The role of government in the economy, nationally down to the local level, has evolved over the years. Historically, government involvement in the economy was frowned-upon and highly circumscribed. Over the years, rules emerged that guided governments’ roles. This essay discusses the foundations to government support of economic development, issues concerning modern economic development programming, and ends with a call for a dialogue on the proper role of state and local government in promoting the Iowa economy.

I. Principles of Welfare Economics

Ours is a market economy. In a market economy we assume a competitive market place, we are intolerant of monopoly power, consumers (including workers and businesses) have knowledge of alternatives (goods and services), and the prices paid for a good or service are reflective of the value of the good and the costs of producing it. If these factors are in place, then we are said to have a successful market.

Market Failure

If we could get everything we need from the market, we would not need government. Indeed, the role of government in a well-running market economy is historically limited. It is limited because the majority of the decisions that are made that benefit citizens are made by consumers of private goods. There are, however, important functions of governments that enhance our well-being – functions that fall outside of market transactions. While markets reflect a system of private choices and the production and consumption of private goods, governments are instruments of collective choice and the production of public goods and services – goods and services, ideally, that cannot be produced efficiently in the marketplace.

The market fails, therefore, in the production of public goods – goods like public safety, clean air, access to public education, etc. – and we rely on governments to provide these goods among the many that are deemed necessary. Government must produce these goods or provide incentives for these goods to be produced because the market can not or will not produce them, or if the market does produce them, access to those goods might be exclusive and discriminatory.
The market also fails because private market activities often produce externalities. Externalities happen when private producers are able to shift some of the costs of production to society at-large rather than have those costs reflected in the price of the goods that they sell in the market. Easy to understand externalities involve pollution, nuisances, noise, or risks to the health of workers or residents caused by industry. Because of the need to mitigate externalities, especially externalities that are directly harmful to public health and safety, governments must regulate and supervise certain aspects of market activity.

Finally the market fails in the case of a natural monopoly. The most common case of a natural monopoly is an electric utility. These firms have very high start-up costs, but average costs to consumers decline as production increases. Consequently, spatially, it is in the public’s interest to limit the number of these entities so that, with a circumscribed service territory, production is maximized among a customer base of sufficient size to produce lower average costs to consumers. Were two or more firms to try to serve the same customer base, average costs would be much higher. Therefore, natural monopolies are regulated by states to help to minimize this potential of cost-generating and highly wasteful competition. Occasionally, governments may themselves provide the service, as in the case of municipal power suppliers or telephone exchanges.

The Roles of Government in the Economy

The government interferes with or, stated differently, supports the economy in several ways. Among them:

- It can act to assure competitive markets by preventing trusts and monopolies and otherwise minimizing barriers to competition.
- It can act where production is inefficient (like natural monopolies).
- The market, a priori, needs government to provide the legal structure to resolve property disputes, protect trade and business secrets, and arbitrate disputes.
- Government provides goods that cannot or will not be provided by the market.
- It can offset market failures with its taxing power, regulatory power, or legal power (penalties and fines).
- It can influence the distribution of incomes and social benefits in a society using its taxing and appropriations powers.
- It can help to promote common economic objectives like full employment and socially desirable rates of growth.

Government promotion or interference in the distribution of private and public goods occurs in three major ways. First, it allocates public goods across its jurisdictions. Second, it attempts to equitably and effectively distribute economic and social resources through tax policies, subsidies, and income transfers. Finally, it attempts to stabilize or otherwise offset undesirable economic outcomes.
We require our governments to be accountable to the electorate for all three of these functions. We require it to allocate a necessary amount of public goods, but not an amount so great as to be burdensome on taxpayers. Some of these must be provided at the local level (police, fire, public education, water treatment, etc). Some must be provided at the state level (higher education, social services, and the administration of justice and corrections). And some, like homeland security or broad monetary policy, are national functions.

Generally speaking, local governments have a limited ability to engage in distributive governmental activities, the second type of government role. For the most part, their taxing and spending powers are pre-determined by state government and therefore strictly circumscribed. Still, within the limits of their authority, local governments must be mindful that the services that they provide are fairly and equitably accessible to all local residents and that the costs of service provision are not unnecessarily restrictive or prohibitive to certain groups of residents.

Finally, governments try to stabilize the economy. State government uses its regulatory powers to make sure that commerce is producing desirable economic and social outcomes. State governments also participate in workforce and welfare assistance programs to offset economic declines. Local governments historically use their power of zoning and land-use planning to assure a proper balance between the needs of commerce and the needs of residents. Most economic stabilization activities, however, occur at the national level utilizing both budgetary and monetary authority. Generally speaking, local and state governments have very little effective control over regional economic conditions or the pace and patterns of growth.

The Case for Economic Development

Increasingly, especially over the past three decades, local and state governments have used more and more tax resources to try to promote economic growth and community revitalization. Economic development in practice and in concept has infiltrated the public goods territory. Municipalities consider it an essential (municipal) corporate purpose in Iowa, and state government considers it an essential state activity. As a consequence, the actual direct funding of business promotion by local and state government competes directly with all other types of public spending categories. Jobs and income growth compete with roads, schools, and libraries. Economic development runs up against environmental enhancement and health and welfare expenditures.

These economic development activities may take the forms of tax abatements, investment tax credits, special financing districts to benefit industry or homebuilders, grants, and subsidized and forgivable loans. State and local governments also dedicate massive levels of administrative and planning expertise to assist business and to help facilitate growth regionally. The justification for this activity falls within the economic stabilization role that our governments have assumed, and which has grown over time. It pre-supposes a market failure of some sort, although the failure is usually very poorly defined.
As an example, historically, there are clearly strong social, economic, and overall community gains that can accrue from a typical urban renewal type of project. The systematic deterioration of a portion of a city can be called a market failure, at least in a localized sense. There exist extra-market factors inhibiting timely investment. Because of a pattern of deterioration, there may be ethnic or racial concentrations, lower income residents, higher unemployment, significant and spreading dilapidation, higher crime and other undesirable social outcomes, and overall taint or deterioration in urban quality of life, along with any number of other community woes. Such a situation might be thoroughly unacceptable at some point from market, social, and fiscal perspectives. The market issues usually evolve around systematic disinvestments, blighting, and neglect in potentially valuable areas of a city. The social consequences are obvious: our society does not tolerate high unemployment, crime, school drop outs, and normally attempts to offset these community negatives. Finally, there is the fiscal dilemma. These areas yield a decreasing amount of public resources. As deterioration spreads, land and housing values plummet, and tax receipts go down.

It is obvious to most that there are legitimate roles that governments may play to offset the social, fiscal, and economic conditions in such a situation. Urban renewal law historically allowed cities to use a variety of mechanisms to attempt to reconfigure land use, settlement, and influence the overall value of a deteriorated area. Cities could use eminent domain to condemn land for redevelopment, cities could use tax increment financing mechanisms to invest in necessary infrastructure needs and otherwise prepare land for redevelopment, cities could use those same tax-based benefits to try to influence the amount and kind of housing that might accrue to a region. And the city could use its zoning powers to make sure that the region developed in accordance with an overall community development plan.

When we count all of the costs and compare them to all of the economic plusses that may accrue over time due to all of these actions, we may actually be able to, within this circumscribed territory, isolate both economic and fiscal tangible benefits that accrue to the residents in the area and the overall community. Over a considerable period of time the region may begin to produce tax receipts that represent a net increase over all public finance costs and all increments to public service costs. It also may not produce tax receipts over the total of public finance costs, such calculations are incredibly difficult to make and in many cases highly arbitrary. The region may however yield sets of both tangible and intangible social and community advantages that may outweigh raw economic gains.

A very different case occurs at the community and at the state level when they are dealing with systematic structural and spatial economic changes. The entire process of urbanization, the most powerful of regional economic forces, yields by definition proportionately less economic activity in most surrounding areas. Consequently, while urban areas may be gaining, and most often are, in many states their neighboring, smaller communities are becoming often less economically vibrant. There is strong pressure on local government leaders in declining or slowly growing communities to attempt to
sustain economic activity. If they don’t or can’t the local value of investments deteriorate, outmigration accelerates, and the overall economic and fiscal health of the community starts to erode.

Is persistent decline in rural areas a market failure? The short answer is no. This has been the process of 200 years of development in this country, and for the most part, the pattern has not abated irrespective of government activity. What is occurring fits more into the realm of the sum of private choices translating over time into specific spatial advantages – almost always urban advantages, but in some instances towards areas with desirable natural amenities. Trade centers may become regional trade and service areas. In rural counties, the county-seat may yield gains or stability while the remaining smaller towns become less vibrant. And overall, metropolitan areas continue to accumulate higher shares of people, jobs, incomes, and commerce. There is not only an inevitability to all of this, there is also an overarching rationality to it all. People, businesses, industries, and institutions are all expressing their preferences in space and in time. After all, ours is a market economy.

Given the dominant patterns, what then is the appropriate modern role for states and communities regarding economic development? Increasingly, the paradigm has shifted from the states and local governments facilitating growth through the provision of public goods, regulatory power, and land use to one where the local government is using taxpayer resources aggressively to attract or retain jobs. This practice has grown tremendously in the last decade.

In the early 1980s, the state of Iowa had an Industrial Development Commission to woo firms to the state. The commission had a limited budget and a limited array of public resources to work with. Over time, that authority transformed. The Department of Economic Development in the mid-1980s, and it was endowed with considerable resources to provide grants, direct loans, loan subsidies and interest subsidies, and an array of technical assistance services to businesses in the state or prospective businesses. The state at the time was in the midst of a powerful and prolonged recession evidence by strong losses in manufacturing jobs, the farm debt crisis, and widespread losses in retail capacity in small communities. The state actively and aggressively began to pursue job growth strategies.

Communities, too, transformed at this same time. Prior to the mid 1980s, community economic development activities were relatively circumscribed. Their authority to leverage local resources to promote business growth was limited. In the mid 1980s, however, economic development was elevated statutorily to the level of an essential corporate purpose. That meant that economic development activities ranked right up there with many of the health, safety and welfare activities, the traditional police powers of municipalities. Communities started slowly in the economic development arena. Their first efforts were in tax abatements, and these early ordinances were usually quite restrictively. Over time tax increment finance district authority was liberalized and also became widely used. Now, cities collect nearly $200 million in tax increment financing property taxes that are used in the name of economic development.
Between the state’s authority and city governments’ activities, hundreds of millions of dollars are dedicated to boosting the state’s economy annually. Proponents argue that the massive spending is necessary – that bidding for or buying, if you will, jobs has become the model of economic development. From both an academic and a good government policy point of view, however, there is no conclusive evidence that the combined levels of local and state spending are, on net, promoting the overall well-being of the state. The reasons are many.

- First, it is difficult to even account for the total of state and local spending due, most especially in the local government sector, to no requirements for record keeping.
- Second, there is no central collection of the industries or firms that benefit from these incentives and the number of jobs that were influenced.
- Third, there is precious little information about net job changes regionally in lieu of growth in one area of the economy versus another.
- Fourth, as an example, the state’s economy produced nearly 300,000 jobs during the decade of the 1990s but only a very small fraction of that job growth occurred in firms asking for or receiving public assistance. Why did so many firms grow without assistance?
- And last, there has been little if any analysis of the alternative uses to which those public funds could have put and how those uses may have benefited the economy.

In all, then, the net beneficial aspects of this spending have not been clearly determined.

II. What is a Benefit?

Everyone involved in promoting the economy likes to tout the “benefits” of their actions. In economics and in governmental investment, however, the term “benefits’ has a highly restrictive meaning, rendering nearly all other casual uses misleading and inappropriate. The term “benefits” is usually properly used in the context of a benefit-cost assessment. A benefit-cost assessment occurs when there is clear evidence that a particular set of public spending actions (costs) will produce a set of agreed-upon benefits. When the ratio of the benefits to the costs exceeds one, then the project is a go. When the ratio of the benefits to the costs is less than one, the project probably should not be funded.

Surplus

We want our governments to be both effective and efficient. Effective public policy does what is intended of it. The money is spent to produce a desired outcome. Efficient public policy produces the desired results with the minimum of public cost or the maximum of desirable outcome. Efficiency principles in the use of public funds demand that we maximize our outcomes as public dollars are scarce and are competed after by scores of worthy uses. When governments divert public resources from one use to another, they inevitably affect the welfare of society and of individuals. In short,
defined broadly, governments want to enhance the welfare of individuals while minimizing the burdens that they place on them.

The historical methods of producing welfare gains have come from the incremental investment by governments in public goods. Bridges, roads, canals, navigations systems, dams, etc., are all forms of public investments that are designed to produce or enhance welfare gains. The same can be said of vaccinations, nutrition programs, screening children for disabilities, other important preventive health and social programs. The gains that are counted are measured as either producer or consumer surpluses over some reasonable period of time. Stated very simply, because of the timely and strategic investment by governments, as would be the case in a public works construction project, consumers and producers realize reductions in the costs of obtaining necessary goods and services or in the cost of selling their labor. In short, their welfares are enhanced because their individual or business costs are lowered yielding higher incomes and greater price competitiveness among firms. Over a standard period of time, the sum of those enhancements to welfare (usually consumer surplus as producer surplus in a competitive market results in price declines) can be summed.

In benefit-cost analysis, then, the discounted present value sum of all benefits over time (say 20 or 30 years) is compared with all public costs in the project over the same time period. If the benefits exceed the costs, then the project is funded. If two or more projects are being evaluated, governments will look at both the benefit to cost ratio and the total of benefits to be achieved after costs have been accounted (net benefits). In most instances, choices that yield the most net benefits are most desirable.

**Tangible Benefits versus Economic Outcomes**

The benefits that are used in a benefit-cost calculation are defined very rigorously as enhancements to consumer surplus. To the extent that these benefits are monetary, they are tangible, meaning that they can be quantified and measured against costs. There may also be significant intangible benefits – outcomes from a project that may yield important economic, social, cultural, or environmental benefits that are difficult to quantify in market terms.

We use benefit-cost methodology to measure tangible benefits against public costs. We do not use pure benefit-cost methodology to measure intangible benefits. Many public officials confuse economic development outcomes – jobs, income, value added, regional sales, etc.—as tangible benefits of the kind appropriate for benefit-cost analysis. They are not. The outcomes from economic development are not benefits in the restricted use of the word, regardless of the tendency of public officials to term them as such. They are economic outcomes that are distinct from the welfare gains necessary for traditional benefits.

The distinction is not trivial. Economic activity occurs. Economies change over time. Benefits in the pure sense refer to an enhancement of total factor productivity net of the changes that are otherwise going on in the economy. Nearly all economic
development activity in communities and in states, including that which might have been enticed to locate in a particular locality, would already have occurred somewhere in the regional or national market. The public money that is being spent on the firm, clearly a public cost, does not produce net benefits in the restricted sense. If anything, public assistance distorts the relationships among firms by requiring local taxpayers to subsidize the price of the goods sold by the recipients of the aid.

The Tendency to Count Value Added as a Benefit

Value added is a very simple thing. It is the payments that are made to the factors of production, land, labor, capital, and indirectly to governments. They are the payments to workers, investors, and to governments that are linked to the production process.

It is extremely tempting for economic developers to compare the sum of public spending on a project against the direct value added that is produced. This temptation is even greater in areas that are depressed or are otherwise undergoing economic stress. This inclination applies to the traditional investment in infrastructure, as would be the case in a benefit-cost consideration, as well as to the modern sense of tax breaks and direct grants-in-aid. Value-added accumulations by private firms that are linked either directly or indirectly to public spending are not benefits as they’ve been described here, and there is ample literature cautioning users from thinking of it as such. If my public investment incites the re-employment of underutilized resources or otherwise re-directs economic activity from one place in space to another, I have not directly enhance consumer surplus, only re-located it. Re-employed, re-directed, or re-located private economic activities are not benefits.

This leads to somewhat of an oxymoronic outcome: most economic development activity, when held up against the rules of economics for measuring the uses of public spending against the production of benefits, does not produce economic surplus; hence, officially it is not beneficial in the restrictive sense. How can that be? We’ve spent public money and we’ve obtained jobs and income in a region. How can that not be beneficial? The answer is that it is absolutely beneficial to the region’s economy, but that does not mean that, overall, the public’s funds were spent most efficiently to produce desirable social and economic outcomes.

III. Evaluating Economic Development Spending

It has been established that benefit-costs analysis has at best only a limited application to economic development activities. It bears repeating: economic development does not produce, in and of itself, consumer surplus and welfare gains. Benefit-cost analysis in a traditional sense, the historically mechanism for quantifying the society-enhancing role of government, does not apply.

There are, however, important measures of effectiveness that can be considered. These measures can be compiled with either a prospective or retrospective frame of reference. A prospective analysis compiles as much information as it can about
competing proposals or projects and compare their costs against a set of desired outcomes before the program is initiated. A retrospective evaluation would look at sets of past programs to determine which mix of them produced the most desired social and economic outcomes. In a mature policy environment, most agencies use retrospective evaluations to produce incremental adjustments to existing programs or policies. When something new comes along or when governments want to make a shift in their spending priorities, then it is frequently difficult to find examples of previous spending in this state or in others that has been evaluated. When that occurs, and it often does, we are left with a prospective assessment.

One would expect academic and applied studies of the state’s overall economic performance. Indeed there are many, but nearly all have been generated incrementally or *ad hoc* depending on different demands of policy makers and the changing character of the overall economy. There are few evaluative efforts aimed at the states’ or communities’ economic development programs. Consequently, there is very little retrospective evaluative material that the state can rely on for justifying or guiding different approaches to public spending for economic development.

**Cost Effectiveness and Goals and Objectives**

Normally, public spending is gauged against a set of goals and objectives. Goals are broad statements of intentions. Objectives are the measurable activities or programs that facilitate goal achievement. How well we achieve our objectives, incrementally, and our goals in light of public costs require measures of effectiveness.

Let’s take it as a given that economic development in Iowa is a goal. First, we need to know what is meant publicly and officially by the term. Does it mean jobs, income, and industrial diversification? Are all jobs equal? Are there important economic goals at work, like producing more exports or capturing value-added possibilities for raw commodities? Are there sets of social goals that need to be considered like women and minority workplace opportunities or access to and the provision of worker benefits like medical insurance and retirement plans? Is there a spatial dimension to economic development in Iowa that is important? Notwithstanding urbanization forces, are there compelling reasons to re-direct resources into areas the market seems to be abandoning?

It is obvious that the goal of economic development has many different facets. These facets suggest different objectives as overall economic development may have many indicators of success or failure, some social, some spatial, and some economic. The objectives then have to relate to the whole in some part. Is it enough to state that Iowa wants to recruit and retain “quality jobs?” Like everything else, the term needs defining and to be compared against the dimensions listed in the previous paragraph. Is a quality job one that’s clean, or pays well, or has benefits, or allows for opportunity for different groups that previously had been denied them?

At the most banal level, in Iowa, what appears to matter are jobs and job incomes. Better paying jobs are a bonus. Jobs that fit the state’s economic development strategies
are even better. Jobs that clearly produce export might even be better as they definitely attract spending from consumers outside of Iowa. But not all jobs producing for export are necessarily good jobs. Jobs that accumulate in more rural areas are also desirable, but in the main, and in the end, what the state and what local leaders usually count is simply jobs. Other factors are secondary, so the state determines success primarily in the number of jobs that it attracts.

How has the state done, with or without incentives, over the past decade or so? Between 1990 and 2000, a decade of comparatively strong growth nationally, the state of Iowa added 295,504 new jobs. A very large fraction of those jobs were taken by existing residents because the state’s population only grew by 147,724 persons over those two measurement periods. The state enjoyed huge comparative gains in manufacturing jobs and relatively strong growth in most of the nonfarm economy. The problem, however, is that the state’s manufacturing wage went from being 107 percent of the national average in 1980, to 91 percent in 1990, to 80 percent in 2000. The average nonfarm job in Iowa in 1980 paid 89 percent of the national rate, paid slightly more than 80 percent of the national average in 1990, and in 2000 it had declined even further to 77 percent.

On net, despite gains in jobs and gains in people, the state has lost ground to the nation when we look at trends in average earnings per job. Even though there is a very strong emphasis locally and at the state level for both job creation and retention, there is a very strong incentive to try to boost the average earnings of workers in Iowa. A premium is paid, in terms of state funds at least, to firms that can bring to the state jobs that compensate workers at or above the state’s average rate of earnings (notwithstanding the state’s eroding position in mean wages).

When measured against these outcomes, one must seriously question whether the state and local government economic development efforts have been instrumental in enhancing the prospects of the average working Iowan. The problem, of course, is that we do not have the ability to do a with-without analysis. Incentives are incremental in nature – sometimes they are greater, sometimes they are less. Cumulatively, too, one cannot gauge the sum of all incentives. There simply is no central reporting of all aid dedicated to businesses in the state. So outcome measurement, the retrospective analysis, is highly problematical. There is no way to determine the marginal effects of state and local programs during that decade on changes in the state. We cannot tell whether they actually exacerbated the trends, offset the trends, or whether for the most part the entire economy was generally unresponsive to state and local efforts.

**Defining Measurement Variables Broadly**

When we measure economic development activities prospectively, there are really only a few numbers that we can use. The first set involves the prospective firm, the kind of product or service that it makes, the number of workers in the firm, and the amount of earnings the firm says that it will pay its workers. We also collect information on land purchases, capital investment, and overall equipment purchases. These we would term
the direct economic numbers – numbers and intelligence that are directly attributable to
the firm in question.

The next set of numbers that we can get a handle on regarding economic
development is the mix of incentives and the cost of the incentives that states and local
governments may apply to a prospect. These values may be grants, subsidized loans,
state and local tax breaks, along with other public service direct or indirect subsidies like
water and sewerage extension, transportation modifications, etc. We would call these
figures the direct public costs – costs borne by the public as either direct payments in aid
or the forgiveness of tax obligations over time.

There are potential indirect economic outcomes from a new firm. For one, the
firm may compete with similar firms in a region for both skilled labor and for business.
Consequently, it very well may be the case that the jobs and incomes in the new firm will
yield output, job, and income changes in other firms in the region or the state. There also
might be anticipated local and regional population shifts. All of this is very hard to know
well prospectively, although detailed analysis by economists and sociologists can
calculate ranges of potential responses given an understanding of the distribution of
similar firms and the size of labor in a region along with the pattern of migrations that are
in evidence. The parameters of indirect effects may, therefore, be estimated, stated, and
used to offset portions of the direct economic numbers.

There is also the possibility of calculating additional secondary economic effects
using an input-output model (I-O). I-O models are compilations of detailed industrial
accounts in a region that solve for inter-industrial trading within a region or outside of it.
The models can be used to help get an idea of the potential total economic effects the new
firm might have in the regional economy. I-O models produce multipliers that can help
planners to anticipate total regional economic gains that might be expected from growth
in a particular kind of industry. Unfortunately, multipliers are often misunderstood and
misapplied, especially by novice analysts or special interests. Consequently, they are
frequently grievously over-stated and over-estimate causation. Because of this, I-O data
are usually not used in economic evaluation without significant reservations.

There are indirect public costs. As the funds allocated to a firm are either existing
or anticipated public funds, there is unquestionably an impact on the availability of public
resources that are available at the local and the state level for the provision of public
goods and services. Stated simply, by spending money in one manner, it affects all other
programs and taxpayers. In the short run, taxpayers are clearly subsidizing a private firm
and must therefore make due with fewer public goods or they must, individually, pay
more to receive the same bundle of public goods prior to the subsidy. The subsidy to a
business automatically affects all taxpayers and all recipients of public goods. There are
very good mechanisms to ascertain specific kinds of shifts per capita in public spending
overtime to see precisely where and how much shifting of spending in one area, like
economic development, influences spending in another. A common and very good
 technique for this kind of analysis both locally and at the state level is shift-share
assessment that looks at detailed real public spending per capita over the years to
determine exactly which kinds of public services are yielding greater or lesser amounts of spending vis a vis other governmental entities (i.e., all cities, a regional grouping of states, etc.).

Another secondary effect on the public front involves the amount of planning, leadership, and staff resources that are devoted to economic development. In general, when we measure the cost of economic development and business promotion, we tend to look at specific grants or subsidies for specific projects. There is, however, an extensive array of interests and activities dedicated to assisting business growth. Those resources will of course be housed in a local or state economic development department, there might also be local or regional planning districts that promote growth, as also are federal agencies and programs. In a state like Iowa, there are significant resources at the Governor’s discretion that are utilized to promote the state. The state’s Department of Agriculture and Land Stewardship, as well, promotes agricultural products and their markets. The state’s Commerce Commission oversees a broad array of economic activity from the regulatory side, and the state’s Department of Transportation has economic development resources for infrastructure improvement, as well. In short, while we may well count the direct aids to a firm, we need also consider the overall local and state government resources that are involved in the broader areas of economic development in the state.

Like the secondary economic effects, the secondary public effects may be difficult to quantify well. They can, however, be stated and itemized and entered into the decision making process so that there can at least be a substantive acknowledgement of potential social costs during the deliberation period. The point is that the evaluators really don’t know much of what might happen, though they may be able to inform themselves somewhat of what has been the pattern in the past. In most cases, in Iowa, this has not been the case, however.

**Defining Measurement Variables Specifically**

Thus far I have established that prospective evaluations, those done prior to the desired policy or spending primarily, must rely primarily on the direct variables: specifically, those attributed to the firm in question and those attributed to the governmental entities that are involved. There are also temporal considerations, to consider. Simply put, money has different values over time. Therefore, the time element of the analysis must be stated. There are also spatially-relevant considerations, as well. The analysts may need to carefully specify where the economic activity is taking place in light of where the economic outcomes might be realized.

Here is a summary of the direct economic variables:

- The production characteristics of the firm gives us insight into the kind of product produced, the growth prospects of that kind of firm, whether the firm has special linkages with other firms in the state or regional economy, and, perhaps, whether
the firm has cyclical characteristics that complement the regional economy structurally or by virtue of the available supply of labor in the region or the state.

- **The number of workers in the firm** and the distribution of workers by occupation and level of compensation helps us to isolate the number and kind of jobs that are being developed. In so doing, it allows economic development planners to estimate the overall availability of appropriate labor in the region to meet the needs of the firm. This analysis helps the economic analysts to anticipate whether the job might compete for regional labor or help to induce in-commuting or in-migration.

- **The total and distributed wage payments** help us to compile weighted averages of different kinds of jobs and their compensation levels. This intelligence may assist our determination of the kind and amount of taxes that these different levels of earners can be expected to pay to state government as state income tax because different earnings levels contribute at different rates.

- **All direct investment in land, capital, and equipment** are important from a temporal standpoint in that the firm may have important links to existing firms in the short run. They also identify the potential additions to capital stock and to the tax base that can be directly attributed to the firm.

Here is a summary of the direct public spending variables:

- **An itemization of all aid** in the forms grants, loans, loan subsidies, and other types of state and local assistance to the firm. This would identify what kinds of state or local moneys were being used, which agencies were involved, and the kind and mix of assistance offered between local and state grantors. It would be very important to also itemize carefully local aid that might come in the form of tax abatements or other kinds of cost-savings activities granted the new firm. As a very large fraction of city governments use Tax Increment Financing (TIF) authority to fund growth and because a growing fraction of that authority is now project specific, it is very important that those resources be documented. Those resources can go to pay for beneficial infrastructure, they may be paid back to the firm in tax rebates, or they may actually find their way into general fund spending, although the legality of that increasingly common practice is highly questionable. Regardless of their uses, the amounts that are linked to the firm need to be documented.

- **Accounting for workforce development assistance.** The state of Iowa has workforce development resources, and firms in cooperation with community colleges can re-direct tax resources to offset labor training costs. These resources must also be identified and the values enumerated.

- **A clear recording of all conditions of assistance.** That means that the state and the local governments have spelled out the terms of the assistance, criteria for successful completion of the terms, penalties for failure to meet the agreements, and mechanisms for recovering public resources if conditional terms are not met.

- **The documentation of the taxes** to be expected as property taxes, state business, or corporate tax collections and when they will be expected. As tax breaks and credits are common development tools, it is important to identify at the outset how much tax liability from the firm has been offset by state programs or local
government actions. Governments should also try to identify state income taxes, sales and use taxes, and other taxes and fees that should be expected from the workforce in the firm. These estimates are more likely to be reliable at the state level as there are significant variations in local government tax collections across the state.

- Finally, other costs by state and local governments dedicated to this business development must be identified and enumerate. This might mean investment in roads or accesses to roads, highway interchanges, or local infrastructure; the exercise of eminent domain; urban renewal activities; or significant changes to local zoning laws or statewide regulations. These actions, though often not easily quantifiable in monetary terms, inform the substantive discussion of the development in question.

A summary of the timing of economic outcomes and public costs must be maintained, too:

- It is a fundamental tenet of public policy analysis that economic values occurring over time must be standardized. We need to do this because the value of money changes over time, as also does our preference for the uses of our money.
- Consequently, a clear statement of the timing of expected economic outcomes and of public costs needs to be made. Often public costs and investments are up-front while economic outcomes accumulate later. Automatically there is a mismatch between the relative value of the public spending versus the relative value of the economic outcomes.
- The standard manner in which economic outcomes and public costs that are measurable in monetary terms are compared is to reduce the stream of costs and economic outcomes to a present value number. That is done using an acceptable and realistic discount rate that reflects both the underlying rate of inflation and the investing or spending agencies’ overall social rate of preference for the use of these public funds.
- It is never appropriate to simply sum a stream of public costs and a stream of economic outcomes over a period of time and compare them. By so doing biases the measures tremendously given the nature of spending, the nature of economic growth, and the timing of the two factors.

**Measurement Indices and Their Reliability**

The evaluating agencies have to calculate indices that allow them to gauge the potential worth and the overall desirability of one firm over another. The first method is to simply calculate a cost to outcome ratio. Imagine a financial firm that will employ 1,000 primarily professional workers with an annual salary of $28,000 in the first year of operation. The firm plans to at least maintain this level employment for the next 10 years. Let us also assume that the present value of the sum of all state and local aid to this firm amounts to $10 million. Let us also assume that there are no other economic outcomes that need to be considered nor other sets of significant public costs. What can we do with these numbers?
The accompanying table summarizes some of our calculations. First, we have allowed worker incomes to increase by 3 percent per annum after the first year through the 10th year of operation, our analysis horizon. Second, we have estimated gross tax collections for state government assuming an effective rate at 6.75 percent and that rate will not change throughout the evaluation period. As not all of the state and local aid occurs in the first year, we assumed that $8,000,000 goes to the firm during the construction period and that the remainder was allocated in slightly decreasing amounts over the next 5 years of operation.

The table has two sets of values. The first set presents the discounted present values of the state and local aid and the economic and state fiscal outcomes at different discount rates ranging from 3 to 6 percent. The second table contains simple ratios for evaluating this project. At 3 percent, the amount of state and local aid per job is $10,000, but we can see that this ratio goes down as the discount rate goes up. This is an important factor about discounting. The higher the discount rate, the lower the present value. Using an artificially low or high rate can drastically alter the values.

We can also express the amount of aid as a fraction of the discounted wage and salary stream. At 3 percent the ratio is .037 or 3.7 percent. That ratio increases as the discount rate increases to .042 at 6 percent. The ratio of state aid to all gross state tax collections at 3 percent is .545. It grows to .626 as the discount climbs to 6 percent.

### Discounted Present Values

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Aid</th>
<th>Jobs</th>
<th>Salaries</th>
<th>State Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>@3%</td>
<td>$10,000,000</td>
<td>1,000</td>
<td>$271,844,660</td>
<td>$18,349,515</td>
</tr>
<tr>
<td>@4%</td>
<td>$9,946,857</td>
<td>1,000</td>
<td>$257,875,095</td>
<td>$17,406,569</td>
</tr>
<tr>
<td>@5%</td>
<td>$9,895,959</td>
<td>1,000</td>
<td>$244,932,692</td>
<td>$16,532,957</td>
</tr>
<tr>
<td>@6%</td>
<td>$9,847,182</td>
<td>1,000</td>
<td>$232,926,506</td>
<td>$15,722,539</td>
</tr>
</tbody>
</table>

### Evaluation Ratios

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Aid:Jobs</th>
<th>Aid:Salaries</th>
<th>Aid:State Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>@3%</td>
<td>10,000</td>
<td>0.037</td>
<td>0.545</td>
</tr>
<tr>
<td>@4%</td>
<td>9,947</td>
<td>0.039</td>
<td>0.571</td>
</tr>
<tr>
<td>@5%</td>
<td>9,896</td>
<td>0.040</td>
<td>0.599</td>
</tr>
<tr>
<td>@6%</td>
<td>9,847</td>
<td>0.042</td>
<td>0.626</td>
</tr>
</tbody>
</table>

Are there other meaningful ratios that might be calculated from the direct data? A state fiscal ratio to the jobs might be calculated indicating the expected, discounted total contributions per job to be expected. At 3 percent, these jobs would each pay a total of $18,349 in gross state taxes over a 10 year period. As the discount rate increases that present value goes down. At 6 percent the present value of the tax collections would decline to $15,722 per job cumulatively over the 10 year period. Again, as is evident, the value of the discount rate is important. More important, however, is the requirement that
values that accrue over time are summarized into a form that allows them to be compared. Failure to do that creates misleading conclusions about the total costs and the economic outcomes associated with a development project.

What could an agency do with these statistics? First, it could compare a set of competing proposals to see which produced the more desirable outcomes relative to the state and local aid. Ideally, the state and local governments have a very strong interest in maximizing the economic outcomes (jobs, income, tax collections) and minimizing the public costs. Development packages that cost less per job or had lower present value ratios of aid to salaries or aid to state tax collections would rank higher than those with higher costs per job or higher aid to salary or taxes ratios.

Each indicator, however, might give different rankings. An aid to jobs ratio of $10,000 for 1,000 jobs paying $28,000 annually is perhaps not necessarily a better bargain for state and local development compared to a situation where $12,000 in aid per worker were given to a firm employing 900 jobs that intended to pay $33,000 per year. In this instance, the aid per job is 20 percent higher, the number of workers is 10 percent less and the amount of gross payroll is 6.1 percent more. How would this compare with an alternative that costs just $8,500 per job, but yields 1,200 workers each making $23,000 per year? Which alternative presents the most desirable outcomes for the state? The analyst is left to do the math, compile the relevant ratios, arrive at a decision which appears to be the appropriate ways in which the two proposals should be evaluated, and then present the findings to decision makers to determine which of the competing proposals best meet the state’s goals.

The indicators above are simple economic evaluation measures. There are other, perhaps more significant, measures that can be included. For one, in tight budget years where resources are proportionately redirected to enhance economic development spending, an analyst can compile the categorical (and service) effects of spending shifts. If, for example, there is only 1 percent new money in the budget, but economic development receives 40 percent of that new money, serious shifting has taken place. Those shifts can be analyzed and described.

Secondarily, other indicators may be included. For example, a region where a proposed development might be taking place may contain a disproportionately high fraction of unemployed workers or it might be in an area where incomes were below the state average. An industry might be thought to significantly complement sets of other industries providing, perhaps, a catalyst of industrial output that might enhance other firms’ productivity (this might be the case under a cluster development assumption, though such regional economic enhancements are very hard to prove).

As Iowa suffers from significant rural area de-population and economic realignment, another goal to the state’s programs might be to invest in firms that help to enhance the stability of non-metropolitan areas by linking well with existing rural economic structures and otherwise providing jobs and incomes to rural residents.
In the main, however, these kinds of regional or social objectives are relatively hard to measure and often only rhetorically discussed. If one were to assess the distribution of economic development incentives at all levels in Iowa, one would be hard pressed to find convincing sets of social or regional objectives beyond the implied benefits of mere job creation.

**How Do Governments Know if Their Efforts Are Effective?**

It is difficult for governments to determine that their economic development efforts are systematically or sequentially beneficial overall to the economy or the fiscal positions of state and local governments. There is so much economic change occurring locally, state-wide, and nationally irrespective of the governments’ efforts.

Public leaders are charged with being extremely careful with the public’s money. They must try to minimize the costs of their activities and maximize their outcomes. They must be both efficient and effective. We demand this of all manner of physical, protective, health and social services that our governments provide. If government leaders spend money but do not produce desired outcomes, they usually re-direct their spending to areas where outcomes are more certain. In the realm of economic development, there often may be confusion about the requirements of both efficiency and effectiveness. Much talk may be dedicated to the apparent effectiveness of a particular program, but this often occurs without any discussion of the overall costs of the program in light of what else might have been done with these resources. What else could have been done is the social opportunity cost of the action. In Iowa, firm viability along with elemental job growth are usually the only criterion for success. Efficiency regarding economic development funding is rarely addressed.

There is a persistent fallacy of success associated with most economic development programs at the state or local levels. Most economic developers in regions of any size do not have a good sense of overall regional and national economic patterns. When they give aid to a firm that promises to develop jobs the conclusion is automatic that the economic development process is successful. We recruited a firm, we came to terms, the firm built a plant, and jobs were created.

Would those jobs have evolved in the region otherwise? Most economic developers would answer: no! Were it not for the local or state effort, these jobs would not have materialized. This is called the “but-for” criterion, as in, but for our economic development efforts, these jobs would have accrued to some other jurisdiction. There really is, of course, no way for economic developers to know this for sure.

We run into trouble trying to assess these programs at the state or local level. First, it is hard to do the net economic evaluation that measures how much growth in the state is due to incentives versus that which is not. Common sense and intricate economics both dictate that the vast majority of growth that occurs does so without direct state or local aid. Automatically, then, questions get raised as to the overall efficiency of this kind of spending.
The next problem area has to do with whether the benefited firm actually needed the state assistance. In recent years, this has become problematical. The state of Iowa has devoted the preponderance of its economic development grants and guarantees to large, established, and competitive firms. In short, most aid has gone to firms that really do not demonstrate the kind of need that might come to mind when we’re thinking of the logic behind economic development. Recently, under Iowa Values Fund authority, a very large fraction of those funds have been devoted to assist one of the nation’s largest banks build a facility in West Des Moines. Obviously, this firm is not in need of state or local aid. In another instance, the combination of state and local aid dedicated to an agribusiness operation expanding in the Des Moines metropolitan region amounted to $80,000 per job -- a very high estimated subsidy per job coupled with a highly financially secure operation. The need for state assistance was simply not evident. As Peters and Fisher point out, because we can’t discriminate well between the deserving and those not deserving, the likelihood is very high that state economic development programs end up costing taxpayers money, not benefiting them.

If we are really unable to measure the net effectiveness of the programs or document the economic need of the recipients, how then can the state justify its expenditures on a fiscal basis? One approach has been to try to come up with measures of “fiscal impacts.” For many, a fiscal impact assumes that over some period of time an economic development prospect will generate more tax revenues than it will cost in subsidies. In the example above, the net present value of the state government tax collections is $18.3 million. Many would compare this figure with the $10 million and say that this enterprise is producing fiscal surpluses of $8.3 million over costs.

This is a grossly misleading and at best crude comparison, but unfortunately it passes for rigorous analysis among state of Iowa economic development program proponents. Most if not all of the expected $18.3 million in this hypothetical example would be consumed by the job holders and their families requiring state services. Their children would need to be educated, and the state pays a large fraction of that cost, all of them would need to be protected in their homes and environments, their roads and other infrastructure would have to be maintained, and they would have to contribute a fair portion of their taxes to the fixed costs of the administration of justice, the passing of laws, and the execution of those laws and services. In short, under normal circumstances, all or nearly all growth in earnings goes to fund state services. There is no measurable surplus, at least not in the amounts used in this example. If surpluses do accrue, they accrue very slowly, and, importantly, only to the extent that average incomes in the region are growing faster the public costs.

The same situation occurs at the local government level. Extensive research at Iowa State University during the 1990s produced sets of fiscal impact models for the state’s local governments. These models were intricately compiled to take into account changes in jobs in an area, the effect of those changes on the regional labor supply and population, and the fiscal impacts that would be expected. These models used observations from all 99 counties and from nearly all of its cities. Constructed properly,
in response to change, these models often generated fiscal losses in response to job
growth. In short, the modeling expected that certain amounts of job growth locally is
potentially public cost generating. For the most part, however, local government
revenues would exceed costs in a growth situation, but only by very small amounts. Why
is that? Because all growth yields concomitant demands for increments in public service
delivery. Simply stated growth creates costs, and the big issue is whether the growth
covers the costs rather than the generation of fiscal surplus for most governments.

Simplistic attempts to determine state and local fiscal surplus run the risk of
seriously overstating the public revenue yield over total costs and should not be done
without extensive research. Unfortunately it is tempting for vendors and decision makers
to try to build models that use simple weighted averages to estimate state and local public
service cost functions. These simple models rarely can stand much scrutiny, however,
before they are determined to be either invalid or simply incorrect.

IV. The Roles of Academic, Administrative, and Legislative Professionals

Economic development cannot occur in a vacuum. Expertise about the economy
and the consequences of economic change is the province of economists and other
regional scientists (geographers, planners, public administration specialists, and
sociologists). Experience in the execution and administration of state and local programs
and laws is the responsibility of local and state government officials. The state
legislature, city councils, and county supervisors enact and oversee development laws.
Ultimately, citizens realize the gains and the losses of collective action.

Traditionally the most power to engage in commerce-promoting activities has
resided in the governor’s office. The governor, as chief ambassador and the most mobile
of all elected public officials, is in the best position to leverage executive resources and
talent in support of state growth. That power has ebbed and flowed over the years.
During much of the mid-1980s to mid-1990s, the governor and the Iowa Department of
Economic Development enjoyed robust funding and authority for developing and
promoting the economy. In the latter parts of the 1990s, much of that funding and overall
authority waned as the General Assembly re-directed resources elsewhere.

Beginning in 2003 there was a renewed emphasis by the governor of Iowa to
promote the state’s economy. Many groups got involved ranging from the Farm Bureau
Federation with a plan to significantly fund economic development and education facility
replacement to different plans by the political parties all advocating some form of
economic stimulus. The Grow Iowa Values Fund was passed with an initial funding
level during its first year of about $170 million. The passage and the funding of this
program have not been accepted uncritically, and there is ongoing debate among
lawmakers, executives, and development interests in Iowa about the appropriateness of
this program.

Academics find themselves in a curious position regarding the state’s stance on
economic development. Some have attempted to guide the state’s efforts by helping
them build analytic tools to assess and evaluate development activities. Many others, however, are stuck in a “first things first” quandary. If, first things first, development incentives are net public costs and not benefits, as nearly all of the major research indicates, are not targeted to produce the maximum amount of socially desirable results, and are received in the main by institutions that simply do not need them, what is the role of economists and analysts in advising state policy? Stated differently, if lawmakers are unconcerned with standard economic principles governing the use of public funds in support of regional economic growth, why would they seek economists as participants in economic development policy development?

A Symposium on Economic Development Reform

A symposium in 2003 at the University of Minnesota’s Humphrey Institute* on the competition among states for capital was a spirited discussion of the issues and controversies that confront decision makers seeking to enhance their state’s position in the national and the global economies. This symposium featured prominent academic and political leaders with perspectives on state’s competition for jobs and investment. Some of the major debilitating factors facing state and local governments include:

- Information asymmetry: governments cannot know a firm’s decision criteria; consequently, it cannot know what is the appropriate “price” to pay to a firm.
- Many firms now use site location consultants who receive a percentage of the amount of incentives they can generate for the firm. There is strong pressure to drive up the incentives to increase commissions.
- Voluntary agreements to curb bidding wars break down (perhaps like OPEC production quotas) because the desire to cheat trumps a level playing field.
- The proliferation of tax breaks and business incentives has resulted in a significant shift in tax liability away from commerce and on to citizens resulting in more tax regression.
- Economic development packages rarely yield meaningful if any fiscal benefits and if they do, they take a considerable amount of time to do so.
- Most incentive discussions do not include citizen interests – they are usually dominated by business and industry – they are, therefore, inherently undemocratic.
- At the community level, many feel they are fighting for their actual existence. Consequently, many decisions are fear-based and not necessarily welfare maximizing.
- Each state attempting to maximize its economic development returns yields a race to the bottom (because of tax-cutting behaviors).
- States have an opportunity to rationalize economic development activities by prohibiting, limiting, or imposing standards on the provision of incentives by local governments.

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* Key participants at this symposium included Ann Markulsen, University of Minnesota, Peter Fisher, University of Iowa, Kenneth Thomas, University of Missouri – St. Louis, Adinda Sinnaeve, the European Commission, Timothy Bartick, W.E. Upjohn Institute, William Schweke, Corporation for Enterprise Development, Andy Isserman, University of Illinois, and Greg LeRoy, Good Jobs First.
While now considered a necessary evil, business incentives can be capped, distributed rationally and with some efficiency, require meaningful economic and social performance standards, “claw backs” can be included that make a firm that doesn’t keep its promises pay the public back, along with penalties and suspensions of firms that defraud the public.

An important first step to economic development reform, however, might involve simply the centralized collection of economic development subsidy statistics along with an itemized accounting of all development aid received by firms – simple sunshine on the practice.

**Academics and Policy Makers in Economic Development**

Economic development jargon is proliferating among decision makers and in media accounts. Our public officials allude to benefits, returns on investment, jobs created, and economic impacts. Many of the terms that have highly restricted or highly specialized usage in both the private sector and in the public sector are bandied about in manners that are not necessarily clear to citizens or legislators when applied to economic development policy. This linguistic fuzziness makes it difficult to evaluate both the substance and the content of economic development policies and their outcomes.

There also exists significant analytic fuzziness as regards Iowa’s overall spending on economic development and the evaluation of that spending. In the first instance, it is not clear precisely how much money is spent annually in support of economic development either administratively or as subsidies. Secondly, there appear to be few evaluations of the efficacy of state and local efforts. Finally, evidence suggests that state and local decision makers often make claims of economic effectiveness that are questionable. The upshot is that it is not clear to the average citizen, newspaper reporter, or local or state decision maker how effective and useful different economic development policies and incentives might be.

There are clear and very knowable rules and guidelines available to state and local public policy makers in the area of economic development investment and evaluation. These rules emanate directly from economics principles and the historic roles of governments in promoting the production and distribution of public goods and private goods. There are also social and political factors that are imperative for decision makers to consider as they allocate scarce public resources from one kind of public spending to another. All of these are important in both considering economic development strategies and in evaluating them.

There is the broad supposition regionally and nationally that states and communities must aggressively recruit and often subsidize business growth via tax cuts, direct investment, and other monetary inducements – that’s the way the economic development game is played now-a-days. The state of Iowa may be spending directly or indirectly as much as $300 million annually on economic development. These
inducements, however, may not be leading to the kinds of outcomes economically, socially, and politically that many policy makers suppose.

There is room for an enhanced dialogue on the role of economics in economic development decision making in Iowa. There are four major participant groups in this dialogue: (1) applied economists and analysts skilled at evaluating public policies and in teaching these skills, (2) state and local policy makers (elected and appointed) and development officials whose job it is day in and day out to promote their local or the state economy, (3) Iowa’s media organizations, especially its newspapers, who have an interest in reporting and in evaluating economic development decisions locally and statewide, and (4) citizen groups who’re interested in promoting more economic development programming along with those that are interested in promoting alternative public investment strategies, say for example in human capital development or amenity enhancements.

A Proposed Dialogue

The state’s efforts and laws notwithstanding, there is evidence of a need to develop rules and consensus on Iowa’s goals for economic development. A first step is to initiate and, potentially, sustain a dialogue on the application of economic principles in economic development. As critical objectives, this dialogue could

- Introduce and explain basic economic principles designed to help guide government activities in support of economic development
- Describe the appropriate uses and the meaning of different kinds of economic evaluation tools and procedures of public spending
- Encourage state and local policy leaders and development officials to share the motivations and constraints under which they must operate in promoting the local or the state economy
- Allow media representatives, editors or business writers, as examples, to outline and identify their information needs for both reporting on and evaluating for public consumption economic change
- Feature diverse points of view both in support of existing economic development policy and against.

The second goal of this dialogue would be to develop a set of generally accepted economic development principles for the state of Iowa and a set of “best practices” to help guide policy makers and evaluators of economic development activities in the state.

The key, natural participants in this process would be

- Representatives of the three Regents’ institutions, especially those that conduct educational programming and research on economic development activities, along with knowledgeable representatives from other institutions of higher learning in the state.
- Representatives of state and local government (elected and appointed) with a special interest in promoting and evaluating economic policy in Iowa and who are politically accountable to citizens
- Business editors and business reporters from across the state
- Other community college, private university, or institutional representatives involved with economic development or its evaluation
- Citizens and other groups with views either converging or diverging from the state’s current policies.
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