KANSAS LEGISLATIVE DIVISION of POST AUDIT

The Rundown podcast transcript for LPA report titled ***LPA Guide to Economic Development Incentive Evaluations*** – Released November 2020

Brad Hoff, Host and Recruiting and Training Manager: [00:00]
From the Kansas Legislative Division of Post Audit, this is The Rundown. Your source for news and updates from LPA, including performance audits recently released to the Kansas legislature. I'm Brad Hoff. In November 2020, Legislative Post Audit released a guide to economic development incentive evaluations. I'm with Andy Brienzo, principal auditor, who authored this guide and who supervises the economic development incentive evaluations. Andy, welcome to The Rundown and thanks for taking the time to discuss this guide with me.

Andy Brienzo, Principal Auditor and Supervisor: [00:40]
Thank you Brad.

Brad Hoff, Host and Recruiting and Training Manager: [00:42]
To start off, explain to our listeners what an economic development incentive is and the different ways these incentives can be used for economic development.

Andy Brienzo, Principal Auditor and Supervisor: [00:56]
Actually, just before I get into that, I'd like to briefly mention what this guide is and why we created it. So LPA in the 2019 legislative session was directed by the legislature through House Bill 2223 to start producing economic development incentive evaluations. So, this is a new product for us. It's not something we've done regularly in the past, we've done some ad hoc ones, but this is something that we're going to be doing on a regular basis going forward. So, we wanted to produce just a short guide for legislators and others who might read our reports to kind of prime them on this topic. Explain some of the basics about economic development incentives and about how LPA will be evaluating them and kind of what to do with this new information that we will be producing in the form of these incentive evaluations. So, that's really the purpose behind the guide itself. Now, moving on to your question at their most basic level state economic development incentives are basically the state giving businesses money to do things that policymakers think will help the local economy. So, this includes things like trying to get businesses to move to their state. It also includes trying to keep existing businesses that are already operating in this state or maybe help them expand. States usually do this through a variety of different mechanisms. The most common are tax incentives. So, these are things like tax credits, tax exemptions, tax rebates. States also do this through cash

subsidies and all these things generally present a cost to the state. Some incentives don't always present a cost to the state, but generally they do and that's why economic development incentive evaluations are so important. It's important for policy makers to think about the ways that state resources are being used. By evaluating economic development incentives, we allow them to better understand how the money that's being used on those incentives is impacting the economy and whether there might be other areas that they would prefer to spend the money that is currently being used on incentives.

Brad Hoff, Host and Recruiting and Training Manager: [03:12]
So, talk about the several ways that an economic development incentive can be evaluated to determine whether it is successful or not.

Andy Brienzo, Principal Auditor and Supervisor: [03:26]
So, there's a lot of different types of incentives and likewise there's a lot of different ways to evaluate incentives. So, they can do things like measuring the number of new jobs or the amount of new investment that an incentive creates that can also try to get at an overall ratio of benefits to costs. So, that's the return on investment or ROI number and in addition to looking at incentives in different ways, they can also vary in their complexity. So, some evaluations can be extremely simple. They may be more descriptive than anything else and they may look at who is using an incentive, how often, [and] whether an incentive is benefiting the people that policy makers intended it to benefit. On the other hand, an evaluation can use extremely complex economic modeling and these models can also look in different directions. So, some models look backward to measure an incentive's actual effects that have been observed over time. Other models look forward and they attempt to forecast what an incentive's effects could be in the future. So, really incentive evaluations can run the gamut in a variety of different ways.

Brad Hoff, Host and Recruiting and Training Manager: [04:37]
Now, the guide notes that evaluations try to estimate an incentive's positive and negative effects, elaborate what some of these effects are, both positive and negative, and how they may partially offset one another.

Andy Brienzo, Principal Auditor and Supervisor: [04:55]
Okay. So, incentives give businesses financial benefits through tax incentives like credits or exemptions or rebates or through cash subsidies sometimes and this makes the business more profitable. It also affects the businesses workers, other businesses, the local and state governments in the area, and these things can at least partially offset one another. So, economic models of the type that I mentioned, use data and assumptions based on research to try to estimate these effects, the estimates are generally reasonably accurate, but no one can really know the effects with certainty. , so among the positive effects would be things like direct economic effects. So this reflects the actual incentive amount that the state provided to try to increase the business's profitability. So for example, the businesses pay less in taxes or they receive cash for things like moving, expanding, or staff training. These are the direct economic that the incentive is having the incentive then also has secondary economic effects. So, when a business receives an incentive, they may create jobs or

raise wages. So, this helps retailers and suppliers in the area because the business is spending more money at retailers and suppliers. Their workers are spending more money at retailers in the area and then these retailers and suppliers grow in turn. As a result, the total income increase is larger than the original incentive amount. So, this is usually reflected in a multiplier in an incentive evaluation. There's also going to be generally speaking, increased tax revenue. So, the increased wages that are being paid to the incentive business' workers, their increased consumption, the businesses increased consumption. These things would all lead to higher tax revenue in the form of income tax and sales taxes. Property values may also go up as businesses hire more workers. People are moving into the area who weren't there before. That increases demand for real estate, which may push up property values, which then would push up property tax revenue. Now on the other side of the coin, there are some negative effects that you as you mentioned before. So one is the but for issue. So, states offer incentives to get businesses to make choices that they would not have otherwise made. So, ideally the state is providing a financial incentive to a business to do something that in the absence of the incentive, they may not have done, but businesses often make location or expansion decisions based on things other than incentives and so there are cases where the state is giving an incentive to a business, to do something they were going to do anyway and actually unless incentives are very large, they generally don't tip the balance in a state's favor. Businesses often make decisions based on other things like whether the right workers are available, how much they'll cost, whether infrastructure like highways and broadband internet is available, whether the area is good schools and sort of, a generally high quality of life. There's other factors that they consider in addition to incentives. The other thing is opportunity costs. This is another potential negative effect. So, paying for an incentive means the state has less money for other things because the state has a finite amount of money. I mean, these other things could be things like education or infrastructure development and actually some of these other options may also spur economic development and they could be better uses of taxpayer money than the incentive. Now it's worth noting that, as I said earlier not every incentive is always going to have an opportunity cost, but in general, most incentives will. Another negative effect is what's called the displacement effect. So, a certain business receiving an incentive may, as it tries to expand, hire staff away from others in the area that didn't receive the incentive and people who used to shop at other businesses may start buying more from the businesses that received an incentive. So, essentially the business receiving an incentive could benefit at other businesses' expense and then finally, another example of a negative effect from an incentive potentially it would be increased demand for public services. So, if a business increases its hiring after receiving an incentive, and it does so by bringing in staff from outside the area that may help ameliorate the displacement effect if they're hiring fewer staff from competitor businesses in the area, but if they're bringing in more staff and they're increasing the population that means more people need public services. So, this includes things like education, roads, public safety, and this makes these services more expensive for the government to provide or it can lower their quality.

Brad Hoff, Host and Recruiting and Training Manager: [10:06]
Now, the guide mentioned that policymakers should evaluate incentives from a variety of angles specifically that policymakers should consider how incentives fit with their policy goals. Explain what you mean.

Andy Brienzo, Principal Auditor and Supervisor: [10:23]
Okay. So, evaluations provide a lot of useful information for understanding incentives for maybe comparing incentives to one another and each element of an incentive evaluation can help inform economic development discussions, but you can't really boil down an incentive into a single number, for example, a single ROI or return on investment number is not really enough to show whether an incentive is working like policymakers expected it to or hoped it would and it's also not enough to simply compare to incentives or ROIs to one another and use that to determine which one is better. Now, part of this is because ROI figures could vary across evaluations depending on which benefits or costs they include. That's not necessarily standard across incentive evaluations, and they may not capture effectively how incentives benefitting or, harming different groups of people, businesses, or areas of the state. So, policymakers as a result should also consider things like how incentives fit with their policy goals. So, incentives are not really an end in themselves. They're generally meant to achieve something that policymakers think will be a benefit to the local economy. And policymakers may have other types of goals, things like environmental protection maybe, or attracting certain types of businesses to the state. and some incentives may be better than others at doing these types of things regardless of what their ROI is. So for example, an evaluation may show that an incentive has a smaller ROI than another incentive, but maybe it's better at achieving certain policy goals that are important to policy makers. So, it's important to look at incentive evaluations in a holistic way that captures not only the information that's, that's in the evaluation, but also, what policymakers are trying to achieve for the state and what their broader goals might be.

Brad Hoff, Host and Recruiting and Training Manager: [12:21]
Finally, what should be the main takeaway of this economic development guide?

Andy Brienzo, Principal Auditor and Supervisor: [12:27]
Economic development incentive evaluations are complex. They're likely to look different from one incentive to another and these evaluations really don't tell the whole story. Incentives are part of a complex economic development landscape. There's other elements that are important that are beyond incentives. The factors that I mentioned before, things like good schools, good infrastructure, having the right types of workers. And there are various policy goals that policy makers are trying to achieve that are important to them. All of these things really should be taken into consideration when considering the results of an economic development incentive evaluation.

Brad Hoff, Host and Recruiting and Training Manager: [13:11]
Andy Brienzo is a principal auditor at Legislative Post Audit. He helped write a guide on how Legislative Post Audit evaluates economic development incentives. Andy, thank you for stopping by The Rundown studio and going over this guide with me.

Andy Brienzo, Principal Auditor and Supervisor: [13:27]
Thank you, Brad.

Brad Hoff, Host and Recruiting and Training Manager: [13:28]
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