Application of a New Model for Assessing Incentive Costs and Benefits

ELLEN HARPEL

ECONOMIC DEVELOPMENT TAX INCENT
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SMART INCENTIVES
SOUND DECISIONS

Response to the model - Michigan

Findings were well-received

How to share model details and outputs widely

Discussions around elements that represented a change in current practices

- Analysis timeframe
- Importance of the incentive – 2 approaches to "but-for"
- ROI calculation and public service costs

1. Timeframe for analysis

Model's built-in parameter is 80 years

- Allows the model to capture long-term effects of reduced education spending on residents' future earnings
- Most relevant if incentives financed through reductions in K-12 spending
- Not the case in Michigan

Presented a 10 year version as alternative

- More standard timeframe and when most meaningful effects occur
- Modeled effect for incentives financed through taxes rather than spending cuts

Importance of the incentive:

Was the incentive needed to drive the investment decision?

How much of the benefit should be attributed to the incentive?

2. Re-thinking “but for”

Incentive impact (“but for”) is not all or nothing

Many factors influence investment decisions. Incentives are considered in combination with these other factors

We will never know for sure what would have happened without the incentive

A percentage between 0 and 100% expresses this uncertainty

- A project’s use of land and labor will displace other job creation, so 100% is not appropriate
- Costs are incurred when applying for and accessing incentives, so zero is not appropriate

The model requires a percentage input to reflect the impact of the incentive

Two approaches

Cost sensitivity

- Assumes incentive % of firm's costs has % effect on probability of tipping job creation decision (incentive/industry value added)
- Bigger incentives imply higher probability

Firm choice

- Assumes incentive influence varies by firm and project characteristics
- Combined the research literature on factors that affect the likelihood that incentives influence company investment decisions with project-specific information to hypothesize the level of influence of Michigan's incentive on each investment
- Certain characteristics imply higher probability

3. ROI calculation and interpretation

Differences in modeled ROI from Michigan's existing practice

- Long term effect on residents' incomes versus state taxes generated during the 2-3 year incentive term
- Model does not attribute 100% of outcomes to the incentive (but-for)
- More specificity of costs and benefits

Takeaways on ROI findings

- How should ROI be used – to rank projects or estimate actual benefits
- Should the goal be to maximize ROI? Pros and cons

Lessons learned

Communication

- No such thing as too much communication
- Context
- Multiple presentation methods
- Avoiding the black box without overwhelming the audience

Consideration of the next steps

- Evaluation findings and recommendations
- But also:
  - How to use the model findings
  - How to adapt internal processes

Contact

Ellen Harpel
571/212.3397

ellen@smartincentives.org
http://www.smartincentives.org/

@SmartIncentives

