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## **Why Sprawl Flourishes, cities don't: State's sales-tax formula costs downtowns billions. Sacramento is Exhibit A.**

**By Robert W. Wassmer**

Imagine the city of Sacramento's shops doing a third more business than they're doing today. As in other vibrant cities, shoppers would fill sidewalks into the evenings, more fine restaurants would stay open later, and those who work or live nearby would linger longer on our central city's streets.

It's not an impossible image.

A statistical analysis of this and other Western metropolitan areas' demographic and economic data shows that Sacramento city retailers likely would be doing another \$1 billion in yearly sales absent a quirk of state fiscal policy.

Instead, those retail sales dollars have been lured to the outlying suburbs of Sacramento, Placer, and El Dorado counties, propelled by a sales-tax allocation formula that inadvertently siphons retail vitality from the central places where, historically, most people live and work.

It isn't wrong, certainly, for retailers to open up new stores to serve suburban consumers. The problem is that a disproportionate amount of business is going to the urban outskirts, significantly more than their populations, 10-year growth histories, average household incomes, land values and other economic factors would warrant. Across California, the central places that give heart, soul and excitement to our metropolitan areas are losing retail business they ought to be capturing.

The cause of these lopsided retail ledgers is simple, really. Cities and counties get to keep a percentage of the sales tax that's generated within their boundaries. From the standpoint of the "big-box" retailers, regional shopping

malls and auto malls, land is less expensive and more available in the suburbs; central cities are older and harder to redevelop. Outlying jurisdictions are actively luring big retailers because they know taxable sales will mean money for local coffers.

Fundamentally, it's a matter of cents. For every one dollar in taxable retail sales, one penny goes to the place where the sale was made. Those pennies add up to millions of dollars each year for California's cities and counties. To be exact, this system meant nearly \$48 million in local discretionary monies for the city of Sacramento in 1998-99, and just over \$71 million for the unincorporated areas of Sacramento County. Local governments must compete for every cent.

"Fiscalization of land use" is public-policy shorthand for suggesting that California's local planning and zoning decisions are being made at least partly to maximize local tax revenues that the land might produce. As Proposition 13 and subsequent state laws made property taxes a smaller share of local treasuries, local emphasis had to shift to generating local money from sales taxes.

While many have assumed this phenomenon promotes increased development on the urban fringes, no one had studied whether empirical evidence does, indeed, show that state fiscal policies are driving land-use decisions – and with what consequences. Until now.

As part of a California State University faculty research fellowship that links academic research and state policy-making, I statistically analyzed economic data from metropolitan areas in California and other western states to determine whether a verifiable connection exists between urban sprawl and the way local governments generate their own revenue.

It was necessary, of course, to first think about what sprawl is. Urban planners have used this catchall term for 60 years to denote nearly all of the seemingly unwieldy growth that people often associate with fringe development. In truth, the suburbs – with their roomier houses, less expensive land, broader open spaces, and sometimes better schools – hold a strong draw, which is why they keep growing. As household incomes rise, people typically seek more space. One person's sprawl becomes another's backyard.

Thus it's important to measure outlying development objectively, to determine when, in fact, it has degenerated into the excessive decentralization of sprawl.

It's also useful to remember that growth isn't necessarily bad. As a matter of economics, bigger populations can sustain more social amenities. From concert halls to sports arenas to medical centers, these major amenities require the

critical mass of a significant population base. As Sacramento knows well, even a cultural treasure such as a symphony orchestra can wither and die without the natural support a stronger population base might have provided.

But growth turns sour when its public and private costs begin to outweigh its benefits in a metropolitan area. This is the economic definition of sprawl: the point at which the costs of fringe development – the longer commutes, snarled traffic, greater air pollution, inefficient use of open space and drains on downtown vitality – become greater than its collective benefits.

As a practical matter, it will never be possible to objectively weigh the full costs and benefits of any development. So it's necessary to further narrow the definition of sprawl in order to quantify it. For my analysis, sprawl can occur when the rate of growth on the urban fringe has exceeded the rate of overall growth in a metropolitan area. When that happens, the metropolitan area is becoming excessively decentralized.

By this measure, sprawl can be documented in more than half of California's 25 metropolitan areas during the 1980s. Statewide, California's urban fringes grew twice as fast as its metropolitan areas overall. In the 1990s, the greatest increases in urban sprawl occurred in Fresno, Los Angeles, Riverside, Merced, Sacramento, Oakland, San Francisco, San Luis Obispo and Stockton, based on a statistical analysis of changes in farm land, population and retail activity.

Further analysis shows that, absent California's site-based system of distributing sales-tax revenues, the historic central places in these 25 metropolitan areas (as defined by the U.S. Census Bureau) would have done \$16 billion more in taxable retail business in 1997. That business instead went to the suburbs. In other words, the way local governments are generating revenue induces sprawl.

The sales-tax distribution system doesn't alter the likelihood that sales will occur in a metropolitan area, but does affect where specifically in the area they might be located.

This suggests that the city of Sacramento would have done 36 percent more business that instead occurred in outlying areas in 1997. In Los Angeles County that year, the central places of Los Angeles, Long Beach, Pasadena, and Lancaster lost nearly \$4.6 billion in business activity to the suburban fringes. In Alameda and Contra Costa counties, the shift in retail business from the cities of Oakland, Alameda and Berkeley to other places in the metropolitan area was \$1.7 billion.

From all these statistics emerges a pattern: California's local reliance on site-based sales-tax revenue encourages the fiscalization of land use, which results in

greater retail sales in outlying areas than the economics of those areas justify, which in turn fosters sprawl.

Hurt by this most, besides Sacramento, are central places in the metropolitan areas of Oakland, Ventura and Orange, which would have generated, respectively, 46, 45 and 33 percent more retail activity in 1997 if outlying jurisdictions hadn't acted on incentives to lure more sales taxes.

Abetted by California's method of fiscally fueling its cities and counties, sprawl has become the most prevalent kind of growth in many of California's urban areas. A case can be made that excessive decentralization will mean higher social costs than otherwise necessary as the state's population grows by nearly half again – to some 50 million – in the next 24 years.

An emerging answer may lie in AB 680, introduced this year by Sacramento Assemblymember Darrell Steinberg. It would create a pilot project in the Sacramento region to direct a portion of the local growth in sales-tax revenue to a pot to be distributed partly on a per-person basis throughout the region. Steinberg proposes to grow this new pot of regional funding even larger by restoring some local property-tax revenues shifted away by the state beginning in the early 1990s. Some of the pot would go to "smart-growth" projects that promote public cost-efficiency in new development.

The purpose of this approach would not be to punish local governments for previous land-use decisions – they'd get to keep all of their current site-based sales-tax revenue – but to alter future land-use planning so that communities on the fringe of California's urban areas no longer see big-box retail as their fiscal nirvana. As all urban economists know, a given metropolitan area will only support a given amount of retail sales. If it goes to the fringes, a gap is left in the central places.

Although Steinberg's proposal is stalled for now, perhaps it ultimately will survive in a form that paves the way for tackling the fiscalization of land use through the kinds of regional approaches that have been lacking in California governance.

Without some intervention, the popular notion that growth is to be feared and sprawl is inevitable may prove enduring truisms in California. That would come at a steep cost to our downtowns, yes. But it also would take a heavy toll on life in the suburbs.

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