



Development and Infrastructure

Eight Rules for Economic Development

By Edward L. Glaeser

Massachusetts' continuing economic vitality represents the triumph of human ingenuity over natural disadvantage. Many areas like Massachusetts that have a cold climate and aging infrastructure have been mired in economic decline. Thus far, through a continual process of reinvention, Massachusetts has so far found ways to be an important cluster of technological innovation in the post-industrial age. But reinvention is always uncertain and the next governor will have to set economic development policies during a period when the state's continuing economic vitality is far from sure. Here are eight principles that guide my thinking about what constitutes good local economic development policy:

1. Do no harm. State government should eliminate regulations and taxes that impose costs on firms and that don't generate enough benefits to justify those costs. Not all regulations are bad and we need taxes to pay for infrastructure and schools. Still, the new governor would do well to take a hard look at what can be done to reduce the government-created costs of doing business in Massachusetts.

2. The costs of attracting new businesses can be too high. It was easy to cheer when the state landed a Bristol-Myers Squibb manufacturing plant at Devens, but it was much harder to figure out if this was actually a good deal for the state. At least \$30 million dollars in tax breaks and \$35 million for infrastructure was needed to generate 550 jobs. With the state's unemployment rate under five percent, most of those jobs will be people moving from one job to another. I am not sure if this was a victory or not, but I am profoundly disturbed by the lack of

serious debate over whether the project's benefits actually cover its costs.

3. Creative workers aren't just employees they are also prospective entrepreneurs.

Increasing our workforce's human capital—either by educating our own or by attracting smart outsiders—pays off doubly by improving the workforce that firms today can hire and by increasing the supply of new firms in the future. A growing body of evidence suggests that people become more productive when they work around other educated people. This importance of human capital pushes us towards more investment in education, but also other policies like reducing barriers to new construction that could reduce the costs of living in Massachusetts.

Biotechnology may be the new, new thing, but if we tax other sectors to prod it onward, who knows what we are discouraging.

4. Know your region's comparative advantage. The state's comparative advantage is in idea-oriented sectors like technology, health care and financial services. Policies shouldn't directly subsidize those sectors, but the governor should make sure that these areas have the basic infrastructure they need to thrive. Just as importantly, the governor should not bet on non-creative sectors that don't need the regions skills. Routine manufacturing will always be cheaper to do elsewhere and it is a fool's errand to try to attract it to Massachusetts.

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5. Invest in idea-transmitting

infrastructure. Government intervention is most valuable in areas where private investors won't get the full benefits from their actions. Since most ideas tend to be in the public domain, private idea producers and transmitters don't get all the social benefit from their activities. This suggests a role for government in things like area-wide WIFI that helps spread and produce ideas.

6. Innovation is unpredictable and government isn't great at picking winners.

The reason not to subsidize particular sectors is that unpredictability is the essential element of an innovation economy. Biotechnology may be the new, new thing, but if we tax other sectors to prod it onward, who knows what we are discouraging. Economic research shows that even Japan's vaunted MITI with its superstar bureaucracy generally supported less productive firms. Why should our state government be able to do better?

While vast tax breaks to a particular firm may be too much, good political leaders always need to listen to the problems faced by particular business leaders, such as obstacles to permitting new facilities in timely and reasonable ways.

7. Most magic bullets aren't all that magical.

There are always new urban planning fads and some of them seem to offer quick fixes, like building a new coffee house or buying public art. Cities should experiment, but most of the time, improvements come from hard slogging. The long-run state of the Massachusetts economy depends on the hard work in

education, infrastructure, housing and reducing taxes, not in any quick fixes.

8. Rules are generally better than discretion, but the optimal amount of discretion isn't zero.

Much of the basic discussion has emphasized the value of focusing on fundamentals and then getting out of the way of dynamic entrepreneurs, but there is also a need for a direct line between the governor and business leaders. While vast tax breaks to a particular firm may be too much, good political leaders always need to listen to the problems faced by particular business leaders, such as obstacles to permitting new facilities in timely and reasonable ways. They need to respond to some of those problems because just as subsidizing biotechnology is a mistake, so is failing to provide the support it needs to grow.

Together, these eight thoughts push me towards a view of economic development that emphasizes ideas, with the big spending oriented towards basic government services but with some creative tinkering on the fringes. We must respect the importance of human capital by investing in schools and by opening up our housing markets. We must tie large-scale spending to rigorous cost-benefit analysis. But at the same time, the governor should be nimble and responsive and look for areas where a small amount of money or time might be able to be speculatively used to build something new.

E. L. G. H. D. I. G. B. H. I. G. E. F. C. C. B. 1640-2003.

Balancing Housing Options

By Edward L. Glaeser

Few decisions facing the next governor will rival housing policy in their impact, but the importance of housing is surpassed only by its contentiousness. The problem is that four powerful constituencies, each representing a different set of values, face off in the debate over new construction. All four have laudable goals, albeit ones that conflict mightily. The new governor will need to find the way between them.

Homeowners form the largest interest group. For them, unaffordable housing is not a problem; it increases the value of their portfolio. Moreover, since any new development brings some inconvenience, most homeowners prefer new construction in any community but their own. Antigrowth homeowners get ideological cover from environmentalists who do not care if housing is cheap or expensive as long as new homes don't eliminate green space. They don't much like cars, either.

On the opposite side, affordable housing advocates, who represent the poorest, count their victories in the number of inexpensive units brought to market, especially those that are subsidized. These friends of affordability have made a strange alliance with the friends of growth, a group that includes employers, builders, and the occasional cranky economist. The growth crowd wants the state to be able to attract new workers without paying a fortune to compensate them for extravagantly expensive housing.

In the quest to satisfy all four groups, the next governor has four big options in housing policy. The time-honored path of doing nothing is always easy and will be particularly attractive if housing slumps. This path represents victory for the homeowners

who now have the upper hand in all but the largest cities. This policy is not perfect for environmentalists, as towns on the suburban fringe will continue to develop former green space, and it is a disaster for friends of affordability and growth because doing nothing means fewer units and ensures that Greater Boston will be a small, pleasant enclave for the privileged few.

The second approach is to build subsidized housing, either directly with public funds or by requiring new builders to include affordable units in new projects. This approach divides the affordable housing advocates from the pro-growthers, who argue that requiring subsidized units is a tax on new construction. Like any tax, it will reduce production, they believe, and ultimately make housing less affordable for those who do not live in the subsidized units.

The third approach expands Chapter 40B, the

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the homeowners of Lexington and Concord to give him or her the same treatment that they gave to King George. Environmentalists will be similarly livid. Daryl Hannah might come east and bring her Californian penchant for protesting development by climbing trees.

The fourth approach ties state aid to local construction, and thereby both provides incentives for communities to allow more building and compensates residents for the inconvenience of new construction. This path was pioneered by Chapters 40R and 40S, recent state laws that give extra funding to communities that allow the construction of dense, mixed-income housing near transit nodes.

Voters and candidates must remember that you cannot favor affordable housing and oppose new development. Restricting supplies always brings higher prices.

The incentive approach seems to balance the need for growth with respect for home rule. Chapters 40R and 40S are great first steps, but since their bonuses are modest, their impact will be modest as well. Communities will need much bigger incentives than these to see a real effect.


Just as important, 40R and 40S tie bonuses to a form of development that appeals particularly to environmentalists. Many friends of growth believe that these environmental restrictions ensure that the incentives will not be widely used.

Candidates who want to tie housing incentives to pro-density restrictions are friends of the environmentalists, not friends of growth. A middle course might reward all new construction but provide extra bonuses for “Smart Growth.”

As voters face the election, they should at least demand that the candidates are clear and realistic about their vision for new housing. Voters and candidates must remember that you cannot favor affordable housing and oppose new development. Restricting supplies always brings higher prices.

E. G. H. D. I. G. B. H. J. B. H. G. B. J. 2006. I. I. E. I. H. B. M. 2006. I. A. Boston Globe's L 3, 2006.





The Big Dig's recent problems show that the next governor will be confronted by three big questions in transportation. First, is the state choosing the right projects? Second, does it have the right amount of money to build, operate, and maintain those projects? Third, will it build and then operate facilities in the right way?

Picking the Right Projects

July's fatal Big Dig accident is a stark reminder that badly built or poorly maintained transportation facilities can be fatal. The next governor, therefore, might ask the state's transportation secretary to bring together a first-rate team to assess the conditions of the state's whole transportation network (and perhaps other critical forms of infrastructure as well). Moreover, given that the Big Dig and several recently built transit projects have cost substantially more than what was estimated when they were being planned, the next



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Opportunities and Minefields in Medical Care and Public Health

By David Cutler

Health care has been a major issue for all of the state's recent governors and it will be a major issue for the next governor as well.

While many specific new issues are certain to arise, almost all of the next governor's decisions about health care in the next four years will fall into two broad categories: medical care delivery and public health. Both offer great opportunities and both can be political minefields.

Medical Care Delivery

Those who fund and provide medical care in Massachusetts (as everywhere) must grapple with three issues: access, costs, and quality.

Massachusetts does very well in access. Even before passage of the state's landmark health care law, only six percent of the state's residents (about 400,000 people) lacked health insurance, more than 50 percent below the national average. The new law will extend insurance coverage to most, perhaps all, of the uninsured. *I*

High spending can be justified if the care that is received is worth it. But most studies suggest that the higher level of spending in Massachusetts is not buying commensurate health outcomes.

In particular, the next governor must be ready to address several contingencies. What will he or she do, for example, if insurance costs increase and the required premiums under the individual mandate become unaffordable?

Will the governor be in favor of less generous coverage – fewer covered services, or higher cost sharing? Alternatively, will he or she try to raise taxes or postpone tax cuts to support the

program? Either course may be necessary. Both are politically unappealing.

High costs are the counterpart to high rates of coverage. Massachusetts is not alone in having a cost problem; health costs have increased about the same rate in all states. But the problem is particularly acute in Massachusetts because Massachusetts has the highest per capita health spending in the nation – 25 percent above the national average. As a result, businesses complain that they cannot compete with firms in other states, while high health care costs forces some individuals into bankruptcy. Similarly, state officials must grapple with the fact that the cost of Medicaid and health insurance for state workers and retirees is responsible for increasingly large shares of state spending. And high costs could even undermine the new health care law's fragile financing system.

High spending can be justified if the care that is received is worth it. But most studies suggest that the higher level of spending in Massachusetts relative to other states is not buying commensurate health outcomes. Rather, we spend more on tests, procedures, and end-of-life care that is not providing enough return for the dollar. Indeed, health care quality as a whole is not up to where it should be. The Institute of Medicine estimates that medical errors kill up to 100,000 Americans annually, and harm countless more. Tests are unnecessarily repeated, prescriptions are misread, and doctors are not prescribing the best medicine for their patients. *I*

The governor has a number of tools to address these issues: the structure and content of the Medicaid program; the new Commonwealth Connector; the Cost and Quality Council

mandated under the new legislation; the Group Insurance Commission (which insures state and many local employees); and others as well.

Two strategies are most prominent in the health policy literature. The first stresses the patient side: health care would work better if people were put in charge of their own care. In practice, this involves giving people information about the quality of medical providers and increasing the amount of money that people pay when they receive care, so they become cost conscious consumers. Governor Romney generally supported reforms along this line. Indeed, his original proposal for the new health care legislation (rejected by the legislature) involved insurance plans with high cost sharing.

The second approach is provider-based. It stresses measuring and disseminating quality information, paying providers more for high quality care and less for low quality care, and encouraging or financing investment in medical information technology. This issue is not an either-or choice, but the Commonwealth will need to do something to address the cost and quality of health care.

Public Health

Just as important as medical care is public health. Five years after the terrorist attacks on New York and Washington, two years after the Avian Flu scare, and one year after Hurricane Katrina, America's public health infrastructure is generally believed to be unprepared for a major public health emergency. The next

governor must decide how to manage the Commonwealth's public health infrastructure. What should be done in advance to guard against these threats?

Public health also encompasses the neighborhoods we live in and the way we live our lives. Massachusetts is generally a healthy state. Smoking rates in Massachusetts are well below the national average (19 percent of adults, compared to 21 percent nationally). Similarly, 54 percent of the adults in Massachusetts are overweight or obese compared to 60 percent nationally. Still, the trends are worrying. The share of Massachusetts's residents who are obese has nearly doubled in the past 15 years. The next governor will need to decide whether and how to address these personal health questions.

A governor who decides to take on these issues has many options: raising taxes on cigarettes or junk food; extending smoking bans throughout the Commonwealth; making changes to the public school environment; building more parks and recreation centers; and others. The governor will also want to develop some strategy about approaches to personal behavior.

Health care issues are among the most pressing problems of government, but also among the most difficult politically. The scale of the medical sector is so great that any change has major implications. The public is naturally wary about major disruption in

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Improving Education By Inviting the Public to the Bargaining Table

By Paul E. Peterson

The Massachusetts school accountability reforms have helped improve schools by opening up school performance to public gaze. Student performance has risen steadily, especially in 10th grade where students themselves are being held accountable.

Now is the time for the state to hold school boards accountable to the public as well. The next governor should ask the legislature to pass “Sunshine” legislature that requires school boards, when bargaining with representatives of school employees, to hold their bargaining sessions in public.

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The gubernatorial candidates who propose to extend the Sunshine concept to the collective bargaining process will be taking on some pretty powerful vested interests. But by putting the issue on the public agenda, they also could do a great service for the state’s children.

In Salem, Oregon, the idea is now being tried out for the first time. But most everywhere else, including school boards throughout Massachusetts, the public is shut out of the conversation. Nothing in state law prevents school boards from making quiet deals with union negotiators that place employee interests ahead of student well being.

Currently, the public gets a glimpse of the action only when strikes occur and both sides run to the public for backing. But strikes occur

less now than ever before. Nationally, back in 1975 when teacher unions were first getting themselves into the collective bargaining game, there were 241 teacher strikes or near strikes. In 2004, that number was no more than 15.

Some may hail the quiet smoothness with which collective bargaining often proceeds. But when the public is shut out of the process, insiders gain the advantage

But changing these policies, or taking even more modest measures to enhance learning, is extremely difficult. In Boston, for example, a coalition of education and business leaders is currently calling for changes in union contracts so that assistant principals can be considered members of the management team, not a group with interests separate and apart from the school system. The reformers would also like to alter the uniform salary schedule so that the school board can take such creative steps as paying higher salaries to science and math teachers (where shortages in qualified instructors are particularly severe). And Governor Mitt Romney has proposed extra pay for teachers recruited to serve students in low-performing schools.

But none of this can happen without changes in collective bargaining contracts. As Samuel Tyler, president of the highly regarded Boston Municipal Research Bureau told *Boston Globe*: “The system is not moving fast enough to deal with the problems that need to be addressed. We need to be able to achieve more through collective bargaining. We’re trying to raise the bar of what should be expected out of this next teachers’ contract.”

The unions representing teachers and other employee groups are likely to oppose these measures. But what is the stance of the Boston School Committee and other school boards

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around the state? On this subject, the public is generally told next to nothing. When asked by the *Globe* reporter for their thoughts on reform proposals, for example, Boston's "school officials did not return several calls for comment."

Unfortunately, boards often are negotiating wimps, too concerned by the need to win their own re-election (when they are elected) or too willing to placate a mayor's electoral coalition (when appointed).

Too often the blame is placed on union negotiators for their intransigence. But one can hardly complain about union opposition to reforms that come at the expense of employee salaries, benefits, security, and autonomy. The fundamental and legitimate purposes of unions [are] to protect the employment interests of their members," says one former Ohio union official. His point is well taken. It's the school board's responsibility to bargain with as much firmness as that exercised by those across the table.

Unfortunately, boards often are negotiating wimps, too concerned by the need to win their own re-election (when they are elected) or too willing to placate a mayor's electoral coalition (when appointed). Employee groups wield political power both during political campaigns and at the ballot box itself. Unions representing teachers and the many other employees of a school district regularly endorse candidates, give campaign donations, and watch every board member's negotiating move. And school employees can be as much as four times as likely to turn out to vote in low-visibility school board elections, as are other registered voters.

Most of all, boards hate the publicity that comes with a strike. Boards must then explain to parents why their children are not in school. It's easier to take the broad, easy road than the narrow, conflict-ridden one.

Some say open negotiations will make it harder for union leaders to make concessions. But closed negotiations allow school boards to privilege the powerful with minimal public scrutiny. If open negotiations won't settle everything, at least the public will have a chance of knowing what's going on.

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The School Money Trials (B. ... ,
I. ...); Choice and
Competition in American Education
(... & L. ... , 2006); ... No Child
Left Behind? The Politics and Practice of
School Accountability (Brookings Institution
Press, 2003).

Social and Human Services**Regaining Control of the Department of Correction**

By Anne Morrison Piehl

The state's next governor can help the Massachusetts Department of Correction (DOC) address many challenges.

As in many other states, these challenges include the rapidly increasing costs of providing adequate care for inmates' medical and mental health needs, the expense of longer prison terms, an aging prison population, and the demands of preparing inmates so that, when they are released, they are prepared to construct new, hopefully pro-social, lives. As in other states, moreover, some of these challenges are the unanticipated or long-delayed consequences of "get tough" anti-crime legislation passed in the 1990s.

But the Massachusetts DOC also faces some unique and particularly intractable challenges. These not only include unusually high labor costs but also union contracts that make it hard for senior officials to effectively manage correctional facilities. As the state's Department of Correction Advisory Council noted in its final report, "the fiscal management of the department is closely linked with labor management and the rising costs of labor."

Like many large private sector firms and public agencies, the Massachusetts DOC has learned the hard way that seemingly modest contract provisions have significant long-term costs. Correction officers in Massachusetts, for example, are paid more than their counterparts in all but two other states and the state has the second highest staff to inmate ratio in the nation. State correction officers, moreover, take an average of 60 vacation and personal days per year and are paid for 52 of those days. Most Massachusetts taxpayers are private sector employees who would be thrilled with one paid day off per month, much less one paid day off per week. Combined, such

provisions mean the state is spending close to a half billion dollars a year to incarcerate less than 10,000 inmates. Moreover, the growth in personnel costs is gobbling up larger and larger proportions of DOC's budget, leaving less and less for programs that help prepare inmates for life after they leave state correctional facilities.

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For the Department of Correction, however, the challenges resulting from past contract negotiations are much more serious than inflated labor costs. Over the past decade, fundamental management responsibilities, such as establishing post assignments, have been negotiated away in contracts with the Massachusetts Correction Officers Federated Union (MCOFU), the primary bargaining unit for line correctional officers. While these issues are common challenges in unionized workplaces, the extent to which the union and management are functioning as opposing forces in the DOC is extreme.

The inability for managers in the DOC to exert basic management rights limits the accountability of the government to the public and compromises the safety of the institutions. The next governor can help by having the state's Executive Office of Administration and Finance work with DOC to reduce excessive worker absenteeism caused by abuse of sick time and to provide better oversight of



sheriffs, state police and corrections agencies,
a wide array of public and non-profit services



Managing State Government

Personally approve each target. If an agency offers you a vague or trivial target, reject it. Ask the agency to come back with a meaningful target — something that is really important to citizens and that the agency ought to be able to do in the coming months. Something that reflects one of the agency’s significant performance deficits.

During the spring, keep track of their progress. I know: You have to write your inaugural address, balance the state budget for this year and next, develop your legislative package, and get all this through the legislature. You have to do a lot in a very short time. But if you ask your key managers to accomplish something and then don’t pay any attention to their work, they will never again take your exhortations to improve performance seriously.

You are now the CEO of state government. If you want to improve the efficiency and effectiveness of state government, don’t ask a bunch of corporate types to nose around looking for waste. Instead, create serious targets, motivate meaningful performance, and acknowledge solid accomplishments. That’s what a real CEO does.

At the end of June, hold a ceremony to announce the accomplishments of every agency that met its target. Ask the leadership team of each of these agencies to come forward and clearly explain what they have achieved. If you can instill in them and their agency some pride in their achievements, you can inspire them to do even more.

And you want to do precisely this. For FY’08, have each agency create some stretch targets. The current fiscal year has been a dry run. You have gotten people throughout state government thinking seriously about how to set and achieve a real target. Now you need to ratchet up the standards. Now you want them to stretch — to push themselves and their organization to make some significant progress.

Some managers and some agencies will get it. They will understand what you are trying to do. They will set useful targets — explicit goals that help them motivate their organization to improve performance. You should use them as models. Ask the top performers to explain their leadership strategies to their colleagues. Ask them to serve as mentors to other agency heads.

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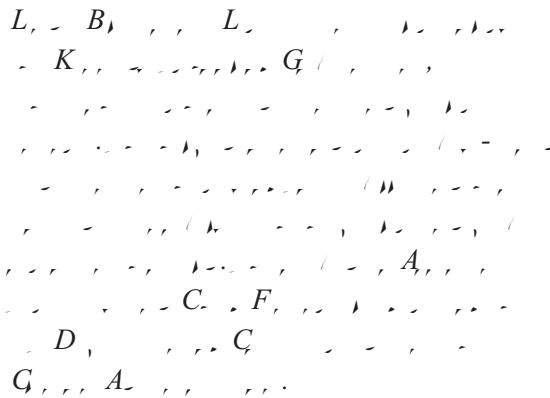
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consultants to help figure out how much time is spent on each activity. In Somerville, for example, students from my Kennedy School of Government class on budgeting and financial management (with support from the Rappaport Institute), helped staff a cross-department exercise to map out city activities and figure out how much time and money was being spent on each activity. This approach highlighted numerous cases where spending in one area has consequences for another (for instance child nutrition programs and school absenteeism). The process also helped the city uncover and address problems, such as activities (e.g. the police detail program) that supposedly were fully funded by user charges but in fact turned out not to be covering their full costs.

There is no doubt that activity-based budgeting can produce positive results. Its main drawback is that it is very time-consuming and can become outdated unless the city overhauls its management information systems. There are several software packages available that can be used to transpose a line-item budget into a parallel activity-based budget that shows how the taxpayers' money is really being spent.

The next governor should introduce activity-based budgeting in Massachusetts because the state has a structural budget shortfall that will only get worse as the state struggles to maintain services, adequately fund local aid, and pay for pensions and health care benefits. We cannot simply rely on potential revenue growth, raiding the state's rainy day fund, or continually raising taxes and fees. Activity-based budgeting is one of the few techniques that can fundamentally make a difference.

No state in the country has done this yet. Massachusetts should take the lead.



Taken as a whole, this approach produced such dramatic results that Tom Keane, a former Boston City Councilor who is now a columnist for *The Boston Globe*, wrote a column in May noting that Somerville, which has often been derided and ignored by its larger and wealthier neighbors, now may be "the best-run city in Massachusetts." Other cities that have adopted similar practices, such as Indianapolis, Milwaukee, and Baltimore, have achieved equally dramatic improvements in city services and city finances. Based on the success in these cities, dozens of municipalities around the country are now exploring the potential of activity-based budgeting.

Although candidates for governor often discuss taxes and spending, they rarely talk the expensive, but largely invisible, problem: what it will cost to provide promised pensions and health insurance to the 135,000 state employees, retirees, and survivors and how the state will fund those benefits.

The amounts in question are huge. As of June 2005, the state reported that it had a \$3.4 billion unfunded pension liability. Moreover, the state recently announced an additional unfunded liability of \$13.3 billion for other post-employee benefits (OPEB), mainly healthcare. Any money used to reduce these liabilities, of course, cannot be used for more visible and politically popular measures such as reducing taxes or increasing local aid. If the problem is not addressed, however, future governors will face even harder choices.

Pension Benefits

Public employees in the Commonwealth are covered by defined benefit (DB) pension plans. Fully vested employees receive a pension equal to about 80 percent of their final salary. This is not unreasonable given that Commonwealth public employees do not receive Social Security and contribute substantially to their own pensions. On average, contributions made by the state's workers provide about two-thirds of the cost of a "normal" pension and some employees, primarily office workers, provide almost three-quarters of these costs.

Before the mid-1980s, the public sector generally did not set aside funds to pay its share of future employee pension costs. When forced to recognize this obligation by new accounting standards in 1987, the Commonwealth disclosed a \$7.4 billion unfunded pension liability for state workers. Via ongoing systematic efforts to address the

problem, that liability has dropped to about \$3.4 billion, so the pension plan for state workers is 83 percent funded. The figure does not include the unfunded liabilities for those public employees, who work for localities and other public entities and participate in retirement plans run by more than 100 separate retirement boards that are regulated and overseen by a state agency. Due to differences in employer contributions, administrative costs, and investment performance, there is considerable variation in the funding status of these local plans.

While continuing to fund the state's pension system, the next governor might consider three other changes that might reduce the state's pension liabilities. First, the next governor could reduce the many ways that some public employees "game" the system to either receive higher benefits or to retire early. Some, for example, buy back creditable years of service at relatively low cost or boost pay used to calculate pensions by working overtime or at a second job. The next governor could eliminate many of these practices by getting the



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“Why Are Smart Places Getting Smarter?”

by Edward L. Glaeser (Harvard University) and Christopher Berry (University of Chicago)

PB-2006-3, May 2006

“The Economic Impact of Restricting Housing

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