THE POLICY PAGE
An Update on State and Federal Action

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Enterprise Fund Policy Page: "High Road or Low Road"

SUMMARY

This policy page provides an analysis of the Texas Enterprise Fund (TEF), including its administrative processes and program results. This page also examines similar incentive programs and provides recommendations for an Enterprise Fund that promotes a "high-road" economic development program.

The Texas Enterprise Fund:

- Includes the largest annual appropriation of any cash-based economic development incentive program in the nation
- Lacks standards to promote high-quality jobs
- Lacks adequate safeguards to foster compliance
- Provides a limited picture of the state's subsidy for a particular project
- Plays a secondary or uncertain role in site selection
- Prefers projects in major metropolitan areas over rural and border regions
- Lags behind other states in reporting, public disclosure, and post-award compliance measures

The Governor has recently called for fully replenishing the Texas Enterprise Fund for the next biennium—at a cost of nearly $300 million. The Governor has also proposed a new economic development program—the Emerging Technology Fund ($300 million)—that would be administered by the Office of the Governor. This new fund would assist research and development of new technologies and create regional collaborations between the private sector and university researchers. Under this proposal, these centers would incubate start-up firms and attract existing companies that can commercialize their development.

In response to the administration of the Texas Enterprise Fund, the 79th Legislature has filed two bills that would regulate how the TEF operates.

SB 277 encourages more geographic equity and enhanced reporting. The bill:

- Requires impoverished regions to get greater consideration for grants
- Allows the fund to be used for job training
- Mandates long-range planning reports to be submitted to the Legislature

SB 105 would also add new reporting requirements to measure job quality. The bill would mandate collection and periodic reporting on the following indicators:

- Jobs promised vs. jobs created each year
- Jobs with health benefits
- Small business participation

BACKGROUND

At the request of the Governor, the Texas Enterprise Fund was established in 2003 to offer direct cash payments to foster economic development and create jobs. The Legislature appropriated $295 million from the Economic Stabilization Fund—a.k.a the "Rainy Day Fund"—for the TEF, making the Texas Enterprise Fund the largest such fund in the country.[1]

The Office of the Governor administers the Texas Enterprise Fund, a program described as a "deal-closer" to encourage business to expand and/or relocate operations within Texas. Most companies have five years to create these positions or face the possibility of refunding the cash grant to the Enterprise Fund. According to the Office of the Governor, the fund can be used "for a variety of economic development projects, including infrastructure development, community development, job training programs, and business incentives."[2]

The Office of the Governor has established general criteria for TEF applicants and projects, including:

- job creation and wages
- capital investment
- applicant's financial strength
- applicant's business history
- business sector analysis
- public and private sector financial support

Before funds can be awarded, the Governor, Lieutenant Governor, and Speaker must unanimously agree to support the use of the Texas Enterprise Fund for each specific project.[3]
To date, almost all of the TEF disbursements have been for business incentives. Virtually no funds have been directly disbursed for community development or job training programs.

TEF'S PROMISE OF NEW JOBS

As of January 3, 2005, the Texas Enterprise Fund had allocated almost $206 million in grants to 17 entities. Several distinct business sectors are represented among the grantees, ranging from agricultural to semi-conductor research. The following table illustrates more specific detail on each TEF grant.

Texas Enterprise Fund Projects—January 2005

Company (Location)	Business Sector	Direct Jobs Claimed	Enterprise Fund Grant	Grant Per Job
Baylor College of Medicine (Houston)	Agriculture	n/a	$2 million	n/a
Univ. of Texas/Texas Instruments (Richardson)	Semi-conductor	1,000	$50 million	$50,000
Vought Aircraft (Dallas)	Aerospace	3,000	$35 million	$11,667
Sematech (Austin)	High-tech	4,000	$40 million	$10,000
Texas Energy Center (Sugarland)	Energy	1,500	$3.6 million	$2,400
Home Depot (Austin)	Retail/Data Processing	600	$600,000	$1,000

[1] The state also promotes economic development through more than 500 local economic development corporations (EDCs) that generate more than $300 million annually in sales tax revenue. The EDCs provide various subsidies and tax incentives to encourage business relocation and expansion. In addition, local taxing units, such as cities, counties, and school districts, may grant property tax abatements or freeport exemptions that reduce taxes paid by new or expanding businesses.
See http://www.oag.state.tx.us/AG_Publications/pdfs/2004econdevhb.pdf.
[2] http://www.governor.state.tx.us/priorities
[3] No public records exist of correspondence or meetings on potential Enterprise Fund projects.

UT MD Anderson (Houston)	Biomedical	2.252	$25 million	$11,101
Maxim (San Antonio)	Semi-conductor	500	$1.5 million	$3,000
Citgo Houston/Corpus	Oil	820	$5 million	$6,098
Cabela's (Fort Worth/Buda)	Retail	600	$600,000	$1,000
Koyo Steering Systems (Ennis)	Manufacturing Auto Parts	200	$333,000	$16,650
Superior Essex Communication (Brownwood)	Telecom.	50	$250,000	$5,000
LEARN & Tigre (Internet 2)	Telecom.	0	$9.8 million	n/a
Huntsman (Odessa, Woodlands, & Port Neches)	Chemicals	326	$3 million	$9202
Lee Container (Nacogdoches)	Manufacturing	105	$300,000	$2,857
Countrywide Financial Corporation (Richardson)	Financial Services	7,500	$20 million	$2,667
BP Chemical (League City)	Petrochemicals	150	$750,000	$5,000
Total		**22,846**	**$205.6 million**	**n/a**
Average per project		*1,523*	*$12.1 million*	*$8,999.39*

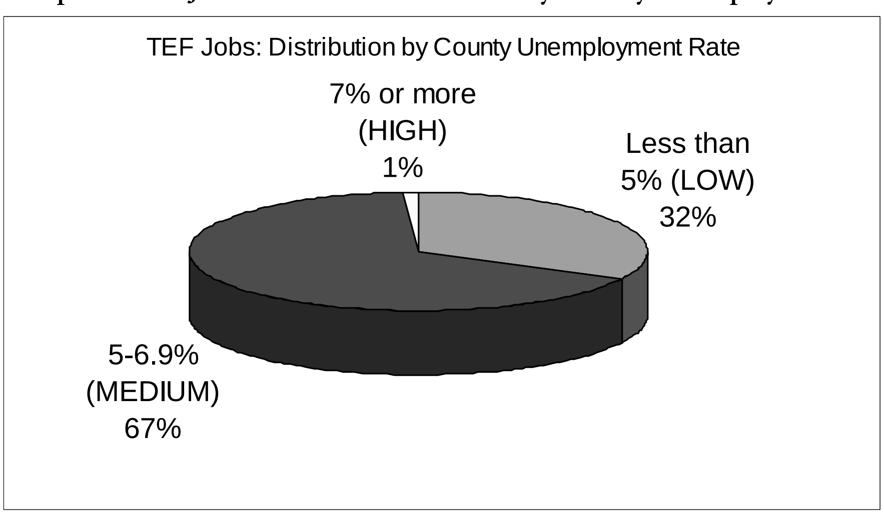
Sources: Office of the Governor, Legislative Budget Board, 2005

CREATION OF NEW JOBS LESS THAN REPORTED

As reflected above, the Office of the Governor claims the Texas Enterprise Fund has created almost 23,000 new jobs at a cost to the fund of $9,000 per direct job. Overall, the Office of the Governor projects that these recipients will invest $6.2 billion into the state economy. To date, TEF grant recipients have created 275 jobs (1.2%) of the total jobs promised. Currently, no comprehensive timetable specifies when companies are required to create the remaining jobs.

The Texas Enterprise Fund has financed business projects largely in areas of the state with relatively modest unemployment rates. The following graph illustrates the distribution of TEF grants for areas with different unemployment levels.

Enterprise Fund Jobs Promised: Distribution by County Unemployment Rate

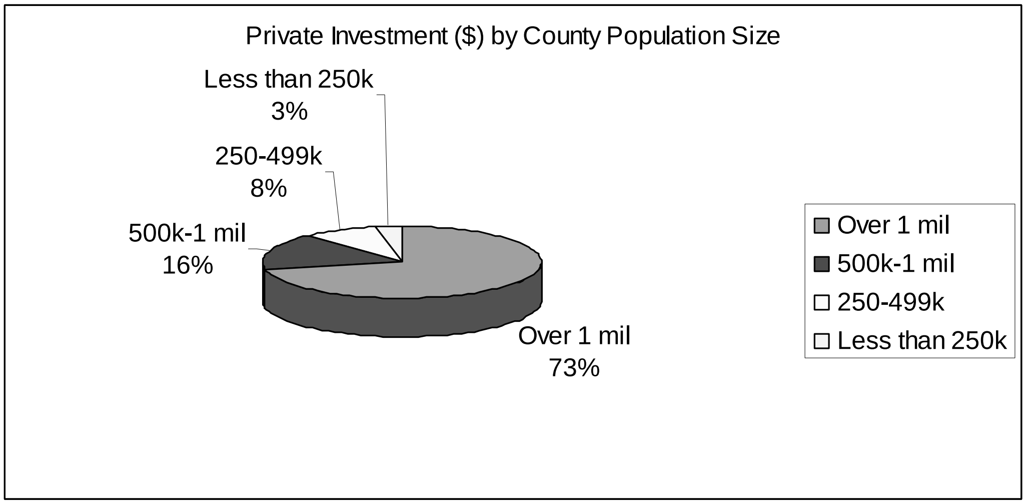


Sources: Legislative Budget Board; Texas Workforce Commission—Texas Labor Market Information

Although 24 Texas counties have unemployment rates at or above 7%, only 260, or 1% of all TEF-financed jobs are expected to be created in those areas.

Additionally, TEF-financed jobs vary widely by population size of the resident county. Medium and large-sized counties will be home to nearly 90% of all TEF-financed jobs.

Enterprise Fund Jobs Promised: Private Investment by County Population Size



Sources: Legislative Budget Board, 2005; CPPP Analysis.

As shown above, smaller counties are receiving modest investment levels from TEF grants.

At least one economic development incentive package requires further illustration. For many companies, a TEF grant was not sufficient to guarantee their decision to expand or relocate in Texas. These companies have also received an assortment of local tax incentives to lure them to a particular city. As a "deal-closer" the Texas Enterprise Fund accompanies existing commitments from local jurisdictions and tax districts. For example, while the TEF grant totaled $8.5 million, Home Depot received a menu of incentives to locate facilities along the Central Texas corridor.

How Home Depot Came to Texas: Anatomy of a Deal

Entity	**Incentive**	**Liability**	**Amount**
City of Austin	Property Tax Abatement	City of Austin	$7.2 Million
Austin Independent School District (AISD)	Property Tax Abatement	State*	$5.7 Million
Travis County	Property Tax Abatement	Travis County	$6.2 Million
Texas Enterprise Fund	Cash Grant	State	$8.5 Million
Total			**$27.6 Million**

*Under HB 1200 (2001), the state reimburses school districts for revenue lost by granting an abatement. The state's liability includes the Enterprise Fund grant and AISD reimbursement.

As shown above, the state is responsible for over $14 million in Home Depot incentives, nearly half of the overall incentive package. In total, the state and local districts committed over $27 million to land approximately 850 jobs, at a rate of nearly $33,000 per job.

Under state law, a company is only eligible for a local tax incentive if the company will pay wages at least 110% of the average manufacturing wage in the county. Normally, the Texas Workforce Commission (TWC) utilizes unemployment insurance tax payments, which are based upon actual wages paid. For Travis County, the average manufacturing wage is close to

$80,000 per year. For Home Depot, TWC used an employer survey to calculate an average annual wage of $49,000 for Travis County.

No Accountability in Texas

For several reasons, the precise role of the Texas Enterprise Fund in "creating" new jobs is difficult to calculate, mainly because the state's cash assistance could be spent on other components aside from direct job creation, such as equipment purchases or bonuses for existing employees or management. The role of local tax jurisdictions in offering tax abatements or other assistance may be a larger deciding factor than any TEF grant. Also, cash grants could subsidize an unrelated component of a company's operations, including bonuses for existing employees or management.

As a result, the state's cash assistance could be spent on other components aside from direct job creation within the state. Finally, tax incentives and cash payments are likely secondary factors in the site selection process for most companies. A recent site selection survey of Louisiana executives revealed that a skilled workforce and labor productivity factors far outweighed state and local tax incentives as relevant factors for relocation and expansion projects. The Louisiana Business Image Survey, conducted in partnership with the Louisiana's Governor's office, found that "workforce issues rate as the most important issue in opening new facilities or moving existing operations."[4] For most businesses, the primary site selection factors include an educated and skilled workforce, efficient transportation and modern infrastructure, and ready access to lucrative markets.

TRAVELING THE "HIGH ROAD"

Economic development experts outline several factors that comprise a "high road" economic development approach. A "high road" economic development policy not only maximizes the economic impact for the state and locality, but also maximizes the public benefits. A "high road" policy prioritizes:

- Transparency, Reporting, & Public Disclosure
- Job Quality
- Local Economic Impact and Program Integrity
- Penalties for Noncompliance, or "Clawbacks"

This section describes some of the high-road policies from similar economic development and job creation programs from across the country, and compares those policies to those of the Texas Enterprise Fund.

Transparency, Reporting & Public Disclosure

Here are some examples of how other states have made their economic development programs accountable:

Minnesota Business Subsidy Accountability Law

Among other important provisions, Minnesota established strong reporting requirements for overseeing development subsidies. At a minimum, these mandated reports are required to include:

- Total amount of subsidies awarded in each development region
- Distribution of business subsidy amounts by size, type, and public purpose
- Percent of all business subsidies that reached their goals
- Total dollar amount of business subsidies that did not meet their goals
- Percent of subsidies that did not meet their goals and were not repaid
- Number of part-time and full-time jobs created within separate bands of wages, and benefits paid within separate bands of wages

Accurate reporting quantifies the cost and impact to the state's budget across various incentive programs. In this way, the actual cost of an economic development subsidy is more transparent and accurate.

[4] See Louisiana Business Image Survey (http://www.survey.lsu.edu/LouisianaBusinessImageReport2004.pdf), January 24, 2005.

In contrast, TEF's authorizing legislation did not mandate any public reports on activities, performance, or compliance. As a result, the Office of the Governor is not required to quantify the impact of the Texas Enterprise Fund on the state budget or stated goals such as job creation and economic development. Unlike most programs authorized by the Texas Legislature, no administrative rules have been drafted, nor has the public had the opportunity to comment on how the program is to be administered.

North Carolina Job Development Investment Grant Program

North Carolina's program mandates regular reporting and follow-up measures to ensure program accountability, including thorough wage reporting and post-award compliance.

The Texas Enterprise Fund's voluntary reporting only includes average annual salary information. This indicator fails to capture valuable data on salary distribution—a more reliable measure. As a result, it is difficult to determine how many targeted jobs will meet minimal cost-of-living standards throughout the state. As such, it is possible that employees of Enterprise Fund grantees may not be earning a self-sufficient wage, compelling these workers to enroll themselves or their dependents in one or more of the state's assistance programs (e.g. CHIP).

Job Quality

Economic development incentives have the potential to enhance job quality and higher wage standards. As a growing trend, more than 90 jurisdictions attach job quality standards to development incentives. Additionally, most states and cities either require health benefits or promote insurance coverage by allowing benefits to count towards wage requirements. Below are a few examples:

Kentucky Jobs Development Act

Participating companies are required to provide benefits, including healthcare to at least 90% of their employees. These benefits must equal 15% of the base hourly wage or a combination of wages and benefits equal to 115% of the base wage. The jobs created must be full time—at least 35 hours per week.

Oklahoma Quality Jobs Program

- Health insurance coverage: All businesses must offer basic health insurance coverage to all employees and pay at least 50% of the cost for health insurance coverage.

- Minimum wage requirement: Minimum average wage requirements, based on the Average County Wage where the jobs are located, apply.

In contrast to programs above, the Texas Enterprise Fund has no public guidelines or administrative rules to address the following job quality indicators:
- Minimum Wage
- Median Annual Salary
- Health Insurance
- Occupational Safety

Local Economic Impact and Program Integrity

When administering a statewide economic development incentive program, some states are using local economic impact as a factor in award decisions. Through program design and guidelines, areas with high unemployment, blighted central cores, and rural characteristics are provided a chance to compete with urban and economically advanced regions within the state. These factors are considered in order to maximize the level of economic impact of any particular economic incentive.

Virginia Opportunity Fund ($19 million/biennium)

The Virginia Governor's Opportunity Fund is relatively similar to the Texas Enterprise Fund. Although appropriated at a much lower level, the Virginia counterpart is also categorized as a "deal-closer" to create new jobs and to spur economic investment in the state. However, the Virginia Opportunity Fund provides grants or loans to localities, instead of companies, to complement their efforts in attracting new jobs and investment. The Virginia Opportunity Fund contains valuable provisions, including:

- Localities experiencing extraordinary fiscal stress, or unemployment rates at twice the statewide average, are given special consideration;
- Individual grants are limited to 10% of the Opportunity Fund appropriation, or up to $3 million per grant;
- Rural areas and areas with high poverty are allowed to receive multiple grants within the same year.

North Carolina Job Development Investment Grant (maximum of $15 million annually—$180 million over 12 years)

North Carolina has one of the model incentive programs because of their mechanisms to enhance program integrity. The Tarheel state's program rules include the following language:

- **Geographic Diversity:** "*The Committee will strive to achieve geographic diversity with its grants. Assuming all threshold criteria are met and that a grant is necessary to secure the Project, decisions to award or not to award may be made on the geographic location of the Project to ensure that the benefits of the program are dispersed.*"
- **Environmental Protection:** "*The ability of the Project to satisfy State, federal, and local environmental law and regulations. Inquiry will be made of the NC Dept. of Environmental and Natural Resources with respect to the nature of a Project being considered for a Grant. Projects that are at significant risk of being unable to satisfy State, federal, and local environmental law and regulations are unlikely to be awarded grants. Projects that pose significant risks to the environment are less likely to be funded.*"
- **Unemployment Mitigation:** "*That a Project would significantly reduce unemployment and the burdens it places on government in North Carolina or in a particular community will weigh in favor of a higher percentage. That a Project has only a marginal impact on unemployment will weigh in favor of a lesser percentage.*
- **Community Economic Development Agreements:** state grants and awards should have a positive impact on the local community in which the project is situated. In North Carolina, these agreements should include the following provisions:
    a. Encouraging the business to hire state residents;
    b. The amount of a grant associated with any specific eligible position may not exceed $6,500.

Taken together, these provisions provide useful ways to balance and promote subsidy impact across the state and to stimulate local economies of various sizes.

In contrast, the Texas Enterprise Fund grants have been targeted towards larger suburban and metropolitan areas experiencing relatively low unemployment and high growth patterns. The rural and border areas have been largely overlooked by the Enterprise Fund. These regions experience higher unemployment rates than the rest of the state, and private investment would likely have a greater impact in those areas of the state.

Restrictions and Penalties for Noncompliance

Standard penalties, or "clawbacks," for nonperformance are useful ways to ensure that companies abide by their performance agreements. A "clawback" (also called "recapture") is a contractual provision whereby a company may be required to pay back all or part of a development subsidy, such as a grant, loan or tax break, if it fails to fulfill its responsibilities as required by the subsidy agreement or program. Over the past decade, 19 states have attached clawback agreements to one or more of their subsidy programs; two states have uniformly applied these penalties for all subsidies within the state. Clawback agreements have become increasingly common mechanisms to enforce job quality and creation, as well as to ensure public integrity of economic incentives.

Pennsylvania Opportunity Grant Program:

Private companies are liable for penalties up to the full amount of the program assistance, plus an additional penalty up to 10% of the grant amount awarded if the company fails to meet any of the following conditions:

- Fails to operate at the project site for a minimum period of five years
- Fails to create or preserve the number of jobs specified in commitment letter
- Fails to inject the required amount of private investment into the project

North Carolina Job Development Investment Grant

The Job Development Investment Grant (JDIG) is a discretionary incentive capable of providing sustained annual grants to new and expanding businesses measured against a percentage of withholding taxes paid by new employees. The authorizing statute includes the following provisions to protect program integrity:

- Workplace Safety: "The Business must have no citations in North Carolina under OSHA that have become a final order within the past three years for willful serious violations or for failing to abate serious violation with respect to the location for which the grant is made."
- Retail/sports prohibition: "The project for which the Applicant seeks a grant may not be a retail facility"; may not be a professional or semi-professional sports team.
- Tax Liability: "A business may not receive a disbursement of a grant, if at the time of disbursement, the business has received a notice of an overdue tax debt and that overdue tax debt has not been satisfied or resolved."

By contrast, the Texas Enterprise Fund contains little or no restrictions to awarding grants to companies with subpar workplace safety or environmental protection records.

More significantly, the Texas Enterprise Fund's disbursement to Cabela's—a sporting goods retailer—contradicts restrictions placed upon economic development corporations—many of whom cannot subsidize retail projects. Under HB 2912 (2003), the Legislature restricted the use of incentives offered by most EDCs to those projects intended to create or retain "primary jobs" – jobs at a company that exports its products or services into regional, statewide, national, or international markets and are in certain economic sectors. As a result of HB 2912, few retail projects would qualify to receive development assistance. In contrast, there are no restrictions on using the Enterprise Fund to subsidize retail businesses.

Conclusion

The Texas Enterprise Fund has the potential to enhance job quality by setting a new standard for state incentive programs. The Texas Enterprise Fund is by far the largest program of its kind throughout the nation; if renewed, it should have the most rigorous compliance measures and the highest job quality standards. The Texas Enterprise Fund has the capacity to improve wages, health insurance coverage, and occupational safety—if deployed correctly.

The Legislature needs to know more about how the Texas Enterprise Fund is used. Although the program's flexibility is viewed by supporters as an asset, enhanced accountability and public disclosure should not be sacrificed. More stringent accountability, along with more meaningful reporting and disclosure, would promote public trust and bolster program integrity. At the same time, the Texas Enterprise Fund needs to leverage its capital more strategically to maximize economic impact by considering regions of the state that have been overlooked.

The Texas Enterprise Fund has the opportunity to travel a "high road" economic development path—paving the way towards transparency, rigorous compliance, higher wages and guaranteed health insurance coverage. Or, it could continue to pursue a "low road" economic development approach—limiting public disclosure and reporting while subsidizing companies that don't pledge to create high-quality jobs.