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# **ECONOMIC AFFAIRS COMMITTEE**

## **MEETING PACKET**

**Wednesday, February 11, 2015  
10:00 AM – 12:00 PM  
Reed Hall (102 HOB)**

**Steve Crisafulli  
Speaker**

**Jose Oliva  
Chair**

# Committee Meeting Notice

## HOUSE OF REPRESENTATIVES

### Economic Affairs Committee

**Start Date and Time:** Wednesday, February 11, 2015 10:00 am  
**End Date and Time:** Wednesday, February 11, 2015 12:00 pm  
**Location:** Reed Hall (102 HOB)  
**Duration:** 2.00 hrs

Presentation by the Office of Economic and Demographic Research (EDR) on the Return on Investments of Economic Incentive Programs

**NOTICE FINALIZED on 02/04/2015 14:04 by Manning.Karen**



# Return on Investment In Florida Practice

February 11, 2015

Presented by:



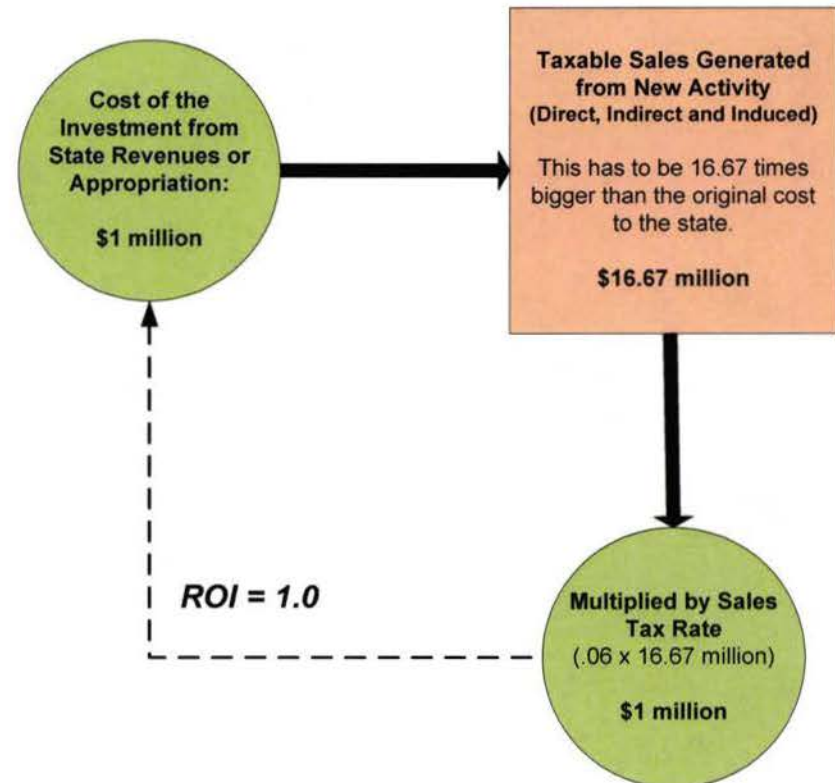
The Florida Legislature  
Office of Economic and  
Demographic Research  
850.487.1402  
<http://edr.state.fl.us>

# Return on Investment (ROI)...

In EDR's work, the term "Return on Investment" is synonymous with the statutory term "economic benefits" which is defined in s. 288.005, Florida Statutes.

*"The direct, indirect, and induced gains in state revenues as a percentage of the state's investment. The state's investment includes state grants, tax exemptions, tax refunds, tax credits, and other state incentives."*

## Sales Tax Example...



# Secondary Effects—The Ripple

- Most analyses by the various estimating conferences focus on direct effects, which are generally static, immediate and “first-round” effects.
- EDR uses the Statewide Model to look at the effects as the policy change ripples through the economy and behaviors change.
- These secondary effects include:
  - “**Indirect Effects**” are changes in employment, income and output of local suppliers that provide goods and services to support direct economic activity.
  - “**Induced Effects**” are the changes in spending by households whose income is affected by direct and indirect economic activity.

# ROI In Practice...

- The measure is ultimately conditioned by the state's tax policy which determines what is taxable.
- EDR's evaluation also requires identification of jobs created, the increase or decrease in personal income, and the impact on state Gross Domestic Product (GDP) to round out the analysis.
- The ROI does not address issues of overall effectiveness or societal benefit; instead, it focuses on tangible financial gains or losses to state revenues.
- It is entirely possible for a project or program to have a negative return on investment but still be desired (for example, to subsidize an essential activity that wouldn't otherwise have occurred).

# Meaning of Returns...

Returns can be categorized as follows:

- **Greater Than One ( $>1.0$ )**...the program more than breaks even; the return to the state produces more revenues than the total cost of the incentives.
- **Equal To One ( $=1.0$ )**...the program breaks even; the return to the state in additional revenues equals the total cost of the incentives.
- **Less Than One, But Positive (+,  $<1$ )**...the program does not break even; however, the state generates enough revenues to recover a portion of its cost for the incentives.
- **Less Than Zero (-,  $<0$ )**...the program does not recover any portion of the incentive cost, and state revenues are less than they would have been in the absence of the program because taxable activity is shifted to non-taxable activity or the costs are greater than the expected benefit.

The numerical ROI can be interpreted as return in tax revenues for each dollar spent by the state. For example, a ROI of 2.5 would mean that \$2.50 in tax revenues is received back from each dollar spent by the state.



# The Tool...

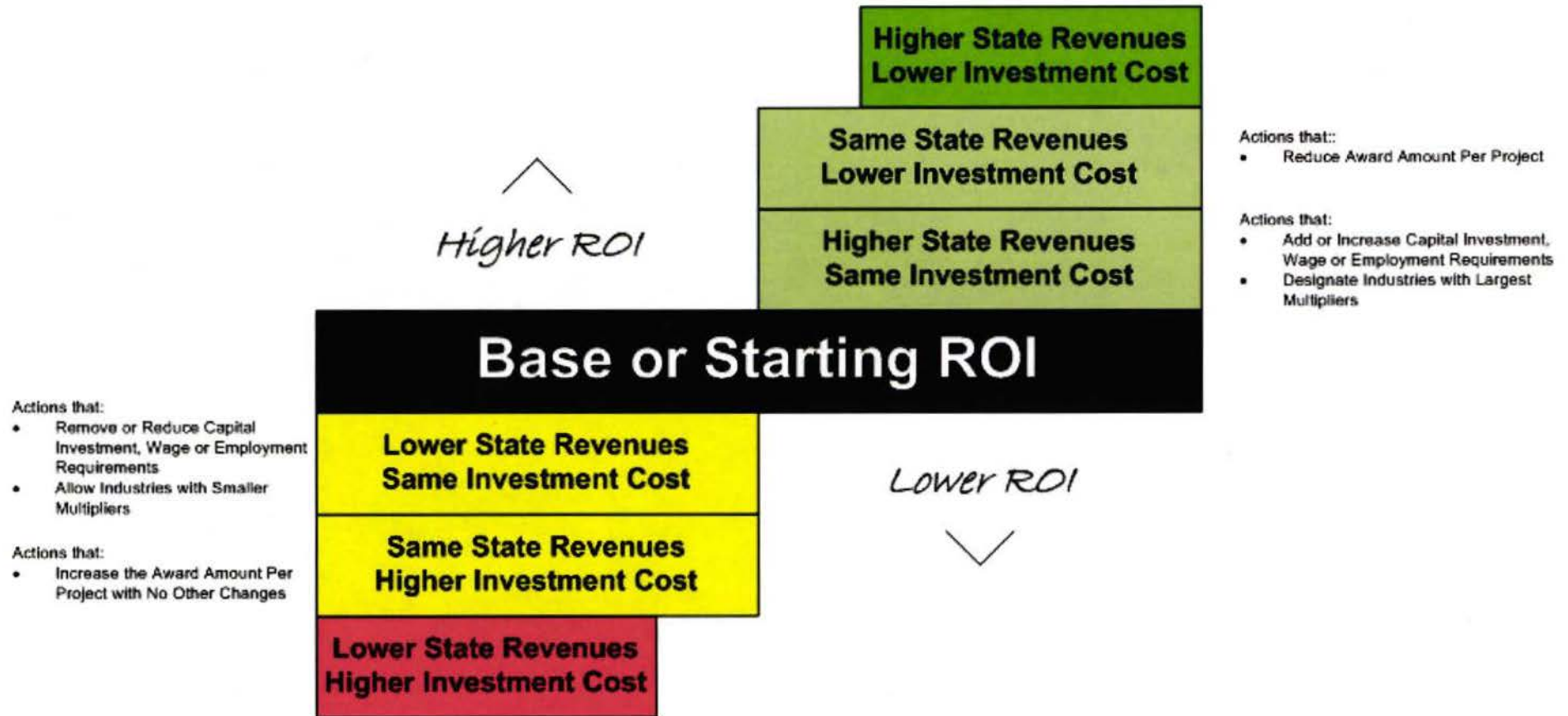
The Statewide Model is a state-of-the-art, customized, dynamic computable general equilibrium model (CGE) originally developed for Florida by Monash University (Melbourne, Australia). This means it:

- Contains a vast amount of data to replicate Florida's economy, tax structure, and state budget.
- Uses hundreds of mathematical equations to account for the relationships (linkages and interactions) between the various economic agents, as well as likely responses by businesses and households to changes in the economy. Started with 388 equations with 1,699,000 total elements within those equations.
- Has a time dimension that adheres to the state fiscal year (July 1 to June 30) to be useful in the state government budgeting process.
- Allows different programs to be evaluated on the same footing.
- Can be modified over time as new research and developments occur.

# Protocols...

- Statewide model, not regional. Therefore, no benefit is assigned to moving within the state. Everything is from a statewide perspective.
- Balanced budget requirement by fiscal year. Costs and relative benefits are taken into account, including choices by state government.
- Model calibrated to current budget policy and the adopted forecasts by the estimating conferences, referred to as the baseline.
- Currently, model results are treated as supplemental information that runs parallel to the traditional, static analyses.
- The goal over time is to allow for greater integration of the model results with the budget process.

# Changing the Reported ROI...



# Options for Improving the ROI...

## Specific Capital Investment Requirements

Capital investments (construction, machinery and equipment) have strong impacts. Benefits are localized, few leakages.

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- Capital investment in physical space has the strongest effect (i.e. construction) due to backward linkages to local suppliers. Machinery and equipment investments have smaller effects, since many of these purchases are tax-free and are often produced out of state. Although sales tax refunds are currently allowed for businesses and individuals who purchase taxable building materials and equipment, there is no requirement to undertake this activity.

## Specific New/Retained Job Requirement

New/retained jobs bring/keep additional income into an area, spending brings additional tax revenue.

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- New jobs should be new to the state (not new to the area) from a new business or a business relocating to Florida. Retained jobs should pass a “but for” test indicating that the company would have left Florida. A company that could easily leave Florida would have: locations in other states, not be market or resource dependent, and not be location-bound due to prior investments in Florida.

## High Wage Requirements

Higher wages linked to higher output and productivity, increase spending.

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- Higher wages lead to greater consumption. However, hiring underemployed and unemployed workers, even at a lower wage, may increase the ROI as it reduces public assistance dollars. Further, those employees spend more of their wages on consumption rather than savings.

# Options for Improving the ROI (continued)...

## Job Training Requirement

On the Job Training (OJT) and GED assistance improve chances of an employee's retention and promotion.

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- The average wage of a worker increases as his education level increases (leads to increased household spending).
- OJT and GED assistance have lasting benefits for the employee and privately funded initiatives defray state costs.

## Targeting Industries with High Multipliers

Industries with high multipliers produce greater returns to the state.

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- Industries with high multipliers typically have strong backward linkages to local suppliers. They also have high employment multipliers. Both result in greater indirect and induced benefits. There are few leakages to the rest of the world.
- Targeting industries with lower multipliers may be desirable in certain cases, but the trade-off is a lower ROI.
- From the perspective of the state's ROI, excluding certain retail and service-based industries generally leads to better results; however, this is part of the policy-goal decision facing the Legislature. For example, retail trade generally has lower output multipliers—but higher employment multipliers. These effects counteract each other in the overall analysis. In using the Statewide Model to calculate the state's ROI, the relationships between these multipliers, as well as differences in market dependence and product taxability, are all taken into account.

# Options for Improving the ROI (continued)...

## Targeting Businesses with High Export Volume or Federal Dollars

Businesses that bring in money from outside of the state grow and diversify the economy.

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- Options include targeting businesses with strong export capability or requiring that a minimum percentage of the products be exported.
- The state could also target industries that receive significant funding from federal contracts (space, military), although this would be subject to the annual federal budgeting process.

## Imposing a “But For” Requirement

Businesses that would not have located in the state “but for” the incentive improve the state’s ROI.

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- Businesses that would otherwise exist bring no additional dollars to the state as a result of the incentive. Essentially, the incentive is unnecessary.
- Similarly, incentives that are too small to induce new activity result in limited or no economic gain.
- Closely related to the determination of market or resource dependence.

# Options for Improving the ROI (continued)...

## Market or Resource Independence Requirement

Granting incentives to businesses that would have created or retained jobs regardless of incentives is a financial loss to the state.

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- Businesses that are dependent on Florida's population growth or resources may be technically qualified to receive incentives from a program, but there is generally no additional state revenue attributed to these businesses, as they (or a competitor) would have existed regardless of the state's investment.
- From an ROI perspective, the state's investment is a pure loss if the company would have otherwise chosen Florida. In some cases, even if that particular business did not come into existence, another business competitor would have satisfied the market demand.

## Limit State Investment

Limit state investment to no more than needed to accomplish goal.

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- Actions that reduce the state's cost improve the ROI, assuming the outcomes stay the same.
- Some form of local participation (incentives or required matches) should be considered in lieu of state investments for incentives that produce largely local, non-taxable or property tax-related results. The size of the state incentives should be linked or calibrated to the expected gain in state revenue.
- Local contributions towards a project may have an ambiguous effect on the state's ROI due to the apportioning process. The gain must be strong enough to produce a solid ROI for the state after apportioning

# Options for Improving Induced and Indirect Effects...

The literature suggests there are three ways to improve indirect and induced effects:

- Improve the direct effects on the front-end, primarily through the creation of more jobs, increased facilitation of new business establishments in targeted industries, enhanced promotion of higher salaries, or additional capital expenditures.
- Impose a requirement for backward linkages in the selection of firms for incentives.
  - Industries with strong backward linkages generate economic activity far beyond the nominal value of their products when they spend locally on inputs instead of purchasing those intermediate goods and services from outside the state.
  - Each dollar that remains in Florida reduces leakages and continues to boost local economic activity, employment, and ultimately tax revenue.
  - All else being equal, the stronger the linkage is, the greater the impact will be on the state's economy.
- Develop strong pools of local suppliers in key locations that can attract businesses which benefit from those relationships.



# Comparison of Programs...

Ranked Incentives and Investments	ROI	STATUS
Qualified Target Industry (QTI)	6.4	More than Breaks Even (State makes money from the investment)
Florida Sports Foundation Grant Program	5.6	
Economic Evaluation of Florida's Investment in Beaches	5.4	
VISIT FLORIDA Advertising	3.2	
Capital Investment Tax Credit (CITC)	2.3	
Brownfield	1.1	
Quick Action Closing Fund (QACF)	1.1	Does Not Break Even (however, the state recovers a portion of the cost)
High-Impact Sector Performance Grant (HIPI)	0.70	
Entertainment Industry Sales Tax Exemption (STE)	0.54	
Entertainment Industry Financial Incentives Program (Tax Credit or FTC)	0.43	
Professional Sports Franchise Incentive	0.30	
Innovation Incentive Program (IIP)	0.20	
Spring Training Baseball Franchise Incentive	0.11	
Urban High-Crime Area Job Tax Credit	0.07	State Loses All of Its Investment (plus incurs additional costs)
Enterprise Zones	-0.05	
Professional Golf Hall of Fame Facility Incentive	-0.08	
International Game Fish Association World Center Facility Incentive	-0.09	