Policy Dialogue

Megaplex: Civic Asset or Public Albatross

On May 23, 1995, a Pioneer Institute Forum addressed the debate currently raging over the proposed construction of a combined sports/ convention facility, or "megaplex," in Boston.
Our panelists were:
- ***Edwin S. Mills*** *(Keynote), Director of Real Estate Research, Kellogg Graduate School of Management, Northwestern University.*
- ***William J. Stern*** *(footnote 1)(Commentator), Former Chairman, New York Urban Development Corporation.*
- ***Robert Tannenwald*** *(Commentator), Senior Economist, Federal Reserve Bank of Boston.*

In the following pages, Pioneer Institute has reproduced an edited transcript of the forum.

Professor Mills: Let me start by saying I am certainly not opposed to professional sports teams, convention centers, stadiums or, in Massachusetts' case, megaplexes. In fact, the construction, operation, and ownership of convention centers and sports facilities are large, sophisticated businesses. These types of facilities are an important part of the rapidly growing entertainment industry. Rest assured, my goal here today is not to denigrate it in the least.

My basic point, however, is that these are indeed businesses, and in this country, we believe quite strongly that business should be left to businesses. The question before us then is: Why should Massachusetts taxpayers be called on to build and operate a megaplex?

It is generally accepted that governments are less efficient at operating these facilities than the private sector. Countless studies have demonstrated that the private sector produces better quality for lower costs than government in a wide range of goods and services, whether garbage collection or wastewater treatment. Across the country, a wide variety of activities, commonly perceived as the province of government, are now being produced and supplied by the private sector. I submit that this is also true for convention centers and stadiums. Contrary to popular belief, there is a very large private market operating in this line of business. Many of the big hotel chains currently run conference centers in connection with their lodging operations.

At the same time, publicly funded convention and sports facilities almost never generate enough revenue to return any of the capital invested. In addition to the obvious construction costs, there is site acquisition, infrastructure considerations, debt service, and the occasional need to renovate. Those are all very expensive capital costs. Most of these facilities do not even cover their operating costs (footnote). It seems absolutely incredible that the public would support a business that historically has not covered its operating costs, despite the fact that operating expenditures are a fraction of a facility's total cost.

Yet government continues to occupy a dominant place in this industry. Why?

The oft-cited justification for government involvement in these projects is the so-called multiplier effect. The multiplier effect is a very simple concept but is frequently dressed up in complicated jargon. Indeed, one of the reasons that these proposals are so readily approved is that large, prestigious accounting and consulting firms produce sophisticated computer analyses that claim to capture this multiplier effect. The complexity of the model often validates the attractiveness of the project.

The rationale behind the multiplier effect boils down to the notion that if you build a facility, people will pay to use it. Many of the people who use these facilities will come from outside the city, state, or whatever the relevant jurisdiction. Furthermore, these same people will spend money on hotels, meals, taxis, and night time entertainment. That money is recycled throughout the local economy.

If the Boston Park Plaza receives $150 a night from someone attending a meeting at the megaplex, the hotel, in turn, spends some of that money on their local vendors, who then spend some of the money locally on something else. Most of that original $150 is spent several times, generating additional income to people throughout the metropolitan area. The money goes round and round. But there are leakages in this cycle of spending. On each round the $150 diminishes because everybody saves a little bit of it. More importantly, people spend some of the money outside the original jurisdiction.

The facility is important only insofar as it draws people from other areas who would not otherwise come to Boston. They bring new money into the local economy. For Bostonians, the facility is simply another local spending option, no better or worse, economically speaking, than any other local alternative. Twenty-five dollars spent in connection with the megaplex has no more economic value than the same $25 spent at the local cinema. Whatever the multiplier effects are, they are the same for each expenditure. For the multiplier argument to be truly compelling, people who would not otherwise visit must come to Boston because of the megaplex and spend money.

If so, that's a legitimate point. However, I think these consulting reports exaggerate the multiplier effect. The reason is that they cannot accurately quantify the leakages. The reports cannot ascertain how much of that $150 the hotel operator spends locally and how much is spent outside the metropolitan area. For instance, does the hotel purchase its bed linen in Norwood or North Carolina?

More importantly, the multiplier effect generated by a megaplex is also generated by any business producing commodities or services sold outside the area. It is produced by the consulting, research, and high-tech manufacturing firms on Route 128. The many fine universities in this metropolitan area, most of whose students come from outside the state, produce the same multiplier effect. All of these organizations are producing goods andd services for export outsidethe metropolitan area or the state. There is nothing unique to publicly owned convention centers or stadiums that causes them alone to generate the multiplier effect. By diverting scarce investment dollars to a megaplex, the state would be reducing the amount of money available for private investment and consumption.

Where does the money come from to pay for constructing and operating a megaplex? Needless to say, out of your pockets. It comes from taxes. There is no other place for it to come from. The consultant studies for the megaplex call these taxes "fees."

The essential truth is that if people have more money taken out of their pockets for taxes, they spend less. It is perfectly symmetrical with a positive multiplier effect, but in this case, it is a negative effect. Everybody who pays a dollar in taxes to support the facility must reduce his or her spending. This reduction sets off a chain reaction. The diminished spending goes round and round, just like the aforementioned positive multiplier effect.

But the studies never mention this phenomenon. The key defect of these studies is that they act as if the cost of capital is free. Look in the studies and see where it says: "Here is what the citizens will have to pay in taxes to cover the debt service on this facility, and here is the negative multiplier effect of that tax revenue." You won't find it because it is not in any of them. This negative effect is the same whether the taxes are used to pay the tremendous debt service for the original construction, or to cover the chronic operating deficits of these facilities.

If people believe that building this facility is the only way to keep the Patriots, then perhaps the voters should be heard via a referendum before such a massive public expenditure is undertaken. The key issue is that building and operating these projects makes it appear that you are going to promote economic development in the metropolitan area, and it just is not so.

Mr. Tannenwald: A few months ago, newspapers carried a report about an honors thesis done by a Harvard undergraduate. It was entitled, "The First Annual Report of the United States of America." The simple, but appealing idea behind this thesis was that investments undertaken or subsidized by the federal government are done on behalf of the citizens of the United States. The people should be thought of as stockholders and federal public officials as management of a large corporation. The bottom line should be how well the government has enhanced the economic well being of its shareholders. Using that analogy, let's evaluate some of the proposals for a megaplex. In this case, the citizens of Massachusetts are the stockholders and state government represents the corporation.

As a stockholder, what information would I want in order to evaluate this investment? The first thing I would need to see is a full, accurate assessment of the project's benefits. From the citizens' point of view, the benefits come down to jobs and income. The feasibility studies clearly provide that information, hundreds of millions of dollars of additional wages and personal income in some of the more optimistic studies. But if you read the fine print, 45 percent of this benefit is just substitution effect (footnote 3). In other words, almost one half of the money that will be spent in Boston as a result of the megaplex would have been spent here anyway. As a stockholder, I do not consider this particularly inspiring.

Next is a section entitled "Fiscal Benefits." This is the additional tax revenue the Commonwealth would realize from economic activity generated by the megaplex. A Price-Waterhouse study claims the fiscal benefit from an exhibition hall of about 650 thousand square feet and a 70,000 seat stadium -roughly what a lot of people are talking about right now - would be $52 million, in 1993 dollars(footnote 4). That sounds a little better.

I see an entry called "Net Annual Fiscal Benefit or Cost," which is the annual estimated amortization cost, or debt service, plus the projected net operating surplus or deficit. Here is where the accounting seems to become a little creative. The taxes I pay to cover the amortization costs and the operating deficit are considered a cost, while the taxes I pay on the earnings from my proposed investment are a benefit. It appears the studies are allowed to count it both ways. Personally, I've always thought of any taxes I pay as a cost.

From there I turn my attention to the corporation's annual financial plan, better known as the Governor's proposed Fiscal Year '96 Budget. The first thing I notice is that it is barely balanced. Admittedly, there's a surplus carried over from last year, but speculation is rife that revenues are overstated by at least a hundred million dollars. The implication is that there is a serious risk that next year's budget may be unbalanced. From this rather precarious financial position, the taxpayers of Massachusetts are being asked to embark on yet another massive capital project along with the Boston Harbor cleanup, Central Artery/Third Harbor Tunnel, and prison construction.

This leaves me a rather unhappy stockholder. Hard working and risk averse, I can't afford to be left with a huge bill that will have to be paid out of my own pocket, or worse yet my kids' pockets. Despite its humble origins, this is the type of inquiry the Commonwealth's citizens should employ when evaluating any proposal that entails pulic subsidization of activity that is largely private in nature. The feeling they will inevitably be left with is one of disquieting skepticism.

Mr. Stern: The discussion today is not about being for or against development, but about how best to encourage economic growth. For years now in Massachusetts and around the country, this goal has been vigorously pursued by embracing what I like to call "state capitalism." State capitalism is a philosophy based on the idea that governments can act as all-knowing capitalists, allocating capital in a way that will maximize the creation of wealth, jobs, and tax revenues. Today, Massachusetts is faced with a decision that is massive in scale: should you undertake a state capitalist endeavor, which the megaplex represents, or should government concentrate its efforts on creating an environment where market forces can function effectively by ensuring good schools, public safety, modern transportation, low taxes, and straight-forward regulation?

I believe that state capitalism inevitably favors older industries over newer ones; established companies over the up-and-coming; and the politically-connected over ordinary citizens. It creates an environment that encourages political influence pedaling and even corruption. At the end of the day, it produces far less wealth, job creation and tax revenues than would have resulted if the same amount of effort and resources went into allowing a market system to work effectively.

The reason convention centers get subsidies is that the benefits flow to established businesses that tend to have more political clout. Perhaps those dollars, driven by countless individual decisions rather than a single political act, should go toward building a high tech fish farm or biomedical research facility instead of a megaplex. Maybe an MIT student has an idea that could result in monumental economic growth. After all, it was a young Harvard drop-out who launched Microsoft.

I would be willing to bet that if the government in Prague or Budapest were about to undertake a megaplex, a number of professors from Harvard and MIT -- and I suspect your own governor -- would be among the first to suggest that they would be making a mistake. The point is that government cannot and should not determine who deserves capital.

Not only is state capitalism philosophically wrong, but it has a proven track record of costing the taxpayers money. In the early 1980's, I oversaw construction of the Javits Convention Center in New York City. When the Javits Center was proposed, large accounting firms produced beautifully presented reports touting its financial benefits. During my tenure, I discovered and made public the fact that the project would not be completed on schedule and was running well above budget projections. I questioned the competence and qualifications of the management team. This troubled project not only failed to provide the promised results, but it has resorted to "turnstile" events - car shows, boat shows - to produce immediate cash. These shows attract an almost exclusively local audience and produce none of the multiplier effects of large conventions that draw people from out of town. Yet even if the project had been managed brilliantly and St. Peter himself were in charge of ethics there, the project would have been a mistake because the fundamental premise was wrong.

While serving as Chairman of the Urban Development Corporation for New York State, I headed up a study group to explore building a domed football stadium in Queens. Creative ideas were generated, like "condoized" stadiums where people would buy a seat and the seat would trade on an exchange. There were ideas for linking it with hotels and convention centers. In your case, if you let the market work, it will come up with a home for the Patriots. But when government says "we are going to build it," creative market solutions are stifled.

The bottom line is that government-driven convention and sports facilities are no different from chasing rainbows. Cities feel they need to subsidize these facilities in order to compete with other areas that have them and it inevitably turns into a deadly competition. It is the same dilemma the Commonwealth finds itself in with manufacturing or the defense industry. And after all this money and effort is expended, my

instinct is that convention centers are like the telegraph: about to be replaced. I don't see people exhibiting products or gathering the same way in the 21st century. My sense is that convention attendance is declining and turnstile shows are on the rise.
As a taxpayer, you have to ask yourself whether you really want your government to take a large financial position in this tough and rapidly changing business. If these stadiums and convention centers make so much sense, let the sports and hospitality industries build them. Let companies with the resources and the expertise take the risks and, if so ordained, reap the rewards. There is simply no need for taxpayers to build them.

Footnote 1: Mr. Stern authored a chapter entitled "The Failure of State Capitalism" in Pioneer Institute's recent publication, Agenda for Leadership.
Footnote 2: Of the 25 largest meeting facilities in the Boston area, 16 are hotels. All but the Hynes Convention Center are privately owned and operated. Boston Business Journal, June 16-22, 1995.
Footnote 3: Commonwealth of Massachusetts, Megaplex, Convention Center, and Stadium Feasibility Analysis; Final Report. Prepared by Coopers and Lybrand (and other consultants). February 5, 1993. Submitted to Executive Office of Economic Affairs, p. 99, Exhibit 4.3-5.
Footnote 4: Price Waterhouse, Expansion of Boston's Convention Center Facilities, Final Report, Phase 2. September, 1993. Prepared for the Massachusetts Convention Center Authority. Exhibit 8, p. 17.

Sidebars

The Toronto Skydome started as a public-private partnership, with the Province of Ontario holding a 51 percent interest and a consortium of 30 private concerns holding 49 percent. The private businesses purchased their share for nearly $4 million each, a total of about $120 million. At the time of the deal, during the mid-1980's, the sum was thought to be about half the price of the project. The consortuim was subsequently given 99-year concession contracts, promotion rights, and contracts to install the dome's utilities and other supply services.
They were also given a deal in which they had no responsibility for any debt beyond their initial $120 million investment.
The problems began when building costs rose. As costs skyrocketed, consultant reports promised the Skydome was still a wise investment. Instead of about $120 million, the cost to Ontario's taxpayers for its 51 percent share ended up at $322 million.
Six of the original consortium members, plus one new member bought out the Province's interest for about $120 million; a $202 million loss for Ontario's taxpayers.
(Source: Financial World, May 25, 1993)

The developers of Jacobs Field in Cleveland pre-sold ten year premium seat licences. Sales raised $20 million that helped finance construction of the stadium.
Source: Gateway Development Corporation.

The scope of the current market for stadiums and convention centers is between $8.5 and $10.75 billion

and private ownership and operation is on the rise. Twenty eight percent of all stadiums in the country are privately owned and operated. Another 14 percent are publicly owned but privately run.
Source: Reason Foundation Privatization '95 annual report.
