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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: Pool Corp. Tax Equalization Renewal Request
Act 704 of 2014 and Act 389 of 2007

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 assessment.

The Department of Economic Development (LED) is submitting such information for JLCB approval of a five-year renewal of a tax equalization benefit for various business entities collectively referred to as POOL. In addition, Act 389 of 2007 requires third and subsequent renewals of tax equalization exemptions be approved by the JLCB under the provisions of R.S. 47:3204. This renewal would be the fourth five-year exemption period for POOL. The analysis of the renewal under both requirements is discussed below.

Act 704 of 2014 Provisions

a) State Commitment: The estimated state tax benefits to POOL over the five-year renewal period (2019 – 2023) are $16.1 million in reduced corporate income and franchise tax liabilities. This commitment of state resources exceeds the $10 million threshold required for consideration under Act 704.

b) Analytical Model: Estimates of the economic impact in Louisiana of the operations of POOL were provided by Paul S. Nelson and Robert C. Eisenstadt; professors of economics at the University of Louisiana at Monroe. They utilized the RIMS II multipliers for the wholesale trade industry of Louisiana, generated by the Bureau of Economic Analysis of the U.S. Department of Commerce. These are standard input/output multipliers commonly utilized for economic impact analysis. Economic impacts were generated from POOL's direct employment of 399 full-time equivalent employees (386 full-time and 27 part-time in 2017) and payroll of $33 million.

c) Economic Impacts: Estimates of economic impact generated by Nelson and Eisenstadt are as follows:
   i) Value Added was estimated for fourteen specific industries and a catchall Other industry for a single initial year, and totaled $113.8 million. This is the industry level and state level equivalent of gross domestic product, and is a broad measure of total economic activity, although it includes components that do not necessarily reflect economic impacts on the households of the state.
   ii) Household Income was estimated for an initial single year and for a ten-year present value. For the single year, total household income in the economy was estimated at $56.7 million; 75% of which are attributable to the direct operations of POOL (it's purchases) and the indirect effect of the firm on other firms (purchases by its suppliers), and 25% of which are attributable to the induced effects in the economy (purchases by employees and other consumers).
   iii) Employment was estimated for a single initial period. POOL is estimated to directly employ 399 full-time equivalent employees; 386 full-time and 27 part-

time employees, where 2 part-time employees are assumed to be 1 full-time employee. Total economy-wide employment is estimated at 939, with indirect employment by supplier firms estimated at 165 (18%), and employment induced in other industries estimated at 375 (40%).

d) Impacts By Industry: Value added was estimated for fourteen industry groups. Of the $113.8 million total estimate, $74 million or 65% was attributable to the wholesale trade industry. A large portion of impact obviously occurs in the industry within which the subject firm operates. Effects step down sharply across the remaining industries with the next two largest effects in real estate-rentals-leasing at $5.9 million (5.2%) and healthcare-social assistance at $4.4 million (3.9%) of the total, respectively. The smallest effects were estimated in the industries of food services and utilities, at $1.4 million (1.2%) and $1.2 million (1.1%) of the total, respectively.

e) Fiscal Costs: Tax Equalization credits extended to POOL over the life of the five-year renewal period are reported by the Department of Economic Development to total $16.1 million. Credits range from $3.1 million for 2019 to $3.4 million by 2023. These credits are taken against corporate income and franchise tax liabilities.

f) Incentive Significance: According to the Department of Economic Development, factors such as transportation, energy, and infrastructure are not critical for the POOL headquarters location, and that the primary factor contributing to a Louisiana location is the comparative tax liabilities between Louisiana and Florida or Nevada. In addition, according to the Department, POOL has indicated that if the Tax Equalization renewal is not provided, the company will strongly consider relocating the corporate headquarters to another state.

g) Fiscal Cost/Benefits: The impact analysis estimated the economy-wide amount of state sales tax and personal income tax associated with the operations of POOL in the state. Effectively 1.8% of total household income was estimated as paid in state sales tax (40% of household earnings were assumed spent on goods & services taxed at 4.45%). These assumptions resulted in estimated initial-year total state sales tax receipts of $1.0 million. The average compensation for POOL FTE-employees ($82,855 and 399 FTE-employees) and the average Louisiana labor income for the indirect and induced employment in the economy ($41,590 and 540 FTE-employment) were used to estimate personal income tax liabilities assuming two-person joint returns with only federal income tax deductions claimed. These assumptions resulted in estimated initial-year total personal income tax receipts of $1.4 million. For these two major state taxes, the combined economy-wide receipts were estimated at $2.5 million for 2019. Non-discounted tax receipts were provided for ten years, with the estimates for 2019 – 2023 growing by 3.4% per year to $2.9 million in 2023. This growth rate is a combination of 5% annual growth projected for compensation at POOL, and an assumed growth in wages for indirect and induced employees of 2.09%, the projected inflation rate in the analysis. Added to these labor based tax estimates were sales tax and corporate tax payments attributable directly to POOL, resulting in total estimated tax payments of $5.9 million in 2019, growing to $6.9 million in 2023. These fiscal benefit estimates are compared to the fiscal cost estimates of the tax exemption ranging from $3.1 million in 2019 to $3.4 million in 2023. By these estimates, fiscal benefits exceed fiscal costs in each year of the renewal period; 2019 by $2.8 million, 2020 by $3.0 million, 2021 by $3.2 million, 2022 by $3.3 million, and 2023 by $3.5 million. Over the entire five-year period estimated benefits exceed estimated costs by a total of $15.8 million.

General Evaluation

The absolute levels of economic impacts estimated from input/output multipliers should be taken with considerable caution. These multipliers are based on dated relationships between industries, in this case as far back as 2007 for detailed industries and only as recent as 2016 for aggregated industries. In addition, multiplier analysis is static and linear, and tends to overstate economic impacts and, consequently, fiscal benefits.

Notably, the majority of estimated total impact is attributable to the indirect and induced components of the analysis (58% as reflected in the employment estimates). These components are the estimates of the analysis and, as such, are necessarily less reliable than the direct effects of the firm's own reported, and presumably confirmable, employment and payroll. While impact analysis might be acceptable as a ranking tool, assuming all projects are analyzed consistently, its weaknesses, combined with the various assumptions that have to be made to extend its economic results to governmental fiscal results, do not provide absolute point estimates of economic impact and consequent fiscal impact adequate for state budgeting decisions.

The analysis also does not account for the state's balanced budget requirement. This omission is common in impact analysis, but means that the $16.1 million total fiscal cost of the exemption, that have to be paid for elsewhere in the state budget, is not considered in the analysis. Lower government expenditures are a negative spending change that have their own multiplier effects that work to dampen the positive effect of the presence of POOL in the economy. Thus, this omission results in total economic and fiscal benefits that are overstated and, consequently, net fiscal benefits that are overstated, as well.

Finally, LED asserts that no other business costs or conditions (such as transportation, energy, and infrastructure) other than comparative tax liabilities are instrumental in the location of POOL in Louisiana. This is a strong assertion and would seem unlikely to be the case for any enterprise, especially in light of the fact that state tax liabilities are typically very small components of total business costs, whereas costs of transportation, energy, infrastructure, labor etc are typically much more significant components of total business costs. However, according to LED, the company has indicated that it will strongly consider relocating to another state if the tax equalization renewal is not provided. If that is true, at best the fiscal costs of the renewal result in relatively small net annual benefit to the state fisc. If not true, the renewal results in absolute costs to the state fisc.

Act 389 of 2007 Provisions

Without regard to Act 704 of 2014, the renewal of the tax equalization exemption for POOL 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 tax exemption, and allowed unlimited five-year renewals of tax exemption if the applicant can demonstrate that its activities generate economic benefits to the state economy that exceed twenty times the tax exemption 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 POOL generate economic benefits to the state economy that exceed twenty times the tax exemption benefit for the year preceding the request for renewal. The analysis estimated total aggregate transactions of POOL and affiliates at $149.7 million, presumably encompassing all purchases made by POOL (direct effect) plus all purchases made by supplier firms (indirect effect), and all purchases made by the employees of POOL and supplier firms as well as all other consumers in the economy (induced effect), and presumably the typical output multiplier effect of RIMS II tables. This amount is then compared to the latest year of tax exemption benefits, reportedly $2.990 million in 2018. The resulting multiple is 50.06, significantly exceeding the 20-times threshold required in law.

While the aggregate transactions concept is the typical headline number of economic impact analysis, it significantly overstates true economic impact. It includes substantial double counting of spending as gross purchases at each stage of production are added together rather than the net purchases after production costs (also counted as purchases in various stages) are deducted at each stage. This double counting is further evidenced by the fact that estimated total household earnings (labor being the largest production input in the economy) in the analysis is $56.7 million, only 38% of the aggregate transactions estimate.

The concept in impact analysis that reflects the economic benefit to the residents of a state is the household earnings concept, in this case totaling some $56.7 million; itself likely to be overstated by the nature of input/output analysis and the omission of a balanced budget requirement. This concept reflects the earnings benefits received by the residents of the state employed by POOL, its suppliers, and all other firms receiving induced purchases. Dividing that amount by $2.990 million results in a multiple of 18.955, close to but under the 20-times threshold. The 20-times multiple could be calculated utilizing the value-added concept, estimated by the analysis at $113.8 million current dollars. That concept avoids the double-counting of the aggregate transactions concept, but reflects more than just the income earnings of the state's residents. The multiple using that concept is 38.06. Thus, if the aggregate transactions or value-added concepts are utilized to reflect economic benefit to the state, then for all practical purposes, it is impossible for the 20-times threshold to not be met.

Finally, R.S. 47:3204.B.(1)(b)(ii) requires that the application for subsequent renewal include an attestation by an independent public accounting firm of the calculation of the economic benefit to the state. An attestation was provided but attests only to the Louisiana payroll expenses and number of employees of the Louisiana Operations of Pool Corporation and Affiliates. The attestation appears to apply only to the direct employment and payroll of Pool Corporation and Affiliates, and not the subsequent estimates of indirect and induced effects of economic impact analysis. Regardless, neither the reported direct payroll of POOL or the estimated economy-wide earnings are what LED utilized as reflecting the economic benefits to the state. As discussed above, gross purchases in the economy (referred to as aggregate transactions in the impact analysis), inclusive of the double counting also discussed above, are utilized to reflect economic benefits in the 20-times multiple test; the use of which essentially guarantees exceeding the 20-times multiple test.