

POLITICAL ECONOMY

IN THE CAROLINAS

WHAT ARE ECONOMIC- IMPACT STUDIES REALLY MEASURING?

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How should we interpret economic-impact studies? What meaningful information, if any, do they provide a public or governing body trying to evaluate either the costs or benefits of a proposed spending project or the value of past projects? I will argue that such studies, which typically are taken to imply that the direct and indirect spending flows that emanate from the projects being considered represent an economic benefit to a community or region, instead should be viewed as a measurement of costs. In particular, I will argue that what is being measured is the extent to which a project—for example, a convention center, a road, a university, or an industry like renewable energy—is commanding the use of scarce resources that would have alternative uses. As such, the economic impact of a given project is not something we should seek to maximize but instead minimize.

I. THE PROCESS (WITH AN EXAMPLE)

Typically, economic-impact studies invoke an “off the shelf” model that has been developed by a private company and then subscribed to by consulting firms that, in turn, use the model in their consulting work with private interests. These interests—which could be industries, universities, individual companies, or government agencies—employ these consultants to show, using these models, how important their activities or investments are to the economy of a particular locality or region. This is usually done to convince state legislators or local governments to provide funding for the interest’s projects or for projects that will provide secondary benefits to the interest.

A typical example (Tveidt 2017) of such a study was recently published by the University of North Carolina–Asheville. The study was produced by a consulting firm called SYNEVA Economics, which used a well-known and standard economic-impact model called IMPLAN (Impact Analysis for Planning).¹ SYNEVA points out that “the overriding objective” of IMPLAN, and presumably its own study, is to “measure the full economic impact to a local economy as the result of a specific economic activity.” For SYNEVA, the economic activity in question relates to money appropriated by the state of North Carolina for use by the University of North Carolina–Asheville (UNCA) and spent by the university. It examines the economic impact of this spending on the Asheville Standard Metropolitan Statistical Area which includes Buncombe, Madison, Haywood, and Henderson Counties.

SYNEVA concludes that state government spending on UNCA has annual regional economic impacts that include, among others, an additional \$450 million in GDP, \$164.4 million in local income, and 3,911 jobs. These impacts are generated by spending that flows from state taxpayers through the university and into the community. The study includes expenditures made by campus operations and construction, alumni who live in the area, students and visitors, and new residents attracted by the university. As the spending flows outward from the university, it generates what economic-impact studies call “direct, indirect, and induced effects,” which, in turn, generate a multiplier effect. As a result of this multiplier effect, the original dollar appropriated by the state ends up generating an economic impact that is a multiple of that dollar. In this

case, SYNEVA and UNCA claim the multiplier is eleven. That is, every dollar the state spends on UNCA yields a return of \$11 in economic impacts region-wide.

II. “THE FULL ECONOMIC IMPACT”? NOT QUITE²

While, as SYNEVA Economics notes, the point of IMPLAN (and, I would add, all of the other standard models being used to measure economic impact) is to estimate the “full economic impact” of the economic activities in question, it in fact does not. Furthermore, if it did, the numbers regarding GDP, employment, wages, and so on would not only be smaller but could actually be negative, a result ruled out using current methodologies.

Looking at the UNCA/SYNEVA study through the lenses of economics, one notices a glaring omission. It is an omission that stems from an unstated, but obvious, assumption: none of the resources being consumed in the spending flows have opportunity costs. In other words, the implicit assumption is that the land, labor, and capital being claimed by the \$450 million in annual economic impact would be unemployed had it not been for the initial state spending. The jobs supposedly created are all going to people who would otherwise be unemployed; there would be no other demand for the business services that are consumed; the capital equipment, land, and natural resources being employed have no other uses in the local market.

But UNCA spending uses resources in the Asheville economy that would be used for other productive purposes if they were not being diverted because of increased demand generated by that

1. Another very standard model is produced by Regional Economic Models Inc. and is known as the REMI model.

2. For a more expansive discussion of the opportunity-cost question as it relates to economic-impact studies, see Cordato (2017). Also see Tuerck, Murphy, and Bachman (2013) for a discussion of a specific application of the problem in a peer review of an economic-impact study by Lawrence and Pereria (2013) looking at the impact of the renewable-energy industry in North Carolina.

spending. These alternative uses would have had their own impacts on employment, income, and additional output. These costs relate to economic activities that do not occur because they are pre-empted by UNCA's expenditures. This is the nature of all opportunity costs: they are unseen but nonetheless real and therefore part of the economic impact. They are never accounted for in this or other economic-impact studies. If they were, they would enter the calculations with a negative sign, thereby reducing the reported impacts. If these opportunity costs were large enough, the changes in output, jobs, income, and so on could be negative. At the very least, because opportunity costs are not considered, all of these studies overstate the economic impact that they claim to be measuring in total.

I want to also note that the SYNEVA study focuses strictly on the impacts of state spending on UNCA in the Asheville area. This means the subsidy money is not being reallocated only from other uses in the Asheville area. But most studies do not have such a narrow focus and are not looking at a situation in which the subsidies come largely from outside the geographical area under study. An important set of opportunity costs not being focused on here relate to alternative allocations of subsidy money on the part of the state, either within the state budget or in lower taxes. The effects of alternative allocations of state resources should typically also be part of impact studies.

III. ARE ECONOMIC-IMPACT STUDIES MEASURING ANYTHING USEFUL?

Because they ignore the impact on businesses, industries, and workers that will be bearing the burden of the opportunity costs associated with the spending flows being analyzed, it is clear that these studies are not assessing the economic impacts as completely as they claim. Furthermore, without

an assessment of the unseen opportunity costs, it cannot even be known whether the monetary value associated with the impact of a particular project, government subsidy, or industry is positive or negative. Under existing methodologies, in which only positive numbers are fed into the models, the possibility that a project may, for example, actually cost jobs or on net reduce GDP is not even considered.

The question arises, are economic-impact studies measuring anything useful? I believe the answer is yes. But what they are actually measuring is quite different from what the special interests and consulting firms that generate these studies suggest. What they are in fact measuring is social costs, not social benefits. As argued above, every dollar spent as a result of the direct, indirect, and induced effects represents a transfer of scarce resources from other uses. This means the dollar value of the reported economic impacts—for example, the \$450 million reported by the SYNEVA study—is an expression of the extent to which the project being evaluated is diverting resources away from other uses in other parts of the economy. I should make clear that such studies are not measuring the value of the forgone output. They are, however, measuring the dollar value of the resources being consumed by direct, indirect, and induced effects of the project during the time frame under consideration by the studies.

This has an important implication for how we should interpret the multiplier in these studies. From the perspective of increasing economic efficiency, the goal should be to have as small an economic impact as possible—that is, to minimize, not maximize, the extent to which a project draws resources from other uses. And smaller multipliers are more desirable than larger ones. The smaller the multiplier, the fewer—and more importantly, less valuable and therefore less scarce—the resources being consumed by the evaluated project.

Economic efficiency and what is typically measured as economic impact move in opposite directions.

In conclusion, the lenses through which policy makers have viewed the results of economic-impact studies have been distorted to the point that the messages the studies convey are exactly the opposite of the studies' true meaning. If such studies are to be used at all in evaluating the effects of government spending projects on the economy, they should be viewed as reporting how economically burdensome the projects are. Such studies do not present estimates of economic benefits but economic costs.

REFERENCES

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