

13 Costs & Benefits
(Economic & Non-Economic)
that Public Sector Decision Makers
frequently fail to take into account

Why do so many 'development' projects fail to provide the economic development benefits that their proponents claim for them?

Tim Chapin in the USA has identified 13 costs & benefits, both economic and non-economic, that public sector decision makers frequently fail to take into account.

Speaking specifically about sporting facilities, he shows that they cannot, in fact, be justified on economic development grounds alone – but, he argues, this may not matter if the non-economic benefits are great enough.

Just about all of his arguments also extend to other development type projects – entertainment centres, tourism attractions, etc.

See how your project 'stacks up'.

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The Employment Impacts of the Grand Prix

(Some years after the first Grand Prix was run in Adelaide I was approached by a lawyer defending Channel 7 against a charge brought by Mal Hemmerling, Executive Director, Australian Grand Prix Office, miffed because Channel 7 had said of him, quite accurately, 'he is paid more than the Premier—and all he does is run a car race!')



Lawyer: "How much employment did the Grand Prix create?"

Me: "Full time, long-term, jobs?"



Lawyer: "Yes"

Me: "In round terms, zero!"

I added that some restaurant workers got extra shifts and some short term employment was generated building the barricades and there was, of course, seasonal work selling food, drink, and tickets, etc and putting up and taking down the barricades and viewing structures—but no full time jobs; after all the race only lasted one week out of the year. And yet the Commonwealth Government supported it to the tune of \$10m.

In the pre-event hype, the media spoke of 'many' (sometimes 'hundreds!') of man-years of employment. It never happened. It was never going to happen. But this does not mean the Grand Prix in Adelaide was not a success. It was a great success, winning prizes and winning hearts and minds. It did a great thing for morale and convinced the locals that they need not consider themselves inferior to the Eastern States, but in fact could confidently approach the world. It could also be considered a political success; the Labor Party won the next election held a few weeks after the event (and they had privately considered that they would be voted out of office because they had that year hiked up electricity prices). It wasn't, however, an economic success. The Grand Prix Office ran at a loss. And this was despite a great many of the costs incurred by the public sector (and, indeed, the private sector) not being counted.

Whether the issue is a ten year car race, or a sporting facility, a successful proposal depends on clearly identifying the goals—and then accurately assessing the costs and benefits of achieving them. This issue looks at those costs and benefits.

Acknowledgements

This issue draws upon the analysis carried out for "The Adelaide Grand Prix: the impact of a special event" edited by P Burns, J. Hatch and T. Mules and published by the Centre for South Australian Economic Studies in 1986.

But it was inspired by—and draws heavily on—the work by Tim Chapin, "Identifying the Real Costs and Benefits of Sports Facilities" (2002), with his permission. Tim is Assistant Professor in the Department of Urban and Regional Planning at the Florida State University. His research was funded by a grant from the Lincoln Institute of Land Policy. This is an excellent paper and everybody who is responsible for putting together a capital development proposal or evaluating one should take the opportunity to read it. It is not long and contains lots of practical, objective, assistance. You can read it at www.lincolninst.edu/pubs/dl/671_chapin-web.pdf

Or simply go the Virtual Asset Management Community Resource Library at www.amqi.com and look up 'Chapin' or 'Project evaluation'

7 Reasons why development projects often fail to deliver on their economic promise

Academic studies have consistently shown that sporting (and, by extension, many other major projects) frequently fail to deliver their promised economic development. Why is this? Why are the end results often so disappointing? Tim Chapin lists a number of reasons. I have summarised these below.

OVERSTATEMENT OF POTENTIAL BENEFITS

1. Substitution Effects

New money? Or old money in new pockets?

Projects need to distinguish what is, in effect, 'new money inflow' into an area. Many projects simply redirect spending that would have occurred within the region anyway. For example, the promotion for the Adelaide Casino looked at all of the spending within the Casino (and its downstream effects) as Benefits BUT did not look at where this was coming from – and most of it was coming from existing entertainment and dining venues in the city. This was not new money; it was mere substitution, involving losses elsewhere in the city (which also had multiplier or downstream effects).

2. Leakages in the Economy

Local employment or employment for others?

Any industry has 'leakages', that is a certain percentage of the money spent on a given industry's local products and services flows out of the local economy to non-local entities. Some projects are particularly susceptible. The Grand Prix for example, generated a lot of demand for food and drink in Adelaide (but most of it was catered for by companies originating in Melbourne!) To track the leakages, it is important to see who gets the money in the initial instance and where they spend it. Leakages can be high even when the focus is at the State level. But they are even higher when the focus is a small regional or rural area.

3. Impacts on Metropolitan Economic Growth

Is it big enough to count?

Academic studies have shown that even quite large events emanating from a new stadium or exhibition centre or tourism attraction may be too small, relative to the size of the economy, to make much of a significant difference.

4. Quality of New Jobs

Full time ongoing jobs—or temporary jobs?

New construction creates jobs, but only for a limited amount of time. Jobs are also created within the facility and by surrounding suppliers. It is important to check however whether they are 'good' jobs, or low paying, seasonal, service jobs 'that cannot serve as the basis for a quality economy'. Where the new sports stadium or capital works has displaced other entertainment or spending activity, what jobs have been lost?

UNDERSTATEMENT OF POTENTIAL COSTS

5. Indirect Project Costs

It is the costs you don't see that are the danger!

"New sports facilities typically require substantial ancillary investments, the costs of which usually fall on the public sector. These costs often include major infrastructure improvements (interstate interchanges, water/sewer lines) and new parking structures, projects that can quickly add [many millions] to a new facility's price tag. In addition, there are other hidden costs that can contribute to the public sector's bill for a new facility, such as large pieces of property removed from the property tax rolls and the relocation of businesses out of the project area" (Chapin, p.6).

6. Opportunity Costs

Not one decision, but two

'The public sector is always short of funding to address all needs in a given community or region. When spending public funds on a sports facility, the public sector has actually made two choices; 1) to spend money on the stadium and/or arena and 2) to not spend this money on other needs. Money encumbered for a sports facility cannot be spent on other needs. In addition, by choosing to use a given piece of land for a sports facility also loses an opportunity to utilise this land for other needs or other uses' (Chapin, p.7)

WRONG ATTRIBUTION OF BENEFITS

7. Flow of Facility Revenues

'Lastly the flow of revenues from sports facilities have helped to consign sports facilities to the status of failure as an economic investment. Most revenues from sports facilities, even those built with public funding, tend to flow to the sports teams and not into the coffers of the public service." (Chapin, p. 7)

This would not be so bad, if the sports teams and their owners spent their money locally but this generally does not happen.

Similarly with other so-called 'income generating' developments such as Casinos. So keen was the State Government to obtain a share of Casino profits that its project assessment neglected to observe that the profits from the Casino flowed out of the State, whereas the profits from the small businesses that were put out-of-business by the Casino stayed locally.

Many 'tourism developments' in rural areas are provided at the expense of local communities, but the taxation revenues flow back to the State or Federal Governments. The **flow of funds** is a critical element to include in any impact statement.

ECONOMIC COSTS

Typically considered by decision makers

- Land Acquisition Costs
- Construction Costs
- Carrying costs (operations and maintenance, debt service)

Typically NOT considered by decision makers

- Required Infrastructure Improvements
- Business Relocation Costs
- Property Tax Losses (Removal from tax rolls, abatements)
- Public Service Costs for Events (Police, EMS, Other)
- Opportunity Costs for Funds
- Opportunity Costs for Land
- Encumbrance of Bonding Capacity
- Demolition and Site Work for Old Facility (if applicable)
- Impact on District Surrounding Old Facility (if applicable)

Economic Costs not typically considered

'The cost of any major infrastructure improvements required for a new facility interchanges, new roads, water/sewer lines) normally fall to the public sector. Alone, these improvements can easily require up [to many millions] in public funds. Other hidden costs include business relocation expenses for firms required to relocate to new locations, property tax losses for land removed from the property tax rolls, and the costs of providing public services for events at the facility. Individually these costs may not seem significant, but they can quickly sum to millions of dollars.

Opportunity costs are also rarely considered by the public sector. The public sector typically has finite resources for seemingly infinite needs, so the opportunity costs for both the funding and the land for the facility must be part of the decision making calculus. In a related issue, there are opportunity costs related to the use of municipal debt for sports facilities. A local government typically has set limits on their bonding capacity, as their debt thresholds are set by local, state, or federal statutes. If a city uses a substantial portion of their available debt on a sports facility, they cannot use debt financing for other community needs even if they are immediate and pressing. Additionally, these debt commitments are usually over a period of at least fifteen years, encumbering a portion of the public sector's financing capacity for a long period of time.

Lastly, in cases where a city is replacing an existing facility with a new one, **the economic costs associated with the old facility** should be considered as well. The old facility will need to be demolished and the debris removed from the site. Site remediation costs should also be factored in. These costs are not trivial and can easily run into the millions of dollars. In addition, the economic impact on the district surrounding the old facility must be considered. If the surrounding land uses complemented the sports facility (restaurants, bars, visitor shopping), then these businesses may relocate or terminate operations as their customer base may have moved to the district surrounding the new facility.' (Chapin, pp 15-16)

ECONOMIC BENEFITS

Typically considered by Public Sector Decision Makers

- Tax Revenues (Sales, Property, Personal, Other)
- Stadium/Event Revenues (that flow to the public sector)
- Total Economic Activity (Dollars and Jobs)
- Spin-Off Businesses
- District (Re) Development
- Impact of Other Events

Typically NOT considered by Public Sector Decision Makers

- Marginal Economic Activity (New Money, New Jobs)
- Reuse Opportunities for Old Facility Site (if applicable)
- Impact on District Surrounding Old Facility (if applicable)

Economic Benefits not typically considered

‘On the benefit side, the most important economic benefit overlooked by the public sector is the marginal economic impact of the facility. A subset of the total economic impact, the marginal impact captures the effect of “new money” in the local economy. As discussed earlier, this number provides a more precise valuation of the economic impact of a sports facility. Decision makers should not accept economic impact studies that do not include this figure. Fortunately for decision makers, estimates of marginal impacts have been become a more common element of economic impact studies in recent years.’ (Chapin, p.16)

Ed: Unfortunately, in many cases in Australia, the amount of ‘new money’ has been overstated. In the case of the Grand Prix, for example, it was commonly mooted—before the event—that the event would attract many big-spending tourists from overseas. The truth of the matter was that most visitors to the Grand Prix were from within the State (not new money), and car racing enthusiasts from interstate who drove over and camped cheaply. Most foreign tourists were from New Zealand and reasonably careful spenders. The flow on effects from new money have also been overstated. (In one case it was stated for the Festival of Arts that every dollar from the Government generated \$11.34 cents for South Australia! Similar very large ‘multipliers’ have been quoted for other Special Events. As a general rule if any event or sum of new money is considered to have flow on effects in a multiple of more than two—be suspicious! (see P Burns and T Mules . ‘*Note of the Policy Implications arising from the misuse of input-output analysis*’ Economic Letters, Dec 1985)

‘Another overlooked economic benefit rests in the reuse of the site of an old stadium/arena and the potential redevelopment of this site and the surrounding district. Large, consolidated pieces of land are valuable and can be resold for substantial return. These sites can also generate property taxes if they are returned to the tax rolls, generating an economic benefit. Additionally, the departure of a sports facility can lead to (re)development opportunities in the surrounding that can potentially bring substantial economic returns’. (Chapin p.16)

NON-ECONOMIC COSTS

Typically considered by Public Sector Decision Makers

- None

Typically NOT considered by Public Sector Decision Makers

- Community Identity
- Community Visibility
- Potential for Political Conflict
- Political Capital Expended
- Political Opportunity Costs
- Disconnect with Development Logic

Non-economic Costs Not Typically Considered

While the vast majority of non-economic benefits are typically considered by decision makers, non-economic costs are generally not. The non-economic downsides of investments in sports facilities are commonly ignored when weighing the costs and benefits of these facilities. Rarely does the public consider the psychic/social and image costs that might potentially flow from a project. For example, the Seattle Kingdome, an ugly, concrete, domed stadium torn down in the late 1990s, despite tens of millions of dollars of debt still owed on the facility, did little to project the image of a successful, vibrant northwestern city. The facility also had maintenance problems over the years, requiring unexpected funding from the public sector. The stadium became something of a public embarrassment, leading to decisions to build two new stadia to replace the Kingdome with a bill approaching \$1 billion, with a majority of funding coming from public coffers.

Similarly, political costs are rarely considered as well. Sports facilities almost always engender tremendous political debate, requiring substantial investments of resources from the governing coalition and diverting attention from other issues of importance. Additionally, these projects often polarize a community, generating political discord that can haunt a community for years. Residents of Minneapolis/St. Paul, and Minnesota more generally, continue to be bitterly divided over the “need” to provide new sports stadia for their MLB and NFL franchises, a debate that has raged almost ten years. While decision makers usually consider the political benefits of these projects, political costs are rarely recognized as an almost certain part of the process.

Lastly, while sports facilities can promote a “development logic”, there are times when these projects actually work against ongoing economic development efforts. Baltimore’s Camden Yards stadia have been hailed as model sports projects. However, these stadia have actually worked against the city’s longstanding efforts to promote industrial development in a district adjacent to Camden Yards (Chapin, 1999). The need for parking for the crowds that attend events at the two stadia has led to numerous new surface parking lots in this industrial district. Similarly, Seattle’s SoDo (South of Downtown) district was envisioned as a light manufacturing, industrial, and waterfront district, but the siting of a new ballpark in SoDo has instead led to new restaurants and other entertainment oriented uses being established in the area. If a facility provides a poor fit to the development logic for a portion of the city, it can retard economic development efforts rather than promote them. These development costs are rarely considered in typical impact studies.’ (Chapin pp17-18)

NON- ECONOMIC BENEFITS

Typically Considered by Public Sector Decision Makers

- Community Identity
- Civic Pride
- Community Visibility
- Consumption Benefits
- Political Capital Gained
- Support of Development Logic

Typically Not Considered by Public Sector Decision Makers

Project Planning/Management Capacity Building

'On the benefit side, there is one potential benefit that is usually overlooked in impact studies. Sports facilities are very complex projects, usually requiring diverse funding sources and attention from multiple governmental organizations. As such, these projects offer opportunities to develop a community's capacity for undertaking and completing very difficult projects. In doing so, a community can benefit from the lessons learned from these projects and apply these lessons to future projects. A community's capacity for undertaking large (re)development projects can be enhanced in the process of funding, planning, and implementing a sports project.' (Chapin, p. 18)

Conclusion

'Any decision regarding the question of public funds for sports facilities requires of decision makers a broad grasp of issues related to economics, politics, tax policy, real estate development, and urban planning. As a consequence, public sector decision makers require a baseline of information at their disposal to provide a more complete picture of the costs and benefits of these projects. This paper has attempted to provide this baseline of information. An understanding of the costs and benefits that flow from sports facilities serves to better shape the debate concerning these facilities and yield decisions that more closely reflect community needs and wants.' (Chapin, p. 18)

Ed: And remember that Chapin's arguments apply not only to Sporting Facilities but, in principle, to every major project that has as its purpose 'development'.

Thus it applies to other entertainment centres and tourism attractions. The arguments typically also apply to private sector ventures that are underpinned by government money—eg office or residential buildings. (In my time in, and watching, the public service—about 20 years now—I have seen many high profile and expensive failures in terms of underwriting private ventures but, to the best of my knowledge, not one genuine success!)