

The Impact of Big Box Grocers on Southern California

Jobs, Wages, and Municipal Finances



**ORANGE COUNTY
BUSINESS COUNCIL**

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EXECUTIVE SUMMARY

Prepared for the Orange County Business Council

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This Executive Summary Highlights the key finding from the research. Persons desiring a more complete description of the research are referred to the final report, available on-line at www.ocbc.org. The opinions expressed in this report are those of Professors Boarnet and Crane.

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ORANGE COUNTY BUSINESS COUNCIL

There is a revolution going on in your grocery store.

It is a change that is in its earliest stages, but it is a change so profound that Goldman Sachs said earlier this year that it is "the biggest secular market share shift in American retailing today - bigger so far than even the Internet."

It is a megatrend that is both consumer-driven and a decision by the so-called big box discount retailers to sell groceries, produce, dairy, and other food products, promising benefits in the form of lower prices and greater choices for consumers. It is a megatrend that will affect what we eat and where we buy it. And it is a megatrend that is colliding with an extraordinarily complex local issue - the fiscalization of land use by local government decisionmakers.

For more than 20 years, cities have been romancing big box retail stores - the sales tax generating land uses that bring tax dollars into city government to pay for police, fire, and other municipal services. However, as the report - *The Impact of Big Box Grocers on Southern California* - illuminates, the decision by big box discount retail stores to expand from taxable (and tax-generating) products to non-taxable (and non-tax generating) groceries could have a profound effect on municipal finances while generating significant community impacts.

To place this national megatrend in a local decisionmaking context, the Orange County Business Council asked UCI Professor Marlon Boarnet and UCLA Professor Randall Crane to explore the impact of big box discount retailers moving into the grocery business - and to develop a checklist that local government officials could use to assess the expansion or conversion of existing retailers into the new supercenters. OCBC believes that the relationship between land use decisions and local finance economics deserves closer examination.

The 115-page report Drs. Boarnet and Crane developed is summarized in this document. It does not advocate nor oppose supercenters or big box retail centers, but does offer key questions on municipal finance and community impacts that local government officials should consider when confronted with local land use decisions which will shape their communities. We hope this study will provide context and assistance to the serious deliberations of decisionmakers who will help shape the revolution that is going on in our grocery stores and our big box retail discount stores.

Sincerely,

President and CEO
Orange County Business Council

The research report, *The Impact of Big Box Grocers on Southern California: Jobs, Wages, and Municipal Finances*, was prepared for the Orange County Business Council by Professors Marlon Boarnet (University of California, Irvine) and Randall Crane (University of California, Los Angeles). The author is published broadly in the areas of local economic development, land use, and municipal fiscal policy. The Orange County Business Council also has a long-standing interest in both the fiscal impacts of local land use issues and the economic impacts of government decision-making and the changing California business climate.

In this report they examine the enormous, and ever-growing retail grocery business, and the many changes occurring in this industry. One of the most important developments is the combination of big-box discount retail and grocery sales into a single store known as a supercenter. Several discount retailers, including K-Mart and Target, have experimented with the supercenter format, but Wal-Mart has been the fastest growing developer of supercenters in the past decade. While K-Mart and others have experimented with retail grocery sales in recent years, Wal-Mart has quietly become the second largest grocer in the country by adding large grocery stores to their retail stores to form supercenters that are often as large as 220,000 square feet. For that reason, this research focuses on the potential impacts of the entry of Wal-Mart supercenters into the Southern California market. Yet the analysis is intended to illustrate some of the impacts of supercenters more generally, while using the case of Wal-Mart as an example of a potential near-term entrant into the Southern California retail food business.

This study is designed as an aid to public decision-making regarding supercenters, which have negative as well as positive impacts. Neither are always well understood, or carefully considered, in the municipal race for sales tax revenue. *However, this report clearly shows that the fiscal benefits of supercenter, and of discount retail more generally, are much more complex, and often lower, than they first appear.*

POLICY QUESTIONS

The nature of the grocery business has changed dramatically in some areas, with conventional grocery stores having difficulty competing on wages.

Cities, starved for sales tax revenue but also protective of their existing retail base, are unsure of how these big-boxes will affect either their economic structure or their fiscal bottom line. This study is designed mainly as an aid to public decision-making regarding such projects, which have negative as well as positive impacts. Neither are always well understood, or considered, in the municipal race for sales tax revenue.

KEY FINDINGS

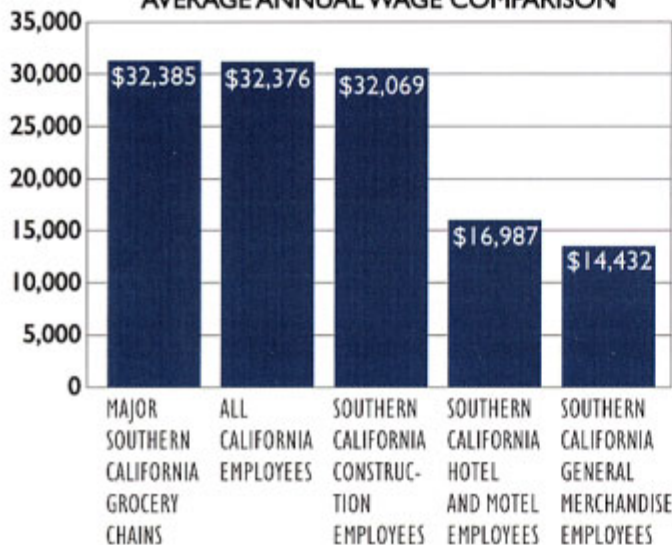
- The aggressive entry of supercenters such as those operated by Wal-Mart into the Southern California grocery business is expected to depress industry wages and benefits at an estimated impact ranging from a low of \$500 million to a high of almost \$1.4 billion per year, potentially affecting 250,000 grocery industry employees.
- The full economic impact of those lost wages and benefits throughout Southern California could approach \$2.8 billion per year.
- Discount retail chains that operate supercenters, including Wal-Mart, typically offer much less comprehensive health care coverage than major California grocery chains. One negative economic impact of Supercenters could be a dramatic reduction in health coverage for most of the 250,000 grocery employees in California. This can lead to lower quality of care for grocery employees whose health insurance benefits are reduced.
- The fiscal benefits of supercenters, and of discount retail more generally, are often much more complex, and lower, than they first appear. This is particularly true when big box retailers close existing stores to move into larger quarters elsewhere, when they expand an existing store into food, and when retailers reconfigure an existing store to sell food without expansion. In each case the additional tax revenues generated will in part come from existing businesses elsewhere in the city in the form of lost market share.
- Supercenters, especially Wal-Mart supercenters, are often conversions of existing discount retail stores. Thus local officials should carefully consider the possibility of a future conversion to a supercenter, and any attendant negative economic, fiscal, or land use impacts, when approving big box discount retail projects, even when the proposed land use does not include immediate plans for grocery sales.

THE ECONOMIC IMPORTANCE OF THE GROCERY INDUSTRY

The grocery industry is an often unnoticed but vital part of many local economies. In an era of increasing part-time employment and reduced pay and benefits, grocery chains provide what is becoming increasingly rare - entry level jobs that pay living wages with good benefits. The retail food sector employs 250,000 persons in California; slightly more than half of those are in the Southern California region. Of the 128,000 Southern California grocery employees, the 80,000 employees of the major chains are unionized and earn attractive wage and benefit packages. The average grocery employee at a major Southern California chain earns \$32,385 on a full-time annual basis - virtually the same as the average statewide pay for all job sectors.

It is also instructive to compare grocery employment and wages with other industries that are commonly considered an important part of the Southern California economy. Employees of the major grocery chains earn wages that are essentially the same as the average annual wage paid in the construction industry, and the 80,000 unionized Southern California grocery workers number about one-third of the region's total construction employment. Few doubt the role that construction plays in providing good wages and economic opportunity to persons with entry-level skills. Grocery employment serves a similarly important role in the economies of Southern California cities and for the entire region. Compared to other industries that provide entry-level jobs, such as the tourism sector, wages at major grocery chains are close to double what can be earned in, for example, hotel and motel employment. Major Southern California grocery chains also pay, on average, more than twice as much as the pay earned by general merchandise employees. This is representative of the pay gap between grocery stores and the discount retail firms that have entered the grocery market in other states.

AVERAGE ANNUAL WAGE COMPARISON



WHAT DOES THIS MEAN FOR ORANGE COUNTY AND SOUTHERN CALIFORNIA?

Three sets of policy issues are important.

1. **Supercenters are often conversions of existing discount retail stores, and local officials should be aware of that possibility.** In 1999, Wal-Mart estimated that 72% of all new Supercenters would be built by converting existing Wal-Mart discount centers. Because the grocery and general retail industries differ dramatically in their pay scales, function within the community, and ability to generate sales tax revenues, this is far from a simple expansion of an existing business. Local officials should be aware of the possibility for conversions of existing discount centers into supercenters.
2. **The grocery industry in Southern California pays substantially higher wages, and offers better benefits, than many of the discount retail chains that currently operate supercenters.** By far the largest controllable cost in the grocery industry is wages and benefits. Large labor cost differentials do not persist in the grocery business. Should a discount retailer enter the Southern California grocery market and compete effectively while paying wages below the current norm for the industry, the pressure on existing chains to lower wages and benefits would be immense. As an example, estimating that Wal-Mart supercenters could capture from 10% to 20% of the Southern California grocery market, we calculate the direct value of lost wages and benefits to range to nearly \$1.4 billion per year. **Accounting for the multiplier effect as those wage and benefit cuts ripple through the economy, the total economic impact on the Southern California economy could approach \$2.8 billion per year.**
3. **The fiscal benefits of supercenters, and of discount retail more generally, are often complex.** Supercenters in particular combine many non-taxable food items under one roof with general merchandise. Furthermore, any discount retail outlet potentially shifts sales from existing local retail, and the net impacts on local sales tax revenues are far from certain.



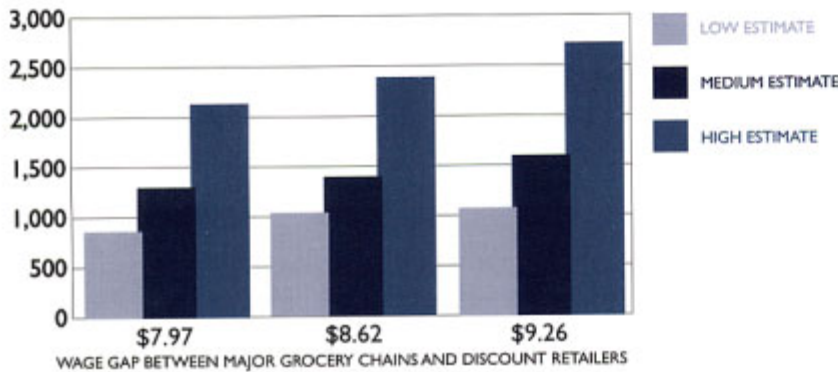
STUDY OVERVIEW

A brief synopsis of the research is given below. For the full study, including citations for all information, data sources, and a detailed description of the methods, see the full report, available at www.ocbc.org. The wage and benefit impacts of the entry of big box grocers into the region are estimated using a two step process. First, we estimate the market share that Wal-Mart supercenters are expected to capture in Southern California, based on current averages of between 47 and 57 stores per distribution center. Using data on market share and number of stores in several urban areas, we conclude that one distribution center roughly translates to a 10% market share of Wal-Mart supercenters in Southern California. The assumptions that led to that estimate were uniformly conservative, and so we also use an estimate of 20% long-run market share for supercenters, comparable to the major existing chains in Southern California.

cery chains typically seek to close approximately one half of the wage gap with major competitors. Over the long term, the grocery chains may seek to lower wages to their workers to eliminate the entire difference between their pay and that of discount retail employees an average difference of over \$9 an hour currently.

Using data on current wages and benefits, we calculated that the direct impact on workers in Southern California would likely fall in the range of about \$500 million to \$1.4 billion per year in lower pay, depending on the big box grocers' market share. Using the Southern California Association of Governments estimates of how these lowered wages would impact the regional economy, the total regional drop in spending ranges from about \$1 billion to over \$2.8 billion per year. The numbers will rise the larger the market share of big box grocers, and could well top even these figures over time.

ESTIMATES OF REGIONAL INCOME LOSSES (IN \$ MILLIONS)
FROM LOWER WAGES PAID BY BIG BOX GROCERS

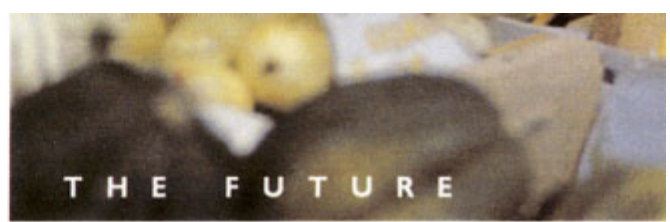


We then calculate the wage impacts of these market share estimates. Even a 10% market share for supercenters is a substantial competitive threat to existing chains, and those chains are likely to respond aggressively. Case studies of similar competition between low and high labor cost grocers illustrate that grocery chains cannot tolerate large labor cost gaps. This evidence indicates that in the short-term gro-

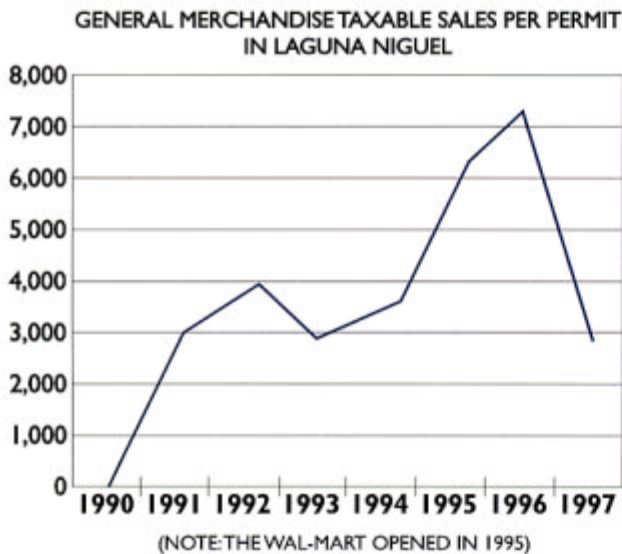
In addition, we find that the tax revenue impacts of big box grocers are uncertain. While big box retail does typically capture taxable sales from outside the jurisdiction, it also captures business from local retail, thus hurting the local economic base of the community. There is evidence as well that the initial growth in sales tax revenues from the big boxes may not be either steady or sustained in some situations.

More to the point of this report, a much larger share of food sales are not taxable at all. Most of the Wal-Mart supercenters result from the conversion of existing Wal-Marts into a combination of general merchandise and food sales. Thus, the floorspace devoted to taxable sales may actually fall as these conversions continue.

There is also evidence that general merchandise stores are far more vulnerable to market shifts than food stores. Thus, this trade off presents itself: big box retailers will most likely boost overall retail sales and tax



revenues on entry, only to be among the first to consolidate or fold when conditions begin to change. If a big box were to include food sales in its operations, then free-standing food stores would likely yield market share and in some cases become vacant, while taxable sales from grocery operations would shift to locations that are much more prone to the impacts of regional business cycles.



HOW SHOULD LOCAL OFFICIALS PROCEED?

These potential impacts are significant, with respect to both the vitality of the local economy and the public budget bottom line. The transformations in the grocery industry thus present local officials with some key policy considerations. The grocery business is a vital part of the economic and the community fabric of most every municipality in the region. The changes occurring in that business have the potential to quickly and adversely affect the economic health of localities, and officials should be aware of that potential as they evaluate future discount retail projects.

In particular, the following questions are important in evaluating discount retail projects.

1. Is there potential for changes in the use of the property? Discount retail chains are increasingly taking on the functions of grocery stores. In light of that trend, local officials should both be aware of the potential for the conversion of discount

retail sites into supercenters and inquire about future plans for discount retail stores seeking local planning commission and city council approval.

2. How will the discount retail store affect the local labor force? Discount retail chains traditionally pay substantially less than the grocery industry in Southern California. Local officials should carefully assess the possibility that a particular discount retail project might depress wages in other stores in the municipality.
3. What are the fiscal impacts of a discount retail store? At the most general level, local business both require public services and have the potential to produce local tax revenues - a point often missed when officials focus exclusively on the tax revenue side of the equation. Any land use, even big box retail outlets that are perceived as municipal cash "cows", must be carefully evaluated. Some land uses do not generate tax revenue that outweighs municipal costs. In other instances, the data in the full report (particularly Chapter 3) suggest that discount retail stores produce only short-term increases in local sales tax revenue. And the cyclical nature of retail sales tax revenue suggests that the revenue streams from supercenters might be highly variable over time. Local officials should carefully evaluate these and related issues when they assess the fiscal impact of a discount retail outlet or supercenter.

For decades, grocery stores have been hidden but important parts of the health of many Southern California municipalities. Recent changes in the grocery industry have the potential for catching local officials unaware of the possible impacts in their communities. The full report (available at www.ocbc.org) highlights the potential for economic impacts as discount retail chains develop supercenters, while also emphasizing the uncertain nature of any local fiscal benefits. Local officials should carefully evaluate the implications for their communities.

A Checklist for Evaluating Big Box Retail Projects

Overall, our analysis of these data illustrate the great complexity, and possibly unintended consequences, of the entry of large footprint discount retail into the grocery business. To help prepare local and regional officials to review proposed big box projects generally, we suggest communities systematically assess the positive and negative local impacts of such projects. The following checklist is one way to do so. It proposes a systematic review of the impacts on local workers, on municipal finances, and on other key community issues.

ECONOMIC AND EMPLOYMENT IMPACTS

How much will the new big-box outlet cut into existing local retail market share?

TASKS: Need to inventory the local retail base
Assess market areas and market impacts

What will happen to the local workforce?

TASKS: Assess impact on existing local retail
Calculate direct impact of job changes, lower wages
Calculate impacts of less medical coverage and other fringe benefits
Calculate ripple impacts of lower wages on local economy (multiplier impacts)

Will the new big-box outlet lead to vacancies or changes in local land use?

TASKS: Inventory vacant land and commercial properties
Assess re-use or redevelopment possibilities for competing sites

MUNICIPAL FINANCE IMPACTS

How much will the new development cost your municipality?

TASKS: Services and capital expenditures: Calculate cost of infrastructure & utilities (i.e., streets, sewer connections, water lines, etc.)
Traffic and other service impacts?
Calculate the cost of associated economic development incentives (e.g., tax credits)
Assess the impact of redevelopment zone tax-increment financing

How much will the new development really change local tax revenues?

TASKS: Assess net changes in local retail sales (e.g., including sales lost to the new big box)
Calculate net changes in sales and property tax revenue
Examine the stability of the retail sales tax revenue over time

COMMUNITY IMPACTS

Will the big-box footprint possibly expand in the future? In the same line of business?

TASKS: Ask about future plans up front
Examine industry trends
Plan for expansion contingencies

What localities will benefit from and/or be disadvantaged by the big-box development?

TASKS: Assess the differences between local and regional impacts
Are local gains at the expense of losses in other cities? Must these be mitigated?

How will the new retail outlet affect your community's quality of life? For example, will it reduce the appeal of a downtown core that you are trying to preserve or revitalize?

TASKS: Inventory locations of competing retailers
Assess impact on existing local retailers

