Iowa Fiscal Partnership

BACKGROUNDER

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Keys to Fairly Assess the Effective Return on Investment from Public Business Subsidies

The following are key factors to assessing the return on investment of public economic development programs, tax credits and expenditures.

Most importantly, it is critical to establish a credible way to estimate the degree to which any state economic development program, tax credit, or expenditure actually produced the economic activity and the degree to which the activity would have occurred anyway. This must go beyond beneficiaries' claims about the value of the business subsidy, to hard evidence that a subsidy or set of so-called "incentives" tipped the balance to assure at least a portion of the investment. After this determination, a methodology for calculating public ROIs must address these key issues:

This is a summary of an Iowa Fiscal Partnership Policy Brief, "Bang for the Buck: Calculating the State's Return on Investments in Economic Development," by Charles Bruner and Peter S. Fisher (January 27, 2010). www.iowafiscal.org

- **Calculate public investments in terms of public returns**, not increased overall economic activity. Public returns involve increased revenue to the state (in taxes and fees) as a result of the increased business activity, and are the way to measure public (tax dollar) investments for their returns.
- **Establish a reasonable time frame for making these estimates, with returns in future years appropriately discounted**. A public investment, like a private one, needs to produce returns over a reasonable time period, and future returns should be appropriately discounted.
- **Compare the return on investment in economic development expenditures with the potential gains from alternative uses of the funds**. A proper analysis would account for the lost opportunities that would come from making those investments elsewhere.
- **Estimate the impact of the investment on the direct level of economic activity that is projected to occur, including any potential for displacing existing economic activity.** The public interest is in net new economic activity, not displacement of one activity with another, which also can provide unfair advantages to new over existing businesses. Displacement occurs when a subsidy simply enables one business to capture an existing firm's share of a state market that is not expanding.
- **Incorporate additional public costs, as well as benefits, from the economic activity.** There may be additional public sector costs that have to be factored in, particularly for additional demands on public services and business-related infrastructure needs or workforce expansions when new economic activity draws people (and service users) to Iowa from outside the state.

- **Only count any return once, even if multiple, independent investments were made to produce it.** When multiple economic development subsidies are used to produce increased economic activity, the public return from that activity needs to be apportioned among those multiple subsidy programs, so it is not counted multiple times.
- **Recognize that ROI is only one factor to consider in determining public purpose and benefit.** Some investments can produce economic gain, but at a public cost (environmental degradation or public health and safety). Others can produce public benefits in those areas. Although these do not have a monetary value, they are important considerations in making public investments and need to be recognized in ROI analyses.
- **Audit for impact and accuracy.** Estimates and claims are only estimates and claims; there needs to be monitoring for actual impact, use, and achievement of public goals.

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The Iowa Fiscal Partnership is a joint fiscal policy initiative of two nonprofit, nonpartisan Iowa-based organizations, the Child & Family Policy Center in Des Moines and the Iowa Policy Project in Iowa City. IFP reports are available at www.iowafiscal.org.