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TIF districts hinder growth

Study finds that cities without TIFs grow faster

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Tax increment financing (TIF) is a policy tool used by municipalities in Illinois and 46 other states to stimulate economic growth in a designated area of a city or village that is by statutory definition "blighted." Do TIF districts work—that is, do they spur economic growth? Our analysis of 235 municipalities in the metropolitan Chicago region finds cities, towns, and villages that had TIF districts actually grew more slowly than municipalities that did not use TIF.

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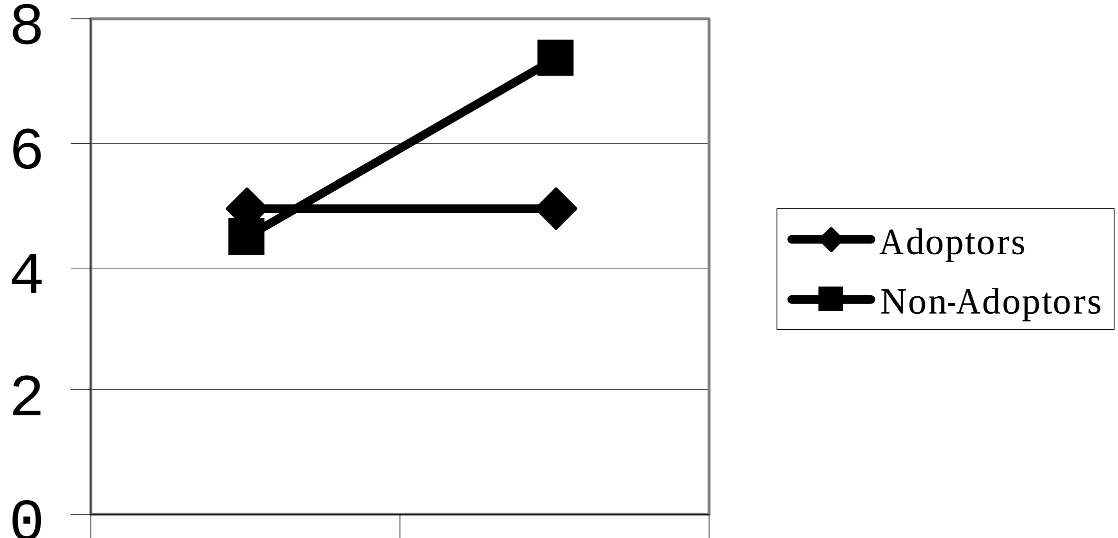
With tax increment financing, a municipality seeks to promote economic development by allowing certain areas, designated as TIF districts, to use the tax revenues generated by increases in the assessed value of properties within them for investment in the district. For example, the improvement of a commercial property within a TIF district may increase the value of that property from $200,000 to $300,000. Applying the combined tax rate of the municipality, the school district, and all other local governments, this increase in property value will result in, say, $3,000 in additional property taxes collected from the owner. The TIF district is then allowed to use all of this $3,000 "tax increment" to finance public infrastructure or to reimburse private developers for start-up costs. TIF district expenditures are often financed by borrowing against 20 or more years of future revenues.

Why use incentives?

Economists identify four main reasons why local governments might want to use economic development initiatives such as TIF. They might seek to improve blighted areas. They might seek to overcome "market failures" that inhibit development, such as when the cost of locating in an area is disproportionately high for the first entrants. In some cases, they might want to use development initiatives to compete with other municipalities in bidding wars for new development. In addition, some critics argue that a municipality might want to use TIF to gain property tax revenue at the expense of the other local governments, such as school districts, in the same area. As a rule of thumb, municipalities receive about 15 percent of property tax revenues in Illinois, school districts 60 percent, and 25 percent goes to all other local governments. The TIF district captures all incremental property tax revenue, including the money that would otherwise go to schools and the other local governments.

Figure 1: Annual Percentage Growth Rates in Municipal Property Value for Pre-TIF Adoption and Post-Adoption Periods



	Pre-adoption (1980-1984)	Post-adoption (1992-1995)
Adoptors	4.94	4.96
Non-Adoptors	4.47	7.38

Whatever the intention, however, designation of a portion of a municipality as a TIF district could actually cause an increase, decrease, or no change at all in the overall economic growth of the municipality. If a TIF district enables a city to correct market failures, the municipality should grow faster than otherwise. If a TIF district simply redistributes growth from one part of a municipality to another, perhaps less suitable, area, a municipality should grow at about the same rate or even more slowly overall than it would have otherwise.

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To find out how TIF affects economic development, 235 cities, towns, and villages in the six counties of northeastern Illinois (not including Chicago) were analyzed. Eighty-one of these municipalities had TIF districts; 154 did not. For each of these cities, towns, and villages, we analyzed the change in assessed value for the years 1980-84 (the pre-TIF adoption period) and 1992-95 (the post-adoption period).

Property values stagnant

The results are clear and discouraging. Figure 1 shows that the rate of growth in property values for municipalities with TIF districts was virtually the same in the post-adoption period as it was in the pre-adoption period. In contrast, the cities, towns, and villages without TIF districts grew much more rapidly in the post-adoption period than earlier. There are, of course, many variables that affect the growth rates of municipalities apart from the decisions to create TIF districts. Statistical techniques were used to account for factors such as fiscal structure, community type, property tax rates, location and size of municipality, size of TIF district, and the number of years since adoption of the TIF district to see how each might affect the basic findings. Although controlling for these factors narrows the difference in post-adoption growth rates, it does not overturn the fundamental finding that TIF municipalities grew more slowly than those without TIF districts.

> “What we find... is a negative relationship. Municipalities that use TIF do worse.”

If the use of tax increment financing stimulates economic development, there should be a positive relationship between TIF adoption and overall growth in municipalities. This did not occur. If, on the other hand, TIF merely moves capital around within a municipality, there should be no relationship between TIF adoption and growth. What we find, however, is a negative relationship. Municipalities that use TIF do worse.

This is consistent with the hypothesis that government subsidies reallocate property improvements in such a way that capital is less productive in its new location. A business is induced by the promise of a subsidy to locate in an otherwise less promising area within a municipality. But other businesses that might be attracted to locate near it are deterred by the inferior location and instead go to another municipality. The TIF has reduced growth.

The additional finding that growth is slower outside the TIF area of a municipality than would be expected reinforces this “inefficient relocation of development” explanation. When we compared the non-TIF area of a municipality to a similar municipality that did not have a TIF, the non-TIF area grew more slowly. In other words, TIF subsidies might be helping growth within the TIF district, but they are hurting growth outside the district by a larger amount.

> “...policymakers should revisit the issue of TIF districts as economic development tools and the question of whether other local governments should have authoritative roles in the decision to create TIF districts.”

Recommendations

Because all local governments and their residents are affected by the consequences of municipal TIF districts, the results of this study suggest that state and local policymakers should revisit the issue of TIF districts as economic development tools and the question of whether school districts and other local governments should also have authoritative roles in the decision to create TIF districts.

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