How Not to Study Economic Development Incentives

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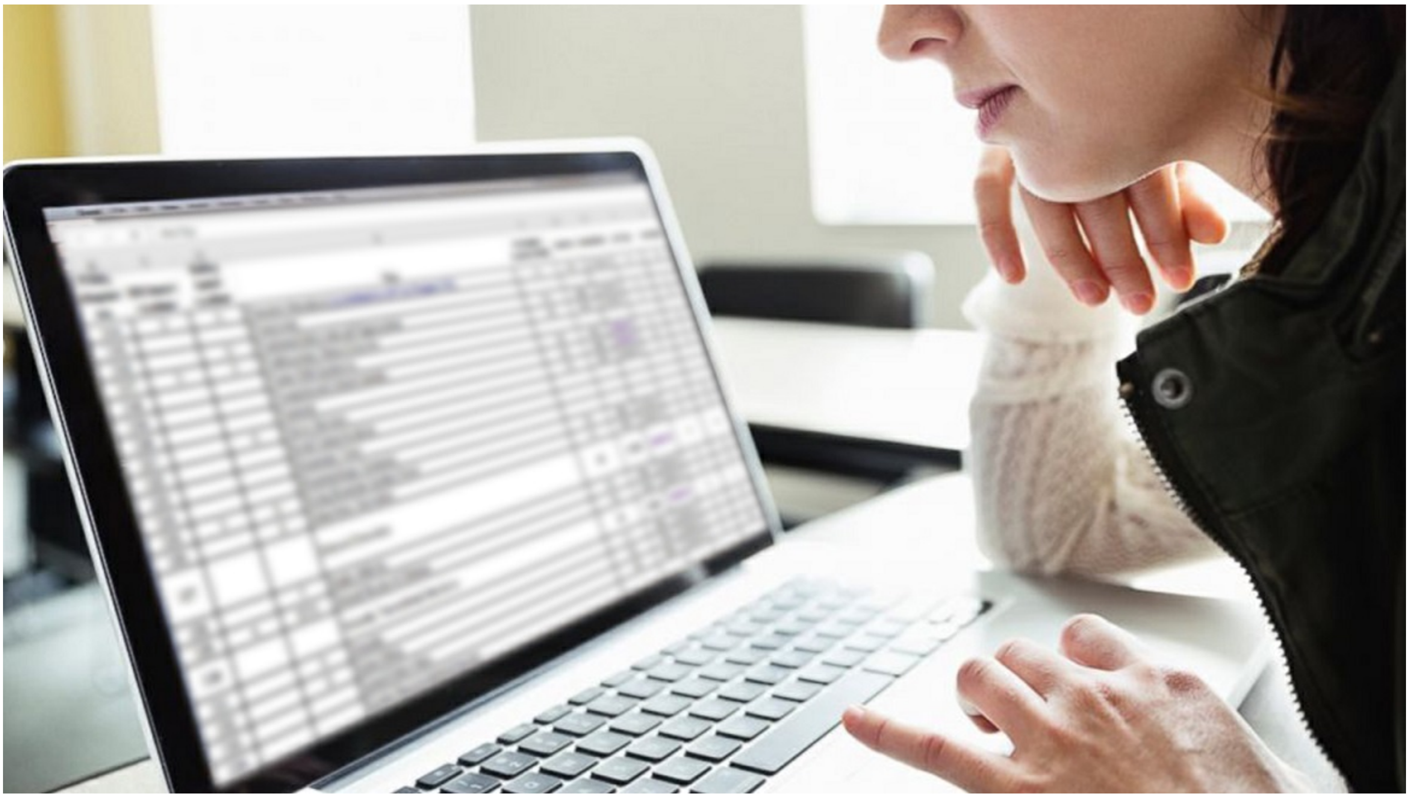

By: Patrick Tuohey

Economic development incentives are all the rage. And they aren't all multi-billion-dollar packages to attract a new Amazon headquarters. Many come from small towns offering sales tax breaks on construction equipment. But either way, cities and states are falling over themselves to underwrite private investment. As the number and size of such subsidies grow, some public officials are asking if these incentives are worth it, while others are relying on questionable assumptions to justify their policies.

Contrary to what proponents of economic development subsidies are claiming, the incentives aren't really driving companies' decision-making. The Upjohn Institute for Employment Research released a study in February which concludes in part that, "for at least 75 percent of incented firms, the firm would have made a similar location/expansion/retention decision without the incentive." Amazon's choice to move its new headquarters to New York City and a suburb outside Washington, DC, illustrates the point: companies do what is best for them, and tax incentives are rarely enough to outweigh other factors (like quality of workforce, for example) that influence decisions about where to set up operations.

Cities are starting to reevaluate their incentive programs. Nashville recently suspended the use of tax-increment financing (TIF) pending a study. St. Louis completed a broader study of economic development incentives in 2016 and is now considering reforms.

Kansas City undertook an effort to study its incentive regime, but the process seems intended to obfuscate. In a July 2016 story in *The Kansas City Star*, Mayor Sly James seemed to appreciate exactly how important a well-done study of incentives could be in improving policy. He said,

> Such an analysis, if done correctly, will take some time to complete; however, we will be working to complete it as soon as possible. The report will provide the sort of data and facts that can lead to reasonable and responsible improvements to our economic development policy.

By October 2016, the mayor appeared to be backpedaling. In a speech to city employees he said, “City Hall doesn’t do a good enough job of promoting how economic development benefits the city.” That suggested a shift in purpose from a serious analysis of city policy to merely a public relations effort to promote existing policy.

Kansas City received eight bids—ranging from $174,000 to $287,000—on the proposed study, including from the PFM Group, an asset management company that had conducted the above-mentioned study in St. Louis. The highest bid came from the Council of Development Finance Agencies (CDFA), which according to its website is “a national association dedicated to the advancement of development finance concerns and interests.” It is not an accounting or economic evaluation firm, but a trade group seemingly placed in a conflict of interest.

Kansas City contracted with CDFA and paid the firm $350,000—more than what CDFA bid on the project, and approximately twice as much as St. Louis paid PFM for their 2016 study. There was now more reason to suspect this was not going to be a serious or rigorous analysis.

CDFA presented its report to the Kansas City Council on August 16, 2018—16 months past the original contract deadline. The report was a disappointment, but not a surprise. Rather than undertake the rigorous work of measuring the real impact of subsidies, CDFA simply assumed that subsidies had a positive economic effect. For example, it appears that the authors tallied up the value of a given economic development incentive and then divided it into the jobs or tax revenue that project generated. As a result, the CDFA report concluded, incredibly, that “each incentive dollar invested generated $3.83 in additional tax revenue.”

Importantly for policymakers, the report made no attempt to determine how or if a given incentive caused the subsequent development. It made no effort to determine if some projects generated more and better returns on incentives invested than others. During the presentation, council members continually questioned the consultants assembled about how the report could help them make better decisions in the future, or when incentives in a particular part of town met with diminishing returns. The consultants could not answer, because the study avoided such important questions.

Some organizations with an interest in promoting economic development incentives, such as the Greater Kansas City Chamber of Commerce and the Downtown Council, have uncritically parroted the $3.83-per-dollar-invested return rate on incentives. They should have known better. The editor of the *Kansas City Business Journal* called the report a “hot box of poo” and wondered, “did Kansas City blow a couple hundred thousand dollars on a completely useless study?”

While other cities are taking this issue more seriously, it appears that in Kansas City the answer is yes.

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