Central Planning Comes to Main Street

BY STEVEN GREENHUT

A casual reader could be forgiven for skimming through a front-page *Los Angeles Times* article from February 12 and thinking that the story was just another *Times* exposé of political corruption in some Third World backwater. The article is like so many others, offering a tale of a government without contested elections, the use of police powers against political insurgents, and leaders who enrich themselves and choose economic winners and losers within their domain.

On closer examination we learn that the story took place, not in some far-off nation, but in California, in the tiny industrial city of Vernon, located only a few miles south of that newspaper's downtown offices.

"Twenty-five years after its elected officials last had a contested ballot, eight strangers took up residence," the *Times* reported, noting that the newcomers had instantly filed papers to run for city council. "Within days, city utility trucks had turned off their power. The building they shared was slapped with red tags by inspectors who said the property was 'unsafe and dangerous' as a residence. Strobe lights flashed through their windows. They and some of their relatives were placed under surveillance. Shortly, city police and the officials drilled holes in the locks and evicted the would-be office-seekers. Having deprived the interlopers of city residence, Vernon officials on Jan. 27 disqualified them from the ballot."

With the newcomers gone, the old guard could stay in power, eliminating yet another election and clinging to the benefits they receive for running this five-square-mile city of 93 people. Who says small towns can't be plagued by big government?

Because Vernon is, in essence, an industrial park that is incorporated as a city, it is an oddity. But in reality, the city is just an extreme example of what's happening in California and nationwide when it comes to municipal government.

City officials don't see themselves as representatives of the "people" who busy themselves with protecting their rights and providing a few fundamental "services," such as infrastructure, public safety, and the like. Instead, city staff and city councils view themselves as economic developers, charged with luring new businesses, keeping old ones from leaving, and micromanaging their micro economies.

Sometimes their goals sound high-minded (rejuvenating downtown), but basically it's about the cash. Municipal governments are hell-bent on maximizing tax revenues at every turn, and they use their vast powers to achieve that end. It's the corporate state at the local level, yet something that many observers and activists—even libertarians and conservatives—overlook as they fixate on state capitals and Washington, D.C.

Cities have carrots and sticks available to achieve the desired outcomes. In Vernon we see the stick in action. The city controls the entire housing market and used its regulatory powers to deny legal residence to newcomers. One cannot live in a non-approved industrial building, so the city sent code officials and police to drive the new residents out of town. I've never seen this before, but I routinely watch cities deny conditional-use permits (CUPs) to churches that want to locate in industrial parks. That's because city planners know that by shifting a use from industry to religion, they lose some of their tax base.

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I have repeatedly seen cities deny approvals for housing tracts for similar reasons—officials view such tracts as a drain on their budget. They much prefer that raw land be used for the construction of big-box stores, hotels, and auto malls, which offer lucrative sales-tax bounty.

The biggest economic-development stick is, of course, eminent domain. That process has gained much attention since last summer, when the U.S. Supreme Court ruled in *Kelo v. the City of New London* (Connecticut) that it's okay for cities to use eminent domain to take nonblighted properties from their owners and give them to developers in order to improve economic development.

The public, understandably, has been outraged at the notion that their homes or small businesses are not safe from the greedy eyes of developers colluding with tax-hungry city officials, and the backlash is still unfolding in Congress and state legislatures. But most of the considerable nationwide focus, and all of the proposed legislative fixes, have been on the act of taking property from one owner and giving it to another owner. Yes, there is a broad understanding that cities do this to expand the tax base, but there has yet to be a wider understanding of the dangers of the entire economic-development process—the driving force behind the eminent-domain controversies.

Too often foes of the eminent-domain aspect of that process bend over backwards to assure officials that they agree with the concept of removing blight and boosting local economies. It's just that cities shouldn't rob one set of owners and benefit another set. Redevelopment is good, as long as eminent domain is left out of the picture, they say.

But it's not just eminent domain that's the problem. It's the entire economic-planning regimen, spoon-fed to cities nationwide by groups such as the National League of Cities and the American Planning Association. It's not just the stick that's the problem, but the carrot, also.

Tools of the Trade

Governments have vast economic-planning tools at their disposal, which usually come with complicated names (Strategic Investment Programs, Tax Increment Financing, Industrial Development Bonds, Enterprise Zones, and more) designed to disguise what they truly are: corporate welfare. The two main categories are direct subsidies and tax breaks, or abatements, in which specific companies or businesses located in specific areas get reductions in their tax payments.

Libertarians are united in recognizing the evil of the first category. Government should not be in the business of robbing Peter and paying Paul. They have different views on the second category. Some argue that any tax break is good, in that it reduces government's transfer of dollars from the private sector to the public sector. Others argue that giving a tax break to one targeted recipient increases the burden on all other taxpayers.

"One theory," says Steve Frates, director of the Rose Institute for State and Local Government in Claremont, California, is "that because government is bloated and not efficient, a targeted tax break can be efficient. The government might tighten its belt, and anytime you cut taxes, it's a good thing. The other argument is that targeted tax breaks allow government decision-makers to make value judgments. Very rarely are government officials good at making such judgments. When they make a decision about economic rewards, it's not based on economic efficiency but on aesthetics, such as deciding they want a new boutique downtown."

Sometimes, Frates argues, government planners succeed at doing things that benefit the city, from a government-finance point of view. Giving a tax break to a car dealership, for instance, might help a city's tax base if the alternative is the dealership locating in a nearby city. But that doesn't necessarily benefit local citizens or the region in general.

The basic question, according to Frates, is: "Does city staff make better decisions than the market?"

Not too tough to answer.

We can argue philosophically about whether a targeted tax break is ever acceptable. The broader point is that such breaks are part of a process whereby local officials pick winners and losers, and those companies that win typically are the ones most adept at political gamesmanship.

In addition to targeted tax breaks, cities offer industrial revenue bonds (IRBs), the interest on which is tax-exempt for investors. As the city of Albuquerque explains in promoting such bonds, "The city issues the bonds but is not making the loan. The investor buying the bond makes the loan. The company must find its own bond purchaser. It can also buy its own IRBs. The city technically owns title to the facility built with IRBs and leases it to the company for up to 20 years. At the end of the term, title is transferred to the company. . . . Because the city owns the title to the project, it's exempt for up to 20 years from 95 percent of property taxes on land, buildings, and equipment. And a company may also receive gross receipts and compensating tax exemptions on initial purchases of equipment made with bond proceeds."

Cities can offer direct loans to companies. I've seen cities give major companies valuable commercial real estate for some nominal fee, such as $1. Sometimes cities will float a bond and use that money to build something for the developer. In one California case, the city of Mission Viejo built a parking garage at a privately owned mall, defending its action as part of the city's infrastructure mission.

Sometimes cities will kick back tax revenues to the business, or offer low-interest loans, subsidized by taxpayers. Pretty much any way you can think of to provide benefits to a favored company has been proposed or tried. These financial benefits are often mated with favorable land-use approvals. Usually, city officials defend these policies as net gains: the city supposedly gets more back in tax revenue than it loses from the transfer. How many times have we heard mayors boast about the latest "win-win" situation? It's not much of a win for taxpayers, who see some of their dollars used to build infrastructure for the new project. Typically, tax dollars are diverted from traditional public services, such as police, fire, and libraries, to parking garages, roads, and other elements of the new redevelopment project.

The Grand Plan

Specific incentives, whether tax breaks or outright subsidies, aren't offered in a vacuum. They are usually part of some grand redevelopment idea. If, for instance, a city wanted just to keep a business from leaving by reducing that business's taxes, that's fairly understandable, even if objectionable compared to an across-the-board tax cut. I've witnessed that in small rustbelt cities which were sure they couldn't afford to lose a major employer.

Increasingly, though, cities are not content using incentives for the occasional hard case. The goal is to embrace an overall central-planning vision, in which local officials carefully control land use and manipulate the market to bring in the highest amount of tax revenues for the city.

There are slightly different rules and processes in each state, but it's done basically the same way everywhere. In California the process is known simply as "redevelopment." Everyone is in favor of redeveloping grimy areas, so the process has marched along its merry way with little criticism for many years.

"There is an unknown layer of government in California, which few understand," explains the booklet "Redevelopment: The Unknown Government," by Orange County supervisor Chris Norby. "This unknown government currently consumes 8 percent of all property taxes statewide. . . . It is supported by a powerful Sacramento lobby, backed by an army of lawyers, consultants, bond brokers and land developers. Unlike new counties, cities and school districts, it can be created without a vote of the citizens affected. Unlike other levels of government, it can incur bonded indebtedness without voter approval."

This unknown government can lavish subsidies on companies and use eminent domain to take properties away from existing owners. Cities—the redevelopment agency is typically run by the city council and city staff—create project areas within their boundaries. Some cities have made their entire boundary a project area.

In California and some other states the agency must first discover "blight" before creating a project area. Almost anything passes for blight. For instance, municipalities can call areas blighted if they have excessive urbanization or too little urbanization, if the median property values are below the state median, or if officials find "piecemeal development" (most properties in an area owned by different owners) or even chipping paint on a few houses.

Blight is usually discussed in the context of eminent domain, because once an area is found to be blighted officials can use that power. But the discovery of blight is also the cornerstone for the creation of these often massive redevelopment areas that transfer decision-making from individual property owners to the government.

Within those areas, government can do largely as it chooses, from taking properties to lavishing subsidies on specific developers.

The key financial mechanism that supports "redevelopment" is Tax Increment Financing, or TIF. It works this way: property-tax revenues from a project go to the city's redevelopment agency, which must use those dollars to pay off bonds that were floated to finance the project. So instead of the tax dollars going to traditional government services, such as road building, schools, and the fire department, the money goes to the agency for development, which gives cities a huge incentive to create as many project areas as possible. It means money and power.

The theory is that the city deserves the new tax dollars because its efforts are improving the supposedly blighted area. But the reality is quite different. Cities don't often use TIF to fix up blight, but to increase their tax base. Often they engage in what is called "growth capture"—city planners wait until a stable or depressed area is starting to bounce back on its own. They then brand the area "blighted" and use that as an excuse to capture the new values and transfer the gain from the old owners, who held onto the properties during the lean years, to new developers who savor the prospect of getting prime property for far-below-market rates.

Because those tax-increment dollars must be used to pay off debt, the cities engage in wild debt-spending sprees. One small city in California with 32,000 people (Brea) racked up more than $600 million in total indebtedness in part to bulldoze its old downtown and create a brand-new one from scratch, built by one developer.

The financial aspect of this is shaky. The redevelopers depend on a constant long-term stream of revenue (usually for the 30-year life of the bond) to pay off the debt used to fund the project. But central plans don't always work as well as the central planners hope. I've witnessed quite a few failed projects, and have watched cities constantly ratchet up the redevelopment game to feed the beast.

Is the tax increment in the project area less than expected due to an economic downturn or competition from a neighboring city engaged in a similar retail project? If yes, then cities create new project areas that can bring in even more tax dollars to backfill the shortfall from the old project areas. Redevelopment debt gets constantly refinanced, and cash-hungry cities frantically look for new projects by luring businesses from neighboring cities.

In southern California, where one city runs into the next, the cross-town rivalry can become intense. It doesn't often matter to, say, a car dealership whether it locates on one side of the 57 freeway in Placentia or the other side in Fullerton. So cities will bid up the subsidies, and current councils will let future councils clean up the mess if the promises don't pan out.

Does It Work?

When these proposed projects are debated before the public (sometimes the projects are snuck through redevelopment agency meetings as quietly as possible to avoid public outrage), city-council members and staff talk about all the great economic benefits that will flood the community. The Favored Developer will stand before the council and show his architecturally lovely drawings of the new downtown, new industrial park, new neighborhood, or new retail center.

I'm reminded of journalist Henry Hazlitt's story about the bridge in *Economics in One Lesson*: "When providing employment becomes the end, need becomes a subordinate consideration. 'Projects' have to be *invented*. Instead of thinking only of where bridges *must* be built the government spenders begin to ask themselves where bridges *can* be built. Can they think of plausible reasons why an additional bridge should connect Easton and Weston? It soon becomes absolutely essential. Those who doubt the necessity are dismissed as obstructionists and reactionaries."

While redevelopment is more about tax revenue than job creation, the same process is at work. Officials look for reasons to create a project. Then the whole economic well-being of the community rests on the shoulders of that project. Those who criticize the project are indeed deemed reactionaries who don't care about the future of the community. Years later, no one examines whether the project actually did as promised, and by then a new council is on to another great idea.

Here's Hazlitt's bigger point:

> The bridge exists. It is, let us suppose, a beautiful and not an ugly bridge. It has come into being through the magic of government spending. Where would it have been if the obstructionists and the reactionaries had had their way? There would have been no bridge. The country would have been just that much poorer. Here again the government spenders have the better of the argument with all those who cannot see beyond the immediate range of their physical eyes. They can see the bridge. But if they have taught themselves to look for indirect as well as direct consequences they can once more see in the eye of imagination the possibilities that have never been allowed to come into existence. They can see the unbuilt homes, the unmade cars and washing machines, the unmade dresses and coats, perhaps the ungrown and unsold foodstuffs.


Officials in Garden Grove, California, "invested" heavily in hotel construction.

Yes, redevelopment and corporate subsidies bring to fruition specific projects, some of which are pretty nice, create jobs, and offer valuable things.

The issue is what we don't see. Redevelopers act as if nothing would be built on the spot had they not built it. This is a ludicrous argument here in Orange County, where land often tops $1 million an acre. Something good, even better than the current project, would certainly have been built in most instances had the market been left to its own devices.

A Net Loser

Even on their own terms, however, these projects typically don't pan out. In Garden Grove, California, officials were intent on capturing tourist dollars from the nearby Anaheim Disneyland resort area, so they "invested" heavily in hotel construction. As an *Orange County Register* editorial explained in 2004, officials in 2000 predicted $33 million in revenue to the city after seven years, but revenues ended up at a mere $13.6 million after three and a half years. Then after the loan and bond payments were subtracted, the gain totaled $2.7 million over that period. Activists argue that if the cost of the land and other costs are figured in, the city was a net loser in the process.

And because the dollars are far short of what was predicted, Garden Grove officials have been on a mission to develop an attraction (theme park or Indian casino) that will keep the underused hotels filled. That mission has driven them to consider using eminent domain against well-maintained neighborhoods and to shower even more subsidies on corporations. Here we see how central planning pushes officials to first abuse taxpayers and then abuse landowners.

"Does the tax abatement method meet with success?" asked Michael LaFaive of the Mackinac Center for Public Policy in a 1999 article. "Not as much as if local officials simply would keep taxes low in the first place. CRC [Citizens Research Council of Michigan] found that economic growth takes place in jurisdictions where taxes are low and which consequently grant fewer abatements."

Even free-enterprise-oriented economic development ideas fall short. Remember "enterprise zones," the brainchild of former congressman and Housing and Urban Development secretary Jack Kemp? Based on the sound idea that grimy areas could be fixed up by reducing regulations and taxes, the Reagan administration made this the basis of its urban policy. Yet because the zones ultimately became the creature of government rule-makers, the results have been less than stellar. A *Los Angeles Times* article from January found that such zones have produced few jobs for low-income people in California.

"Businesses in upscale areas such as the Long Beach waterfront and San Francisco's fashionable South of Market district get tax breaks because zone boundaries are based on decades-old census data," the newspaper reported. "Employees of such companies who live in town houses in and around parts of San Francisco's exclusive Nob Hill neighborhood, beach lofts in Long Beach and vintage bungalows of Oakland's upscale Rockridge district can qualify their employers for credits; dated maps show those neighborhoods as low-income. The state is subsidizing six-figure salaries in these zones."

The obvious point: If fewer regulations and lower taxes cause an economic boom, why not simply reduce regulations and taxes across the board?

Local economic planning, especially the creation of redevelopment project areas, actually slows down neighborhood improvement. Once an area is deemed a redevelopment area, property owners stop investing in their properties because they are not sure that they will ultimately reap the benefit of the investment. They become subjects of the central planners who will make the main decisions that affect the economic vitality of the area.

The *L.A. Times* in 2000 did a computer analysis of North Hollywood, recipient of some of the most aggressive redevelopment activities in the region. "Two decades and $117 million in public money later, efforts by the city of Los Angeles to rescue suburban North Hollywood from creeping blight have largely struck out," the newspaper concluded. "Of perhaps greater significance, North Hollywood's recovery has lagged behind other depressed areas in Los Angeles that improved without any money from the city's CRA [Community Redevelopment Agency], according to the Times analysis of census, property and employment data."

Could it be that the marketplace works after all?

Problems with Incentives

Most city managers and economic-development officials that I've talked to fancy themselves as CEOs of companies, and they argue that what they are doing is no different from what private companies do: maximizing revenues. "Why wouldn't a libertarian support what we're doing given that you value private business and understand the importance of profit?" I've often been asked.

The answer is simple. Cities are not businesses. They take the tax dollars of residents and make decisions about land use that are backed by police powers. They do not operate in a market; they do not have voluntary stockholders. Despite the delusions of city managers, the city staff usually is not as sophisticated or as skilled as corporate staff, which means cities often get a poor deal when negotiating with rent-seeking corporations.

When cities insert themselves into the economic development game, either with carrots or sticks, they:

- Shift decision-making from individuals to governments;
- Take money from taxpayers and redistribute it to individuals and companies;
- Undermine property rights and other freedoms;
- Encourage a class of rent-seekers, who learn to lobby city officials for favors and special financial benefits;
- Put unfavored businesses at a competitive disadvantage with those who are favored; and
- Stifle political dissent, as companies that are dependent on the city for lucrative work become reluctant to speak their minds about any number of city issues.

Despite what city managers will tell you, the choice is not between economic development and letting a city rot. The choice is between central planning, empowering officials to decide which businesses are worthy of their help, and the good old free market, which lets free people decide which business should succeed or fail.

City officials like to be "proactive," as they say, and help with economic development. There is something they can do. They can get out of the way, by lowering tax rates, deregulating, ending zoning restrictions, and eliminating exclusive contracts with utilities and developers. It's not out of the question. The city of Anaheim is doing just that, with remarkable results.

Mackinac's LaFaive puts it well in a 2003 article: "The best business climate is one in which government 'sticks to its knitting' and does its particular assignments well, at the lowest possible cost while creating a 'fair field with no favors' environment for private enterprise."

Not a bad template. Sure beats a world of central planning, where city officials can choose who gets handouts and even who gets driven out of town.