Recruiting Big-Box Retailers as an Economic Development Strategy

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National Public Policy Conference, Fayetteville, Arkansas, September 17-19, 2006

Abstract: Retail recruitment, particularly of "big-box" or discount department stores, has become an increasingly popular economic development strategy. Historically, public subsidies to attract new retail businesses were used sparingly because retail was viewed as an economic "given." Provided adequate job growth in manufacturing and other export-based industries, incomes would grow and retail spending would grow in response. This view is changing with the growth of shopping malls and discount mass merchandisers, To the extent that new retail attracts customers from outside the community or if it entices residents to buy locally when they had been previously shopping outside the community, some argue this is local economic development. Yet, unlike recruitment of manufacturing firms, which sell to markets outside the community, retail development that is not driven by increased incomes or population has the potential to simply redistribute income between communities or *within* the community with little impact on overall economic growth.

A factor that may be driving the recruitment of retailers through incentives is the increasing reliance on sales taxes as a source of local government revenues. We find that in general the characteristics of Wal-Mart stores do not meet the three tests for use of incentives proposed by Bartik (2005). In addition Wal-Mart stores have many of the characteristics that Bartik (2005) suggests will lower the value of the incentives for the community. There may be differential impacts of Wal-Mart stores between rural and urban areas. More research is needed on the impacts of other big-box retailers. At the same time a community that does not offer incentives may face negative impacts when the store locates in a neighboring community.

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Background

Retail recruitment, particularly of "big-box" or discount department stores, has become an increasingly popular economic development strategy. Historically, public subsidies to attract new retail businesses were used sparingly because retail was viewed as an economic "given." Provided adequate job growth in manufacturing and other export-based industries, incomes would grow and retail spending would grow in response (Lackey and Eckenstahler, 1995). This view is changing with the growth of shopping malls and discount mass merchandisers. To the extent that new retail attracts customers from outside the community or if it entices residents to buy locally when they had been previously shopping outside the community, some argue this is local economic development (Pittman and Culp, 1995). Yet, unlike recruitment of manufacturing firms, which sell to markets outside the community, retail development that is not driven by increased incomes or population has the potential to simply redistribute income between communities or *within* the community with little impact on overall economic growth.

Drastic changes in retail market structure over the past few decades have led to a significant decline in rural retail sales. This is a well-documented phenomenon not only in a variety of academic studies, but also in the vacant storefronts on Main Street of countless small towns. A 1980 study of retail sales in the Midwest found that retail sales leakages from small towns had risen from about 5% in the 1950s to 15% in the 1970s (Stone and McConnon, 1980). Retail sales leakages occur when the amount of retail sales in a community falls short of the amount of sales expected based on population, income and past spending patterns. Sales leakages imply that community members are "out-shopping" or purchasing their goods and services outside of the community. Another, more recent study of retail sales leakages nationwide found that sales leakages were more likely to occur in rural counties than urban counties and that these leakages were increasing over time (Gale, 1996).

Declining rural retail sales are a growing concern to rural policymakers for several reasons. First, the ability of a community's retail sector to retain local customers (and to attract customers from other communities) is an important indicator of that community's economic health (Deller, et al. 1991). The loss of retail sales in a small town may have devastating effects on the stability of the town's retail sector. Declining sales may eventually lead to the closing of local businesses, which in turn may significantly alter the buying behavior of local consumers. Consider the loss of a grocery store. If residents are forced to shop outside the community for such necessities as food, they will likely begin to "outshop" for other goods as well. As a result of reduced local spending, the sales of the remaining local businesses will suffer, spurring further decline.

Small town retailers are not the only ones affected by declining retail sales in rural areas. The loss of local businesses can erode a small community's tax base (Leistritz, Ayres and Stone 1992). The deterioration of a community's downtown business district is likely to have a psychological impact on local citizens as well. One author describes such loss as "a visual and symbolic decline of the entire town" (Ozment and Martin 1990). Finally, the retail sector accounts for roughly twelve percent of employment in non-metropolitan areas, about equal that of manufacturing (U.S. Department of Commerce 2006). If declining retail sales threaten the survival of rural retailers, a significant source of jobs is jeopardized as well.

A number of factors have contributed to the changing structure of rural retail markets and the decline in rural retail sales.

1)Better cars and better roads facilitate long distance shopping trips. The advent of the shopping mall and increasing retail concentration in urban areas offer consumers "one-stop" shopping, greater variety and improved convenience.

2)The customer base of many rural retail businesses has been eroded further by declining populations in rural areas and by increasing numbers of rural residents who must commute to larger towns for work.

3) Consumers are spending a smaller percentage of their incomes on goods and an increasing percentage on services.

4)Most recently, a rapid expansion of discount stores such as Kmart, Target and Wal-Mart, along with their sector specific counterparts like Home Depot, Office Max and Staples, Circuit City and Best Buy, has further altered the structure of rural retail markets and forced small town retailers to change their ways of doing business.

On the one hand, mass merchandisers threaten the survival of many small town retailers because they offer low prices and a wide range of goods all under one roof. Research finds that the expansion of stores like Wal-Mart that offer one-stop shopping and sector specific stores like Home Depot have forced some local retailers to close their doors because they can not compete with these large, nation-wide chains (Stone, 1997). In more rural trade centers retail trade is akin to a zero-sum game. Unless population or incomes are growing substantially, there is a relatively fixed amount of money to be spent in the retail sector. A new large store will capture considerable trade, which must come at the expense of other merchants in the trade area (Blair and Kumar 1997).

On the other hand these retailers, which locate the majority of their stores outside of major urban centers, provide a variety of retail goods and services and jobs to residents. In addition, they attract trade from surrounding areas (redistribution between communities) and keep town residents shopping at "home." Merchants that do not compete directly with the discount store will likely benefit from the increased traffic flows it generates (Irwin and Clark, 2006).

Many would argue that this new wave of mass merchandisers is just part of the free-market system. National and regional discount stores are simply more efficient than local businesses and increasing retail concentration is just economic evolution. Increasingly, however, local governments are actively recruiting retailers as an economic development strategy, and offering them substantial public subsidies to seal the deal. Thus, not just market forces are at work.

Impacts of Big-Box Retailers

The most prevalent, arguably most controversial, and most researched, mass merchandiser is Wal-Mart. The nation's largest retailer currently operates nearly 4,000 U.S. stores in four formats: discount stores, Supercenters, Sam's Clubs and Neighborhood markets. While about 17 percent of the population resides in non-metropolitan counties, over one-quarter of Wal-Mart's stores are located in non-metropolitan counties (U.S. Department of Commerce, 2006; compiled from data on store locations at www.walmartfacts.com).

Recent academic studies have evaluated the impacts of Wal-Mart stores at both the local and national level. This research shows both costs and benefits associated with Wal-Mart's growth, which are distributed across consumers, workers, business owners and tax payers in unequal ways.[1]

Several recent studies analyzing the impacts on employment and wages in the retail sector after Wal-Mart's entry into the local market find that retail employment and earnings decline as a result of Wal-Mart (Neumark, Zhang and Cicarella 2005; Basker 2005a; Dube, Eidlin and Lester 2005). A study of Alabama counties, however, finds evidence that Wal-Mart's presence reduces unemployment rates of blacks relative to whites (Keil and Spector, 2005).

Irwin and Clark (2006) suggest that Big-Box Retailers may have negative impacts if their employees are those who were displaced from higher paying retail jobs. "[I]n urban counties, a Wal-Mart store opening led to a 0.5% to 0.8% reduction in average earnings of workers in the general merchandise sector, and a 0.8% to 0.9% reduction in average earnings of workers in the grocery sector. This translated into a combined 1.3% reduction in total earnings (wage bill) of workers in these sectors (Dube, Eidlin, Lester 2005 p.30)" This results in an estimate of a $4.7 billion reduction in total earnings of retail workers nationwide due to Wal-Mart's presence (Dube, Eidlin, Lester 2005).

There are differences in Big-Box impacts depending on location because what is a "good job" varies according to local economic conditions. Dube, Eidlin and Lester (2005) found that in non-metropolitan counties, the opening of a Wal-Mart store decreased wages of grocery store workers but increased wages of general merchandise workers. As a result there is almost no impact on total earnings by retail workers in those counties. In line with Dube and Wierthem's (2005) finding that Wal-Mart's health benefits are at least as good as those of small retailers, this may be because much rural retail work is in small establishments with wages lower than those paid by Wal-Mart. Wal-Mart distribution centers pay higher wages than their retail centers, generally above $10 an hour. They require about 100 acres of land and are most often located in

[1] For an overview of the existing research on Wal-Mart's impact see Irwin and Clark, 2006 and Renkow, 2005.

rural areas near an interstate highway (Mattera and Purinton 2004). By standards in many rural areas, these are good-paying jobs.

Consumers, in contrast, appear to benefit from Wal-Mart's entry in the form of lower prices. Not only does Wal-Mart offer lower prices, but their entry may have the indirect effect of lowering prices at competing stores. Studies focused on consumer impacts have found that a Supercenter's entry reduces grocery prices. Estimates of this indirect effect range from 3 percent overall to as high as 13 percent for specific items (Basker 2005b; Hausmann and Leibtag 2005). It should be pointed out that a fall in prices may reduce individual retail spending, resulting in lower than expected sales tax revenues, an increasingly important source of revenue for local governments.

In general, Wal-Mart's effect on existing local retailers is negative, although complementary businesses may benefit from Wal-Mart's presence (Irwin and Clark 2006). For grocery stores, competition from Wal-Mart discount stores (not Supercenters) is relatively limited (Gruidl and Kline 1992; Stone 1995b; Artz 1999). Supercenters, however, pose a more serious competitive threat since they offer a full line of grocery items. A recent study of Wal-Mart Supercenters in Mississippi finds that stores located in non-metropolitan counties capture, on average, 17% of the existing grocery market within the first two years of operation. In metropolitan counties, Supercenters capture about 4% of existing grocery stores' sales one year after entry (Artz and Stone 2006) after which they do not appear to gain market share.

Mattera and Purinton (2004) list the direct public subsidies given to Wal-Mart and developers working with Wal-Mart. In addition to the direct subsidies to a firm for locating in a community there are also the indirect public subsidies that go to employees who receive housing vouchers, food stamps and Medicaid. These costs are estimated at $86 million for Wal-Mart employees in California of which $32 million is for medical care (not including uncompensated care for the uninsured) (Dube and Jacobs 2004). Nationwide, public medical costs of Medicaid and uncompensated medical costs of uninsured workers for Wal-Mart are estimated at $658 million (Dube, Jacobs, and Wertheim, 2005). Of these costs, the main direct costs to the local community are the uncompensated medical costs, if the local hospital is publicly owned. The other costs tend to be financed at the state and federal levels.

But certainly, Wal-Mart is not alone in this game. A study of working poor families in California finds that retail workers receive over twice the amount of public assistance received by workers in any other sector (Zabin, Dube, Jacobs, 2004). Although Wal-Mart does not provide the same level of health benefits as other large retailers it is no worse, and perhaps better, than smaller retailers (Dube and Wierthem 2005).

Public Subsidies for Economic Development

Economic development practitioners justify the use of development incentives with several arguments: 1)the costs outweigh the future benefits in terms of increased tax revenue and economic growth, 2)incentives are necessary to retain firms or attract outside firms because other localities are offering incentives as well, and 3)incentives are “free money,” because they often take the form of foregone revenues rather than direct outlays (Buss 2001). This latter reason we do not address because it violates economic principles—foregone revenues are a cost.

While some studies find small positive impacts of incentives on job growth, others report no impact at all or even negative results (Buss 2001). For example, in a study of incentives given to expanding Ohio firms, Gabe and Kraybill (2002) find that firms receiving incentives added an average of 10.5 *fewer* jobs than they would have had no incentives been available. Using a simulation, Lugar and Bae (2005) report a consistent finding for North Carolina.

Even following a more general strategy of low overall tax rates is not a guarantee of long-term economic success. Rork (2005) found that states with lower corporate income tax rates have more labor intensive manufacturing, using low-wage, unskilled labor, than do states with higher rates. A lower corporate rate reduces the cost of capital and leads to substitution of labor for capital by all firms. At the same time the firms that find the lower tax rate a sufficient incentive to relocate are the less capital intensive firms because their re-location costs are relatively low. The low-tax incentive for relocation by labor-intensive firms "counteracted the capital upgrading of firms already there (Rork 2005, p.38)." Southern states, which led in the drive for lower corporate tax rates, increased employment in the short run, but they also became particularly vulnerable to jobs moving overseas.

Bartik (2005) suggests three rules for using local economic incentives: 1) if public infrastructure is underutilized, 2) if market failures impede the use of local resources or 3) if the project overcomes barriers to the use of brownfields. He also points out that the benefits of local incentives will be reduced if 1) there is low unemployment, 2) the new jobs are low wage, 3) few local workers are hired for the new jobs or 4) there are significant infrastructure or environmental costs.

Generally, economists agree that incentives should only be used when they do not place other local businesses in less competitive positions. Stallmann and Ball (2002) state: "To maintain competitive conditions, the public sector should avoid actions that directly favor one firm over another, often referred to as maintaining a level playing field. When the public sector takes actions that relax the rules or lower the costs of doing business specifically to benefit one firm, but not for all, it is adding a noncompetitive element to the business climate." Providing an incentive to a big-box retailer will disadvantage existing businesses that offer a line of any products similar to those carried in the big-box. Some economists would further argue that incentives should be avoided when they harm one local economy in favor of another because in that case they do not contribute to overall economic growth. In the case of retail, incentives may merely move sales from one community to another. Goss and Phillips (1999) find that Nebraska counties with historically higher economic performance are the areas that offer economic incentives, contributing to greater economic disparity among regions.

In many rural towns with stagnant or declining populations, public infrastructure is underutilized—it has excess capacity. A business that puts that infrastructure to use would be a benefit as it spreads the same costs over a larger number of users, lowering costs to the other users. Irwin and Clark (2006) find that big-box retailers do not tend to locate in areas of a town or city where infrastructure already exists. Because of space needs, for both the store and parking, they tend to locate on the edge of the city where some new infrastructure is likely required. This location pattern also means that in most cases they are not likely to locate in brownfields.

Unemployment is an example of an underutilized local resource (Bartik, 2005). The more local residents employed the higher the local benefits. This might seem to be an argument in favor of low-wage employers as the unemployed generally have lower skills. Bartik (2005) points out, however, that lower wage jobs will decrease local benefits. Bartik (2004) estimates that jobs that pay 10-15 percent less than the average industry, controlling for worker skills, produce few earnings benefits for local workers. These jobs also generate low fiscal benefits for the local community.

Underemployed labor, people whose jobs do not use their skills or who cannot find jobs that offer all the hours they want, is also an underutilized local resource. Jobs requiring higher skills that allow the underemployed to move up to their skill level, opening their jobs to the unemployed, use two types of labor in the community and provide benefits to the community (Bartik, 2005).

Communities need to be concerned not only with the employment and level of wages in the Big-Box Retailer seeking incentives, but also their longer-run impact on wages in the community. Basker (2005a) finds that initially total retail jobs increase when a Wal-Mart store locates in a community. This suggests that for people taking the big-box jobs when the store first opens, this is their best alternative. Over time, however, total retail jobs decrease. This increases the underutilized resources in the community.

As discussed above, Wal-Mart is a low wage employer and its entry into more urban markets lowers retail wages in that labor market. At the same time Wal-Mart's entry into a rural market has no overall impact on wages. In non-metropolitan counties, providing an incentive to Wal-Mart will increase low-wage employment in a community, diminishing the public benefits of providing an incentive.

We were not able to find studies indicating if Big-Box workers are local or come from outside the community. Jobs going to workers outside the community would reduce the benefits to the community of any incentives it offered. Because the majority of the retail jobs are lower wage, these are not the sort of jobs for which people are likely to migrate or commute long distances. Thus, many of the new retail workers are likely to be fairly local. In suburban areas, it is more likely that workers will be from outside the community that provided the incentive. While this lowers the number of local unemployed who might obtain jobs, it also lowers local public expenditures that might otherwise be needed if there were an influx of new workers (Ingraham, Singer and Thibodeau 2005). It should be pointed out that the higher income management jobs are likely to go to workers brought into the community by the employer rather than to residents.

There is no comprehensive list of incentives given to Wal-Mart. Mattera and Purinton (2004) used newspaper archives to identify Wal-Mart locations that received incentives from the public sector. They then called local officials to get more information about the incentives. They identified 91 retail stores for which the company and developers working with it received $245 million, about $2.8 million per store. Wal-Mart's distribution centers create full time jobs and generally pay higher wages than the retail stores. Mattera and Purinton (2004) estimate subsidies to distribution centers at $624 million. They documented incentives for eighty four of the then open ninety-one distribution centers. In Barnstable, Massachusetts, the estimated net cost to the community of a new big-box retailer was $468 per $10,000 square feet (Irwin and Clark, 2006), so that the costs did not outweigh the benefits.

New retail may re-distribute income within the community and between communities. In a recent study of the Dallas area, Ingraham, Singer and Thibodeau (2005) estimate the 'cannibalization rate' of retail sales within a 15-mile radius of the city center to be 0.34. That is, for every new dollar of retail sales within the 15-mile radius of Dallas's center, 34 cents represents cannibalization or capture of existing retail sales, while 66 cents represents incremental sales to that market (Ingraham, Singer and Thibodeau, 2005). Part of that 66 cents may be due to increased population and income. The authors suggest that the primary source of the incremental 66 cents is likely existing retail sales from nearby cities outside the 15-mile radius. Their measure of cannibalization *does not* account for retail sales cannibalized within Dallas itself. The authors calculate that as long as the incremental tax revenue from a proposed project exceeds the cost of subsidizing a retail development, it is in the city's best interest to offer incentives. The high rate of cannibalization, within and outside the 15 mile radius of the city center suggests that what is one community's gain is another community's loss and there is little contribution to overall economic growth.

This points out a conundrum for communities. Even if the community prefers not to have a big box store for fear that is will cannibalize sales from existing retailers and lower local wage rates over time, it will suffer these same effects if a big-box store locates in a nearby community. In addition, once a store has identified the region in which it wishes to locate, its costs within that region are likely to be quite similar. The one cost difference for the firm may be local taxes. In a review of the literature Wayslenko (1997) finds that intraregional tax elasticities for employment are between -.8 and -1.95 (A ten percent lower tax will increase employment 8 to 19 percent). These two factors may explain the willingness of communities to compete for big-box retailers by offering incentives. The increasing dependence of local communities on sales tax revenues is a further inducement to offer incentives to big-box retailers. Further, Goss and Phillips (1999) find that Nebraska counties with historically higher economic performance are the areas that offer economic incentives, contributing to greater economic disparity among regions.

Conclusions

Historically, public subsidies to attract new retail businesses were used sparingly because retail was viewed as an economic "given." Provided adequate job growth in manufacturing and other export-based industries, incomes and populations would grow and retail spending would grow in step (Lackey and Eckenstahler 1995). But more recently, with the growth of shopping malls and discount mass merchandisers, this view is changing. If new retail attracts customers from outside the community or if it entices residents to buy locally when they had been previously shopping outside the community, some argue this is local economic development (Pittman and Culp, 1995). Yet, unlike recruitment of manufacturing firms, which sellale to markets outside the community, retail development that is not driven by increased incomes or population has the potential to simply redistribute income between communities or *within* the community with little impact on overall economic growth, or even regional economic growth. In this sense, incentives for most retail development clearly fail the 'level playing field' test.

Most of the research on big-box stores focuses on Wal-Mart. Research shows that Wal-Mart captures sales from existing retailers within the community and also in surrounding communities. Consumers benefit both from lower prices at Wal-Mart and from lower prices as existing establishments respond to the entry of Wal-Mart. At the same time, Wal-Mart decreases local employment in retail and lowers local retail wages, so that some workers in the retail sector suffer losses.

The impacts of Wal-Mart do vary by local economic circumstances. In rural areas, consumers benefit not only from lower prices but also from the wider variety of items that Wal-Mart offers. Wal-Mart's effects on local wages are different in rural than in urban areas with wages sometimes exceeding those of smaller local retailers. Future research on big-box retailers might focus on their impacts based on local economic conditions.

It should be pointed out that it is not only market forces that are at work in the location of big-box retailers; public subsidies are involved. Given the conditions under which offering an incentive may provide local public benefits, retail, particularly big box retail, generally fails the test. Big-box retailers use new rather than under-utilized existing infrastructure, they offer low wages, and they usually do not locate in brownfields. In addition, they offer advantages to one firm over another and in general re-distribute retail sales within and between communities rather than contributing to overall economic growth.

At the same time communities face a conundrum. Given their increasing dependence on local sales taxes and given that the retailer is likely to locate in a nearby community if they do not offer incentives, they will suffer the same ill effects without any of the benefits

Most of the research on big-box retail has focused on Wal-Mart. Big-box retailers will often be able to gain sales from smaller retailers. But many big-box retailers offer higher wages and benefits than Wal-Mart so that their impact on local labor markets may differ from those of Wal-Mart. Further research is needed on other big-box retailers.

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