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The Economic Development Bubble

By Ohio Auditor Dave Yost & Matt A. Mayer

The states and cities of America are creating a classic market bubble by the way they chase economic development. The cure is better transparency, which can be achieved through performance audits.

A market bubble is a segment of a market economy that is behaving inefficiently due to a lack of information. From the Tulip mania of the 17th century to the South Sea bubble in the 18th century, from Wall Street in 1929 to the CDO-driven real estate crash in the 21st century, markets that lack information morph into casinos — with the predictable result: a few win, most lose and the house always makes its vig.

Like prior bubbles, this economic development bubble is marked by a desirable product for which buyers are willing to spend ever-increasing sums, and a lack of transparency.

By transparency, we mean enough information to allow buyers — state and local governments, on behalf of taxpayers — to properly evaluate the offering. (That evaluation includes making sure packages don't place recipients at an unfair advantage over existing businesses within the state.)

Too often, economic development activities lack these core principals. And we aren't talking about nickels and dimes — the competition among states and cities for speculative economic development hit $45 billion in 2015, according to one researcher.

In the last year, Americans watched as states and cities scrambled to put together enormous packages to lure Foxconn, which promised to invest nearly $10 billion and create up to 13,000 new jobs wherever it landed. After site visits and private negotiations, Wisconsin's offer of roughly $3 billion in tax breaks sealed the deal. A state fiscal analysis concluded taxpayers wouldn't recoup their investment until 2042-43. The deal put Foxconn at an apparent advantage compared to other manufacturing entities.

The full deal remained shrouded until the very end.

Currently underway is the competition to land the second headquarters of Amazon, which would result in nearly 50,000 new jobs and $5 billion in new construction. Amazon has cut the list of competitors down to twenty jurisdictions, including our state's capital, Columbus. Amazon has conducted site visits and competitors are putting together largely secret economic development packages. As with Foxconn, little about the Amazon HQ2 competition adheres to the principles of transparency, fairness, and a quantifiable return on the investment for taxpayers.

Jamie Dimon, the CEO of JP Morgan Chase, said that the winning state can expect a call from him asking for the same deal for his company. JP Morgan Chase employs over 23,000 Ohioans, so this demand could get very expensive for Ohio taxpayers, especially if other companies do the same. No one can blame Mr. Dimon for his position, as it is only fair for his company to get the same deal as Amazon.

Ohio provides a great illustration of these problems. Ohio privatized its economic development function in 2011, creating a private corporation. That one-of-a-kind entity, JobsOhio, was capitalized by monetizing future liquor sales from the state-owned liquor monopoly. JobsOhio has operated for seven years and has claimed great success in its activities.

Unfortunately, we have no idea if its claims are true, as JobsOhio largely has no outside oversight and is in control of the information it wishes to report. This lack of transparency makes it impossible to independently analyze either the fairness of its deals or whether those deals are providing real returns to Ohio. Policymakers even prohibited the State Auditor from conducting a financial or performance audit of JobsOhio.

What we do know is that the longer JobsOhio has been doing its work, Ohio's private sector job growth has gotten weaker — despite tens of millions spent to keep and attract businesses. We recognize that this fact does not constitute causation, but in an information desert, the observation is troubling.

How to cure the information desert? No one negotiates a competitive deal in public. Private companies are justifiably protective of their proprietary information. The traditional transparency tools — public meetings, public records — work against those considerations.

A performance audit of a jurisdiction's economic development activities could be the compromise solution. Performance audits are data-driven reviews that include bench marking against peers, outcome measurements and process analysis and are widely used in public activities.

An outside, independent entity would be engaged to review the work with appropriate safeguards to protect against the disclosure of private information. In the case of a privatized agency, the entity would have to be contracted through a public entity to ensure objectivity.

Using public resources for speculative ventures without transparency, fairness, and measurable results is creating a growing bubble that will one day pop. We can wait for that day — or we can act now to increase the amount of reliable, verified information in the marketplace.

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