Utah FOUNDATION Research Report

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LOCAL ECONOMIC DEVELOPMENT

IMPORTANCE OF THE SALES TAX AND OTHER FACTORS

HIGHLIGHTS

- Cities rely heavily on the sales tax. Not including Salt Lake City, the sales tax makes up 46% of city tax revenues statewide. The property tax comprises 32% of tax revenues. This tax structure can create a preference for retail development rather than other commercial developments that may provide higher-paying jobs.
- Despite some evidence of a preference for retail development, local officials describe many other influences that affect their choices, including: supply and demand for land, business decisions on development feasibility, previously approved plans and zoning, costs imposed by developments, and local political culture and characteristics.
- The sales tax may actually be a more balanced economic incentive than it seems at first glance. Many retailers prefer locating in a city with good jobs and well-to-do residents, creating an incentive for cities to pursue balanced development to foster strong retail sales.
- Changing the tax structure could create more revenue-neutral city decisions. This could be done through modifying sales tax distribution formulas or rates; sharing income tax with cities; changing property tax exemptions, rates or distribution; or changing local fees, such as impact fees. However, each potential change could cause significant problems.

10 West Broadway, Suite 307
Salt Lake City, UT 84101
(801) 355-1400 • www.utahfoundation.org

The last decade in Utah has seen unprecedented growth as tens of thousands of people have moved into the state, complementing an already high birthrate. Among the foremost concerns weighing on the minds of Utah residents and policymakers alike is how the state economy is scaling to meet the employment and consumption needs of current and new state residents. While Utah has recently enjoyed high job growth and low unemployment rates compared to the rest of the country, the question of how the state can facilitate economic development is crucial to ensure Utah retains its favorable economy.

Economic development implies the general growth of an economy, in terms of how much it produces and consumes. One role of state and local governments is to facilitate a high standard of living for their residents by promoting economic growth. The state does this by trying to attract and keep employers that offer high-paying jobs, particularly those jobs that complement Utah's comparative economic advantages. Utah state economic development officials are currently working to attract employers in the aerospace, high-tech, life science/biotech, industrial banking, energy/natural resource, and outdoor industries.[1]

However, in addition to attracting jobs and industries, local governments must provide services to their residents such as roads, water and sewer infrastructure, and fire and police protection. Local governments must also ensure that their communities develop in an orderly manner and that residents have good access to retail and commercial services. However, providing these services and infrastructure projects is costly.

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Driven by the need to provide residents with essential city services and infrastructure, local governments must deal with the realities of funding them. Not having adequate revenues to fund city services can have an immediate and visible impact on the residents of a city.

On the other hand, while bringing high-paying jobs to cities is essential to creating desirable places to live and work, the fruits of these efforts are often diffuse and difficult to measure in terms of direct and tangible benefits to cities.

So, while both the long-term community impacts of a vibrant local economy and providing necessary services and infrastructure are both important to municipalities, the immediacy and necessity of funding city-specific service and infrastructure needs can overshadow the more strategic concerns of securing high-paying jobs and attracting growing industries.

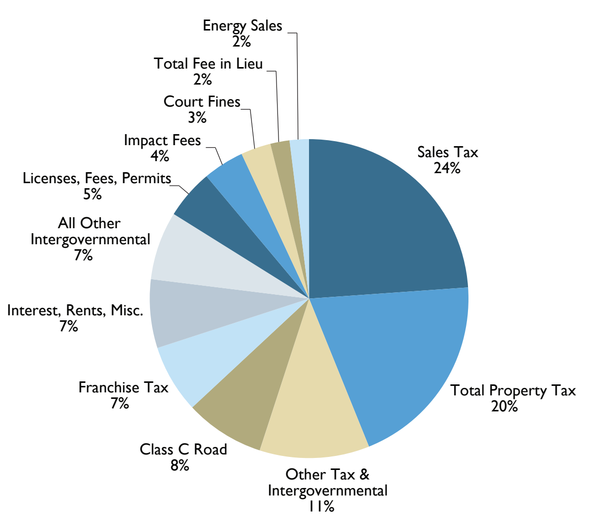
LOCAL REVENUE SOURCES

In Utah, most cities and towns receive revenue from two primary sources, the local property tax and the local sales tax. For Utah municipalities in aggregate, property taxes generate 36% of local tax revenue and one-fifth of local general fund revenue. On the other hand, sales taxes generate 43% of local tax revenue and one-fourth of local general fund revenue (see Figures 1, 2, and 3). These ratios are quite similar for most cities and towns in the United States.[2]

Because cities in Utah and around the country rely so much on the sales tax for the revenues that fund local services and infrastructure, political observers have coined the phrases "zoning for dollars" and "fiscalization of land use" to describe what they view as a trend towards municipalities zoning land for uses, such as retail development, that produce the most revenue for the city.[3] This idea has raised concern because it would lead city officials to make less-than-optimal decisions about how a city should develop as a community and as an economy.

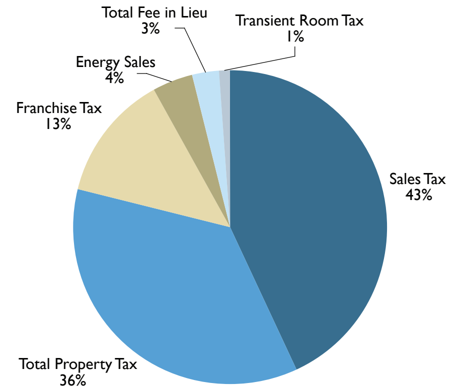
While retail development might be good for city revenues, it does little to provide high-paying jobs for residents. Unlike high-paying jobs, retail development does not bring new dollars to the state or its cities, as much as it draws from the existing wages of residents.[4] Furthermore, the benefits of high-paying jobs are not as tangible as the immediate revenue benefits received from retail development, with its higher associated tax revenues, but lower wages and lower long-term economic benefits.

Figure 1: General Fund Revenues of All Utah Cities
Fiscal Year 2005



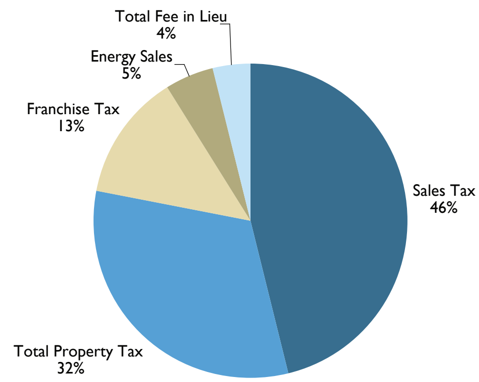
Source: Utah League of Cities and Towns.

Figure 2: Tax-Only Revenues of All Utah Cities
Fiscal Year 2005



Source: Utah League of Cities and Towns.

Figure 3: Tax-Only Revenues of Utah Cities, Excluding Salt Lake City
Fiscal Year 2005



Source: Utah League of Cities and Towns.

RESEARCH METHODOLOGY

Initially, the research question that was envisioned for this report was "what role does the local tax structure play in local officials' economic development decisions?" As data from focus groups and interviews was examined, however, it became apparent that focusing solely on the role of the local tax structure on local economic development decisions was overly simplistic. The data revealed that local officials' decisions are not the sole, or perhaps even the main, determinant in local economic development. So, while this report will somewhat emphasize an analysis of the tax structure question, its scope will not be limited only to that factor. As a result, the research question was expanded to be "what factors, including the local tax structure, have an influence on local economic development?"

The data to answer this question came from focus groups of municipal officials that were conducted for this report and from a review of other research on local economic development issues. Additionally, local officials, state officials and individuals from the private development sector were interviewed.

Three focus groups were conducted in Ogden, Salt Lake City and Orem, Utah. Between five and seven city officials participated in each group. For convenience, participants were invited to attend the focus group held nearest their city.

The participants were local government officials from across the state. These officials included mayors, city council members, city administrators and managers, city planners, and economic development officers. They represented cities of varying size and type (i.e. bedroom communities, economic hubs, etc.). The focus group participants were ensured anonymity and encouraged to discuss the questions openly.

The groups were asked to discuss several questions designed to determine what factors influence local economic development generally, what factors influence local officials' economic development and zoning decisions, the role that the tax structure plays in local economic development, and what changes might be made to the tax structure that would affect local economic development.

The interviews were conducted to expand on the findings from the focus groups with follow-up questions for local officials and insights from developers and state officials. The information from developers and state officials was also used to balance the perspectives of local officials.

This report examines the themes and data that arose from the focus groups and interviews and supplements that with previous research to identify the factors that influence local economic development. The resulting list of factors includes things that local and state officials can determine, factors that state and local officials can influence, and influences that are independent of government.

Some of the following factors have been identified by other studies and others are unique to this report. It should be noted that much of the literature in this report's research review focused only on those factors that state and local officials can determine or influence. Not as much attention has been paid to those factors that are independent of and exert influence on the officials themselves. This report seeks to provide an overview that, if perhaps not exhaustive, at least touches on the main variables that play a role in local economic development.

FACTORS THAT AFFECT LOCAL ECONOMIC DEVELOPMENT

Market Factors

Supply of Land
The supply of land is the land that is available for development within the borders of a municipality. It includes undeveloped land or open space and land that can be redeveloped.[5] Factors that affect the supply of land include the amount and density of development within a city or town.[6] Additionally, local governments sometimes have the possibility of annexing previously unincorporated lands into their municipalities. This can increase the stock of land, subject to the borders of other nearby cities. Geographic features, such as mountains and bodies of water, are other factors that can affect the supply of land by limiting possibilities for annexation and development of existing land.

The focus groups noted that the supply of land affects local development by limiting the land that local governments can develop or redevelop for the purposes of economic development. For some municipalities in urban areas, for example, this is a much bigger concern than for municipalities in open, rural areas. Furthermore, since retail and office developments often must be located with good visibility and access from residential areas, the locations of these developments is also constrained.

Demand for Land
This is the set of conditions that affect the market for different types of land. Demand for land is primarily affected by the real estate markets for office, retail, residential, industrial and other types of development. The demand for land and the supply of land are related. When supplies of developable land are limited and demand for land increases, prices for and competition over developable land will increase.[7]

The demand, by private individuals and businesses, for certain types of land (e.g., office, retail, and residential) can exert a strong influence on local government decisions on how to plan and zone available land for specific types of development, both in terms of long-term, strategic planning and in terms of short-term decisions and zoning changes.[8]

Business Decisions
Business decisions are a subset of the market demand for land. Business decisions are the result of analyses conducted by private companies and developers in determining where best to locate a store, office building, factory, or other type of commercial development.

Interviews with developers and local officials, as well as discussion in the focus groups, revealed that these private entities determine where to locate based on factors such as the intended market's demographics, market conditions, costs of development, access to roads and transportation and, under certain conditions, the incentives offered by municipalities. Notably, this topic was not prevalent in research studies on the subject. The interviews with local officials and the focus groups emphasized the extent to which they are subject to business decisions. Officials stressed how they simply cannot go out and expect to entice businesses to make a decision about locating to a city when economic realities would not justify such a decision.

While emphasis is often placed on the influence of incentives on business decisions, the focus groups and interviews indicated that incentives only influence business decisions under specific circumstances. One such circumstance is when, in the absence of financial incentives, the cost of a specific development is not financially viable for a company. Another is when a company has already chosen to locate to a certain region and two or more locations are available that are otherwise identical in terms of demographics, target market, etc. Another case, somewhat similar to the previous one, is when a company that has a large, regional market has a choice among several locations within that market, all of which are similarly attractive.

State Policies and Institutions

Other research has shown that state policies, as a whole, have a significant effect on the local economic development decisions of local officials.[9] The following outlines how specific state policies affect local economic development.

State Incentives for Business
State incentives to businesses are the tools the state uses to actively recruit businesses to locate in Utah. By nature, state government is concerned about the economic development of the state as a whole, rather than any given city.

After Governor Jon Huntsman Jr. was elected, the Governor's Office of Economic Development (GOED) was established to foster economic growth in the state, focusing on certain "clusters," or industries in which Utah has some comparative economic advantage. These clusters include aerospace, high-tech, life science/biotech, financial services/industrial banks, energy/natural resources and the outdoor industry.[10]

In order to connect businesses interested in locating in Utah with the cities and towns they might be interested in locating to, GOED works through the Economic Development Corporation of Utah (EDCU). EDCU is a public-private partnership non-profit that seeks to promote economic development in Utah. Working with EDCU, GOED administers two basic types of incentives to businesses that locate in Utah.

Economic Development Tax Increment Financing (EDTIF) is a state incentive to businesses that locate in Utah. EDTIF incentives are essentially a rebate of up to 30% of state taxes paid by the company that locates in Utah. EDTIF incentives are for companies that are in the "cluster" industries targeted by Utah and that provide a certain number of jobs above the median Utah wage. The EDTIF incentives are disbursed after the company has met certain obligations for performance, which are negotiated with GOED, such as actually hiring a given number of employees above the median wage.

Industrial Assistance Fund (IAF) grants are similar to EDTIF incentives in that they offer post-performance incentives to cluster-industry companies that bring high-wage jobs to Utah. However, IAF grants take the form of state grants to companies, rather than tax rebates.

While the full effects of GOED and its incentives on local economic development are yet to be determined, GOED has, to date, administered EDTIFs and IAFs to 20 companies that have located to cities and counties all across Utah.[11] So far, these measures appear to have had a positive influence on attracting high-paying jobs to the state.

Tax Structure and Revenue Systems

In many of the municipalities in most states, the sales tax makes up the largest portion of local revenues. "Zoning for dollars" and "the fiscalization of land use" both imply that the tax structure and local revenue systems incentivize cities and towns to zone land for retail development when they might not otherwise do so, or when it might not be the best use of the land for the community.[12]

In Utah, local government tax revenues primarily come from the local property and sales taxes. Local property tax revenue is received from that portion of the overall property tax assessed to both homeowners and businesses. Primary residences are assessed at 55% of their value, while business property and secondary residences are assessed at 100% of their value.

On the local level, increases in property tax revenues are held in check by Utah's "Truth-in-Taxation" law. This law requires local governments to fully disclose, through public notices and hearings, any increases in property taxes. Tax increases are defined very strictly by Truth-in-Taxation, basically labeling any increase in revenues over a previous year's property tax revenues as a tax increase, unless the increase is caused by new development.[13]

Truth-in-Taxation requirements are one reason why Utah's property tax burden has remained among the lowest in the nation.[14] In the focus groups and interviews, local officials commented that it is much easier to raise revenues by increasing the sales tax than by raising the property tax, because of the strong political opposition to the latter.

The sales tax is collected centrally by the state and then distributed. Utah's formula for distributing the local sales tax is to give 50% of local sales tax revenues to the city where the sale was made, or the "point-of-sale," and 50% to municipalities statewide, based on their proportion of the state population.

This system was implemented in response to the large sales tax revenues received by cities with large retail centers, relative to primarily residential cities. Cities with fewer retail hubs, but large residential areas were receiving significantly less revenue while needing to provide city services to the populations that shopped in the cities with bigger retail developments.

The Utah tax structure and revenue system have a considerable effect on local economic development. Because of low property tax rates, compared to the rest of the nation, and Truth-in-Taxation, Utah cities receive less revenue from the property tax than from the sales tax.

As mentioned previously, the sales tax makes up 43% of all Utah city tax revenues, the largest single source of revenue. The property tax is the second largest source of revenue, comprising 36% of city tax revenues. Furthermore, Salt Lake City is one of only three communities in Utah that receive more property tax revenue than sales tax revenue (due in part to having many high-value business properties which have no tax exemption). When Salt Lake is removed from the equation, the city tax revenues from sales taxes go up to 46%, with property taxes comprising 32% of municipal tax revenues.[15]

As noted earlier, the officials involved in the focus groups remarked that getting additional revenue from the sales tax is much easier than getting it through the property tax, because of Truth-in-Taxation and public opposition to the property tax. The officials noted that this combination of factors has led cities to rely on the sales tax for much of their ability to provide their residents with services.

How *much* this reliance on the sales tax has driven cities to "zone for dollars" and "fiscalize land use" is debatable. According to the interviews and focus groups conducted for this report, the prevalence of these phenomena varies from city to city and seems to depend on the characteristics and administrative decisions of different cities.

Any evidence that retail development has supplanted office, industrial and other types of development that are conducive to high-paying jobs locating in cities is even thinner. Most local officials indicated an understanding of the positive impact that high-paying jobs have on local economies, even if those impacts are not directly beneficial to them, in fiscal terms.

Compounding this is the possibility, which was noted by one of the focus groups, that the sales tax, if viewed by local officials in the long run, could be a more balanced incentive than it first appears. Because of decisions made by businesses, unless a local economy can support retail development, retailers will not choose to locate in that area. For example, some retailers require a well-developed daytime workforce and residents with enough disposable income to support their retail operations. Therefore, it is actually in the long-run revenue interests of municipalities to promote high-quality housing and job opportunities in order to support thriving retail establishments, thereby bolstering local sales tax revenues.

With some variation among cities, officials recognized the indirect benefits of having well-paid workers because they were likely to bring additional dollars to spend in existing local stores, restaurants, etc. Many officials also recognized that well-paid workers help foster wealthier communities and improve the image of the city as an attractive place to live, work and shop.

Many local officials pointed out that it might matter very little how much a city might even *want* retail development because businesses and developers already know where they want to locate, regardless of incentives.

Furthermore, the focus groups and other studies indicate that the city revenue benefits from bringing in large retail are sometimes outweighed by the costs associated with it. These costs include providing infrastructure, such as sewers and water, as well as providing city services, such as police and fire protection. Other, less obvious, costs include accounting for increased traffic and its associated road wear and auto accidents as a result of the increased draw of customers to the retail area.[16] The focus groups noted that many smaller cities might not be equipped, in some cases, to perform the cost-benefit analyses necessary to assess the full impact of retail versus other types of development, possibly leading to less-than-optimal decisions.

Local Policies and Institutions

Local Incentives to Business

Local governments can offer incentives to attract businesses to locate within their boundaries. These incentives include formal redevelopment incentives as well as ad hoc incentives. The formal monetary incentives include Redevelopment, Community and Economic Development Agencies (RDAs, CDAs and EDAs), along with their associated Tax Increment Financing (TIF). The ad hoc incentives include local governments offering to subsidize or pay for certain aspects of a development.

RDAs and the other types of development agencies consist of local governments getting exclusive rights to future, expected increases in property tax revenues, which come as a result of increased property values, as opposed to dividing increased property tax revenues with school districts, counties, etc. Some or all of those incremental revenues are then used to aid in the development or redevelopment of certain areas for the purpose of attracting the new business developments that will raise the property values. Often, TIF revenues are dedicated to debt service on bonds that financed improvements to a property for initial development.

Development agencies and TIF incentives seem to be effective at attracting some business development to cities and towns. However, according to information from the focus groups and interviews, such developments might have occurred, regardless of RDA or other incentives. However, RDAs and other such incentives can affect the *timing* of developments. While a developer might choose to locate somewhere regardless of incentives, they will not start developing until financial timing is right. Economic or tax incentives at the local level often serve to expedite this process. Independent of economic development considerations, however, development agencies also serve the purpose of developing or redeveloping blighted and otherwise undesirable city land.

On the other hand, ad hoc incentives include the local government offering, for instance, to pave land or otherwise modify a development, at its own expense, for the purpose of attracting businesses to locate there. The effects of such incentives on economic development are similar to those of redevelopment agencies.

In regards to such incentives, a local official in one of the focus groups related an anecdote of how a Kmart wanted to locate in his city. The city agreed to extend sewer and water infrastructure to the new development. However, in addition to this, Kmart wanted to have the elevation of the lot raised and leveled so that it would be more economically feasible to build the store. The city refused to do this, saying the financial impact to the city would outweigh the benefits to the community. In the end, the Kmart was not built. This case highlights how local officials can carefully evaluate the costs, including any incentives, of certain types of commercial development, especially retail, and weigh them against the benefits to the community.

Local-Option Taxes and Impact Fees

Local governments in Utah have the ability to levy local sales and property taxes. In addition, local governments can choose to impose impact fees on new developments within their boundaries. These taxes and fees can ease some of the burden on the city of providing infrastructure and services to new and existing developments. However, the literature has shown that high taxes and large impact fees can have a negative effect on the decisions of businesses to locate in a given area.[17] Local officials must carefully weigh economic development, including its revenue and long-term benefits to the city, with the effects on the community and the overall local economy of imposing high taxes and fees, which, while providing more revenue from new developments, might affect the amount of new development in the city.

General Plans and Zoning

One prominent theme that emerged from discussion in the focus groups included the role of the general plan and individual zoning decisions. The general plan and zoning decisions by city governments have the potential to greatly impact local economic development. This is because retail, office, residential and other kinds of development can only occur on land that has been zoned for that specific type of development.

A city's general plan is a strategic, long-term view of how the city intends to develop. The general plan can dictate where single-family residential, multi-family residential, retail, office, and other developments will occur. This report found from focus group discussions that the effect of general plans on local economic development depends on how a city uses and chooses to adhere to its plan. Some general plans have binding legal effect, while others are merely outdated guidelines that few local officials pay attention to. The importance of and adherence to the general plan is determined by the city itself. The more binding a general plan is, the more likely it is to have an effect on local economic development within the city.

In addition to the general plan, case-by-case decisions can be made regarding either zoning land that has not been previously zoned, or by rezoning land for a new purpose. It should be noted that these decisions are, in turn, affected by the importance of and adherence to a city's general plan. The impact that new zoning and rezoning decisions can have on economic development is significant.

Local Officials

Another set of factors that can affect the development of local economies includes the resources and capabilities of local officials.[18] The capability of cities to analyze the costs and benefits of different development options affects the information the mayor, city council and city staff have in making economic development decisions, such as rezoning an area for retail development. The resources, time, number and expertise of officials directly affect a city's ability to assess these costs and benefits. If local officials have more resources, time, etc., they can also better evaluate the proposals of businesses seeking to persuade them to zone or rezone an area for development or evaluate whether it is beneficial to the city to provide incentives to a business to locate within the city boundaries.

Local Impacts and Costs of Development

The local impact on and costs of development to municipalities does not directly influence economic development as much as it influences the cost-benefit decisions that cities make in relation to economic development. When the impacts of a particular business development are perceived as higher than the benefits to the city, in terms of revenue, community benefits, long-term and other benefits, then the city is less likely to allow or incentivize that development. However if the benefits from a particular development appear large in relation to the costs to the city, local officials will be more likely to provide incentives for and encourage the development in their city. As has been mentioned before, particularly in smaller cities where manpower and resources are limited, the ability of city officials to accurately assess the costs and benefits of a given development is sometimes limited.

Utilities

When a business locates on previously undeveloped land, sewer and water utilities must be built and maintained by the city. Cities sometimes will foot the cost of the expansion of sewer and water infrastructure to entice businesses to come, at cost to the city. Despite this, the focus groups and interviews did not indicate that providing sewer and water infrastructure had a major impact on local economic development, possibly because such services are usually expected by businesses that want to develop new land in a city. In addition to economic development reasons, sometimes cities view expanding their sewer and water lines as a way of installing infrastructure that can be used by other nearby, future developments. This highlights how, in some cases, RDAs and other development incentives can provide benefits beyond the immediate development. This strategic view of expanding infrastructure helps offset some of the costs to cities associated with providing new sewer and water lines.[19]

Transportation

Transportation consists of the effects from providing for and maintaining physical access to a development. These effects consist of the roads and mass transit provided to developments that allow access to offices, retail stores, houses, etc. It should be noted that large transportation projects are often a joint venture between cities and the state and the federal governments. In such cases, the transportation factor can be much more dynamic because of the multiple players involved in the decisions regarding the transportation development. Therefore, planning for such projects can be key in aligning state and local economic development priorities.

Naturally, businesses want cities to provide people with as good access as possible to retail districts. However, studies have shown that the costs to cities of providing access and other infrastructure to retail development often outweigh revenue benefits received through the sales tax.[20] This is because such areas are usually heavily trafficked and thus require high road maintenance costs, additional mass transit lines and dealing with increased traffic accidents. The focus groups confirmed this assessment generally, although most cities appeared not to have quantified the costs associated with providing access. Despite these costs, it should be noted that cities do observe some benefit through providing their residents with convenient access to local shopping.

City officials should carefully weigh the costs and benefits of providing roads and mass transit for new commercial development. However, as is the case with most infrastructure costs, commercial office development has significantly less impact on roads and mass transit than retail development does.

According to interviews, existing transportation infrastructure, or promises by cities of good access once a commercial area has been developed, can weigh significantly in businesses' decisions to locate in an area, particularly with regards to large retail stores. In this sense, roads and mass transit do influence local economic development. However, upon weighing the net benefits, certain cities might find that certain commercial developments cost more than they benefit the city.

Public Services

These are the services, such as police, fire, ambulance and others that cities provide to residents and businesses within their boundaries. Expanding services to meet the needs of new developments can entail significant costs to cities. As an example, one focus group participant said that if a city allows an office building to be built that is much higher than existing buildings, a large, costly fire engine capable of servicing that building would need to be purchased. Although some of these additional costs can be justified in terms of providing for additional developments as a city continues to grow, the up-front costs can be considerable.

This is another area where retail development in particular can be more taxing on city resources than office or other developments. According to the focus groups, retail developments tend to require greater police presence and other public safety services, whereas most office developments require relatively little servicing. As with sewer and water, public services do not generally seem to play a large role in influencing local economic development. However, providing these services can factor into decisions by city officials concerning how to zone certain areas and whether certain types of commercial development present a net benefit to the community.

Local Characteristics

City Characteristics

One noteworthy issue from the focus groups, interviews and this report's research review is the influence the internal and external characteristics of a city, such as the type of city and its location, have on economic development. For example, a city that is a suburb of a large economic hub will experience different economic development from an identical city that is further away from a metropolitan area.

Internal characteristics include: the make-up of individual communities within a city, such as economically segregated neighborhoods; the size of the city, in terms of geography and population; whether the city is mainly comprised of urban apartments, or if it is a quiet, suburban bedroom community.[21] External characteristics include the city's proximity to other similar sized, smaller, or larger cities and the role that the city plays regionally as, for example, a bedroom community or financial center.

Another external characteristic of note is regional, inter-city competition.[22] In some areas of the state, the focus groups indicated that cities compete with one another over things such as attracting population growth, high-paying jobs and large retailers with regional markets or retailers that are considering locations in nearby cities. The officials in the focus groups discussed how regional, inter-city competition usually only benefits business and how inter-city cooperation and a regional perspective are beneficial for all involved. The officials gave an example of such cooperation, citing how some neighboring cities had come to agreements about sharing sales tax revenue from large retailers that wanted to locate in markets that would serve both cities. Through cooperation, cities were able to avoid being pressed into competition and offering incentives that end up only benefiting the businesses. However, such cooperation is not often the case and it was evident from the focus group participants that competition between cities occurs.

Based on the interviews and focus groups, internal and external city characteristics can have a large influence on economic development. For example, certain retailers will be more likely to locate close to wealthier communities, while others target a broader customer base. A financial business might be more likely to locate near an urban finance center than in a suburban office complex. Collectively, city characteristics can play a large role in influencing how a city develops economically.

Local Political Culture and Public Opposition to Development and Taxation

Public opposition is determined by the political climate of a given city and how reactive residents are to certain types of development and taxation.[23] Truth-in-Taxation has played a large role in keeping property taxes down in Utah.[24] Therefore, given the political atmosphere, it is unlikely that cities would be able to shift primary tax dependence from sales tax back to property tax. This could potentially have the effect of promoting "zoning for dollars" in cities where the sales tax comprises the largest portion of their budget, compared with cities where the property tax is the largest source of city revenue. Cities want to provide necessary services, but they also want to keep their tax-paying residents happy. This report's research review indicates that citizens are more willing to approve sales tax increases than property tax increases.[25] The incremental nature of the sales tax can seem less burdensome to taxpayers and is therefore more politically feasible to elected officials.

Public sentiment also applies to the types of zoning decisions a city can make with public approval. Some communities are very averse to certain types of development. For example, it is unlikely that a bedroom community comprised of larger, single family homes would condone the introduction of large retail development or high-density, mixed-use development in the immediate neighborhood.

In the focus groups, local officials noted the benefits to their communities of, for example, mixed-use and higher-density developments, but pointed out that the Not-In-My-Back-Yard (NIMBY) principle often comes into play. This is where residents see the value of and want to bring high-density or retail development to their communities, as long the developments are not located near their own homes. Local officials remarked that personal property rights are a much more sensitive issue in some communities than others.

SUMMARY OF FACTORS

One of the primary findings in this report arose, as was mentioned earlier, from the focus groups. It was that, while the tax structure or "zoning for dollars" definitely exerts some influence on some city decisions, it is by no means the only or even the dominant variable in the economic development decisions of local officials.

The focus groups participants often did not even identify the tax structure as an influence until asked specifically about it. Upon being questioned about the role of sales and property taxes, the officials did recognize the important role they play from a revenue standpoint, but emphasized that other, sometimes more influential factors are also part of their zoning calculations.

Furthermore, the officials expressed the relative inability of cities to affect local economic development, despite the ability to zone and rezone land and to offer incentives to businesses. They emphasized the role that factors totally independent of city decisions, such as business decisions, market conditions and community characteristics play in how local economies develop.

In other words, the development of local economies is a very complex and dynamic sphere that is certainly subject to state policies, including local tax structures and local decisions. However, the influence of markets and other unchangeable parameters in a community play a role that can be much larger and significant than government policy.

HOW CHANGES TO THE TAX STRUCTURE COULD AFFECT LOCAL ECONOMIC DEVELOPMENT

This report began with the idea of looking at how the "zoning for dollars" and "fiscalization of land use" concepts affect local economic development decisions. As the findings from the interviews and focus groups emerged, it became clear that, while sales tax revenue is sometimes an important factor in local officials' economic development decisions, other factors also play a critical role. However, in line with the examination of how sales tax revenues affect local decisions, this report will limit its analysis of factors that could affect local economic development to the structure of local taxes and revenues.

Fiscal Pressure

Revenue Neutrality and Incentivizing "Balanced" Economic Development

The ideas of "zoning for dollars" and the "fiscalization of land use" rest on the premise that cities are under fiscal pressure when it comes to providing infrastructure and services for their residents. While the large majority of local officials in the focus groups expressed that they felt like they were under great fiscal pressure, it is difficult to determine this objectively.

Regardless of whether fiscal pressure actually exists, the assumption is that if cities were incentivized to facilitate "balanced" economic development or, if their development decisions were "revenue neutral," by being free from fiscal constraints, then officials would be in a better position to make good economic development decisions.

There are a couple of problems with this assumption, however. First is defining what "good" or even "balanced" economic development is. As our focus groups revealed, this is the topic of much debate. Even if it was known what development strategy would be "good" or "balanced" for one city, it might differ entirely for another. Additionally, since factors other than tax revenues can have such a large impact on local economic development, simply adjusting the tax structure to incentivize local officials to make "good," "balanced," or even revenue neutral decisions may not actually result in better local economic development.

Having said this, one major theme in the focus groups and interviews was that cities are basically reactionary when it comes to revenue and the tax structure. This means that the city officials recognized that whatever the tax structure might be, because of fiscal pressure and constraints, they would adapt to take advantage of it. The city officials recognized that they are also relatively reactionary when it comes to local economic development because businesses often have already chosen where they want to locate based on sophisticated models and analyses, which incentives might do little to affect.

Given these limitations, this report will examine several options for changing the tax structure, along with the potential ramifications of each option. These alternatives are drawn from changes to the tax and revenue structure that were suggested by the focus groups.

Local Sales Tax

Point of Sale/Population Distribution

As was discussed earlier, Utah currently has a policy of distributing local sales tax revenues by allocating 50% to the municipality where the sale was made or the "point of sale" and 50% to cities across the state, based on their proportion of the state population. Prior to 1983, all sales tax revenues were kept at the "point of sale." This is still the case in many other states.

Focus group participants commented how they thought the change in sales tax distribution was a step in the right direction because it puts less pressure on cities to develop sales tax revenue-generating retail because they can rely partly on the population-distributed revenues. The participants noted that the less that cities need to rely on the local sales tax, the more revenue neutral their decisions might be.

However, if the sales tax distribution were to be entirely based on population, then cities that have large retail centers would be at a disadvantage compared to those that provide little retail, due to the costs to cities of servicing retail centers. If, as was noted earlier, the cost to provide and maintain services and infrastructure for large retail centers is higher than the benefits for some cities, distributing too much sales tax revenue based on population could actually create a disincentive for cities to allow even necessary retail development in their communities.

Local officials pointed out that if tax revenues were distributed entirely based on population, cities would start "chasing" population instead of retail by zoning for high-density or attractive residential communities, leading to yet another form of "zoning for dollars" that could incentivize less-than-optimal land use decisions.

Amount of Sales Tax

Increasing the local sales tax rate that cities can levy, or broadening the sales tax base (e.g., taxing services) could decrease some of the fiscal pressure on cities. However, Utah already has a high sales tax burden relative to most of the country.[26] Also, it is unclear whether an increase in sales tax rates would incentivize cities simply to keep the retail they have, given the additional tax revenues, or if it would motivate cities to seek after even more retail. Finally, increasing the sales tax rate or broadening the base might have an adverse effect on the decisions of businesses looking to locate somewhere with low sales tax rates or somewhere that does not tax business services, for example.

Local Income Tax

Creating a local-option income tax or apportioning some of the state income tax to municipalities, based on payrolls or residency, for example, would be a new alternative for providing cities with revenue. Currently, in Utah, the income tax is only a federal and state-level tax. State income taxes are funneled exclusively to education. Allowing local governments to levy income taxes or apportioning state income tax revenues to municipalities could have a number of ramifications. First, local income tax revenues, depending on the portion of total city revenues they would comprise, could incentivize cities to attract high-paying jobs because of the increased city revenue it would provide.

However, as the focus groups revealed, city officials tend to react to whatever the revenue system is. If too much revenue emphasis were placed on income taxes, then cities could end up "zoning for dollars" by zoning to attract an inordinate number of residents or employers (depending on whether the tax were based on residence or place of work), instead of balancing residential development with retail, office, industrial and other development. Also, high income taxes could serve as a disincentive for businesses, particularly those with high-paying jobs, to locate in a city. Finally, because there is currently no local-option income tax, there could be some public backlash over the introduction of a new tax.

Local Property Tax

Exemptions

Changing the exemptions from local property taxes would entail removing some or all of the exemption that home owners have on the value of their primary homes. According to the focus groups, with the amount of property tax that cities currently receive, which is a small proportion of overall property tax revenues, primary homes don't pay for themselves in terms of the city services and infrastructure they require.

On the other hand, commercial developments, which do not have an exemption, provide much more property tax revenue. A change in the exemptions level on primary residences could provide significantly greater revenue to cities. This could, in turn, lead to less reliance on sales tax revenue and therefore might influence more balanced, or at least more revenue neutral, development.

However, raising property taxes can be particularly unpopular among Utahns, who, while having some of the lowest property taxes in the country, nonetheless have experienced large tax increases over the past few years due to increasing home values.

Distribution of Revenues

Another possible tax structure change could be revisiting how property taxes are distributed. As noted above, cities receive a relatively small portion of the property tax revenue pie. On average, Utah municipalities receive 15% of each property tax bill. School districts receive the largest portion of property tax revenues, over 50% of each bill.[27] Allocating more property tax revenues to cities, in combination with limiting local sales taxes, could serve to balance local governments' reliance on sales tax revenues, which could encourage more revenue neutral economic development decisions. However, this approach might prove unpopular among schools and special districts, which rely heavily on the property tax, even if their lost funds could be offset with funds from other sources. The property tax is a very stable tax, and schools may not view a tradeoff with another tax as an equal trade.

Fees

An alternative to changing the tax structure, which was brought up in the focus groups, was to examine the government finance system in terms of revenue, rather than simply in terms of *tax* revenue. This implies looking at sources of revenue other than taxes, such as fees. Fees in lieu of city revenue from property taxes and sales taxes would probably take the form of impact fees, which are locally-charged fees on new residential and commercial developments. These fees help offset the city costs of expanding and providing services for new developments. Impact fees are a way of directly making new city developments pay for their impact on city spending. If fees were used as a substitute for tax revenues, they could lead to more revenue neutral economic development decisions at the local level, as long as the revenues generated from fees were not in excess of cities' cost of providing services.

Our focus groups noted that fees are a good source of revenue as long as a city is growing. However, the officials in the groups noted that fees are not as sustainable as tax revenue and can't be counted on in the long run to fund city needs if growth slows. This is because they are one-time, rather than ongoing payments. Fees are also restricted in their use; they can only be used for infrastructure costs related to the new development. Additionally, overly heavy impact fees could have a deterring effect on businesses' decisions to locate to a community.

CONCLUSIONS

When examining different ways that changes to the local tax and revenue system affect local economic development, it is important to realize that all the options discussed here have both positive and negative ramifications. A diversified tax and revenue system would be the approach most likely to avoid the perceived conflicts between balanced economic development and development that provides needed city revenue.

Figure 4: Factors Affecting Local Economic Development in Utah

Market Factors
1. Supply of Land
2. Demand for Land
3. Business Decisions

State Policies and Institutions
1. State Incentives for Business
2. Tax Structure and Revenue Systems

Local Policies and Institutions
1. Local Incentives to Business
2. Local-Option Taxes and Impact Fees
3. General Plans and Zoning
4. Local Officials

Local Impact/Costs of Development
1. Utilities
2. Transportation
3. Public Services

Local Characteristics
1. City Characteristics
2. Local Political Culture/Public Opposition to Development and Taxation

ENDNOTES

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This research report was written by Utah Foundation Research Analyst David Newell and Center for Public Policy & Administration Research Analyst Jennifer Robinson. Mr. Newell may be reached for comment at (801) 355-1400. He may also be contacted by email at: david@utahfoundation.org. For more information about Utah Foundation, please visit our website: www.utahfoundation.org.

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Utah FOUNDATION
10 West Broadway, Suite 307
Salt Lake City, UT 84101