TESTIMONY

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SALES TAX POOLING SHOULD BE EXPANDED IN MISSOURI

By David Stokes

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To the Honorable Members of the Committee:

INTRODUCTION

My name is David Stokes and I am a policy analyst for the Show-Me Institute, a nonprofit, nonpartisan Missouri-based think tank that supports free-market solutions for state policy. My testimony relates to the expansion of sales tax pooling for municipalities and counties in Missouri. The ideas presented here are my own.

The federal government recently released the 2012 Census of Governments. According to that data, Missouri has the sixth-highest total of local governments of the 50 states.[1] More directly to the issue of sales tax pooling, Missouri has the fourth-highest number of municipalities and the fourth-highest number of counties. This is pertinent because many other types of local government (school districts, special road districts, etc.) lack authority to impose sales taxes, but all cities and counties have that authority. With so many cities and counties imposing sales taxes, tax competition can be a major factor in Missouri. Competition is good, but as with many things, it can be taken too far. When it comes to municipal sales tax competition, Missouri has gone too far. In some counties, expansion of the policy known as sales tax pooling is necessary to improve our tax base and limit government involvement in the economy.

TAX INCREMENT FINANCING IS HARMING MISSOURI

Missouri has gone too far because sales tax competition has morphed beyond the application of comparative advantage where some cities might compete via lower sales taxes and cities with malls might understandably depend on them more. The explosion of special taxing districts and tax subsidies has altered the implementation of sales taxes in negative ways. In particular, tax increment financing (TIF) has distorted local tax funding mechanisms throughout Missouri. TIF has encouraged cities to provide excessive property tax subsidies to developers because other taxing districts bear the brunt of the costs. Cities can easily make

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Table 1: TIF Fostering Inefficient Economic Development

Jurisdiction	NPV of Diverted Property Taxes	NPV of Additional Property Taxes	NPV of Additional Sales Taxes	Net Impact on Total Tax Revenue
Municipality	$1 million	$0.4 million	$0.8 million	$0.2 million
School District	$1 million	$0.4 million	$0	-$0.6 million
County	$0.5 million	$0.2 million	$0.4 million	$0.1 million
All Jurisdictions	$2.5 million	$1 million	$1.2 million	$-0.3 million

Source: Show-Me Institute Policy Study "Tax Increment Financing and Missouri," by Paul F. Byrne

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up for lost property taxes with higher sales taxes. Other units of government, such as school districts, cannot do that. Consider Table 1, which illustrates a theoretical example where a city rationally supports a TIF that increases its tax base while decreasing the overall tax base. This has been happening in Missouri for two decades. Municipalities support TIFs that benefit their own city while harming the overall region.

The consequences to the state of Missouri would not be as bad if municipalities' abuse of TIF had only reduced tax levels and government funding in Missouri. But the consequences have been much worse. The abuse of TIF and other subsidies has created many problems for our state, specifically:

1. The heavy use of TIF has led to increased involvement and economic planning by local governments in favor of subsidized retail developments.

2. It has been the primary cause of eminent domain abuse in Missouri.

3. It has made subsidies a permanent fixture of development.

4. It has failed at its ostensible mission of economic development. The East-West Gateway Council of Governments (the area planning agency) has estimated that the Saint Louis area has spent $370,000 in tax subsidies for every one job that TIF has created.[2] That is not a route to economic growth. TIF and other subsidies shrink the pie and move it around the plate; they do not feed more people.

POLICY SOLUTIONS FOR MISSOURI

The combination of having a large number of cities with state-granted authority to impose TIF and other subsidies has led to these problems. There are several policy solutions that should be seriously considered. These necessary changes include:

1. The imposition of county TIF commissions and the removal of city authority to override the county commission.[3]

2. State caps on total local sales tax rates.

3. Restricting the practice of local governments using taxes to lobby the state and federal governments.[4]

4. Improved accountability and new limitations on the use of transportation development or community improvement districts (TDDs or CIDs).[5]

While all of those alterations are important, the policy solution with the largest potential for economic gains is the expansion of sales tax pools. Currently, Missouri has only one sales tax pool.[6] It was formed in the late 1970s in Saint Louis County. It last went through major changes in the early 1990s. Municipalities in Saint Louis County are either "point-of-sale," a.k.a., "A," cities or "pool," a.k.a., "B," cities.[7] "A" cities keep the majority of the 1 percent general county sales tax collected within the city boundaries. They share a portion of their tax collected with the pool on a sliding scale basis according to a complicated formula. "B" cities put all of the 1 percent general county sales tax into the pool, which is then distributed to the pool cities based on the same formula. (City population is a major part of the formula.) There are other factors in the pool, such as the optional one-quarter-cent general sales tax, but the larger point is the most important. Cities share sales tax collections within Saint Louis County.

Pooled sales tax systems are not unique to Saint Louis County. New York, Illinois, Colorado, and California are four states that allow various forms of sales tax pooling or sharing.[8] Pennsylvania authorized a major sales tax pool in Allegheny County, which includes Pittsburgh. This is notable because Pittsburgh, like Saint Louis, is considered a heavily fragmented area with many local governments. The goal for Allegheny County, much like Saint Louis, was to reduce disparities in funding between cities. According to one case study, the Allegheny County pool system "has worked well."[9]

THE SAINT LOUIS COUNTY SALES TAX POOL

How has this system worked within Saint Louis County? In my opinion, it has been a major success. Cities that are "pool" cities use TIF and other tax subsidies far less than "point-of-sale" cities. The differences are substantial. Within Saint Louis County, "point-of-sale" cities have enacted 53 TIFs and redirected $392 million to developers.[10] The "pool" cities have enacted only 32 TIFs and redirected $160 million to developers.[11] That difference is even larger than it may appear, because "point-of-sale cities constitute only 36 of the 90 municipalities in the county and make up just 38 percent of the county's population, yet redirected more than twice as much money to developers. **Thirty-nine percent of the cities account for 71 percent of the total TIF payments.**

Five cities have voluntarily switched from "A" status to "B" status in recent years. That act should be commended and supported. Three of them instituted TIFs before the change. If you add those five cities back into the "point-of-sale" category, you find that **44 percent of the cities have accounted for 75 percent of the total TIF payments.**[12]

The facts are clear. The "point-of-sale" cities use (abuse) TIF with far greater frequency than the rest of the county. This means that the "pool" cities are staying out of local development decisions and letting markets work with far greater frequency. That lack of involvement in local economic planning is something that needs to be encouraged and incentivized. Sales tax pools are that incentive.

A "pool" city benefits from development wherever it occurs in the county. "Point-of-sale" cities only benefit from development within their boundaries. That encourages "point-of-sale" cities to abuse subsidies, and that harms the region. Markets work best without restrictions or subsidies, and development works best when its location decisions are based on business factors, not tax giveaways.

The arguments against the sales tax pool are weak. The system is not socialism, as some have claimed. All the money involved is government money — none of it goes back to the private sector if the system is changed. Like any mobile area, residents shop at stores in a variety of cities. All governments should benefit from the dollars those citizens spend. Host cities do not "deserve" all the sales taxes just because they host a major shopping center. Host cities rarely pay for the transportation assets that bring people to those malls in the first place. Every major shopping center in Saint Louis County is on a state or county road. The costs that are imposed on host cities by a major mall can be more than met by property taxes, other non-shared sales taxes (e.g., the parks and stormwater sales tax), business licenses, and other fees.

In recent years, some "point-of-sale" cities have tried to revise the pool system. While the system is not perfect (it is more complicated than it should be), Saint Louis County should move in the direction of a wider pool, not a smaller one. Any attempts to eliminate the pool would greatly harm the region because it would increase the use of subsidies. The county should go in the other direction and expand the pool. All general 1 percent sales tax dollars in the county should be put in the pool

Sales tax pools are a more free-market change that encourages growth for the whole region instead of having cities fight with each other for retail development.

and then shared by population formula. No exceptions.

There are other benefits to sales tax pooling besides reducing the use of subsidies and limiting government planning, though those reasons are more than strong enough on their own. Pooled sales tax systems give local governments more flexibility and reduce their focus on sales taxes. Pooled sales taxes are better able to account for use taxes and the future potential/threat of Internet sales taxes. (There is an error rate to tax reporting with so many small cities.) The bottom line is that sales tax pooling has many benefits and little costs for the people of Saint Louis County.

WHERE ELSE WOULD SALES TAX POOLS WORK IN MISSOURI?

Where else in Missouri could sales tax pools be introduced? They will not work everywhere. In counties where one large city dominates the county, they would be a moot point. Most of the sales taxes will always occur in one city. This would include Greene, Boone, Buchanan, the independent city of Saint Louis, and a few more.[13] In smaller rural counties, they would probably also not accomplish much. I do not think a sales tax pool would be harmful in these areas; just not very beneficial. The benefits of sales tax pools will likely be concentrated in larger counties with a significant number of cities. This includes the collar counties of Saint Louis and Kansas City, and Jackson County itself. Mid-sized counties with two comparable cities may also be sound areas to consider sales tax pools. This includes Gasconade and Cape Girardeau counties.

Jackson County in particular should consider a sales tax pool. The majority of Jackson County's 19 cities have made use of TIF, including Jackson County itself.[14] Sugar Creek is one example of a very small city that has aggressively used TIF, alongside eminent domain abuse, to subsidize new retail developments. What is more, Jackson County cities including Independence and Kansas City have witnessed substantial TIF failures where taxpayers have ended up directly footing the bill when project bond payments could not be made. TIF has been harmful to Jackson County, and a county sales tax pool is one way that could be corrected.

Saint Charles, Jefferson, Clay, and Platte are the collar counties where the establishment of a county-wide sales tax pool could reduce the incentives for tax subsidies and local economic planning. These counties combine multiple competing cities with large populations and significant retail needs. That is a recipe for TIF abuse. A sales tax pool could prevent that abuse, and have many other positive benefits. There should be no single formula for a sales tax pool. Each county that should be encouraged to enact one should create a formula that is right for that county.

CONCLUSION

Many key Missouri counties should carefully consider sales tax pooling. While it may sound great that cities compete with each other for retail development, the reality is that the effects of that government competition have been devastating for Missouri. It has resulted in tax giveaways and home takeaways, all for the sake of bureaucrats trying to plan our local economies. The government planning and the abuse of TIF have failed to benefit our state's economy. It has not grown jobs or opportunity.

There is a better way; a more free-market oriented way. Sales tax pools are a more free-market change that encourages growth for the whole region instead of having cities fight with each other for retail development. Missouri counties need to move in that direction.

NOTES

1 http://www.census.gov/govs/cog2012/

2 East-West Gateway Council of Governments, January 2011. "An Assessment of the Effectiveness and Fiscal Impact of the Use of Local Development Incentives in the St. Louis Region." Final Report: 18.

3 http://www.showmeinstitute.org/publications/commentary/corporate-welfare/743-tif-gives-unfair-advantage.html

4 http://showmeinstitute.org/publications/commentary/privatization/820-missouris-taxpayers-lobbying-to-pay-more-taxes.html

5 http://www.showmeinstitute.org/publications/commentary/taxes/601-the-nixa-cid-public-dollars-for-private-benefit.html

6 You could consider the Saint Louis city and county regional hotel tax to be another pooled tax.

7 "A" cities can switch to become "B" cities. Five have done so. "B" cities cannot become "A" cities. "A" cities that incorporate "B" areas must maintain that portion of the city within the pool. They are known as "A/B" cities. For our purposes here, because any TIF within an "A/B" city would be done within the "point-of-sale, or "A" portion of the city, they are counted with the "A" cities.

8 Source: Research for the Show-Me Institute by policy extern Levi Bennett. To the best of our knowledge, no other pool sharing system in the United States is exactly like Saint Louis County's. As such, comparative study of the topic is limited.

9 BBC Research and Consulting, "Local Revenue Sharing Methodologies," October 2001, pp. 17-18.

10 Source: East-West Gateway Council of Governments data. Analysis of data breakdown by "A" and "B" cities by Show-Me Institute researcher Kacie Galbraith. View online here: http://www.ewgateway.org/DIRR/DIRRData/dirrdata.htm

11 The list of "pool" cities would include unincorporated Saint Louis County as its own municipality, as that is how it is included in the sales tax pool formula calculations.

12 For that calculation, you would use 92 total municipalities, counting unincorporated Saint Louis County as one and adding back the dis-incorporated village of Saint George, which was in existence during that time.

13 On a related note, any legislation regarding the city of Saint Louis re-entering Saint Louis County should mandate that the city re-enter as a pool city.

14 Source: Missouri State Auditor's office annual TIF reports.