Infrastructure Investment and Economic Development in Idaho

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Executive Summary

Idaho competes with nearby states for private investment, economic development, and a robust labor force. Idaho faces stiff competition, ranking in the bottom half of business and tax indexes compared to nearby states. This paper compares Idaho's economic, fiscal, and investment climate to the seven "competitor states" of Arizona, Colorado, Nevada, New Mexico, Oregon, Utah, and Washington. It finds higher hurdles in Idaho for municipal finance options that are critical to necessary investment in public infrastructure compared to its competitor states, suggesting underdevelopment and additional opportunities for economic growth.

Idaho and Its Competition

Idaho faces a competitive landscape. The seven mountain and northwest states of Utah, Colorado, Nevada, New Mexico, Arizona, Oregon, and Washington all compete with Idaho for private investment, economic development, and a robust labor force.

Idaho is not strongly positioned compared to the above seven states in macro-level tax statistics. The Tax Foundation's State Business Climate Index puts Idaho fifth among the eight states in business tax climate. It sits sixth in individual income taxes and fourth in corporate income taxes, solidly in the bottom half compared to its competitor states.

Table 1, Tax Foundation's 2015 State Business Tax Climate Index[i]

	Business Tax Climate Index	Individual Income Tax	Corporate Income Tax
Arizona	7	5	5
Colorado	6	4	3
Idaho	**5**	**6**	**4**
Nevada	1	1	1
New Mexico	8	8	7
Oregon	4	7	8
Utah	2	3	2
Washington	3	2	6

Note: Rank is among the eight states listed.

With 7.4% individual and corporate tax rates, its marginal tax rates are higher than all except Oregon. From 2011 to 2014, Utah and Colorado's economies grew twice as fast as Idaho's economy; Washington's grew three-quarters faster.[ii] When the state government does not respond to a competitive landscape, it is up to local governments to use whatever tools are available to them to encourage economic development.

Table 2, Individual and Corporate Tax Rates, 2015

	Highest Individual Tax Rates	Highest Corporate Tax Rate
Arizona	4.54%	6.5%
Colorado	4.63%	4.63%
Idaho	**7.4%**	**7.4%**
Nevada	0%	0%
New Mexico	4.9%	7.3%
Oregon	9.9%	7.6%
Utah	5%	5%
Washington	0%	0%

Supporting Local Development

One way to encourage economic development is to raise the expected rate of return on investment for entrepreneurs and developers by providing modern infrastructure. Another is to raise the standard of living through investments in commercial zones, new developments, open spaces, and public services. Yet another is to increase the return on human capital by investing in higher quality schools and community improvements aimed at increasing safety.

Local governments in Idaho have looked at the options available in other states and found Idaho lacking in flexibility and creativity. Other states have lower tax rates, more tools available for municipalities to initiate projects on their own, and lower barriers to obtaining funding.

Some states like Utah have several options for targeted local development. Depending on the project needs, localities in Utah can set up urban renewal areas, economic development areas, or community development areas. Each has its own purpose and set of tools, allowing municipalities in Utah to tailor their solution to each unique situation.

Idaho remains limited in its options. It has the ability to set up Urban Renewal Districts and use property tax dollars to encourage targeted economic activity. But the restrictions faced by URDs include months of approval processes, few funding options, a fixed time frame, and high hurdles to initiate the process in the first place. A lack of flexibility in Idaho makes predicting economic development more difficult and lowers the likelihood of future investment in the state.

Municipal Finance Options

Infrastructure development options in Idaho are either more limited than those in comparable states or more difficult to enact. Idaho could benefit by loosening funding restrictions in smart, targeted ways in order to respond to the unmet demand for infrastructure investment.

General Obligation Bonds

General obligation bonds are municipal bonds issued by state or local governments that are often repaid from general tax revenues. They are typically backed up using revenue from property taxes, which are less volatile than income or state sales taxes over time. General obligation bonds pay for construction of public projects like schools, roads, or other needed infrastructure.

Utah, Colorado, New Mexico, Nevada, Arizona, and Oregon require a majority vote from the public to issue a general obligation bond. New Mexico limits outstanding general obligation bonds to one percent of the statewide assessed property value, which is equal to one-third of the actual property value in the state. Some municipalities in Colorado face limits on the amount of outstanding bonds based on assessed valuation of property in the entity. Arizona's cities and towns may issue bonds, but the state faces strong limitations. Many states limit the size of any single general obligation bond.

Washington requires a sixty percent vote from qualified voters and a voter turnout of greater than forty percent of the previous state general election turnout in order to pass general obligation bonds.

Idaho, on the other hand, requires a two-thirds vote to issue new general obligation bonds. Idaho invests in infrastructure approximately one-quarter as much as Utah per capita. One obvious explanation is the higher bar for funding. Even if Idaho retained its voting requirements for issuing new bonds, the public may be more likely to support debt-financing for investment in education, infrastructure, or other projects that lead to more economic growth. Any future bonds would need to alleviate concerns from the public about the possibility of higher taxes due to increased costs from newly issued bonds.

Revenue Bonds

Revenue bonds are issued in conjunction with an infrastructure project, most commonly water, sewer, electric, or other utilities that promise steady future revenue streams. They are paid back using those newly created revenues.

Neighboring Utah allows the relevant governing body in a municipality to issue the revenue bonds for projects deemed necessary. Many states don't require voter approval since no new taxes are required to pay for the bond costs.

Several nearby states use state agencies to coordinate revenue bonds. Colorado's constitution requires a majority vote for all bonds, with the exception of enterprises. Most of its revenue bonds are structured as enterprises, and are allowed to be issued without a majority vote. Smaller localities may borrow from the Colorado Water Resources & Power Development Authority, but must still have their bonds approved per their statutes or charters. The New Mexico Finance Authority passes along recommendations for revenue bonds to its board (consisting of state legislators) for consideration. Nevada uses the Division of Environmental Protection Board for Financing Water Projects in order to facilitate water projects identified by localities as necessary.

Revenue bonds in Oregon are subject to voter approval, but revenue obligations are not. In Washington, the relevant legislative body passes an ordinance that is then ratified by the public by a majority vote.

Idaho requires a majority vote from the public to issue revenue bonds. In other comparable states, water projects financed by revenue bonds are typically left to localities or state agencies, demonstrating a lower barrier to beginning necessary infrastructure projects than in Idaho. Since revenue bonds are paid out of future revenue streams from the projects they fund, the general population doesn't experience tax increases.

Tax Increment Financing

Tax Increment Financing (TIF), sometimes called Urban Renewal Bonds, claims future property tax revenue for a specified period of time from projects developed as a result of the financing. In Idaho and many other states, TIF projects are financed by the anticipated future increases in

property tax revenue. It is assumed that without the financing and subsequent development, the promised future revenue would not occur.

With the exception of Arizona (which does not use TIF) and New Mexico (which requires majority approval from real property owners), Idaho and its comparable states all allow the use of tax increment financing through the authorization of the relevant municipal governing body.

Thirteen states and Washington D.C. use non-property tax increment financing in addition to future property tax revenue. Future sales and use, income, hotel occupancy, and other taxes are allowed in various states. Of the eight states mentioned in this report that compete with Idaho, three of them (New Mexico, Colorado, and Utah) allow for a combination of property and non-property tax increment financing.

Other states have limits on the additional, non-property tax increments. Missouri, for example, limits the amount of non-property tax revenue available to fifty percent of the estimated increase in revenue. The idea is to protect taxpayers and bondholders in the event of an economic downturn.

It seems reasonable to include some forms of non-property taxes if they are directly tied to the project area. For example, if a TIF bond is issued to develop an area that includes a new hotel, then a portion of future hotel occupancy taxes can reasonably be attributed to repayment of the TIF bond.

Idaho should expand its municipal finance options by considering non-property tax options for increment financing.

Special Assessment / Local Improvement District Bonds

Special assessments are bonds paid by the beneficiaries of the project. If a neighborhood gets new streetlights, its residents bear the cost of paying back the bond through a special tax that applies only to them. If a new sewer system were implemented in a certain district, only that district would pay for it.

Utah allows authorization of special assessments through majority vote of city councils. Authorizations vary in Colorado, but generally a majority vote of the city council plus approval from property owners is enough.

New Mexico offers two methods of setting up a Special Assessment District: A city may initiate a district for the purposes of making special assessments, or two-thirds of the benefitting properties may petition a city to establish a district. Nevada likewise allows a city council or half of all affected property owners to set up a Special Assessment District.

Arizona has a slightly more permissive system, allowing affected land owners to request a judicial review once the city council authorizes the creation of a district. Oregon and Washington allow municipalities or city councils to form districts without a vote of affected land owners.

Idaho again sets a higher bar. It requires a 60% vote of property owners and a half plus one vote by the city council. Even dropping the property owner requirement to 50% would make Idaho more competitive with its surrounding states.

Industrial Revenue Bonds / Private Activity Bonds

Industrial Revenue Bonds (IRB), sometimes called Private Activity Bonds, are used by many states to facilitate loans from one private party to another. They are often looked at in a skeptical manner because state governments are prohibited from making loans that benefit specific individuals or corporations.

IRBs are mostly used for small industrial development such as land, buildings, furniture, and equipment, but not working capital. Oftentimes they are used for manufacturing or industrial parks.

No tax revenues are pledged as collateral, and no collateral is pledged by the locality. Instead, states or localities connect borrowers with lenders. A borrower must secure its own purchaser of the IRBs, or alternatively purchase its own. Oftentimes the IRBs are attractive because they allow businesses to take advantage of the tax-free status of municipal bonds.

Idaho uses Industrial Revenue Bonds and should continue to support them. No one option fits every funding need, and encouraging private development comes in many forms.

Certificates of Participation, Excise Tax Bonds, and Lease Revenue Bonds

In the competing states referenced throughout this report, all three funding options listed here are comparable or competitive with Idaho and don't stand out as obviously critical areas where Idaho should pursue reform. Municipalities should continue to consider them as real options in an effort to remain flexible and results-driven when considering options for future funding needs.

Other Types of Bonds

States have responded to municipal funding needs with creative ways to issue capital for public projects. Colorado, for example, requires voter approval for multi-year fiscal obligations. As a result, it sometimes issues Tax Anticipation Notes that are paid off within one year.[iii]

New Mexico develops its oil, gas, and other natural resources through the issuance of Severance Tax Bonds.[iv] They act similar to revenue bonds in the sense that they are paid back through future tax revenues. However, revenue is more volatile and may require higher coupons or other forms of collateral.

Oregon's Infrastructure Bonds are similar to general obligation bonds in the sense that they are intended for big infrastructure projects, but can also share characteristics with revenue and tax increment bonds if they fund something like a toll road or public roads that lead to highway use taxes.[v]

Any new bonds Idaho creates should respond to the funding challenge that is presented. Other states can offer ideas, but should not represent the only available options for Idaho.

Falling Behind on Urban Renewal

Urban Renewal Areas (URA) are a popular way for states or municipalities to redevelop areas that have deteriorated or develop promising industrial zones that offer job growth. Communities that establish URAs are granted certain taxing abilities and oftentimes limited power of eminent domain in order to fulfill their stated objective. Through URAs, municipalities are able to invest in necessary infrastructure to attract local businesses and new residents to a previously dilapidated or otherwise promising area.

Compare Idaho's URA policies those of with Utah. Utah has three options available to municipalities: urban renewal areas, economic development areas, and community development areas. The first mirrors Idaho's only option. It requires an area to be blighted, allows for limited eminent domain, and is structured specifically for urban areas. The second, an economic development area, is allowed to target areas specifically for job creation and do not require a finding of blight nor a promise to eliminate it. Proposed projects must show that additional economic development creates new jobs. The final option, a community development area, is for projects where there are public benefits to government-supported investment. These range from basic standards that help shape future residential developments to construction of community centers or public spaces. All three make use of tax increment financing, although they could be altered to come with additional financing powers.

Idaho's only option is the urban renewal area, and its express purpose does not include economic growth, job creation, or community development.

In Nevada, either the county board of commissioners or landowners can establish general improvement districts to provide services like electric light and power, street lighting, storm drainage, sanitary sewer, garbage and refuse disposal, and fire protection. The districts can levy *ad valorem* taxes or special assessments, or issue general obligation bonds (with voter approval), special assessment bonds, or revenue bonds. The districts are governed by the board of county commissioners.[vi]

Denver, Colorado uses local improvement districts for neighborhood improvements. Property owners with at least 35 percent of the area property may petition for the creation of an LID.[vii]

Some states are similar to Idaho in their operation of urban renewal. Oregon's legislature allows cities and counties to create an urban renewal agency with the express purpose of removing blight.[viii] Developments as a result are financed through future property taxes, like Idaho, but also through the use of a special "urban renewal" levy.

Article VIII, Section 4 of Idaho's constitution prohibits loans to individuals, associations, or corporations. But other states have the same restriction, and have successfully used many different financing options or created new ways to respond to infrastructure needs. Idaho has

many options to consider that would remain well within the spirit of the law, and serve to promote economic growth and higher standards of living.

The Economic Benefits of Infrastructure Development

There is a robust literature of economists and political scientists studying the economic effects of infrastructure investment. As a conceptual starting point, infrastructure is a necessary complement to future economic development. Neighborhoods need roads, utilities, school systems, and other public investment to thrive. Private individuals also benefit from the additional economic activity.

For example, Cellini, Ferreira, and Rothstein (2010) measured the effect of school bond authorizations on local housing prices in California. They found "…passage of a bond measure causes house prices in a district to rise by about 6%. This effect appears gradually over the two or three years following the election and persists for at least a decade. Our preferred estimates indicate that marginal homebuyers are willing to pay, via higher purchase prices and expected future property taxes, $1.50 or more for an additional dollar of school facility spending, and even our most conservative estimates indicate a willingness to pay (WTP) of $1.13."[ix]

Other studies include Abdih and Joutz (2008), who find a positive and significant long run effect of public capital, skill-adjusted labor, and technology on private sector output. Duggal et al. (1999) find positive effects of public capital investment on output, as does Nourzad and Vriese (1995) and Wylie (1996). Everaert and Heylen (2004) find positive effects of public capital investment on private output and capital formation, but negative effects on employment, suggesting they are substitutes. In an international study, Kamps (2005) found positive effects on output from investment in public capital.[x]

Not every academic paper finds strong positive effects, and overinvestment is a real concern in some areas. But Idaho's per capita infrastructure investment is lower than many surrounding states, including Utah, suggesting both a capacity and an opportunity to boost economic development throughout the state.

Long Term Perspective and Developing an Economy Built For Growth

There are always trade offs to government spending and investment. Faced with no such trade offs, state and local governments would borrow and spend to excess in order to promote economic growth. But after the Great Recession, many states learned the perils of overspending and under saving. Some states, like Indiana, had successfully restrained government spending and built up economic reserves. Indiana's four fiscal steps are good policy for any state.

In order to retain a robust fiscal and economic climate, states should follow the four steps in order:

First, balance your budget. While many states have balanced budget requirements, some states find themselves scrambling every year to cut programs as a result of sustained overspending.

Second, pay back debts. Lowering future liabilities grants flexibility to states in the form of lower interest repayments, higher future borrowing capacity, and higher credit ratings.

Third, build reserves for the bad times. States cannot control the broader American economy. Even if they do everything right, financial crises or economic downturns can negatively impact their tax revenues and derail carefully planned spending.

Fourth, cut taxes and invest in your state. Once a state has sufficient reserves to protect it against economic downturns, it can afford to cut taxes and invest in worthy projects in order to raise economic growth.

Most states are perpetually attempting to achieve the first step, balancing their budgets. But Idaho has had good governance and long-term planning. It is one of the few states that have accomplished steps one through three. Idaho ended fiscal year 2015 with a $108 million budget surplus and a sizeable budget stabilization fund.

Idaho can afford to invest in new infrastructure and build new schools. It can be proactive about identifying economic development zones, providing incentives to companies to increase job growth, and building new roads or utilities. It is in an enviable position among states in that it could take on many new projects and not place its fiscal policy in disarray.

Any new projects should of course be judged on their merits, and if possible, done with public support. One of the reasons Idaho is in such a strong fiscal position is because its citizens have supported restrained spending. In order to invest in necessary infrastructure, the state and local governments in Idaho will have to convince the public that increased spending is both affordable and beneficial.

Economic Reforms and Policy Suggestions

Public policy should encourage economic dynamism and productive market activity with minimal interference to prices or the ability of consumers and producers to conduct mutually beneficial voluntary exchanges.

This paper is focused on economic decisions and activity that occur at the local level. But Idaho faces stiff competition from its neighbors on statewide decisions that include sales and income taxes, labor standards, and required compensation.

Multinational corporations that shop from state to state are looking for a long-term, credible commitment to low taxation, simple and predictable regulatory rules, and a high quality workforce. At the individual level, entrepreneurial activity is determined by start up costs, regulatory burdens on small businesses, infrastructure availability, and the overall economic climate.

Infrastructure Investment

As detailed above, Idaho has a less permissive environment for investing in necessary infrastructure. It also has fewer tools for economic revitalizations led by local communities.

Unlike most of the nearby competing states, Idaho requires a majority vote in order to issue revenue bonds. Revenue bonds don't increase taxes, which is why most other states do not require explicit voter approval. Idaho could consider the path taken by Utah and allow their authorization by the local governing body, or it could mirror Colorado, New Mexico, or Nevada by having the state take a larger role in administering bonds based on local petitions.

Idaho's tax increment financing is in line with many other states, although it does not allow for TIF districts to include non-property taxes in its financing schemes. If a TIF district attracts retail businesses or new hotels, then including a future portion of the sales or hotel occupancy taxes should be considered. Non-property tax increment financing would allow for more projects and a shorter payoff time, returning previously earmarked tax revenues to the local government quicker than the current system.

Idaho has borrowing capacity and a favorable investment setting, but perhaps not the willingness to take advantage of it.

Openness to new infrastructure investment can have large payoffs. There are numerous stories of Kansas City's developing tech hub as a result of being the first city to have Google Fiber.[xi] The provision of fast Internet isn't the only thing needed to develop a budding tech industry; instead, it represented a culture shift in Kansas City that resulted in a presumption of a permissive business environment and an attitude of entrepreneurialism by future small business owners.

Local governments in Idaho should work with both the state government and businesses looking to expand their labor forces or production facilities to attract new private investment. City councils and state legislators will succeed if they embrace a presumption of fewer restrictions on entrepreneurship, hiring, and growth.

Urban Renewal and Economic Activity Zones

Idaho's urban renewal options are limited compared to other states. It should consider the ability to designate an area specifically for future job growth or for community development, without also having to prove that blight exists. Signaling that an area is likely to turn around is a good way for the government to nudge businesses into new investment.

Labor Standards

Idaho's labor standards are quite good compared to the rest of the nation and competitive with the other states listed in this report. Idaho is one of four right-to-work states of the eight.[xii]

The 2015 White House report on occupational licensing puts Idaho at third of the eight states in percent of the workforce that is licensed.[xiii] The changing economy is quickly rendering licensing an antiquated method of ensuring safety for consumers. Instead, occupational licensing increases the barriers to workforce entry for many low-skilled workers while protecting those who have

gone through the licensing procedures. The Idaho state legislature should strongly consider removing licensing requirements for many occupations in order to better help those still on the peripheral of joining the workforce.

Income and Corporate Tax Rates

At 7.4%, Idaho's highest individual marginal tax rates is between 48 percent and 63 percent greater than Arizona, Colorado, New Mexico, and Utah. It doesn't compete at all with Nevada or Washington, whose marginal rates are zero. Its corporate tax rate is in a comparable position, although Arizona and New Mexico's rates are closer to Idaho's than their income tax rates. Only Oregon has a higher income and corporate tax rate. Any business that is considering moving its workforce to Idaho compared to, say, Utah, will realize very quickly that the take-home pay of employees drops by a few percentage points. All else being equal, that employer will need to raise its compensation for equally skilled employees to adjust for the difference in take-home pay.

The complexity of a tax code matters as well. Colorado has a flat tax rate; it charges 4.63% of a taxpayer's federal adjusted gross income. Utah also keeps tax returns simple by having only one tax bracket of 5%. The purpose of the tax code is to raise just enough revenue necessary for the government to operate without altering the behavior of taxpayers.

Idaho should consider lowering its rates and broadening its tax base. It could collapse individual income tax brackets and expand its already generous standard deductions and personal exemptions in order to maintain the current progressivity of the tax code.

ENDNOTES

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[ii] Bureau of Economic Analysis, "Broad Growth Across States in 2014," June 10, 2015, Tables 1-4.

[iii] Colorado Department of the Treasury, "Public Finance & Debt Issuance," available at: https://www.colorado.gov/pacific/treasury/public-finance-debt-issuance

[iv] Justia US Law, New Mexico Statutes, Chapter 7, Article 27, Severance Tax Bonding Act, available at: http://law.justia.com/codes/new-mexico/2006/nmrc/jd_ch7art27-46f5.html

[v] Oregon State Statutes, Chapter 367, Financing for Transportation Projects, available at: http://www.oregonlaws.org/ors/367.015

[vi] Nevada, General Improvement Districts, available at: http://www2.census.gov/govs/cog/2007/nv.pdf

[vii] City and County of Denver, Department of Public Works, available at: https://www.denvergov.org/Portals/705/documents/District%20Characteristics%20(within%20the%20City%20and%20County%20of%20Denver.pdf

[viii] http://www.oregon.gov/dor/ptd/pages/ic_504_623.aspx

[ix] Stephanie Riegg Cellini, Fernando Ferreira, and Jesse Rothstein, "The Value of School Facility Investments: Evidence From a Dynamic Regression Discontinuity Design," *The Quarterly Journal of Economics*, February 2010, p. 218

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[xii] National Conference of State Legislatures, "Right-To-Work Resources," available at: http://www.ncsl.org/research/labor-and-employment/right-to-work-laws-and-bills.aspx.

[xiii] White House Report, "Occupational Licensing: A Framework for Policymakers," July 2015, Table 1.