Economic Analysis: Reserve vs. Pay-As-You-Go

$250 Million for Economic Development

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Presented by:

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Appropriations Question...

- The Executive Office of the Governor has proposed the creation of the Florida Enterprise Fund, a dedicated $250 million fund for Quick Action Closing Fund (QACF) projects.

- The Office of Economic and Demographic Research (EDR) has been asked if there is a difference to the state from an economic perspective between two possible funding choices with the same overall commitment level of $250 million. The two choices are:
    1) Reserve, or
    2) Pay-As-You-Go.

- EDR used the Statewide Model to analyze the effects of the two alternative appropriation scenarios on Florida's economy, as well as to calculate the projected return-on-investment (ROI).

Two Scenarios...

- **RESERVE SCENARIO**...In the first scenario, $250 million in state funds is appropriated and fully transferred to a state trust fund in Year One, effectively acting as a reserve until the payments are actually released to businesses. These payments will not be made until the businesses meet their contractual obligations.

    - This is very similar in construct to the current use of the EFI escrow account. The stated benefit of this scenario is that businesses would be assured that funds have already been set aside for them. Payment would occur once the contractual obligations have been met.

- **PAY-AS-YOU-GO SCENARIO**...In the second scenario, state funds are appropriated on a pay-as-you-go basis, meaning the payments are appropriated in the year that businesses are anticipated to meet their contractual obligations.

    - This would function in a similar manner as the High-Impact Sector Performance Grant (HIPI). The HIPI grant is paid in two equal installments, one upon commencement of operations and the other upon commencement of full operations. In practice, HIPI grants have been appropriated as a line item in the Department's budget in the year in which the scheduled payment is anticipated. Considering that all HIPI project requests have been appropriated as requested, it is reasonable to assume that payments for the new incentive fund projects would be treated the same.

Consistent Framework...

- During fiscal years 2012-13 through 2014-15, the Department placed $123,693,940 into the EFI escrow account for 51 projects. The timeframe for those projects to receive full payment from the EFI escrow account ranged from 6 months to 10 years from the date of the award. The date of the award was considered to be the date that the QACF was approved by the Governor. Of the projects reviewed by EDR, only $32,070,553 or 25.93% of the $123,693,940 was paid to QACF businesses within three fiscal years of the money being placed into escrow. Available data included:
  - The industry of the project's primary job function;
  - The number of new and/or retained jobs the project was supposed to create and the year in which the job creation and/or retention was to supposed to occur;
  - The average annual wage of the new jobs;
  - The amount and timing of capital investment to be made by the project;
  - The number and timing of payments from the Enterprise Florida Inc. (EFI) escrow account to the project recipient; and
  - The amount of additional incentives received by the project.
- Data obtained on the individual projects (including milestones and payments) was grown to simulate a project pool totaling $250 million in commitments. This project pool is used in both scenarios: same project composition, business activity and capital investments.

Flow of Funds, $250 Million Annually
(difference from baseline, in millions of dollars)

Scenario One: Creation of a $250 Million Reserve Fund...

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Appropriated to Reserve	**250.00**	0.00	0.00	0.00	0.00	**250.00**
Impact on Government Market Basket	**(250.00)**	0.00	0.00	0.00	0.00	**(250.00)**
Release of State Funds to Economy	0.00	**7.78**	**13.73**	**25.94**	**19.99**	**67.45**

Scenario Two: Pay-As-You-Go...

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Appropriated to Reserve	0.00	0.00	0.00	0.00	0.00	0.00
Impact on Government Market Basket	0.00	**(7.78)**	**(13.73)**	**(25.94)**	**(19.99)**	**(67.45)**
Release of State Funds to Economy	0.00	**7.78**	**13.73**	**25.94**	**19.99**	**67.45**

ROI Results...

RESERVE SCENARIO...

- ROI of **<u>0.6</u>** over a five-year-period.

PAY-AS-YOU-GO SCENARIO...

- ROI of **<u>2.6</u>** over a five-year-period.

GENERAL FINDINGS...

- With respect to state revenues, the Reserve Scenario does not break even, meaning the state only recovers a portion of its cost. In contrast, the Pay-As-You-Go Scenario more than recovers its cost.

- Florida's economy is overall better off under Pay-As-You-Go Scenario.

  The state's Gross Domestic Product (GDP), Output, Personal Income, and Job Creation are all higher under Pay-As-You-Go.

Economic Comparison...

Statewide Economic Model Impact Projections
(millions)

	Five-Year TOTAL		Year 5 JOBS	
Scenario One...Reserve Fund				
Real Gross Domestic Product (GDP)	3,301.2		6,481	
Real Output	5,949.0			
Nominal Personal Income	3,867.7			
Scenario Two...Pay-As-You-Go				
Real Gross Domestic Product (GDP)	4,723.4		7,397	
Real Output	7,542.5			
Nominal Personal Income	5,064.7			
Loss Under Reserve Relative To Pay-As-You-Go				
Real Gross Domestic Product (GDP)	(1,422.2)	-30.1%	(916)	-12.4%
Real Output	(1,593.5)	-21.1%		
Nominal Personal Income	(1,197.0)	-23.6%		

Statewide Economic Model Impact Projections of the Creation of a $250 Million Reserve Fund

Economic Indicator	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Total		Average per Year
Personal Income	Nominal $ (M)	(277.3)	88.9	694.0	1,466.9	1,895.1	**3,867.7**		**773.5**
Real Disposable Personal Income	Fixed 2009 $ (M)	(206.2)	76.9	530.8	1,111.5	1,411.1	**2,924.1**		**584.8**
Real Gross Domestic Product	Fixed 2009 $ (M)	(368.8)	52.4	654.3	1,338.6	1,624.7	**3,301.2**		**660.2**
Consumption by Households and Government	Fixed 2009 $ (M)	(533.4)	(207.5)	273.1	835.0	1,132.9	**1,500.2**		**300.0**
Real Output	Fixed 2009 $ (M)	(430.4)	199.9	1,133.1	2,264.6	2,781.9	**5,949.0**		**1,189.8**

Economic Indicator	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Minimum	Maximum	Average per Year
Total Employment	Jobs	(2,938)	79	3,327	6,302	6,481	***(2,938)***	***6,481***	**2,650.3**
Population	Persons	0	(1,376)	(960)	2,048	7,776	***(1,376)***	***7,776***	**1,497.6**

Tax Type	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Total		Average per Year
TOTAL NET STATE REVENUES	**Nominal $ (M)**	**-6.6**	**9.4**	**30.9**	**55.3**	**63.4**	**152.3**		**30.5**
STATE INCENTIVES	**Nominal $ (M)**	**250.0**	**0.0**	**0.0**	**0.0**	**0.0**	**250.0**		**15.6**

RETURN ON INVESTMENT 0.6

Statewide Economic Model Impact Projections of the Pay-As-You-Go

Economic Indicator	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Total		Average per Year
Personal Income	Nominal $ (M)	0.0	361.2	947.4	1,678.9	2,077.1	**5,064.7**		**1,012.9**
Real Disposable Personal Income	Fixed 2009 $ (M)	0.0	277.0	715.0	1,265.6	1,542.0	**3,799.6**		**759.9**
Real Gross Domestic Product	Fixed 2009 $ (M)	0.0	386.4	947.6	1,571.8	1,817.6	**4,723.4**		**944.7**
Consumption by Households and Government	Fixed 2009 $ (M)	0.0	283.1	696.9	1,179.2	1,421.2	**3,580.4**		**716.1**
Real Output	Fixed 2009 $ (M)	0.0	576.5	1,456.5	2,517.9	2,991.5	**7,542.5**		**1,508.5**

Economic Indicator	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Minimum	Maximum	Average per Year
Total Employment	Jobs	0	2,110	4,843	7,357	7,397	***0***	***7,397***	**4,341.1**
Population	Persons	0	0	1,472	5,216	11,328	***0***	***11,328***	**3,603.2**

Tax Type	Units	Year 1	Year 2	Year 3	Year 4	Year 5	Total		Average per Year
TOTAL NET STATE REVENUES	**Nominal $ (M)**	**0.0**	**15.1**	**36.1**	**59.7**	**67.4**	**178.3**		**35.7**
STATE INCENTIVES	**Nominal $ (M)**	**0.0**	**7.8**	**13.7**	**25.9**	**20.0**	**67.5**		**13.5**

RETURN ON INVESTMENT 2.6

Economic Results...

- While the state's obligation is the same over the entire lifetime of the commitments, the difference in the ROIs between the two scenarios is due to the timing and amount of the release of the initial investment. In one case, the entire $250 million is pulled from alternative expenditures, whereas in the other case, those expenditures continue until the funds are released into the economy.

- The reserve feature of the proposal effectively makes the initial expenditure nonproductive. Growing the data and related payments, jobs, and capital investment results in the release of state funds of $67 million into the state's economy over a 5-year period. In the Reserve Scenario, the state is investing $250 million for the exact same increase in business activity and capital investment that a $67 million investment would have achieved on a pay-as-you-go basis.

- The Reserve Scenario does this by removing those dollars from circulation within the economy, thus negating the multiplier effect of the spending. This can also be thought of as an opportunity cost of the proposal by the Executive Office of the Governor.

Repercussions of a Reserve...

- The money is idle from the moment it hits the reserve until it is released back into the economy.
- Idle money has an opportunity cost.
  - From an economic perspective, lost economic activity.
  - From the state's perspective, forgone state expenditures on alternative investments—either through appropriation to other programs or through tax relief.
  - From an individual taxpayer's perspective, forgone savings or consumption that could have occurred otherwise; essentially, taxes are being paid before they are needed.
- For these reasons, the creation of a reserve is ultimately the result of a policy decision where the desired benefits are deemed to outweigh the costs described above.
- For example, the state's Budget Stabilization Fund fulfills an overarching purpose of self-insuring the state against emergencies and economic downturns.

Final Note...

When EDR performed the original return on investment analysis for the Quick Action Closing Fund in 2013, the ROI was 1.1. Given the results of Scenario One, it is anticipated that the ROI for the review due January 1, 2017, will be significantly lower than 1.1 due to EFI's increased use of the escrow account. Very few projects in the 2013 review were subject to this type of reserve. During the next review, virtually all projects will have been subject to the reserve. This means the ROI at the next review will be highly unlikely to break even.