

February 5, 2005

To the Sedgwick County Legislative Delegation, regarding the sales tax for building the proposed downtown arena, and why you should vote against it.

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Honorable Senators and Representatives:

I realize that the voters in Sedgwick County voted for the arena sales tax increase. I believe, however, there is ample reason why you should vote against the tax. I wish to present what my research has uncovered.

WSU Study Not Complete

On of the main arguments advanced for having all the residents of Sedgwick County pay to build the arena was a study prepared by the Center for Economic Development and Business Research at Wichita State University. The study claimed a large economic benefit from the arena. It is because of this economic benefit that arena supporters say the entire community should pay to build the arena. This study, however, is incomplete in two important areas: its lack of depreciation accounting, and it ignores the substitution effect.

No Depreciation Accounting

Government Accounting Standards Board Statement 34 requires governments to account for the cost of their assets, usually by stating depreciation expense each year. Through a series of email exchanges with Mr. Ed Wolverton, President of the Wichita Downtown Development Corporation, I have learned that the WSU Center for Economic Development and Business Research was not aware of this requirement when they prepared their study. Mr. Wolverton admitted this after checking with the study authors. Furthermore, Mr. Chris Chronis, Chief Financial Officer of Sedgwick County, in an email conversation told me that the county will take depreciation expense for the downtown arena. I do not know what a figure for depreciation expense would be, but it would likely be several million dollars per year, and it would materially and substantially change the arena's financial footing.

No Substitution Effect Allowed For

In a television new story reported by Mr. Erik Runge of KWCH Television on October 25, 2004, I was interviewed, and I mentioned the substitution effect. This is the term used to describe what research has found: that much of the new economic activity such as bars and restaurants that might appear around a downtown arena would be bars and restaurants that have moved from other parts of the city. There is little or no new economic activity, just movement of existing activity. Mr. Runge interviewed Mr. Ed Wolverton, President of the Wichita Downtown Development Corporation, who said "In WSU's report they felt like there definitely could be some substitution effect." The reporter explained "But how much was never studied. Downtown development backer Ed Wolverton says mostly due to time restraints."

These two glaring omissions of materially important facts by the WSU study should warn us to question its other findings. Other than the report on KWCH, I saw no reporting of these two matters.

Claimed Economic Benefit is Not Realized

Arena supporters say that everyone should pay to build and operate the arena because it will generate economic impact that everyone will benefit from. The economic benefit claimed by arena supporters, however, has not been found to materialize in other cities. In the March 2001 issue of "FedGazette," published by the Federal Reserve Bank of Minneapolis, an article titled "Stadiums and convention centers as community loss leaders" contains this quote:

"Current research indicates that stadiums and arenas have a particularly bad track record when it comes to delivering on promises of community economic windfalls. University researchers Mark Rosentraub and Mark Swindell found that three decades worth of studies 'lead to the inescapable conclusion that the direct and indirect economic impacts of sports teams and the facilities are quite small' and do not create much in the way of new jobs or economic development."

In a paper titled "Professional Sports Facilities, Franchises and Urban Economic Development" (UMBC Economics Department Working Paper 03-103) by Dennis Coates and Brad R. Humphreys of the University of Maryland, Baltimore County we find this quote:

"Siegfried and Zimbalist (2000) recently surveyed the growing literature on retrospective studies of the economic impact of sports facilities and franchises on local economies. The literature published in peer-reviewed academic journals differs strikingly from the predictions in 'economic impact studies.' No retrospective econometric study found any evidence of positive economic impact from professional sports facilities or franchises on urban economies."

Arena Tax Requires Everyone to Subsidize the Interests of a Few

Since, as current research has found, arenas do not generate the positive economic impact that their supporters claim, the arena tax instead becomes the public as a whole subsidizing the leisure activities of a relatively small number of people. The people who do use the arena, moreover, are quite easy to identify: they purchase tickets to events, or they pay to rent the arena. It is these people who should pay the full cost of the arena construction and operation.

At the time the legislature is dealing with issues involving a moral dimension, such as gay marriage, the death penalty, and gambling, we should also consider the moral aspects of requiring everyone to pay for something that benefits only a few.

Local Officials Not Entirely Truthful

Sedgwick County Commissioners stated that if the downtown arena sales tax did not pass, they would borrow money to renovate the Kansas Coliseum. If we do the math on the figures they quoted, that is to borrow \$55 million and pay it back at \$6.1 million a year for 20 years, we find that the interest rate is 9.17%, which is a terribly high interest rate for a government to pay. The county commissioners told us they were ready to pay this much if the arena tax didn't pass.

I wrote to Sedgwick County Commissioner Tom Winters, asking him for an explanation. He replied that the interest rate is really 7.5% for this reason: To the \$55.3 million cost of the renovations, we

must add \$6.5 million for capitalized interest during the construction period, and \$.9 million for debt issuance costs. So yes, Commissioner Winters is correct about the 7.5% rate, but this also means that the cost of the Coliseum renovations should be stated as \$62.7 million instead of \$55 million. But even 7.5% interest is too high to pay.

What is troubling is that local government officials are not being truthful with the public. I saw no reporting of these facts.

Unintended Economic Effects

A paper titled "An Assessment of the Economic Impact of a Multipurpose Arena" by Ronald John Hy and R. Lawson Veasey, both of the University of Central Arkansas, (Public Administration & Management: An Interactive Journal 5, 2, 2000, pp. 86-98) looked at the effect of jobs and economic activity during the construction of the Alltel Arena in Pulaski County, Arkansas. This arena cost \$50 million. It was funded in part by a one percent increase in the county sales tax for one year (1998). The sales tax generated \$20 million.

In the net, considering both jobs lost and jobs gained due to sales tax and construction effects, workers in the wholesale and retail trades lost 60 jobs, and service workers lost 52 jobs. There was a net increase of 198 jobs in construction.

The fact that jobs were lost in retail should not be a surprise. When a sales tax makes nearly everything sold at retail more expensive, the supply curve shifts to the left, and less is demanded. It may be difficult to estimate the magnitude of the change in demand, but it is certain that it does change.

Workers in these sectors, should the sales tax increase take effect, may want to reconsider their career plans. How many retail and service workers can make the transition to construction work is unknown. It is certain, however, that when workers lose their jobs it imposes benefits costs on the government -- and the taxpayers.

The population of Pulaski County in 2000 was 361,474, while Sedgwick County's population at the same time was 452,869, so Sedgwick County is a somewhat larger. Our sales tax will last 2.5 times as long, and our proposed arena is about three times as expensive. How these factors will impact the number of jobs is unknown, but I feel that the number of jobs lost in Sedgwick County in retail and services will be larger than what Pulaski County experienced.

It is interesting to note that the authors of this study, while measuring a positive net economic impact for the Alltel Arena, make this conclusion:

"The primary reason for this positive economic impact is that the state of Arkansas contributed \$20 million to the construction of the arena. As a result, the economic impact of building the arena in Pulaski County is greater than it would be if the county had funded the arena by itself. A vast majority of the jobs that will be created will be in the service sector that frequently offers lower wages than jobs in other sectors of the economy."

The proposed downtown Wichita arena does not have the advantage of having 40% of its cost paid for by outsiders. It may be that we feel even more strongly the negative impacts of the sales tax.

Downtown Development Automatically Assumed Good

In any discussion, the desirability of downtown development seems to be a given. But what people actually do is different. When a family decides where to spend its money to build or buy a home, very few have chosen downtown. And businessmen, when deciding where to invest capital or the capital of others, few have decided to invest downtown.

The Difference Between a Publicly-Owned and Privately-Owned Arena

Instead of the government building an arena, suppose that arena supporters, along with those who voted yes for the sales tax and anyone else who wants to, formed a corporation to build and own an arena.

Instead of having paid taxes to the government, arena supporters would be investors and they would own something: their shares in the arena. They would have the pride and responsibility that comes with ownership. They would have a financial stake in its success. Even taxpayer-funded arena opponents might see merit in investing in a local business rather than paying taxes to a government.

Instead of government bureaucrats deciding what the people of our town want and need, a privately owned arena would be subject to the guidance and discipline of free markets. It would either provide a valuable service to its customers and stay in business, or it would fail to do that and it would go out of business. Governments do not have such a powerful incentive to succeed.

Instead of the bitter feelings dividing this town over the issue of a taxpayer-funded arena and other perceived governmental missteps, the arena corporation would act in the best interests of its shareholders and customers. Even if it didn't, it wouldn't be the public's business, because after all, the corporation is formed of private individuals investing their own money.

When individuals invest in an arena they are nurturing the virtues of investment, thrift, industry, risk-taking, and entrepreneurship, Wichita having an especially proud tradition of the last. There is nothing noble about a politician taxing and spending someone else's money on projects like a downtown arena, or a renovated Kansas Coliseum for that matter.

At this time in our town we have a chance to let private initiative and free markets work, or we can allow the government to continue to provide for us in ways that few seem truly satisfied with. Writing about a public utility in England that was transferred to private enterprise, economist John Blundell observed:

"When it was 'public' it was very private. Indeed, it was totally captured by a small band of bureaucrats. Even members of Parliament struggled to find out what was going on. No proper accounts were produced, and with a complete lack of market signals, managers were clueless as to the correct course to take. The greatest casualty was a lack of long-term capital investment.

Now it is 'private' and very public. Not just public in the sense of open, but also in the sense of accountable directly to its shareholders and customers. Copious reports and accounts are available and questioning citizens will find their concerns taken very seriously indeed."

If we allow the government instead of private enterprise to build a new arena or to renovate the Kansas Coliseum, this is the opportunity we lose.