Section 4A and 4B Economic Development Sales Taxes

The Issue

The Development Corporation Act of 1979 allows cities to create economic development corporations (EDCs) whose purpose is to encourage new growth in the local economy. Before the 1987 constitutional amendment, these entities had to seek private funding. Not long after its passage, the Legislature created the Section 4A and Section 4B sales tax to fund these economic development activities overseen by the board of a corresponding EDC. If approved by voters, the sales tax increase under a section 4A or 4B may be: one-eighth, one-fourth, three-eighths, or one-half of one percent.

The Section 4A sales tax primarily targets manufacturing and industrial development. Specific EDCs can use Type A revenue to fund land, facilities, targeted structures and improvements for projects. Examples of Type A projects include: infrastructure improvements that promote or develop business enterprises, maintenance and operating costs associated with projects and job training classes. Type A sales taxes are mostly restricted to spending for economic development purposes.

The Section 4B sales tax may encompass any project under Type A rules, along with other project types including quality of life improvement projects. Examples of Type B EDCs include: professional and amateur sports and athletics facilities, tourism and entertainment facilities, affordable housing projects, water and sewage facilities and parking and transportation facilities. Type B EDCs may also fund projects that develop and expand business enterprises or retain jobs; however, landlocked cities with populations of 20,000 or less may use Type B sales tax funds to promote or expand business development that does not create or retain jobs. Generally speaking, Type B sales tax revenues have more flexibility in their use.

Cities may adopt either of these taxes or both, as long as they meet the criteria and do not exceed the 2 percent local sales tax cap.

According to the Texas Comptroller, the use of economic development incentives is as strong as ever. New economic development corporations continue to be created, even as many cities have maxed out on their local sales tax cap. In 1997, there were only 336 economic development corporations. In 2011, there were 697, with the number having increased every year.

The Arguments

Proponents of economic development corporations, which are funded through the use of 4A and 4B sales taxes, often argue that these tools equip communities to be able to attract and retain highly valued industries and businesses that might not otherwise be interested in relocating to the region. Successful recruitment of these businesses promotes job creation, complements a community's quality of life, and more fully develops markets within local communities.

Proponents also contend that the cost of incentives is balanced by the additional tax revenue derived from economic development.

In contrast, critics of Texas' 4A and 4B programs argue that these tools let local governments pick winners and losers in the marketplace. This public policy approach is not only contrary to free-market economics, but also puts existing area retailers at a distinct economic disadvantage since they are both providing the subsidy and competing against the company receiving it.

In addition, economic development programs, like those funded through 4A and 4B sales taxes, can create an environment conducive to "rent-seeking," a phenomenon whereby companies, organizations, or individuals actively seek financial gains through the political process instead of through productivity increases. Among other things, rent-seeking encourages unproductive behaviors.

Finally, free-market advocates rightfully contend that the best way to attract and retain business enterprises is not through artificial means, like economic development programs, but by adopting the Texas Model which emphasizes low taxes and limited government. This governing approach not only creates a desirable economic environment, but also is more fiscally sustainable over the long term.

Recommendations

- Eliminate the ability of political subdivisions to impose section 4A and 4B sales taxes.
- Discontinue public funding for economic development corporations.

Resources

Texans on the Left and Right Agree: It's Time for Transparency in Economic Development by Jess Fields, Texas Public Policy Foundation (March 2015).

An Overview of Local Economic Development Policies in Texas by Jess Fields,
Texas Public Policy Foundation (Jan. 2014).

Economic Development 2013, Office of the Attorney General, 1-7 (2013).

Economic Development Corporation Report 2010-2011, Office of the Texas Comptroller, 9 (2011).