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Understanding Assessments

Economic impact assessments exist for almost everything, but knowing when to trust the information isn't always easy. Here is a short lesson to help you separate fact from fiction.

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Economic impact assessments exist for almost anything imaginable: arts and cultural events, legislation, natural disasters, sports franchises, wars, pollution, terrorism, and spotted owl conservation. Some authors have substantial training in the field, but the understanding by other authors of even basic economics is dubious. Here are a few straight-forward guidelines to remember when evaluating an economic impact study.

Defining "Economic Impact"

Traditional economic impact analyses look at the amount of economic activity (jobs or incomes) generated by a specific event. The traditional model uses an Input-Output model, developed by 1973 Nobel Prize laureate Wassily Leontief. Essentially, the model estimates the amount of inputs from other industries that is required to produce the output of the subject industry. Once these inter-industry linkages are measured, the model provides the multiplier for that industry in that specific region. Authors will refer to three specific figures:

- The *direct effect* is the expected initial amount of outside spending.
- The *indirect effect* measures the total increase in production of local inputs needed to create the product or event.
- The *induced effect* is the amount of spending by employees of both the subject industry and firms producing the intermediate goods.

The multiplier is calculated by dividing the total of the three categories of spending by the initial injection of cash.

Accurately calculating impacts is not easy, quick, or inexpensive. Some Internet sites provide interactive economic impact calculators to estimate such impacts like the arts, sporting events, and wind plants. These estimates are easy and speedy, but they often ignore local supply networks and tax structures. When they ignore these critical ingredients, such analyses are bogus.

Spotting Overzealous Studies

First, can you find an author's name? If nobody is willing to personally take ownership of it, the study is scrap paper. Second, does the study mention the size of the direct, indirect, and induced impacts? If not, it ignores economic theory and thus is not an "economic" study. Finally, if the multiplier is not expressly stated, or if the multiplier is substantially larger than "2", the study's veracity, or commitment to providing truthful analysis, is dubious.

Besides using large multipliers, double counting and over counting often pad an impact statement. Economic impact studies should note the increased economic activity stemming from NEW funds injected into an area. To estimate tourist or entertainment impacts means determining how much will be spent by outsiders. Visitor spending is almost always counted as new spending. Prudent researchers do not include spending by residents because new entertainment facilities merely transfer spending from an old venue to a new venue. Restaurants near an athletic event benefit at the expense of distant cafés.

Incidences of double counting are subtle and are often found only after carefully analyzing the appendix. Commonly buried overstatements add together the effects of both total revenues and total spending; or they include the amount of payroll in both the industry spending as well as an induced effect (spending by employees).

If the proposed events or facilities are underwritten by government, competent authors adjust the size of the multiplier for the opportunity cost of public funds. Local tax money is not a new injection. For example, say that St. Cloud decided to build a sports stadium to be maintained by local government as an economic development program. To estimate the opportunity cost of tax dollars we compare the multiplier of spending by taxpaying households (generally between 1.10 and 1.20) with that of the facility (about 1.005). In this instance, local tax payers would create and sustain more jobs than the sports facility would. The multiplier for such a sporting arena would be negative (1.005 - 1.10).

On the supply side, impact analyses assume that industry bottlenecks or supply constraints in housing or schools will not constrain growth. Even more tenuous is the assumption that a tourist event will generate X number of jobs in the hospitality sector. If the hotels, motels, and restaurants are booked anyway, an event will crowd out regular customers in favor of new ones. Only the impact of the vacancies if the event did not take place should actually count.

Many economic impact studies are done carefully and precisely. The unacceptably small estimates of these studies are seldom provided to the news media. The studies authored by people who use more creativity than the methods can support are more widely publicized. The guidelines presented here allow the reader to be able to judge the quality and veracity of such studies.

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References

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