and so the owner of the property benefits.<sup>3</sup>

Achieving a self-sustaining threshold of economic activity may well be a public good for property owners in Bricktown. No one enterprise might be able generate enough activity to draw a lot of people into the area. The Bass Pro Sportsman's Center will benefit other Bricktown businesses, and indeed will help the area draw the critical mass of customers on a daily basis to make these surrounding businesses successful. Bricktown businesses might have a substantial financial stake in Bass Pro opening a store in Bricktown. But they face difficulty organizing their own incentive package to entice Bass Pro because each business knows it can benefit if Bass Pro locates in Bricktown, regardless of whether they contribute to the effort. Oklahoma City could consequently offer an incentive package to Bass Pro on behalf of Bricktown businesses.

But we should be clear who benefits from the Sportsman's Center: property owners in Bricktown. The benefit principle of taxation holds that the beneficiaries from government spending should pay the taxes to fund this spending. The principle is appealing both on the grounds of justice (the beneficiaries should foot the bill for government services) and on the grounds of economic efficiency (if the beneficiaries pay for the public good they make sure the goods provided are worth the cost). The benefit principle suggests that a special tax on Bricktown property would be an appropriate way to pay for the City's participation in the deal. The sales tax is generally a regressive tax, and it seems improper to employ a tax falling disproportionately on lower-income families to fund a project which will primarily benefit a handful of property owners and the investors in the Bass Pro Shops company.

The typical resident of Oklahoma City will not benefit from the economic activity in Bricktown, and the value of an additional retail store in the Oklahoma City metro area is quite modest, and essentially zero if Bass Pro opens a store elsewhere in the metro area if the Bricktown deal falls through. For the typical resident, the best argument for the City's participation is the prospect that the project will more than pay for itself in terms of tax revenue on sales that otherwise would not occur within the City. Spending \$17 million on the project now might conceivably yield much more in extra tax revenues later, which could allow provision of more and better public services without tax increases, or provision of the same public services with a tax cut. Whether the project will actually provide such a return is an empirical question, which I will discuss below. Since the tax revolt of the late 1970s, however, politicians have promoted a wide range of spending programs as self-financing, promising that increased future tax revenues or reduced future spending would more than offset today's cost. Taxpayers have been told that spending on everything from public schools to highways and infrastructure to job-training programs to sports stadiums and even the Clinton health care reform plan would be self-financing. Citizens would be wise to carefully scrutinize this well-worn argument.

#### **Will the Bass Pro Shop Investment Pay for Itself?**

The strongest reason for the typical Oklahoma City resident to support the City's funding of the Bass Pro project is that the project could pay for itself that new tax revenues generated by the project will exceed the cost. PGAV Consultants of St. Louis performed a revenue analysis for the city to estimate the revenues from the project. Their report suggests that the project will pay for itself; the executive summary states that the direct revenue available for the Project from the sources analyzed in this report is approximately \$17.4 million, while the cost of the project is estimated at \$17.1 million. The project seemingly will generate net tax revenues for the City even without considering any indirect revenues or spillover economic activity; PGAV estimates the project will generate another \$94 million in indirect revenues over 15 years.

Critics of the Bass Pro project have raised a number of objections to the study, including the cost of the study, the consulting company's objectivity, and the use of proprietary data in estimating potential revenue. Citizens Against Taxpayer Abuse, a coalition of citizens and businesses opposed to the project, recently released a study by economic consultants at Intecap attacking PGAV's revenue analysis.<sup>4</sup> Economists can always quibble with every assumption used in studies like these. Ultimately, however, disputing every number down to the third decimal point is unproductive. Indeed, such debates contribute to the popular impression that economists never agree on any conclusion. In this case, the PGAV report suffers from two serious flaws and the executive summary's conclusion is overstated, even if we accept the report's own revenue estimates.

The PGAV study projects sales of \$38.5 million annually, based on a questionable methodology which they must employ because they do not report sales at comparable Bass Pro stores.<sup>5</sup> Some of these sales would occur within Oklahoma City even if the Bass Pro project is not undertaken; only the net new sales produce new sales tax revenue for the City. The report recognizes this fact, and estimates that about 60 percent of taxable sales will be net new sales. Table 3-1 reports estimated direct revenue for the City from the project while Table 3-2 reports estimated net new direct revenue. Net new direct revenue is clearly appropriate to assess the City's return on its investment, but the executive summary reports (and media stories have quoted) the total from Table 3-1.

Furthermore, the PGAV study fails to calculate the present value of this revenue stream. A dollar one year from now or 15 years from now is not worth as much as a dollar today because people are impatient. The City proposes to issue bonds to pay for the project, and will have to pay interest on the bonds. Alternatively, the City could invest the money it would spend on the Bass Pro development. The return on this investment represents the opportunity cost of the money spent on the Bass Pro project. If we discount the City's new direct revenues using a discount rate of 6 percent, which is approximately the interest rate the City pays on revenue bonds, we have a present value of direct revenues of \$8.4 million, about half the City's cost on the project. If sales at the Bass Pro store fall short of the report's (perhaps optimistic) estimate, or if more sales are diverted from within Oklahoma City than PGAV estimates, the

City's direct revenues will be even lower. I do not believe the weaknesses of the PGAV study mentioned here would be highly contentious among economists. When calculated appropriately the City will realize direct revenues of less than half of its cost on the project.<sup>6</sup>

The PGAV report estimates indirect revenue for the City of \$94 million on the project, which might suggest that Bass Pro would benefit the City even if direct revenue falls short of cost. Yet this total is based on a series of questionable assumptions, in addition to the failure to distinguish net new tax revenues and to calculate the present value of these revenues. The Intecap study discusses these flaws in detail and estimates a present value of indirect revenues of \$3.3 million.

The site of the proposed Bass Pro store has been vacant for over 25 years and owned by the City since 1977. The property's lengthy disuse should trouble anyone evaluating the Bass Pro project. On the one hand, PGAV's report states that "[b]ecause the site has been vacant since 1975 ... it is obvious that the site is blighted and represents a physical and economic liability to the City ... [I]t is apparent that without public assistance, no private investment is likely to occur."<sup>7</sup> Yet Downtown OKC Inc. has argued that the Bass Pro project makes sense because of "this location's premier situation at the crossroads of I-40 and I-35."<sup>8</sup> These assessments cannot both be true. If this is a good retail site, some retailer should be willing to buy it from the City for this purpose, and this value plus the subsequent property taxes must be counted against the Bass Pro net revenue calculation. The City has in this case done taxpayers a disservice by failing to put this valuable property to productive use for 25 years. If this is a bad site for retailing, Bass Pro Shops may be unlikely to meet their sales projections due to the site's disadvantages.

One aspect of the PGAV indirect revenues calculation which deserves discussion is the inclusion of revenues from subsequent phases of the Bricktown Entertainment Center (BEC). The subsequent plans tentatively involve a virtual reality game arcade, a movie theater, restaurants, and a hotel. The report's rationale for including revenues from subsequent phases of the BEC program is that "without the Project, it is unlikely that the larger BEC redevelopment program will occur as envisioned, within a near-term time frame or may not occur at all."<sup>9</sup>

This report's argument, if valid, suggests that Oklahoma City should consider the entire BEC project as a whole instead of the Bass Pro project separately. If the remainder of the development cannot be undertaken without Bass Pro, and if the City's investment in the Bass Pro project is to be justified by revenues from the remainder of the development, a decision on the overall development should be made now, with the full cost to taxpayers revealed now as well. The City is only considering the Bass Pro project at this time, so subsequent development of the site should be excluded from the current discussion. The Bass Pro and BEC projects are potentially separate. The rest of the BEC may not be built after the Bass Pro store (taxpayers might demand an end to public investments in Bricktown), or the BEC could be completed, perhaps in modified form or on a reduced scale, if Bass Pro does not locate in Oklahoma City.

### **A Positive Environment for Business?**

Some people have argued that Oklahoma City must go forward with the Bass Pro project to create a positive business climate for the area. Downtown OKC Inc., claims that if the project does not proceed, "a sad legacy of being hostile to outside investment will continue and Oklahoma City's reputation will take a serious hit in the eyes of outside investors."<sup>10</sup> After all, more businesses are footloose today than ever before, able to move operations almost anywhere in the country. Cities and states compete vigorously with incentive packages to attract businesses. Putting together a deal with Bass Pro shows that Oklahoma City is "pro-business."

Many local businesses oppose the plan, so not everyone thinks that public incentives are good for business. Other retailers and developers decry the use of tax dollars to subsidize a competitor. Incentive packages for some businesses create an uneven playing field, with some businesses paying market rent trying to compete against a rival paying only a fraction of market rent. And other businesses potentially would have to fear City-subsidized competition in the future. An uneven playing field, they maintain, is "anti-business."

Do incentive packages like the one tentatively being offered to Bass Pro create a positive or negative climate for business? Economists proclaim the benefits of competition in markets. Shouldn't competition between cities and states be equally beneficial? Mobile businesses should reduce state and local government's ability to impose regulations that wastefully increase the cost of doing business. Deals with businesses that reduce burdensome regulations or onerous taxes benefit the economy. But incentive packages involving government-financed goodies are a different matter altogether.

Are incentives like the City is offering genuinely pro-business? Incentives certainly benefit the businesses lucky enough to receive them. More significantly though, the availability of government

subsidies for some businesses under some circumstances creates a politicized environment for business, and this hurts the economy. Once incentives and subsidies are on the table, businesses will undertake efforts to secure these favors from government, a process economists call rent seeking.<sup>11</sup> Entrepreneurs begin to succeed in the market not based on whether they can produce a better product at a lower cost, but based on whether they can secure the favor of politicians in charge of distributing the incentives.

Economic historian Burton Folsom calls such business leaders "political entrepreneurs," to contrast them with market entrepreneurs. This creates two costs for the economy. First, subsidies help political entrepreneurs gain command over more resources, resources which market entrepreneurs would employ more efficiently. Folsom documents the inefficiency of the transcontinental railroads built at public expense by political entrepreneurs.<sup>12</sup> As governments offer incentive deals to more businesses, government slowly takes on the role of picking winners in the economy. Publicly subsidized companies have a considerable advantage in the market and businesses which do not receive incentives are progressively disadvantaged as more of their competitors receive a subsidy. Unfortunately though, government has a very poor track record in picking winners. Second, the politicized business climate diverts resources and entrepreneurial talent from the making and marketing goods and services.<sup>13</sup> Business spends more time lobbying politicians than building better mousetraps, and profitability depends more on pleasing politicians than customers. Even market entrepreneurs must eventually play the political game or risk losing out to those who do. Business owners not interested in receiving incentives from local government might have to lobby to prevent their competitors from receiving subsidies.

Government's successes in luring businesses cannot be considered in isolation. Even if the Bass Pro project produces revenues in excess of the City's cost, which seems highly unlikely, there will be other projects which will not work out as well. The poor choices by City leaders come as a package with the good choices. The costs of mistakes must be weighed against the City's development "successes."

Economic growth comes from small and new businesses. Small businesses are the heart of the American economy's job-creation machine. Small and start-up businesses inevitably lose out in the incentive game. Individual small businesses lack the political influence needed to get Oklahoma City to build and lease them retail space at less than the market rent. And the Mayor and City Council can't be expected to negotiate an incentive package for every new store that might employ five or 10 persons. Yet these small businesses face higher taxes and fewer public services because of the deals offered to politically favored enterprises.

### **But We're Just Responding to Their Incentives**

Project proponents might agree that no community should offer financial incentives to businesses in a perfect world, but respond that we don't live in a perfect world. Oklahoma City is just responding to the incentive packages offered by other communities; for instance, some have suggested that if Oklahoma City rejects a deal with Bass Pro Shops, another metro community will simply step up with their own incentive package. In our imperfect world, refusing to make deals with companies would amount to Oklahoma City unilaterally disarming in the midst of an arms race. Pragmatic politicians could argue that public incentives are a reality in today's world and critics are naive to think Oklahoma City could attract businesses without them.

We can distinguish subsidies in two different instances. Competition for national businesses against cities in other states truly is like the arms race. Oklahomans cannot stop other governments from offering incentives. Here Oklahomans must decide whether to participate in such bidding contests and accept the likely consequences if we opt out.

But the Bass Pro case is different: It pits one Oklahoma community against another. Bass Pro seems likely to open a store somewhere in the Oklahoma City metro area. We as Oklahomans can avoid playing this game. While government, when limited to its proper role in a free society, works in the common interests of all citizens, the rent-seeking society pits citizen against citizen, or in this case community against community. Having cities throughout the state compete using subsidies and incentives for area businesses like Bass Pro Shops or Wal-Mart Supercenters politicizes business and hurts Oklahoma's economy.

How can we just say no when our community is up against the town down the road? Citizens should remember just how little they have at stake in these location decisions. The typical resident of Oklahoma City would have only a slightly longer drive to patronize Bass Pro if it is located in Midwest City instead of Bricktown. City residents who don't happen to own land in Bricktown are unlikely to see any personal financial benefit from the store's locating in Bricktown. There remains only the prospect that a Sportsman's Center in Bricktown will generate enough net new tax revenue for Oklahoma City in the years to come to earn a competitive return on the proposed \$17 million investment today. In this case,

proper calculations using the very revenue analysis paid for by the City to promote the project suggests that this will not happen. Just saying no to subsidies to business is easier when we remember exactly how minuscule the benefits are for most of us.

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#### **Endnotes**

1 PGAV Urban Consultants, "Revenue Analysis, Bass Pro Shops, Bricktown Entertainment Center," March 1, 2002, p. 3-2.

2 According to John Henry, an Oklahoma City developer, a retail firm with estimated revenues comparable to the Bass Pro Shop's Sportsman's Center would pay over \$16 per square foot. Letter to Oklahoma City Council, February 1, 2002.

3 If the restaurant owner also owns the property, economists would say that the profits are earned by the property, not the restaurant.

4 Alan Meister, "The Potential Economic Impact of Bass Pro Shops on the City of Oklahoma City, Oklahoma," Intecap, April 2002.

5 The PGAV study does not use sales data from other Bass Pro locations because the company considers this to be proprietary information. Privately held companies have a right to protect information; nonetheless, the Bass Pro company should understand that people may be skeptical of their claims about sales at other stores made without supporting evidence. It is an interesting question whether privately held companies which seek public-sector assistance should have to fully disclose information that would otherwise be proprietary. Indeed, Citizens Against Taxpayer Abuse has ongoing litigation against the City for forced release of such information. The issue though is not relevant to the questions examined here.

6 Note that the City will still own the Bass Pro Shop building at the end of the 15-year period examined by PGAV's revenue analysis. The building could be sold or rented to subsequent retail tenants, so the discounted market value of the building at the end of the project period must be added to the City's direct revenues in determining the City's return on the project. PGAV estimates that the assessed value of the building would be about \$900,000, which does not reverse the conclusion that direct revenues will be considerably less than cost.

7 PGAV Urban Consultants, p. 2-2.

8 Downtown OKC Inc., "The Case FOR Bass Pro in Oklahoma City: How Misstatements and Unchallenged 'Facts' Have Clouded the Argument," not dated, p.10.

9 PGAV Urban Consultants, p.2-2.

10 Downtown OKC Inc., p.11.

11 On the concept of rent seeking see Gordon Tullock, *The Economics of Special Privilege and Rent Seeking*, Boston, Kluwer Academic Publishers, 1989.

12 Burton W. Folsom, Jr., *The Myth of the Robber Barons*, Third Edition, Herndon VA, Young America's Foundation, 1996.

13 See Kevin M. Murphy, Andrei Shleifer, and Robert W. Vishny, "The Allocation of Talent: Implications for Growth," *Quarterly Journal of Economics*, Volume 106, pp.503-530, 1991.

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