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To: Honorable Members of the Joint Legislative Committee on the Budget

From: Greg Albrecht, Chief Economist, Legislative Fiscal Office
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Subject: Act 704 of 2014 Economic & Fiscal Impact Evaluation, CenturyLink

Act 704 of the 2014 Regular Session requires a standard set of economic and financial information be submitted to the Joint Legislative Committee on the Budget (JLCB) for projects that involve a state commitment in excess of $10 million over the term of a project. The Act requires the Legislative Fiscal Office to provide an evaluation of the submitted project's economic and fiscal impact assessment.

Act 704 of 2014 Provisions

a) State Commitment: The estimated benefits provided to the firm over the five-year period of 2016 – 2020 are reported by LED as $58.2 million; composed of $15.2 million of Tax Equalization, $22.9 million of Quality Jobs Rebates, and $20.1 million of various grants through the Mega-Project Development Fund and the Rapid Response Fund.

b) Analytical Model and Inputs: Estimates of the economic impact in Louisiana of the operations of the firm were prepared by Robert C. Eisenstadt, professor of economics and director of the Center for Business and Economic Research at the University of Louisiana at Monroe. Economic impacts were generated using the RIMS I and RIMS II 2014 multipliers (2007/2013) for the wired telecommunications industry and the data processing, hosting, and related services industry in Louisiana. These multipliers are generated by the Bureau of Economic Analysis of the U.S. Department of Commerce, and are commonly utilized for economic impact analysis. The basis of the estimates is CenturyLink's Louisiana payroll and full-time employment for 2014. Direct, indirect, and induced effects are presented for a single year as well as a five-year present value. CenturyLink's growth over the discounted five-year period of 2016 – 2020 is restricted to the rate of inflation only, with no real or net-of-inflation growth assumed. Future values are discounted to current dollar values by a 8.90% factor reflecting the five-year average rate of return for five-year U.S. Treasury bonds and the five-year rate of return on the Wilshire 5000 index, the broadest U.S. stock market index.

c) Economic Impacts:

   i) Value-Added is estimated across industries for a single year. Total economy-wide value-added attributable to the firm's operations is estimated to total some $851 million. Value-added is the difference between an industry's or establishment's total output and the costs of its intermediate inputs, the sum of which is gross domestic product, the broad headline measure of economic activity, although it includes components that do not necessarily reflect economic impacts on the households of the economy.

   ii) Household Earnings are estimated for a single year and on a five-year present value basis. Total economy-wide household earnings attributable to the firm's operations is estimated to total some $385 million for a single year, and $1.634 billion on a five-year present value basis. Household earnings are composed of all forms of employment income and benefits, including proprietor income. This concept is the most important reflection of economic impact on the population of the economy.

iii) Employment is estimated for a single year. Total economy-wide full-time equivalent employment attributable to the firm's operations is estimated to total some 6,285 jobs. Employment is defined as the annual average of monthly jobs. A job lasting 12 months is equal to 2 jobs lasting 6 months each or 3 jobs lasting 4 months each etc. A job can be either full-time or part-time, and no distinction is made. This concept of employment is consistent with the standard concepts utilized by the U.S. Department of Labor.

d) Impacts By Industry: Total economy-wide value-added is estimated for 19 industry sectors for a single year. The majority of economic impact (over 61%) occurs in the Information sector within which the firm is categorized, and with the next largest share (6%) in real estate/rental/leasing, then the professional/scientific/technical sector (4.2%). While the analysis does not explain the distribution of impact, large portions of impact obviously occur within the firm's own sector reflecting its own spending, as well as in sectors that supply its operations. Induced consumption effects will typically be strong in the service sector, entertainment, and trade sectors. Impacts step down significantly outside the information sector and are fairly broadly spread across the economy.

e) Fiscal Costs: LED reports the following state benefits to be provided to the firm through the period 2016 - 2020, (1) Tax Equalization (R.S. 47:3201) benefits to offset higher tax liabilities at a Louisiana site relative to a site in another state totaling $15.2 million, (2) Quality Jobs Rebates (R.S. 51:2451) providing 6% payroll subsidies totaling $22.9 million, (3) a facility grant of $14.9 million of reimbursable project costs at a rate of $1 from the state for each $2 expended by the firm, (4) a relocation cost grant of $4.6 million reimbursing costs incurred in year 2010 through 2015, (5) a job creation grant of $163,183 based on $1,714 for each job up 350 jobs in years 2010 through 2013, and (6) grants to LA Tech of $516,000 to support a telecommunications professorship and curriculum at LA Tech University.

f) Incentive Significance: According to LED, site decision factors such as freight costs, energy costs, and infrastructure are not critical factors to CenturyLink's headquarters location. Factors contributing to the retention of CentryLink's headquarters in Louisiana are primarily related to access to workforce and comparative tax liabilities between Louisiana and Arkansas.

g) Fiscal Cost/Benefits: The impact analysis estimated the amount of state sales tax and personal income tax attributable to the firm's operations in the state. Since not all expenditures are subject to sales tax, the analysis assumed 48% of estimated household earnings were spent on goods and services subject to state sales tax. No explanation of the basis of that factor was provided. A 4% tax rate was applied to that portion of estimated earnings to arrive at a first-year sales tax estimate of $7.4 million. Effectively 1.9% of the total household earnings estimate was assumed to come back to the state in the form of sales tax receipts. This is not an unreasonable estimate, and is actually conservative in light of the recent increase in the state sales tax rate to 5% for the next two years. The analysis also made a first-year estimate of state personal income tax receipts attributable to the firm's operations, amounting to $7.7 million. This is based on a 2% tax liability of the household earnings estimate, as suggested by the Institute on Taxation and Economic Policy (Washington DC, 2009). This also results in a reasonable tax receipt estimate as evidenced by the fact that aggregate sales tax and income tax are comparable amounts in the state's actual tax receipts mix. Combined first-year tax receipts are estimated at $15.1 million, and are fairly conservative for this type of analysis since only two tax sources are estimated and a current higher tax rate is not utilized. The five-year present value estimate of receipts is over $64 million.

LED compared these state tax receipt estimates to the fiscal costs of the state incentives, to generate estimates of the annual net state fiscal impact for the five years 2016 - 2020. The LED table appeared to compare annual present value discounted state tax revenue estimates to the current dollar value state incentive costs. This works to narrow the excess of estimated state revenue receipts over state incentive costs, but these are not comparable concepts, and this evaluation adjusts the estimates of state tax receipts to the

2016 single-year estimated value and then applies the 2.15% inflation assumption of the impact analysis for the years out to 2020. Those adjusted annual receipt estimates were compared to the annual incentive costs provided by LED. Estimated state tax revenue exceeds state fiscal costs in all but one of the five years, with a $7.4 million net revenue loss in the second year primarily due the provision of the $14.9 million facility grant in that year. The other four years of the analysis each reflect greater receipts than costs, with the five-year current-dollar sum of state tax revenue receipts some $21 million greater than state incentive costs.

General Evaluation

The economic results of the input/output analysis are essentially mechanical, and are driven by the inputs of direct employment and wages paid, provided by the firm itself. In addition, the absolute levels of economic impacts estimated from input/output models should be taken with considerable caution. These are based on somewhat dated relationships between national industries. In addition, input/output analysis is static and linear. Firms are assumed to purchase inputs from in-state industries to the same degree that average purchases in the firm's industry are exhibited, and no negative effects on local firms that compete for those inputs is accounted for unless explicitly inserted into the analysis. In addition, induced consumption is assumed to be directly proportional to the income attributable to the firm's spending. For example, if a consumer were buying one cup of coffee a day from a local vendor before the firm's spending occurred, and income doubled after the firm's spending occurs, input/output models assume the consumer now buys two cups of coffee a day from the local vendor. Consumers clearly do not do that, and are likely to spend the additional income received on a varying mix of good and services that may or may not be locally supplied, or even save the additional income. It is material to note that over half of the total estimated economic impact appears comes from the indirect business effects and induced consumption effects that are estimated by the model and, assuming accurate reporting of direct spending and employment by the firm itself, are the least reliable components of the analysis. Thus, input/output analysis tends to overstate economic impacts, and consequently the associated fiscal impacts.

The analysis does not account for the state's balanced budget requirement. This omission is common in impact analysis, and means that the $58.2 million of total fiscal cost of the incentives, that have to be paid for elsewhere in the state budget over the next five years, are not considered in the analysis. Use of these public resources to support this firm results in lower government expenditures elsewhere in the budget and economy. This concept of opportunity cost is applicable to all government expenditure, but is less obvious and intuitive with respect programs such as Tax Equalization and Quality Jobs since benefits associated with these programs are charged against gross state receipts and result in lower net receipts before any other use of these funds can be considered in the appropriations process. This diversion of resources result is effectively a negative expenditure that is ignored in the analysis and that has its own negative multiplier effects that work to dampen the positive effect of the presence of the firm's spending in the economy. Thus, total economic and fiscal effects are overstated and, consequently, the net excess of state revenue over state costs are overstated, as well.

A couple of relatively minor issues are also usually noteworthy. First, input/output analysis provides no temporal dynamics. That is, all of the resulting impacts of the expenditures of interest (the firm's direct expenditures) are assumed to occur essentially instantaneously, within the same period of the firm's direct expenditures. However, it can take a surprisingly long time for spending to flow through an economy and result in subsequent rounds of spending. This means that the economic and fiscal effects of spending in one period (typically an annual period) are actually spread over a number of subsequent periods. Thus, total economic and fiscal effects tend to be overstated in the early periods of analysis, and accumulate up to full effects over time.

Another issue involves the various state budget means-of-finance affected. The state tax revenue associated with firm expenditures will be received by the State as various different tax and fee revenues, and the estimates of these revenues typically do not distinguish the availability of these revenues to the state general fund. However, the fiscal costs of the incentive programs will primarily if not entirely be carried by the state general fund or equivalent resources. This will generally not be a large discrepancy since much of the estimated state revenue will be from income and sales taxes, which are primarily general fund revenue sources, but it is likely that actual general fund receipts will not be as large as the estimated amounts, even without considering the overstatement of economic and fiscal effects discussed above. In this particular case though, only sales tax and personal income tax have been included in the estimated state tax revenue receipts, and the large bulk of those two taxes are general fund resources.

Disregarding the various issues discussed above concerning the overstatement of economic and fiscal effects, the net annual fiscal effects reported by the analysis are material but relatively small, estimated at $3.1 million in the first year before a negative $7.4 million occurs the second year, then settling into the $8 million to $8.5 million range in the third through fifth years of the analysis. The likelihood of overstatement of economic and fiscal effects means that positive estimated net effects are likely smaller, and the negative in the second year is likely more negative, than discussed above.

Act 389 of 2007 Provisions

Without regard to Act 704 of 2014, the renewal of the tax equalization benefit for CenturyLink has to be approved by the JLCB under the provisions of R.S. 47:3204, the tax equalization program, as amended by Act 389 of the 2007 Regular Session. Act 389 of 2007 removed the then current ten-year maximum number of years of benefits, and allowed unlimited five-year renewals of benefits if the applicant can demonstrate that it's activities generate economic benefits to the state economy that exceed twenty times the benefit to the applicant. Economic benefits to the state are to be determined by the use of the appropriate nationally recognized multipliers published by the U.S. Department of Commerce.

The economic impact analysis discussed above is utilized by LED to test whether the activities of firm generate economic benefits to the state economy that exceed twenty times the program benefits to the firm for the year preceding the request for renewal. LED selected the estimate of total household earnings as the measure of economic benefits to the state economy. That figure is $385 million and encompasses all income earned by resident households through compensation paid by CenturyLink (direct effect), compensation paid by supplier firms (indirect effect), and all compensation associated with all other consumer spending in the economy (induced effect). This amount is then divided by the latest year of tax equalization benefits, reportedly $3.035 million in 2014. The resulting multiple is 126.85, far exceeding the 20-times threshold required in law.

The household earnings concept is the most appropriate concept in impact analysis reflecting economic benefit to a state, and even recognizing the likely overstatement of the earnings estimate by the nature of input/output analysis and the omission of a balanced budget requirement, the overall size of the firm's activity in the state relative to the tax equalization benefit in isolation is so large as to make it essentially impossible to not achieve the 20-times threshold.