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POLICY BRIEF

November 2017

TAX-INCREMENT FINANCING IN SAINT LOUIS AND KANSAS CITY

By T. William Lester and A. Rachid El-Khattabi

To accompany the essay "Does Tax-Increment Financing Pass the 'But-For' Test in Missouri," by T. William Lester and A. Rachid El-Khattabi.

INTRODUCTION

In the second half of the 20th century, policymakers developed a broad set of tools to lure economic activity back to urban areas in response to the suffering many American cities were experiencing as a result of earlier shifts in economic opportunity toward suburban areas. Among the most popular of these tools was tax-increment financing (TIF), now one of most common forms of local public subsidy.

TIF is meant to attract business, create and retain jobs, increase the tax base, and stimulate investment in areas where investment is either considered too risky or not likely to occur without some form of public support. Specifically, local governments agree to underwrite certain redevelopment project costs to attract new private development in a redevelopment area. The new tax revenue generated is then used to retire notes or bonds that were issued to pay for the redevelopment project costs. In general, TIF works by freezing real estate taxes at their current levels in taxing districts that fall within the redevelopment area where a TIF plan is adopted. The increased assessed valuation resulting from redevelopment—the tax "increment"—is then used to pay directly for project costs or to retire any debt that was issued to pay for the project costs. Missouri's TIF statute differs from those in most other states in that it also allows for up to 50 percent of economic activity taxes (sales, earnings, and payroll taxes) in the designated area or project to be diverted to TIF in addition to property taxes.

From a developer's perspective, the appeal of the subsidies associated with TIF is clear. Less obvious, however, is the economic benefit to the municipalities that offer TIF as an incentive. How effective is TIF at attracting new businesses and increasing employment and sales in a given area? At the heart of the justification for offering TIF to a developer is the "but-for" test—a statutorily required finding that the redevelopment area has not been subject to growth and development through private investment and that development cannot reasonably be anticipated *but for* the adoption of TIF. The essay that informs this policy brief, "Does Tax Increment Financing Pass the "But-For" Test in Missouri?" represents an attempt to determine the impact of TIF on economic development in Saint Louis and Kansas City.

RESEARCH METHODOLOGY

The most logical starting point for measuring the impact of TIF is simply to compare indicators of economic activity (e.g., employment, sales, creation of establishments) in areas before and after they received TIF designation. The information gained it this way, though insightful, does not prove a causal relationship between TIF and economic development. To put any growth in TIF areas in context, we need to know how much growth occurred during the same time period in areas that did not receive TIF. Comparing the before-vs.-after data in areas with TIF designation (i.e., treated areas) to those without it (i.e., control areas) is an example of the *difference-in-differences* (DiD) methodology that underlies the basis of the study.

Since economically distressed areas would theoretically be more likely to receive TIF than areas that are thriving, refinements of the methodology are needed in order to account for the process of selection. To that end, appropriate control (non-TIF) areas for the study were selected on the basis of similarity in terms of their economic conditions relative to the (pre-treatment) conditions of areas that did receive TIF. In other words, the study compared areas that *did* receive TIF with areas that were similarly likely candidates for TIF even though they did not receive it. The level of economic development in the control areas, therefore, offers an approximation of how the TIF areas might have fared but-for the awarding of the incentive.

A specific focus of the study, therefore, was the performance of the "but-for" provision in determining the need for TIF. Because satisfaction of the but-for test requirement is made via an affidavit by the proposed developer (who stands to benefit if TIF designation is awarded), it is reasonable to be skeptical of the rigor with which the test is applied.

Working from a time-series dataset covering the period from 1990 through 2012 of detailed employment levels, establishment counts, and sales at the census block group level, the study compares the control and treatment groups to measure the effects of TIF at the local level in Kansas City and Saint Louis.

RESULTS

Overall, the analysis conducted in this study finds the level of economic activity in TIF areas was not discernably greater than the levels in similar areas where TIF projects were not designated. In other words, the development seen in TIF areas is roughly what would have been expected in the absence of the TIF program. Specifically, in Kansas City, the estimated impact of TIF designation across all categories is very close to zero with relatively small standard errors, which suggests that the TIF program in Kansas City has been ineffective in promoting business development. In Saint Louis, the results are slightly negative and, for the most part, statistically significant. Despite the significance, we cannot yet conclude that TIF has a negative causal effect because there may be differences among the areas compared that the study was unable to capture.

CONCLUSIONS/RECOMMENDATIONS

Although we find that the use of TIF has not diverted investment or increased economic activity beyond what we would have expected if TIF was not used, it is important to acknowledge that this refers to the use of TIF in these cities on average. Our analysis does not enable us to make any claims regarding individual TIF projects, and we acknowledge that TIF could be justifiable and effective in certain cases or for different reasons beyond a pro-growth economic development argument (e.g., for the sake of equity). Accordingly, we recommend that the TIF approval process be modified to promote transparency and accountability, so that TIF be awarded only for those areas and projects where it really is needed. Specifically:

- TIF proposals could be coupled with a cost-benefit analysis that projects and clearly articulates the job creation outcomes of the redevelopment proposal.
- Local or state government bodies could be empowered to disband TIF designated regions that are underperforming and immediately return any accrued increment to the public tax rolls.

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