Utah FOUNDATION Executive Summary

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LOCAL ECONOMIC DEVELOPMENT

IMPORTANCE OF THE SALES TAX AND OTHER FACTORS

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. 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.

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. The question this report will seek to answer is "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. Local officials, state officials and individuals from the private development sector were interviewed. These findings were complemented with a review of research on local economic development issues.

This report is a joint research project of Utah Foundation and The University of Utah's Center for Public Policy & Administration (CPPA)

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. [1] The focus groups noted that the supply of land affects local economic development by limiting the land that local governments can develop or redevelop for the purposes of economic development.

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.[2] 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.[3]

Business Decisions

Interviews with developers and local officials, as well as discussion in the focus groups, revealed that 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. Officials stressed how they are reactive to business decisions and simply cannot go out and expect to entice businesses to make a decision about locating to their city when economic realities would not justify it.

State Policies and Institutions

State Incentives for Business

The Governor's Office of Economic Development (GOED) administers two basic types of incentives to businesses that locate in Utah. These are Economic Development Tax Increment Financing (EDTIF) incentives, which rebate taxes to companies, while Industrial Assistance Fund (IAF) incentives are grants.

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.[4] So far, these measures appear to have had a positive influence on attracting high-paying jobs to Utah.

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Tax Structure and Revenue Systems

In Utah, local government tax revenues primarily come from the local property and sales taxes. 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, the proportion of revenues that most Utah cities receive from the property tax is smaller compared to revenues received from the sales tax. The officials involved in the focus groups remarked that getting additional revenue from the sales tax was 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. 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, one of the focus groups noted that the sales tax 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.

Local Policies and Institutions

Local Incentives to Business

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. 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.

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.[5]

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 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. 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 previously been zoned, or 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.

Local Officials

Another factor that can affect the development of local economies includes the resources and capabilities of local officials.[6] 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.

Local Impacts and Costs of Development

Utilities

When a business locates on previously undeveloped land, sewer and water utilities must be built and maintained by the city. Cities will sometimes 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.

Transportation

Cities provide for and maintain physical access, or transportation, to commercial and residential developments. 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 to an area, particularly with regards to large retail stores. 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 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 characteristics of a city, such as the type of city and its location, have on economic development. These characteristics include the economic, social and housing-type characteristics of individual communities, the geography and population of the city, 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.[7] Based on the interviews and focus groups, city characteristics can collectively 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.[8] Cities want to provide necessary services, but they also want to keep their tax-paying residents happy. This report's research review indicated that citizens are more willing to approve sales tax increases than property tax increases.[9] 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, such as high-density housing or "big box" retail.

HOW CHANGES TO THE TAX STRUCTURE COULD AFFECT LOCAL ECONOMIC DEVELOPMENT

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 city officials recognized that whatever the tax structure might be, because of fiscal pressure and constraints, they would adapt to take advantage of it. Given these limitations, this report will examine several options for changing the tax structure.

Local Sales Tax

One change to the sales tax that might affect local economic development would be a change in the point-of-sale/population distribution system. Focus group participants commented how they thought the change to distributing 50% of the sales tax based on population was a step in the right direction because it puts less pressure on cities to develop sales tax revenue-generating retail. However, 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."

Another change could be increasing the local sales tax rate that cities can levy, or broadening the sales tax base (e.g., taxing services), which could decrease some of the fiscal pressure on cities. However, Utah already has a high sales tax burden relative to most of the country.[10] 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.

Local Income Tax

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, 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

One option, with regards to the property tax, would be 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. A change in the exemptions level on primary residences could provide significantly greater revenue to cities. 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.

Another possible change could be revisiting how property taxes are distributed. Cities receive a relatively small portion of the property tax revenue pie. Allocating more property tax revenues to cities could serve to balance local governments' reliance on sales tax revenues. 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

One alternative to tax structure changes would be to examine local finances in terms of revenue, including fees, rather than simply in terms of *tax* revenue. Fees in lieu of city revenue from property taxes and sales taxes could take the form of impact fees, which are locally-charged fees on new residential and commercial developments. 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. Also, overly heavy impact fees could have a deterring effect on businesses' decisions to locate to a community.

ENDNOTES

1 Lewis, Paul, and Max Neiman. 2000. "Residential Development and Growth Control Policies: Survey Results from Cities in Three California Regions." Public Policy Institute of California and the Center for Social and Behavioral Science Research at the University of California, Riverside.

2 National League of Cities. 2004. "Land use and Development Challenges in America's Cities." Washington, DC. Accessed at www.nlc.org.

3 Thomas, John V. 2006. "Dividing Lines and Bottom Lines: The Forces Shaping Local Development Patterns." *Journal of Planning Education and Research*. 25: 275.

4 From Utah Foundation interviews with GOED officials, Feb 2008.

5 Bartik, Timothy J., 1985. "Business Location Decisions in the United States: Estimates of the Effects of Unionization, Taxes, and Other Characteristics of States." *Journal of Business & Economic Statistics*, Vol. 3, 1: 14-22.

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7 Goetz, Edward G. 1994. "Expanding Possibilities in Local Development Policy: An Examination of U.S. Cities," *Political Research Quarterly*. 47(1): 85-109; National League of Cities, 2004. "Land use and Development Challenges in America's Cities." Washington, DC. Accessed at www.nlc.org; Thomas, John V., 2006. "Dividing Lines and Bottom Lines: The Forces Shaping Local Development Patterns." *Journal of Planning Education and Research*. 25: 275.

8 Goetz, Edward G., 1994. "Expanding Possibilities in Local Development Policy: An Examination of U.S. Cities," *Political Research Quarterly*. 47(1): 85-109; Lewis, Paul, and Max Neiman, 2000. "Residential Development and Growth Control Policies: Survey Results from Cities in Three California Regions." Public Policy Institute of California and the Center for Social and Behavioral Science Research at the University of California, Riverside; Fleischmann, Arnold, Gary P. Green, and Tsz Man Kwong, 1992. "What's a City to Do? Explaining Differences in Local Economic Development Policies." *The Western Political Quarterly*. 45(3): 677-699.

9 Utah League of Cities and Towns, 2005. *ULCT Tax Survey*.

10 Utah Foundation, 2007. *Utah's State and Local Tax and Fee Burdens*. Accessed at utahfoundation.org.

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