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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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# Ordinance to Protect Small and Neighborhood Businesses

## OVERVIEW

On June 23, 2010, the Land Use and Housing Committee received a presentation from Councilmember Gloria regarding proposed legislation to address potential threats to San Diego neighborhood business districts posed by supercenters. The Committee voted 3-1 (Councilmember Faulconer dissenting) to refer the item to the City Attorney and the IBA for additional review and analysis. On September 15, 2010 the City Attorney released a legal analysis of the proposal along with a draft ordinance for Council consideration. The proposed ordinance would amend the Land Development Code to establish certain regulations with respect to superstore development.

This report examines a number of potential economic and fiscal impacts related to superstores and big box retailers that have been widely discussed in professional and academic studies. In addition, this report provides an analysis of the proposed ordinance, focusing on a number of key regulatory mechanisms and other technical and administrative issues. Finally, a number of recommendations are provided for Council consideration.

## FISCAL/POLICY DISCUSSION

The proposed ordinance would amend the Land Development Code to define superstores as a new, specific type of land use, and establish certain regulations for superstore development. Under the proposed ordinance, a superstore would essentially be defined

as a retail establishment with more than 90,000 square feet of gross floor area that devotes at least 10 percent of the sales floor area to the sale of nontaxable goods (i.e. groceries). Significantly, the definition of a superstore would specifically exclude wholesale membership clubs or other discount retailers that sell primarily bulk merchandise and charge membership dues.

If adopted, the proposed ordinance would require new superstore developments to obtain a Site Development Permit (SDP), approved in accordance with a Process Four (Planning Commission approval with appeal to City Council). In addition, the proposed ordinance would establish certain additional supplemental findings that would need to be made before a SDP for a superstore can be approved. These supplemental findings are as follows:

1. The superstore will not increase the potential for neighborhood blight;
2. The superstore will not adversely affect the City's Business Improvement Districts, Redevelopment Project Areas, or Micro Business Districts;
3. The superstore will not adversely affect the City's neighborhoods and small businesses;
4. The superstore will not adversely affect the character of the surrounding neighborhood.

The proposed ordinance would also require, as a supplemental regulation, that an economic and community impact analysis report be prepared and submitted as part of the application for the SDP. The economic and community impact analysis report would be prepared at the expense of the applicant, by a consultant approved by the City Manager.<sup>1</sup>

This report begins by examining some of the economic impacts that may potentially result from the development of superstores and other large retail or "big box" establishments. The report then focuses on a number of specific issues pertaining to the proposed ordinance, including the required economic and community impact analysis report, the supplemental findings, and other technical and administrative issues. Finally, several recommendations are provided for Council consideration.

### **Economic and Fiscal Impacts of Superstores**

The Land Use and Housing (LU&H) Committee Report states that the intent of the proposed Ordinance is to "preserve the economic viability of neighborhood commercial centers which could be negatively impacted by superstores that could draw sales away from the traditional supermarkets that anchor neighborhood-serving commercial centers."

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<sup>1</sup> It is unclear why the proposed ordinance references the City Manager. Given the current form of government, it may be more appropriate to reference the Mayor, COO or other designee.

Since this policy goal is based on the premise that superstores have a negative economic impact on the surrounding community, it is prudent to examine the potential economic and fiscal impacts that may result from the development of superstores, and large retail (big box) establishments in general.

In conducting this analysis, the IBA reviewed a number of professional and academic studies that have investigated the impact these types of retail establishments have had on communities. Several of these studies have been provided as backup materials to the docket item, including a 2004 analysis by the City's Community and Economic Development Department titled *Fiscal and Economic Impacts of Large Retail Establishments* ("C&ED Study"), and a 2004 study by the Bay Area Economic Forum titled *Supercenters and the Transformation of the Bay Area Grocery Industry* ("BAEF Study"). In addition, the IBA has also researched other professional studies such as a 2004 analysis by the Los Angeles County Economic Development Corporation titled *Wal-Mart Supercenters: What's in store for Southern California?* ("LAEDC Study"), as well as a number of academic studies.

Overall, the existing literature is marked by a general lack of consensus with respect to the economic impact of superstores and big box retail establishments. While the studies on such impacts have been numerous, conclusions are often inconsistent. Some studies find that superstores clearly have a negative impact on communities, while others conclude that the impacts are positive<sup>2</sup>. Others still find little impact at all. However, after reviewing the literature, there are a number of themes that consistently emerge in regard to superstores and big box retail establishments.

First, the development of a new superstore or big box retailer is not likely to produce a net increase in retail sales or jobs, but rather, shift sales and jobs away from existing retail centers. As discussed in the C&ED Study, retail activity is not typically considered to be a base economic activity, meaning that it does not import wealth or economic activity into a region. Retailers compete amongst themselves for a slice of the overall economic "pie." As the C&ED study states, "sales revenue and jobs added by one retailer will, almost without exception, result in a commensurate loss of sales revenue and jobs at...competing retailers."

Second, wages offered by superstores and big box retailers are often lower than those at competing retailers and major supermarket chains (Dube, Lester and Eidlin 2007). The 2004 BAEF Study estimated that the value of wages and benefits earned by grocery workers at Wal-Mart was \$11.68 per hour less than that of employees at unionized supermarkets in the Bay Area.<sup>3</sup> Furthermore, the BAEF Study suggests that the entrance

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<sup>2</sup> For instance, Basker (2005b) and Neumark, Zhang and Ciccarella (2008) reach divergent conclusions with respect to Wal-Mart's impact on county-level employment.

<sup>3</sup> It should be noted that the 2004 LAEDC Study, using different assumption, estimated the wage differential to be much smaller, between \$2.50-\$3.50 per hour.

of a low-wage competitor into the grocery industry will likely put downward pressure on wages and benefits for grocery jobs throughout the region. The BAEF Study estimates that the total value of wage/benefit payroll reductions could fall by \$353 to \$677 million if superstores in the Bay Area obtain a market share of 6-18 percent. The Study notes that as these reductions in wages and benefits roll through the regional economy, the total economic impact could be more than double the direct loss.

However, superstores and big box retailers also provide benefits, primarily in the form of lower prices for groceries and general merchandise. Numerous studies have shown that supercenters and big box retailers generally offer lower prices than their competitors (see Basker 2005a; Hausman and Leibtag 2007). These savings can be significant; Basker (2007) notes that “estimates of the difference between Wal-Mart’s and competitors’ prices range from 8-27 percent, depending on the market and selection of products.” Furthermore, the lower prices offered by a superstore or big box retailer would likely result in downward pressure on prices at competing retailers (Noel and Basker 2007). The 2004 LAEDC Study estimated that the aggregate savings to consumers in Los Angeles County as a result of these savings would be at least \$1.78 billion. The Study further estimated that these savings, once redirected for other expenditures, could result in the creation of 17,300 new jobs county-wide.

Finally, from a fiscal perspective, it is unlikely that a new superstore or big box retailers would have a significant impact on sales tax revenue. As mentioned, the establishment of a new superstore or big box retailer is not likely to produce a net increase in retail sales. The indirect effects of superstores or big box retailers, such as reduced income due to lower wages, could have a greater impact on sales tax revenues as less money is spent in other areas. However, this could also be offset by greater spending in other areas as a result of the lower prices offered by superstores. The net impact of these effects, while difficult to determine, will likely be minimal. The 2004 BAEF Study states “an analysis of the most recent data available finds weak correlations between the presence of large retail general merchandise stores and taxable sales in the Bay Area.” However, there is an important caveat to this conclusion: if a supercenter or big box retailer is located near the city limit, it could potentially “steal” sales from neighboring jurisdictions, thereby increasing sales tax revenues for the host city.

In conclusion, the net economic impact of supercenters and big box retailers is complex and difficult to determine. As mentioned, the existing literature lacks consensus with respect to these impacts. Even the broad themes discussed in this section are not universally supported. While there are indications that supercenters and big box retailers have certain negative economic impacts, on balance, evidence suggests that the net impacts may be less than commonly perceived.

### **Economic and Community Impact Analysis Report**

As previously mentioned, the proposed ordinance would require, as a supplemental regulation, that an economic and community impact analysis report be prepared and submitted as part of the application for the SDP. The LU&H Committee Report states that requiring an economic impact report would be a useful tool to assist the decision-maker in making an informed decision with respect to superstore development.

The IBA agrees that such an impact analysis could be an appropriate policy instrument to assist in determining relevant impacts associated with certain types of development such as superstores. This concept is rooted in the General Plan: Policy EP-L.3 of the Economic Prosperity Element states “Prepare a Market and Fiscal Analysis for discretionary permits involving large retail establishments over 100,000 sq. ft. of gross floor area.”

While the IBA supports the concept of an economic and community impact report, it is unclear why 90,000 sq. ft. gross floor area has been chosen as the threshold for such a requirement, particularly when the General Plan establishes a threshold of 100,000 sq. ft. The LU&H Committee Report, in response to a similar comment made by the Director of the Development Services Department in an October 6, 2010 memorandum to the Planning Commission, notes that the General Plan policy relates to large retail development, while the proposed ordinance would apply to superstores, which would be defined as a separate type of land use with additional regulations.

However, the need for establishing a new type of land use is equally unclear. Many of the potential negative impacts associated with superstore development, which could warrant an economic and community impact analysis, are likely to also be associated with large retail establishments over 100,000 sq. ft. gross floor area. The IBA recommends that as an alternative, the Council consider applying the requirement of an economic and community impact analysis to the development of all large retail establishments with more than 100,000 sq. ft. gross floor area, consistent with the General Plan policy.

### **Supplemental Findings for Site Development Permit Approval**

As discussed above, the proposed ordinance would also establish additional supplemental findings that would have to be made before the SDP for a superstore development could be approved. According to the LU&H Committee Report, these supplemental findings are to ensure that the decision-maker considers the required economic and community impact analysis before making a decision on the project. The Committee Report also notes that the proposed ordinance would impose these additional requirements on the development of superstores rather than prohibiting superstores outright.

However, we are concerned that the findings may be overly restrictive as currently written, and may constitute a *de facto* ban on superstore development. For instance, the

third finding in the proposed ordinance states “The superstore will not adversely affect the City’s neighborhood and small businesses.” However, any shift in sales from existing retail establishments to a new superstore could be considered an adverse effect. Since retail establishments exist in a highly competitive economic environment, it is unclear how this finding could be made for any new retail establishment, much less for superstores.

In addition, some of the findings may suffer from a lack of clarity. The fourth finding states “The superstore will not adversely affect the character of the surrounding neighborhood.” However, without further clarification as to how the “character” of a neighborhood is defined, it is unclear upon what basis this finding could be made or rejected by decision-makers, or supported by evidence in the economic and community impact analysis. If the Council determines that supplemental findings are an appropriate regulatory mechanism, we would recommend that the language of the findings be amended to be less restrictive and provide greater clarity in order to allow decision-makers the appropriate flexibility in determining the impacts of a proposed development.

#### **Other Administrative and Technical Issues**

According to the Development Services Department, there are several technical aspects of the proposed amendments to the Land Development Code that may potentially be problematic. A number of these concerns were raised in the October 6, 2010 memorandum from the DSD Director to the Planning Commission. However, based on the IBA’s discussion with DSD staff, we believe there are two issues of prominent concern.

First, the proposal attempts to regulate superstores by requiring a Site Development Permit, when a Conditional Use Permit may be more appropriate. Staff has indicated that using a SDP as the regulating mechanism presents administrative challenges, and is inconsistent with the current design of the Land Development Code. Second, DSD staff has indicated that the proposed superstore regulations would not apply to Planned District Ordinances. This could result in the unintended consequence of encouraging superstores to locate in the City’s many planned districts.

In addition, there are a number of administrative issues that will need to be considered, such as the potential need for enhanced code enforcement, administrative costs associated with administering consultant contracts related to the economic and community impact analyses, and establishing mechanisms to recover such administrative costs from project applicants. Given these technical and administrative concerns, we recommend that the Council provide policy direction to the Development Services Department, and request that the Department to provide a recommendation for how to best achieve the Council’s policy objectives.

## CONCLUSION

The proposed ordinance, first introduced at the Land Use and Housing Committee on June 23, 2010, would amend the Land Development Code to provide for tighter regulation of superstores. Specifically, the proposed ordinance would define superstores as a separate type of land use, require a Site Development Permit (SPD) in accordance with a Process Four, establish supplemental findings for approval of the SDP, and require the submission of an economic and community impact analysis report.

This report examines a number of potential economic and fiscal impacts related to superstores and big box retailers that have been widely discussed in professional and academic studies. While the existing literature is generally marked by a lack of consensus, there are indications that that supercenters and big box retailers may have certain negative economic impacts. However, on balance, evidence suggests that the net impacts may be less than commonly perceived.

This report also provides an analysis of the proposed ordinance, and focuses on a number of specific issues including the required economic and community impact analysis report, the supplemental findings, and other technical and administrative issues. Overall, we support the concept of an economic and community impact analysis as a policy instrument, but recommend that a number of changes to the proposed ordinance be considered. Specifically, we recommend that the City Council:

- Consider applying the requirement for an economic and community impact analysis to the development of all large retail establishments with more than 100,000 sq. ft. gross floor area, consistent with the General Plan;
- Amend the supplemental findings to be less restrictive and provide greater clarity in order to allow decision-makers the appropriate flexibility in determining the impacts of a proposed development;
- Provide policy direction to the Development Services Department, and request that the Department to provide a recommendation for how to best achieve the Council's policy objectives.

**[SIGNED]**

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**[SIGNED]**

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