

# Economic Analysis of the Baseball Agreement between the District of Columbia and the Expos

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The District of Columbia is promising to subsidize a \$440 million baseball stadium for the Expos. This document is an analysis of the Baseball Stadium Agreement (“Agreement”) that the city recently released.<sup>1</sup> The analysis reveals that:

- Hundreds of small businesses will pay the stadium tax. Many of those businesses will be restaurants and other entertainment venues that will lose some business as spending shifts to the stadium, meaning that these businesses will be taxed to subsidize their competition.
- The Agreement contains hidden subsidies. The stadium will include 40,000 square feet of office space for the Expos. At today’s market rate of about \$40 per square foot for prime office space, this amounts to a \$1.6 million annual subsidy.
- The Agreement requires the District to pay for cost overruns. The Agreement makes cost overruns more likely by requiring a state-of-the-art stadium comparable to other new stadiums. A similar requirement in Cleveland caused that city’s stadium to exceed its projected budget by \$120 million.
- The Expos’ rent is scheduled to increase at a rate lower than inflation is likely to be, meaning that their rent will actually decrease each year.
- The Agreement calls for a stadium designed to discourage fans from spending their money in the surrounding neighborhood. The Agreement calls for restaurants, shops, and a museum inside the stadium, where revenues go to the Expos rather than to local businesses. This design reduces the already small chance that the surrounding neighborhood might benefit from the stadium.
- The agreement allows the Expos to make capital improvements to the stadium but requires the city to pay for them.

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<sup>1</sup> A vast body of economics research has established that stadiums are unlikely to generate net economic or fiscal benefits or help revitalize neighborhoods. Some research even finds a net negative effect of stadiums on local economies. This document is not intended to review those solid economic findings, which are available elsewhere. Excellent examples of this research include Noll and Zimablist (1997), which is a collection of 14 studies, Rosentraub (1999), Zimablist (1992; 2003), and Delaney and Eckstein (2003).

### *Hundreds of small businesses will pay the stadium tax*

The new stadium tax will be levied on businesses with gross receipts of \$3 million or more. Although private businesses do not make their revenues public, US Census data allows us to estimate the types of firms likely to pay the tax.

County business patterns (CBP) provides an annual breakdown of firms by size range and industry.<sup>2</sup> Data for 2001 are the latest available. They show a total of 19,689 non-government “establishments” employing 422,549 people in the District.<sup>3</sup>

The data show the number of firms in each size category in each industry represented in the District. It is therefore possible to estimate the size categories of the 2000 largest firms, by employment, and their industry.

In 2001, 26 businesses had more than 1000 employees, 47 had 500-999, 151 had 250-499, 492 had 100-249, and 782 had 49-99 employees. This represents the 1,498 largest businesses.

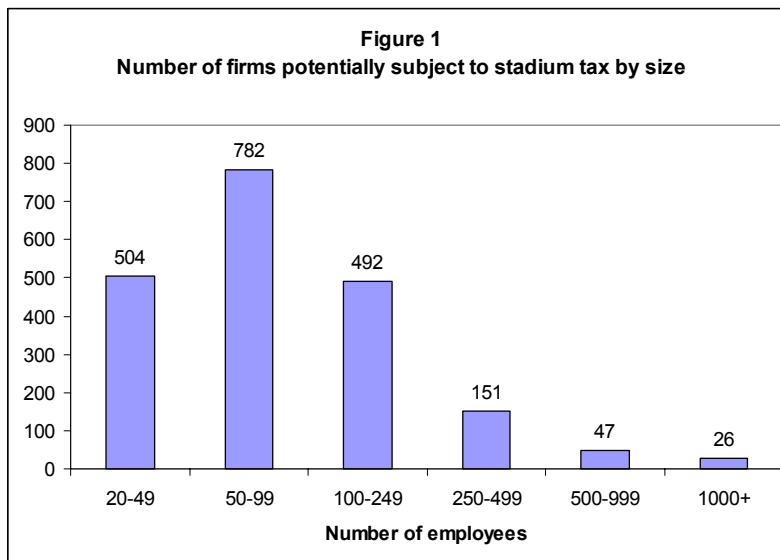
The next smallest size category is 20-49 employees. In 2001 there were 2,014 businesses employing a number of workers in this range. If the largest 2,000 businesses in the District will pay the tax, then approximately one-quarter of the firms in this category will qualify: 504 firms.

Figure 1 presents this information. It is clear from the figure that the number of very large firms that will pay the tax is small, simply because there are few very large firms in the District.

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<sup>2</sup> US Census County Business Patterns available here: <http://www.census.gov/epcd/cbp/view/cbpview.html>; Industry definitions are based on the North American Industrial Classification System (NAICS): <http://www.census.gov/epcd/cbp/download/naics.ref>. Size ranges include 1-4, 5-9, 10-19, 20-49, 50-99, 100-249, 250-499, 500-999, and 1000+ employees.

<sup>3</sup> An “establishment” is not exactly the same as a “business.” According to the Census, “An establishment is a single physical location at which business is conducted or services or industrial operations are performed. It is not necessarily identical with a company or enterprise, which may consist of one or more establishments. When two or more activities are carried on at a single location under a single ownership, all activities generally are grouped together as a single establishment. The entire establishment is classified on the basis of its major activity and all data are included in that classification.” For clarity we will use the term “business” instead of “establishment.” <http://www.census.gov/epcd/cbp/view/genexpl.html>



Source: Author's calculations from 2001 US Census County Business Patterns

Table 1 (attached) presents more detailed data by industry. The table shows that the biggest firms are in “health care and social assistance.” The industry with the largest number (443) of firms affected is “professional, scientific, and technical services”—probably primarily law firms and lobbyists. The next largest industry group is “other services (except public administration),” which includes businesses like auto repair shops, beauty salons, and photofinishing stores, with 326 firms. The third largest group is “accommodation and food services”—that is, hotels and restaurants—with 296 firms affected.

These estimates come with some important caveats. First, the tax will be based on revenues, while these estimates are based on employment. There is a positive correlation between number of employees and revenues, but not a perfect correlation. It is not clear, however, whether this difference means that more small firms will be included or fewer.

Second, some of the establishments in the table may not be subject to taxes. Twelve of the very largest firms are related to health care (including hospitals), while seven are “educational services.” It is possible that some establishments in those and other categories are tax-exempt. The more tax-exempt organizations this list includes, the more the distribution will differ from these estimates.

The bottom line is that despite the mayor’s claims, hundreds of small businesses will pay the tax. Many of those small businesses will be restaurants and other entertainment venues. And many of them will lose business as consumers shift their spending to the stadium, meaning that they are being taxed to subsidize their competition.

### ***Hidden Subsidies to the Expos***

The subsidies extend beyond the District's out-of-pocket expenditures for the stadium. The agreement also contains hidden subsidies for the Expos. For example, the agreement mandates that the stadium will include 40,000 square feet of office space for team management.<sup>4</sup>

Prime office space in the District rents for approximately \$40 per square foot. At today's market rates, this office space amounts to a \$1.6 million per year subsidy to the Expos. This number will never show up in any accounting of the stadium, but it is a real cost.

### ***The Expos' rent will decrease each year in inflation-adjusted dollars***

According to the agreement, the Expos will pay the city \$3.5 million in rent its first year, increasing to \$5 million by the fifth year, and then increase by \$10,000 less than two percent a year after that.<sup>5</sup>

This analysis will not address the question of whether the rent is fair. Instead, it makes one simple point: It is important to factor expected inflation into future rent to determine the real, or inflation-adjusted, rent the Expos will pay.

Assuming positive inflation, tomorrow's dollars will be worth less than today's dollars. Nobody knows for sure what future inflation will be. The inflation-adjusted rent the Expos will pay is two percent minus the inflation rate. If inflation is one percent, rent will increase by one percent in real terms. If inflation is two percent, then real rent remains constant (ignoring the \$10,000 reduction).

Inflation, however, is rarely below two percent. Over the past 30 years, the consumer price index (CPI) has averaged 4.7 percent per year. The past few years have seen very low inflation—the CPI has averaged about 2.4 percent over that period.

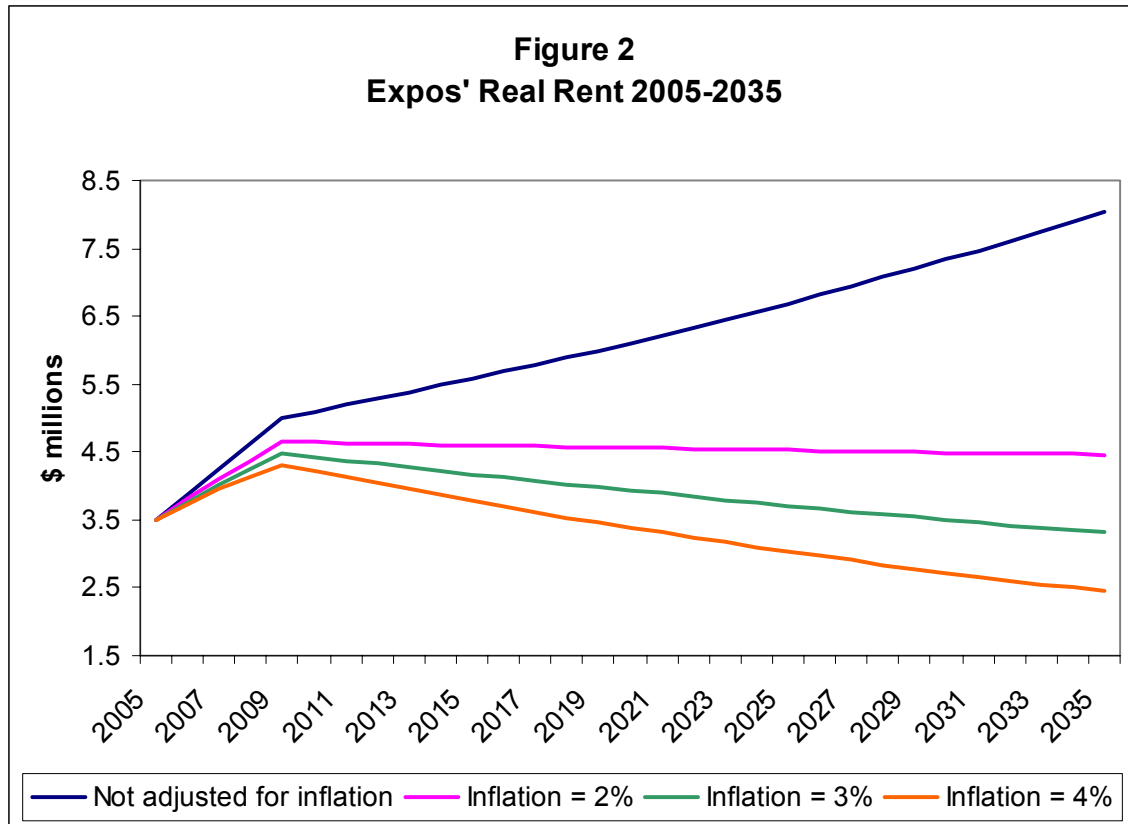
At 4.7 percent inflation, the Expos' real rent would decrease by 2.7 percent. At 2.4 percent it would decrease by 0.4 percent. Figure 2 shows nominal (that is, not adjusted for inflation) rent, as well as real rent under three inflation scenarios.

Future inflation can only be guessed, and with less accuracy the farther into the future one tries to predict. The city could have protected itself by, for example, stipulating that rent would increase by 2 percentage points more than inflation.

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<sup>4</sup> See Agreement Section I(4), page 19.

<sup>5</sup> See Agreement Exhibit E "Rent Schedule."



***Cost overruns are common, and the District is required to pay for them***

Stadium projects are notorious for going over their projected budgets. Cleveland’s Jacobs Field, which the District touts as a success story, was projected to cost \$344 million, but ended up costing \$462 million.

One reason for Cleveland’s \$120 million cost overrun was that the city had promised the Indians a state-of-the-art facility, which the Indians interpreted as meaning the best—and most expensive—amenities among all the stadiums in the country.

The District is poised to make exactly the same mistake. Like Cleveland, the District has promised a “first class open air baseball stadium...having...fixtures, furnishings, equipment, features and amenities on par with comparable ballparks recently built in Cincinnati, Detroit, Philadelphia, Pittsburgh, San Diego, and San Francisco.”<sup>6</sup> This is especially nice for the Expos because the District has agreed to pay for cost overruns.<sup>7</sup>

The District has drawn up an agreement increasing the probability that the stadium will go over budget, while simultaneously agreeing to foot the extra bill.

<sup>6</sup> See Agreement, pp. 1-2.

<sup>7</sup> See Agreement, Section 4.06.

### ***Reduced neighborhood benefits because fans spend money inside the stadium***

Baseball stadiums are unlikely to help revitalize their surrounding neighborhoods, in part because stadiums are empty three-quarters of the year, providing little incentive for investors to build new businesses nearby, and also because stadiums are designed to get fans to spend their money inside the stadium rather than at any nearby businesses.

The District could have insisted on a design that would encourage fans to spend their money outside the stadium, but instead the agreement calls for “market-appropriate concession, entertainment and retail areas” inside the stadium.<sup>8</sup>

These include a 500-person restaurant and picnic grounds for up to 2000 people where food and drink will be available.<sup>9</sup> These diners might have patronized nearby restaurants, but now they won’t because they’ll be spending their money inside the stadium, further benefiting the Expos.

The stadium agreement also calls for 5,000 square feet for merchandise stores, including a permanent store, “high-end merchandise store,” and a store “catered to kids.”<sup>10</sup> Again, without these amenities a local entrepreneur might have built such stores near the stadium, but now they are less likely to if they have to compete with the Expos. And, like anything sold inside the stadium, the revenues go to the Expos.

Finally, the stadium will include a “Hall of Fame/Museum,” complete with a 500 seat theater. The District has agreed to pay up to \$750,000 for this facility, whose revenues accrue solely to the Expos.<sup>11</sup>

Under the best of circumstances, there is only a small chance that the stadium could benefit the surrounding neighborhood. The District’s agreement with the Expos reduces that slim chance even further by ensuring that the retail establishments most likely to locate near the stadium will instead be inside the stadium where their revenues go to the Expos.

### ***Conclusion***

Economic studies are nearly unanimous in their findings that stadiums do not deliver economic benefits to cities, help revitalize neighborhoods, or pay for themselves. There is no reason to believe the District’s experience with a subsidized stadium will be any different.

The agreement the city has worked out with the Expos makes the economics even worse. Its language increases the chances of cost overruns and requires the city to pay for them, includes hidden subsidies, and taxes small businesses to cover the costs. The Expos,

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<sup>8</sup> See Agreement, pp. 1-2.

<sup>9</sup> See Agreement Exhibit D, II(D)(5) & (7).

<sup>10</sup> See Agreement, Exhibit D, II(E)(2).

<sup>11</sup> See Agreement, Exhibit D, II(H)(6).

meanwhile, face rent almost certain to decrease each year in inflation-adjusted dollars. Finally, the stadium itself is designed to encourage fans to spend their money inside the ballpark rather than at any businesses in the surrounding neighborhood.

Under the best of circumstances stadiums are unlikely to deliver net economic benefits. The agreement between DC and the Expos further reduces that already small chance.

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