

For the Common Good?



Evaluating Economic Development Initiatives in Texas



Center for Public Policy Priorities

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Initiatives in Texas*

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EXECUTIVE SUMMARY

Texas provides unique opportunities for examining the effects of economic development (ED) on communities, because it contains both great wealth and extreme poverty. Bolstered by high-technology sectors, business and financial services, and manufacturing—in addition to the still-important oil, gas, and petrochemical industries—Texas’ economic growth as a whole is outpacing the nation’s. Unfortunately, economic growth is not reaching all parts of the state equally, or improving all communities’ economic and social well-being to the same extent.

This analysis of \$4.5 billion spent by the state on economic development over two years reveals:

Tax expenditures for economic development are a large and growing cost. Based on very conservative estimates, economic development tax incentives will cost Texas at least \$3.8 billion in the 2000-01 biennium. The cost of tax incentives is growing rapidly in comparison to the state budget and to state spending on direct economic development programs or workforce development. New tax incentives, like new economic development programs, are often enacted with little information provided about their long-term contribution to state or local efforts. In several instances, the total cost of existing and new incentives is unknown—especially the long-term costs.

Economic development activity is not targeted. State economic development programs and tax incentives often benefit areas and firms already enjoying high levels of economic activity. Provisions targeting economically disadvantaged areas or groups are used only in a small fraction of state programs and incentives, leaving communities with fewer resources to fend for themselves.

Texas has average levels of economic development spending, but no budget or plan to guide that spending. Direct spending on economic development programs will total at least \$729 million in the 2000-01 biennium, almost 1 percent of the state budget—similar to amounts identified in other states. Various state entities operate dozens of economic development programs, and higher education institutions play a much larger part than is generally recognized. Together, however, these do not constitute a true system, because they have been developed without a state economic development plan or other comprehensive policy to shape decision-making.

Tax incentives take resources away from investments critical to long-term economic growth. Texas’ already low tax burdens and evidence of the relatively minor role of taxes in influencing business location and expansion decisions make it difficult to justify new tax incentives for economic development, yet they continue to be enacted. Tax breaks take much-needed resources away from more efficient economic development programs and from investments in workforce development that businesses need and that will truly contribute to long-term economic growth.

Policy Solutions

Balance tax incentives with workforce investments. The state needs to strike a better balance between economic development program spending and tax incentives, and investments in its workforce and other capacity-building measures. Growth in tax expenditures must be monitored and controlled relative to the size of the state budget and to specific investment areas such as public education and other workforce development efforts.

Focus state resources on areas most in need. As part of an overall state plan, Texas should take a comprehensive approach to improving economic conditions in underdeveloped areas of the state. Where considerable resource gaps exist, state funds and other economic development incentives should be focused on areas least able to strengthen their own communities.

Develop an integrated economic development budget. Texas needs a complete, integrated economic development budget that includes the cost of all business tax incentives and ED programs, and that applies better performance measures to these initiatives. Improving cost and outcome information for ED programs and tax incentives is a critically important first step in identifying the most efficient uses of public funds for economic development.

Develop a state economic development plan. A coordinated, strategic state economic development plan that is clearly linked to the integrated ED budget should be developed, with goals and benchmarks for *all* existing and new incentives to measure progress and accomplishments. Texas needs a statewide economic development plan to guide and improve long-term community development. A good plan would establish clear, realistic short- and long-term goals and objectives for specific state economic development investments.

Review all programs and keep only the most effective incentives. The state should assess all economic development expenditures and continue only those programs and incentives that represent the most efficient and effective use of state resources. The sunset process used for state agencies should be applied to existing economic development programs and tax incentives. All new programs and incentives should include sunset language.

This report presents information that could greatly improve the state's approach to economic development, but it is only a first step in analyzing state-level activity, its links to workforce development, and its effects on community development. Further research on what local governments are doing and on how workforce investments fit into economic development strategies will provide a more complete picture.

INTRODUCTION

At the dawn of a new century, Texas' diverse communities have begun to reap the fruits of rapid economic development and growth. But not everyone is sharing in that growth. State and national economic data verify that Texas has more high-tech and other manufacturing jobs, higher salaries, and more prosperity than ever before—but also more poverty and more low-paying, low-skill service jobs with few or no benefits. Texas continues to be a leading state in corporate facilities and jobs created, but also leads the U.S. in residents lacking health insurance and access to basic social supports.

Even more troubling, prosperity and poverty are increasingly concentrated in separate communities. In December 1999, the communities of Fort Worth - Arlington and McAllen-Edinburg-Mission in South Texas each had roughly 27,000 jobless Texans on the official roster of the state's unemployed. But the unemployed in McAllen-Edinburg-Mission were job hunting in a labor market about one-fifth the size of Fort Worth's—giving the South Texas communities an unemployment rate of 14.3 percent, compared to 2.8 percent for Fort Worth-Arlington. In fact, McAllen-Edinburg-Mission's unemployment rate at the end of 1999 was more than three times the state average (4.2 percent) and third highest in the United States. Job-seekers in El Paso and Brownsville-Harlingen encountered unemployment rates twice as high as the Texas average.¹

Finding and keeping a job are not the only economic challenges facing many Texans: even in areas where jobs are plentiful, pay and benefits differ widely.

In December 1999, San Antonio manufacturing workers averaged a weekly paycheck of \$437, compared to \$658 for Houston workers. The state average was \$541 per week. Even after high-paying petrochemical, oil/gas, and other nondurable goods producers are taken out of the equation, Houston manufacturers still paid \$112 more per week on average than did San Antonio firms.²

Joblessness and lower wages in turn translate to less income per resident—and fewer resources that can be invested publicly or privately to sustain and improve the quality of life for community residents. For example, Brownsville's city government has per-capita revenue levels that are less than two-thirds of Austin's.³ Other indicators of the resource gap between Texas' poorest and wealthiest counties are even more troubling:

- According to state estimates, 22 Texas counties (mainly along the U.S.-Mexico border) had child poverty rates of **40 percent** or more in 1999, including six—Willacy, Starr, Brooks, Dimmit, Maverick, and Zavala counties—with child poverty rates exceeding **50 percent**.⁴
- Per-capita personal income in five South Texas counties was less than \$10,000 in 1997, ranking them among the nation's 15 poorest counties.
- Meanwhile, with per-capita income of \$33,540 in 1997—four times as much as Starr County—the Metroplex's Collin County is one of the nation's most prosperous areas. The poverty rate for Collin County is only 5.1 percent, according to the latest estimates.⁵

Dallas County, with per-capita income of \$32,270, is not too far behind Collin County. But county-level data for urban areas such as Dallas and Houston can hide pockets of concentrated poverty similar to those in South or East Texas, where local economies show little improvement or fall behind while other areas of the state prosper. Statewide, 3 million Texans (15 percent of the population) live below the official poverty line, and 4.9 million (24.5 percent) lack health insurance.⁶

Employment rates, wage levels, and income figures are by no means the only measure of economic development. High education and skill levels, low illiteracy rates, cultural attractions, and family cohesiveness can and should also be used as gauges of true economic development, which help build communities where

people and businesses want to be. Other important measures of whether communities are being strengthened include the quality of schools and other public services, the local availability of capital, local ownership of homes and businesses, and the quality of basic infrastructure.

Regardless of which measures are used, it is clear that substantial disparities in economic activity exist among regions and communities in Texas. It is also apparent that several Texas communities and regions need effective economic development strategies and investments—and lack the public or private resources to implement such strategies on their own.

Resource disparities exist despite a substantial state investment in economic development. The state will be spending at least \$729 million in the 2000-01 biennium—and forgoing \$3.8 billion in business taxes through incentives and other tax breaks—in the name of economic development. Yet there is little proof that these expenditures are effective, or that they reach the communities most in need. Of equal concern, reliable information on economic development programs' total cost or outcomes is so scarce that, in many cases, justifiable and effective economic development spending cannot be distinguished from “corporate welfare”—programs or tax incentives that benefit individual firms at society's expense, without making substantial and permanent contributions to community development.

Many economists and other experts have suggested ways to distinguish corporate welfare from legitimate public economic development incentives.⁷ Most of these can be summarized in the following set of questions:

- Do the public benefits outweigh the public costs?
- Will goods created through public investment remain public?
- What would companies probably do if the incentives were not offered?
- Does the incentive subsidize an activity that would actually harm society?

- Would another, less expensive proposal achieve the same amount of public benefit?
- Are decisions about the proposal being made in ways that are open to public scrutiny and debate?
- Are those communities with below-average economic activity receiving the assistance, or is help going to those already doing well economically?

These questions are used in this report to begin analyzing Texas' economic development initiatives and assess whether they are building more equitable and sustainable communities or exacerbating existing disparities. The amounts that Texas will be expending in the next two years, directly or through state tax provisions, on economic development programs and incentives will be estimated. These expenditures have rarely been subjected to these questions or any other comprehensive review. Then, a summary of the new programs and tax breaks created by the 76th Legislature in 1999 will examine the continuing trend in Texas to enact economic development incentives with little, if any, effort to seek answers to these important questions. Analyses of existing and new incentives show how the state continues to devote more of its economic development “budget” to tax cuts—even though Texas taxes are already among the lowest in the nation—while it neglects the workforce challenges that have already raised serious obstacles to business growth and community development.

In addition, this report offers recommendations to address the various shortcomings identified, such as the lack of a unified economic development budget and of reliable information about past and future return on public investments in these incentives. Recommendations also include ways to target economic development programs and spending to those Texas communities in greatest need, and to make needed linkages to workforce development spending.

This report does not contain comprehensive figures on all public (i.e., federal, state, and local government) and private-sector spending on economic development in Texas. Nor does it attempt to analyze state spending

or policies in areas that are critically important to the future health of the state economy, such as education, workforce development, the regulatory climate, or highway and other infrastructure projects. Future CPPP reports will discuss these economic development components in more detail, again assessing how well public funds are being invested to strengthen Texas communities and families.

¹ Texas Workforce Commission, Labor Market Information, “MSA Current Unemployment Rates-December 1999,” <http://www.twc.state.tx.us/lmi/lfs/type/unemployment/unemploymentsarankcurrent.html>; U.S. Department of Labor, Bureau of Labor Statistics, “Metropolitan Area Employment and Unemployment: November 1999,” <http://www.bls.gov/news.release/metro.nws.htm>.

² Texas Workforce Commission, Labor Market Information, “Hours and Earnings–December 1999,” <http://www.twc.state.tx.us/lmi/lfs/type/hoursandearnings/hoursandearningscurrent.html>.

³ General fund budgets for Brownsville and Austin, fiscal 1997-98, and city population estimates from the US Bureau of the Census.

⁴ Hidalgo, Cameron, Kinney, Webb, Duval, Presidio, Real, Zapata, Jim Hogg, Crosby, La Salle, Edwards, Uvalde, Jim Wells, Val Verde, and Frio counties all have child poverty rates ranging from 40 to 50 percent. Estimates by the Texas Health and Human Services Commission, at http://www.hhsc.state.tx.us/cons_bud/dssi/cntypov99.htm.

⁵ Per-capita income figures are from the U.S. Department of Commerce, Bureau of Economic Analysis, Regional Accounts Data. Poverty estimate is from the Texas Health and Human Services Commission for 1999.

⁶ U.S. Bureau of the Census, March Current Population Survey state-level estimates on poverty and health insurance status for 1998.

⁷ See, for example, Corporation for Enterprise Development, *Improving Your Business Climate: A Guide to Smarter Public Investments in Economic Development* (1996), or Frank N. Laird and Robert Reich, “The Rhetoric of ‘Corporate Welfare,’” *American Prospect* (September-October 1998), pp. 74-77.

CHAPTER I: EXISTING ECONOMIC DEVELOPMENT ACTIVITY

Economic development (ED) efforts, whether in the form of direct public spending or tax exemptions or other tax breaks, are part of what is commonly called “business climate.” Business climate includes those features of a national, state, or local economy which help determine operating costs (such as wages, land costs, taxes, and government regulation) and non-cost factors which are important to businesses and their employees (such as the quality of life).¹ Besides ED efforts, four other major categories of a business climate were identified in an interim study to the 1999 Texas Legislature: workforce, tax environment, legal and regulatory environment, and business infrastructure.²

Texas’ Evolving Business Climate

Throughout the majority of its economic history, Texas, like many other Southern states, relied mostly on the workforce element of “business climate”—meaning, the availability of low-cost labor—and two other factors not listed above: its natural resources and climate. Well into the 1980s, state economic growth was largely linked to the health of the cattle, cotton, and other agricultural sectors and of oil and gas production, and to the availability of low-wage, low-skill, and non-unionized workers. Even today, the Texas Department of Economic Development (TDED) promotes Texas as a business location in part because of its “pro-business environment,” which includes

- being a right-to-work state,
- having lower workers’ compensation costs due to recent legislation,
- having no personal income tax,
- ranking third lowest among states in business taxes as a share of all state taxes, and
- having an average manufacturing wage (\$12.15 per hour) that is almost 10 percent below the national average (\$13.49).³

TDED also lists as assets the state’s large population and labor force, which are growing rapidly; high rela-

tive growth in manufacturing, personal income, and gross state product; a nationally and internationally strategic geographic location; a “world-class” transportation infrastructure; and several public research institutions.⁴

But all of these assets combined are not considered enough to give Texas the definitive advantage. TDED provides information on a maze of local, state, and federal economic development services and tax incentives that new or existing businesses can use to lower operating costs, find new markets, or improve productivity. And because an abundance of low-skill workers can be a disadvantage when trying to lure technology and other higher-paying industries and firms, Texas can also provide workers trained to a company’s specifications, or subsidize the firm’s training costs.

State Government’s Offerings: ED Programs and Tax Incentives

While the majority of economic development activities are carried out at the local level, Texas has made an effort to match other states’ incentives (see Appendix C). For this report, Texas’ wide range of economic development incentives is divided into two basic categories: actual programs operated by a state agency or university, and tax expenditures such as exemptions or other tax provisions that treat a certain type of business or business activity more favorably than others.

The term “tax expenditure” clarifies that tax incentives have the same effect on a state’s budget as direct appropriations—reducing revenue available for other purposes. Creating tax expenditures in a time of budget surpluses to aid certain businesses means that other firms or individuals could end up paying higher taxes when the surpluses no longer exist, in order to ensure enough revenue for basic government infrastructure and services.

2000-2001: Texas will Spend at Least \$729 million on ED Programs

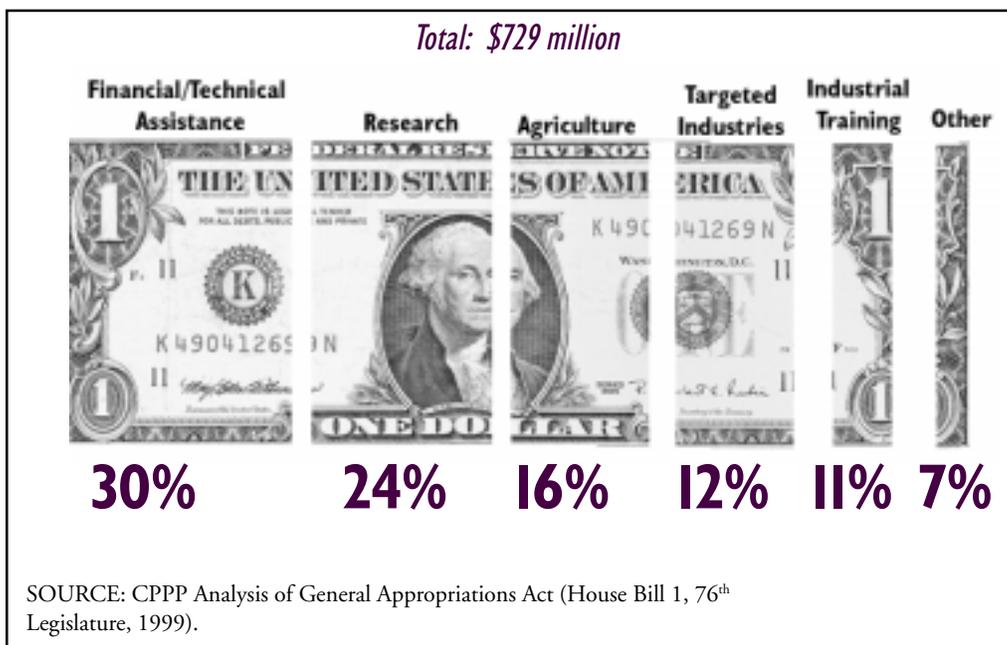
With a two-year budget of \$100 million, the Texas Department of Economic Development oversees many state ED programs and incentives, including business loans, tax-exempt financing, enterprise zones, manufacturing assistance, small business assistance, and the Smart Jobs customized training program. But TDED is by no means the only state agency spending taxpayer funds on economic development. In fiscal 2000 and 2001, at least 42 state agencies and higher education institutions will spend more than \$729 million on economic development assistance for businesses and communities.

Because Texas does not have a unified economic development budget that identifies all ED programs for legislative or public scrutiny, these figures are estimated based on an item-by-item review of the act authorizing state spending for 2000-01. In the 1999 session, this legislation was the 900-page General Appropriations Act, or House Bill (HB) 1. Figures in the appropriations act capture most—but not all—of the state’s direct ED spending, for various reasons. The figures should thus be viewed as conservative estimates, to be refined as more information becomes available. (Ap-

pendix A describes the methodology used to identify direct ED spending and explains why actual spending is probably higher.)

Analyzing ED program spending in the appropriations act is complicated by the fact that it requires not just identifying funding for a particular budget “strategy” (usually, the smallest level of detail used to appropriate money), but also examining “riders,” language that further directs how money can be spent or transferred to another state agency. The method of finance for programs—whether state general revenue, federal funds, dedicated tax revenue, or some other source, including required local matching amounts—is very rarely provided in HB 1. Nor is there any information on how spending will be allocated across local communities. Finally, even though Texas has a performance-based state budgeting system with funds allocated by strategy and output and efficiency measures to track and assess how that money is spent, many of the programs identified in this review show no performance-related information of any kind in the appropriations act.

Exhibit I. Economic Development Program Spending, Fiscal 2000 and 2001



With these caveats in mind, Exhibit 1 shows state ED program spending aggregated into categories. (Specific programs within the categories in Exhibit 1, along with the agencies operating the programs and their location in HB 1, are listed in Appendix B.) All state spending authorized in the appropriations act totals \$98.1 billion. Thus, \$729 million for ED programs equals approximately 0.7 percent of state spending in the next two years. As an interesting comparison, this amount is also about \$190 million more than the state has allocated for cash grants to families on welfare in 2000 and 2001.

Development Assistance is the Biggest Piece of the Pie

The largest ED category, financial/technical/educational assistance, represents almost \$225 million in two-year funding. About \$169 million in this category is for a program at the state housing and community development agency providing federal funds and technical assistance for water/wastewater projects and other economic development infrastructure.

Another \$2.3 million funds development assistance for communities using historical buildings and sites to foster tourism. Most of the educational assistance is an agricultural extension services strategy called “economic competitiveness” (\$46.4 million).

Other Major Areas: Research, Targeted Industries, Agriculture, Small Business Aid

The research category, with \$175 million in biennial funding, is carried out by colleges and institutions such as the Texas Engineering Experiment Station (receiving \$109 million). The Advanced Technology Program, overseen by the Higher Education Coordinating Board, provides almost \$40 million for applied research grants in areas deemed vital to the state’s industries and economic growth.

In “targeted industries,” the lion’s share of funding (\$78 million) pays for various travel and tourism programs administered by TDED, the Historical Commission,

and the Department of Transportation. Other targeted industries include aerospace, film and music production, natural and LP gas, and recycled product markets.

The \$116 million for agriculture development and research could also be viewed as a state effort to target its economic development dollars at a specific economic sector, but the programs in this category benefit several distinct industries—wine marketing; research and marketing of food and fiber products and other “value added” activities; and livestock, cotton, and poultry research. Higher education institutions play a large role in this category as well.

Development of small businesses (\$9 million) and of foreign markets and trade opportunities (\$4 million) each account for less than one percent of direct ED spending. Industrial training, the final category shown in Exhibit 1, totals \$80.5 million, most of it for the Smart Jobs and Skills Development Fund customized training programs. Employer demand for state-funded customized training consistently exceeds state appropriations, but funding for these relatively new efforts has not changed much. These programs are listed separately, rather than in the development assistance category, because they benefit specific firms.

How Texas ED Costs Compare to Other States and to Past Spending

Complete information does not exist on all states’ direct ED spending as a share of their total budgets, but a leading state in the economic development race, North Carolina, devoted about 1 percent of its spending on average to ED programs in 1995-96. That percentage had not changed much over a four-year period.⁵ Similarly, a review of Texas appropriations for 1998-99 shows direct ED spending taking up about 0.9 percent of all state spending, not too different from the 0.7 percent figure for 2000-01. In total dollars, 1998-99 direct ED spending that could be identified came to \$743 million.⁶ Most of the decrease between the two budget periods is due to less state ED assistance for communities undergoing closures of federal

military installations (\$20 million in 1998-99, falling to \$1 million in 2000-01).

Comparisons of 2000-01 economic development spending to amounts in the 1998-99 budget or earlier budget periods are not exact because the level of detail changes every two years. For example, Texas Tech University's funding in the 1998-99 budget included the following ED-related programs under "Special Item" support: rangeland management; textile research; wind power and other alternate energy sources research; research in agriculture, business administration, engineering, home economics, and leather; beef production research; arid and semi-arid land research; robotics and high-tech research; wine marketing; cotton economics research; biotechnology research; a small business development center; and an international trade center.

However, calculating any increases or decreases for these specific items in Texas Tech's funding for 2000-01 is not possible because the latest version of HB 1 identifies funding only for the small business development center and the trade center under "Special Items." The rest are lumped together under strategies for research in (1) agriculture, (2) energy, or (3) emerging technologies. In neither budget do any of these items list performance measures or any other kind of outcome-related information.

Major Role of Higher Education is Often Overlooked

The Texas Tech example illustrates another distinguishing feature of Texas' spending on ED programs: higher education institutions play a significant and growing part in the economic development of their communities and of particular industries. A look at Appendix B shows the many business development services, business-oriented research, and other ED activities carried out by Texas colleges and universities. Visits to state universities' World Wide Web sites turn up even more business-oriented centers and institutes, some funded entirely with local funds that do not appear in the state appropriations act.⁷

Legislators and local community leaders realize the important roles played by higher education institutions not just in producing college graduates, but also as part of local or regional economic development strategies, and work hard each session to preserve or increase funding for higher education and to add new institutions or programs. But the state's higher education system, while large, lacks the resources to serve all communities to the same extent, especially where ED programs are concerned.

No Statewide ED Plan Linked to Program Budgets

The other significant finding that emerges from this report's examination of direct ED spending is that no statewide plan or perspective exists with respect to the specific amount or purpose of these investments. Texas does have a Strategic Economic Development Plan for 1998-2008, issued by a special commission in October 1998 at the legislature's request.⁸ The plan includes the following mission statement:

Texas must develop a knowledge-based economy that maximizes prosperity for all its citizens and ensures global competitiveness across all its regions.

It also spells out five broad goals for the state; the first is to "make education and workforce development the state's number one economic development priority." The report adds that "a knowledgeable and skilled workforce is the greatest economic development tool the state can acquire" and calls for a "strong and unequivocal commitment to education." The fifth goal, recognizing that not all communities are prospering, states that "Texas' high-growth economic strategy should be inclusive of all regions of the state."

However, the 1998-2008 Strategic Plan does not shed much light on the resources already devoted to state business tax incentives or economic development programs, other than saying that the bulk of ED efforts and tax incentives is found at the local level. Nor does the plan provide cost/benefit information for any of

the new ED incentives or programs it recommended (such as a research and development [R&D] tax credit and a targeted job creation tax credit). Finally, the ten-year plan provides performance measures for the tax cuts and other strategies it recommended, but does not review performance information for existing programs or recommend the creation of any new measures for the latter.

The state's strategic plan—a promising start—would be more useful if it provided information on the current use of ED resources at the state level such as that presented in this report, and contrasted it with state investments in education and workforce training (discussed below in more detail). A more thorough accounting of the state's ED incentives is possible, but legislators would have to create reporting requirements and systems and budget processes to come up with a complete picture. After these important first steps, ED spending could be better coordinated and re-shaped into an economic development tool for the state that takes into account critically important long-term issues such as water availability and environmental protection, affordable housing, and workforce development.

Related, but Uncoordinated Spending: Workforce Development

An analysis of workforce development funding indicates that the state will spend about \$2.1 billion in 2000 and 2001 (not counting basic K-12 and higher education funding) to improve the skills and employability of current and future workers.⁹ Major categories include:

- \$696 million for vocational-technical education programs at the state's two-year higher education institutions;
- \$59 million in state support for allied health professions training;
- \$653 million for general employment services and training through local workforce development boards;
- \$293 million for programs serving public assistance

- recipients;
- \$217 million for vocational education and job training activities for youth and adults in the state's correctional institutions; and
- \$80.5 million for adult education and literacy.

Past criticism of Texas' administration of federal and state employment services and workforce development dollars led to major legislative reforms in 1995. These included consolidating many small programs into a re-designed state agency (the Texas Workforce Commission), and giving county and city officials the authority to form workforce development boards responsible for deciding how workforce funds would be spent in their local areas, operating one-stop centers, and linking local workforce development spending to local economic development efforts.

Since 1995, local workforce development boards have formed in all of Texas' workforce regions, replacing the private industry councils (PICs) that oversaw the distribution of local Job Training Partnership Act funding. However, TWC and the local boards are still working to create a new structure that truly involves economic development officials and regional growth strategies in ways that PICs rarely did. To ensure more strategic uses of state and federal workforce development dollars, the state must first come up with an overall economic plan that takes into account community or regional economic development goals and state/local workforce development needs.

The link between economic development and workforce development is critical to building human capital and economically stable communities. While the legislation that created the Texas Workforce Commission and the local board structure speaks to this priority, little actual coordination has developed. Future reports will focus on this issue and identify opportunities for joining economic development and workforce development more closely.

Pre-1999 State ED Tax Incentives Worth at Least \$2.8 Billion

The largest costs to Texas state government for economic development cannot be found in the appropriations act because they are tax expenditures, not program spending items. Since 1989, legislators have received a biennial tax expenditure report prepared by

the Comptroller of Public Accounts, the state's tax collection and revenue estimating agency. As required by law, the report estimates the total cost of business and consumer exemptions from four state taxes that generate about 80 percent of all state tax revenue: sales, franchise, gasoline, and motor vehicle taxes.¹⁰ It also estimates the value of exemptions made to local school property taxes. It does not include exemptions for other

*Exhibit 2. State Business Tax Incentives,
Prior to the 76th Legislature*

	Cost in 2000 and 2001 (in million \$)
SALES TAX EXEMPTIONS	
Manufacturing machinery and equipment	\$952.4
Manufacturing uses of gas and electricity	668.8
Feed, seed, chemicals and supplies used by agricultural businesses	451.5
Packaging and wrapping supplies used by manufacturers	208.6
Agricultural machinery and equipment	100.8
Mining uses of gas and electricity	85.2
Newspapers and newspaper inserts	75.9
Certain ships and ship equipment	61.2
Other sales tax provisions	<u>169.5</u>
	\$2,773.9
FRANCHISE TAX DEDUCTION	
Reduction of taxable capital for enterprise zone investments	\$13.5
GASOLINE TAX EXEMPTIONS	
Aviation uses	7.3
Agricultural uses	7.1
Construction uses	1.5
Industry/commercial uses	<u>7.6</u>
	\$23.5
MOTOR VEHICLE TAX EXEMPTION	
Farm use	\$6.2
TOTAL, STATE BUSINESS TAX INCENTIVES	\$2,817.1

state taxes such as those assessed on oil and natural gas production, tobacco and alcoholic beverages, insurance, or various smaller revenue sources such as the state hotel occupancy tax. Hence, like direct ED spending totals, these figures should be seen as conservative estimates.

The expenditure report prepared for the 76th Legislature estimated that all state tax exemptions would be worth \$44 billion in lost revenue during 2000–2001, in addition to \$5 billion in school property tax exemptions.¹¹ A closer analysis of the report indicates that a significant share of these exemptions benefit businesses, with many clearly designed to encourage certain types of economic activity. The amount of state tax expenditures for these purposes far outweighs Texas’ direct ED spending.

Before changes made by the 76th Legislature, at least \$2.8 billion in state taxes would have gone uncollected because of tax provisions that lower businesses’ operating costs or encourage them to undertake certain economic activities.¹² Additionally, \$2.4 billion in local school property tax exemptions would benefit certain types of business activity. Major existing tax breaks and their costs appear in Exhibit 2.

1999 Legislature Creates \$943 million in New Business Tax Incentives

With the new provisions added in 1999 (see Chapter 2), identifiable tax expenditures for economic development will reach \$3.8 billion in 2000–01, or about 84 percent of Texas’ state economic development “budget.” Business tax expenditures will outweigh direct ED spending by a ratio of 5.2 to 1, placing Texas in the mid-range based on other states’ expenditure-to-program-spending ratios (3:1 to 9:1).¹³ The \$943 million in new incentives gives business tax expenditures a biennial growth rate of 33 percent, compared to a 2 percent drop in direct ED spending. A rapid increase in tax expenditures relative to direct ED spending has also been seen in other states.¹⁴

Manufacturing, Agriculture, Benefit Most from Business Tax Incentives

The figures in Exhibit 2 underscore a considerable tax preference for manufacturers, who would save more than \$1.8 billion in state taxes from existing exemptions. The sales tax exemption for manufacturing machinery and equipment alone will cost almost \$1 billion in the next biennium. It was identified in the 76th Legislature’s interim committee report on the state business climate as one of the “major actions” taken in the past decade to improve the Texas tax environment, along with the local freeport tax exemption.¹⁵ Farms and agribusinesses save at least \$565 million through provisions listed in Exhibit 2. They are also major beneficiaries of tax provisions that exempt farm products and implements of farming or ranching from school property taxes and allow lower valuation of land used for agricultural purposes.

How Much Lower Do Taxes Need to Be?

Looking again at the total amount of business tax exemptions, Texas’ heavy past reliance on tax expenditures to support economic development could be justified in that it has contributed to a low overall tax burden. However, the state’s continued and rapidly growing use of tax expenditures to foster economic development—when it already has the lowest taxes of any major state—is harder to understand. Several surveys and studies have shown that state tax climates are not the principal factor shaping business location decisions.¹⁶ Continuing to use the tax code to encourage economic growth will also reinforce disparities between higher and lower-developed parts of the state, creating the most benefits where the most activity already exists.

The 76th Legislature’s interim study on the state business climate began by mentioning several indicators that Texas already has one of the nation’s best business climates: within the last few years, *Site Selection* magazine, the Small Business Survival Foundation, and a survey by the Texas Association of Business and Chambers of Commerce have all ranked Texas as one of the

best states in which to do business.¹⁷ Yet, one of the report's findings was that "the state incentives menu is limited," and that more tax cuts (for targeted investment or job creation, and for R&D) were needed to maintain the state's competitiveness. Nowhere did it mention that Texas' tax burden is already lower than its chief competitors in attracting new businesses.

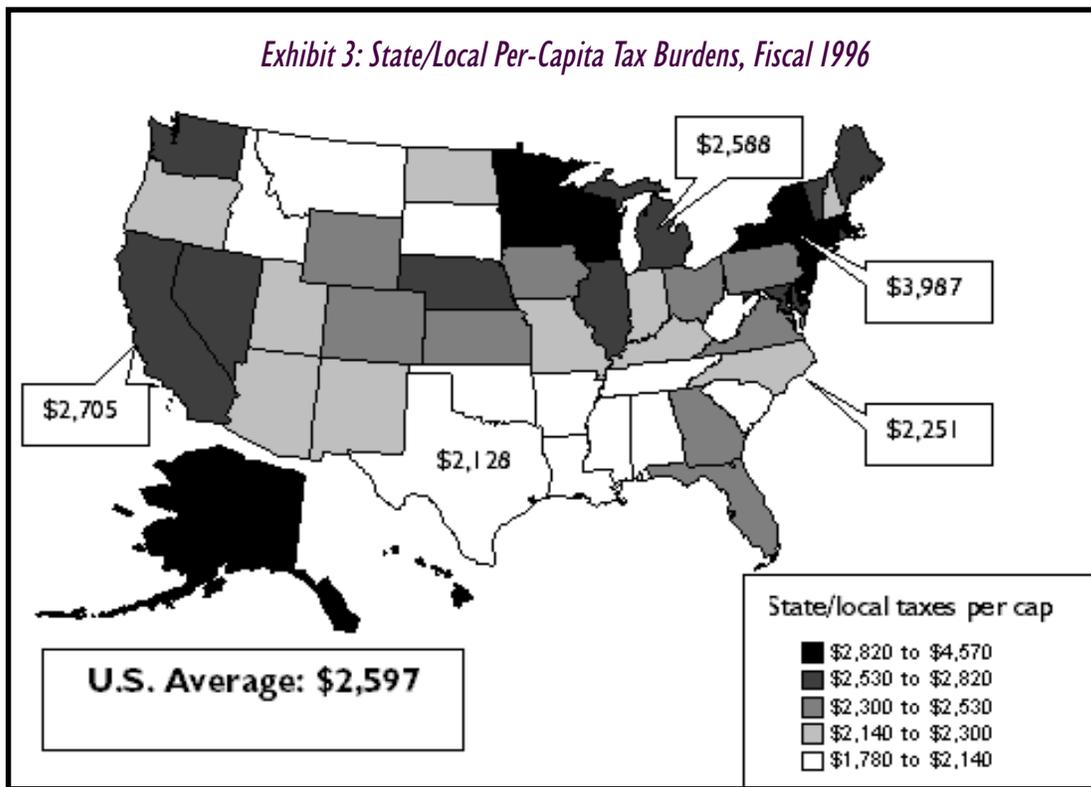
Texas' Taxes Would Be Low Even Without Incentives

Exhibit 3 shows that Texas, with per-capita state/local taxes of \$2,128 in 1996 (11th lowest), shares its low-tax distinction with several Southern states. When state-level taxes alone are considered, Texas' per-capita tax bill is even more favorable, at \$1,246 in 1998 (3rd lowest). But how much this status contributes to recent economic expansion is hard to say. Surveys of relocating or expanding employers consistently put other factors, such as the availability of skilled workers, ahead of taxes in the list of prime considerations. And a re-

cent "scoreboard" compiled by *Site Selection* magazine showed various high-tax states—such as Michigan, California, North Carolina, and New York—beating Texas in the competition to attract new facilities and expansions in 1998. Clearly, the higher tax levels in these states have not put them at a severe disadvantage. In fact, if Texas collected the \$3.8 billion it will forgo through state tax breaks for businesses in 2000-01, its annual per-capita tax burden would rise only \$92—giving Texas the 5th lowest state taxes nationwide. This level would still be well below the national average or the average tax load in other leading states in the economic development race.

Lost Tax Revenue Could Pay for Education, Training, Other Community Needs

An amount as large as \$3.8 billion could make substantial improvements in the "business climate" component that companies are increasingly demanding: better trained workers. The 1998-2008 strategic plan



SOURCE: U.S. Department of Commerce, Bureau of the Census, *1996 State and Local Government Finances, by State*.

identified workforce development as the most important ED issue for Texas. The 1998 interim committee ED report also highlighted workforce development as a major issue, identifying it as the second major ED challenge facing Texas based on concerns raised by small businesses, technology firms, and local ED professionals about skills deficiencies and inadequate numbers of qualified workers.¹⁸ Finally, both the 1998-2008 plan and the interim committee report noted Texas' third-highest ranking among states in adult illiteracy. Neither report identified the amount of spending needed to address illiteracy and other workforce challenges.

An additional \$3.8 billion would almost triple the state's current spending on workforce development, and would make a much larger and longer-lasting impact on growth in higher-paying industries such as high-tech sectors, manufacturing, and business services. Even part of this \$3.8 billion could have also made a dramatic impact if it had been invested in those communities still suffering from high unemployment and economic instability despite statewide economic growth.

Until Texas strikes a better balance between tax incentives and investments in workforce and community development, it will be unable to meet the long-term needs of employers and more than 10.4 million Texans currently in the workforce. This group already contains thousands of Texans working every day at below-poverty wages, as well as former welfare recipients who have recently entered the labor market. High-tech employers and others needing highly educated and skilled workers will increasingly look to other states and foreign countries to fill new jobs and vacancies.¹⁹

Judging Existing Economic Development Programs and Incentives

The introduction to this report posed several questions that can be used to evaluate proposed economic development programs and incentives. Again, the questions are:

- Do the public benefits outweigh the public costs?
- Will goods created through public investment remain public?

- What would companies probably do even if the incentive were not offered?
- Does the proposal subsidize an activity that would actually harm society?
- Would another, less expensive proposal achieve the same amount of public benefit?
- Are decisions about the proposal being made in ways that are open to public scrutiny and debate?
- Are those communities with below-average economic activity receiving the assistance, or is help going to those already doing well economically?

To some degree, these questions can be used to analyze *existing* programs and tax incentives, but answers are much harder to find, and the number of programs involved makes it a daunting task. The answers provided here should be seen as examples of what legislators should try to determine before ED program budgets are again decided in 2001.

Do the benefits outweigh the costs? Earlier descriptions of how direct ED spending and tax expenditure estimates were derived illustrate why this question is hard to answer: in many cases, the total cost side of the equation is left unexplored by legislators. Except for a few programs which are perennially under fire (such as Smart Jobs and state marketing offices in foreign countries), funding for existing programs tends to be reauthorized each biennium with few questions asked, especially when no budget increase is being requested. Occasionally, programs will be transferred to another agency, or have small budget cuts; in other instances, legislators will request special reports on how money is being spent. But rarely are ED programs required to justify their existence every two years.

On the benefits side, some efforts are made in performance-based budgeting to quantify returns on public investments. For example, for the Aerospace Commission, one efficiency measure appearing in the appropriations act is "Average Cost Per New Job Announced in the Aerospace Industry in Texas Attributed to the Activities of the Texas Aerospace Commission." For 2000, the targeted cost is \$190; for 2001, it should

drop to \$175. But without knowing what federal or local funds are being spent to attract those jobs, it is hard to say whether those amounts are too high or too low.

For the Smart Jobs program, an efficiency measure puts the average cost per trainee served at \$1,265. But the appropriations act does not indicate what benefit this will produce for the general public, or even to the individual company that will hire those trainees, or to the trainees themselves (such as wage increases due to the training). Moreover, a recent State Auditor report on Smart Jobs has raised serious concerns on the extent to which program funding was not spent for its intended purposes, including instances in which companies overbilled the state for training costs.

A comprehensive cost/benefit report would have to be prepared for all existing efforts to allow legislators to see not just which programs are plainly costing the public more than they are worth, but also which programs offer the highest return on taxpayer dollars. This could also help answer the question of whether another, less expensive program could achieve the same results. As a National Conference of State Legislatures (NCSL) report on ED incentives found, "Probably every legislator can point to a success story as well as to a program that involved mind-boggling costs and few apparent benefits."²⁰ But anecdotal evidence is insufficient in developing a long-term economic development plan and budget.

Will goods created through public investment remain public? This question is most relevant to the various economic research and development programs being funded by the state through public universities. Especially in the development of high-priced pharmaceuticals, the state should ensure that it at least recovers the total costs of taxpayer-subsidized products when they are commercialized by private firms. Basic research findings that would benefit many companies should be made widely available (through the agricultural and

manufacturing extension services and other higher education facilities), to avoid giving unfair advantages to individual firms.

What would companies do even if the incentive were not offered? For most existing programs and incentives, this is another way of asking, "Would growth have occurred without the program or incentives?" Some programs do not have growth as a goal; instead, they try to keep an ailing industry from shrinking even faster. In either case, this question is particularly difficult to answer for programs that are already in place.

That Texas is experiencing relatively rapid growth overall is not in question; June 1999 estimates from the Bureau of Economic Analysis show Texas with a per capita 5.2 percent increase in real Gross State Product (GSP) between 1996 and 1997, higher than any other state except for New Hampshire (6.4 percent), Oregon (6.0 percent), or Connecticut (5.3 percent).

Among Texas industries, agriculture/forestry/fishing saw the largest 1996-97 increase (27.8 percent), followed by wholesale trade (13 percent) and manufacturing (9.2 percent). As contributors to overall state growth, manufacturing (1.4 percent, of the state's 6.8 percent increase), services (1.3 percent), and wholesale trade (0.9 percent) were the leading drivers.

If an economic development focus could be assumed from the state's direct ED spending and tax incentives, it would appear to include manufacturing and agriculture, two of the sectors which are indeed experiencing economic growth. But as Texans saw in 1998 and other recent years, natural factors such as drought conditions can have much larger impacts on agricultural productivity than any incentive or program offered by government. And the second-highest contributor to growth in real GSP, services, is largely a function of population growth (which in turn is a function of high birth rates in Texas). So in this sector as well, it is difficult to attribute growth primarily to economic incentives or programs.

As in the question of costs versus benefits, performance measures in agencies' budgets do try to identify only those economic outcomes which can be attributed to the existence of an ED program. For example, the TDED strategy that offers business assistance has an outcome measure gauging the numbers of job announcements and job creations by businesses helped by TDED staff. But no comparative information is provided (i.e., the total number of job announcements or job creations statewide) to help determine the magnitude of the program's impact.

Is a social harm subsidized? Because environmental protection programs directed at businesses are not analyzed in this report, this question is not as applicable as it would otherwise be. However, some tax incentives may encourage higher levels of economic activity, particularly in manufacturing and oil/gas industries, that cause pollution and other costs to society. Additionally, some incentives allow large companies to deduct the cost of pollution control equipment, even when they would have been able to pay the full cost without much effect on industry profits or employment. The long-term environmental costs/benefits of economic development in Texas are significant and complex enough to merit a separate and thorough study by legislators, who could then use it to help shape a statewide ED strategic plan.

Are programs open to public scrutiny and debate? This question is related to the benefit versus costs issue: if the public does not know what ED programs it is funding, it may not feel the need to become involved in the state budget process, by contacting legislators or testifying for or against a program's funding. Furthermore, open government laws and technological improvements have made much more information available to outsiders than was previously the case in Texas, but a significant part of the state budget process is still closed to all but a handful of key legislators, state officials, and lobbyists. As long as a unified ED budget does

not exist, public interest groups and individual citizens who take it upon themselves to find out the cost of ED programs and incentives will find it hard to monitor spending on ED programs.

For tax expenditures, public scrutiny has been greatly improved by a new report that the Comptroller is required to prepare, showing the initial and final incidence of major taxes and tax exemptions, by industry and by family income group. This information helps legislators, advocates, and other interested parties determine who will pay or who will benefit from changes in certain tax provisions.

Are those communities with below-average economic activity receiving the assistance, or is help going to those already doing well economically? Most existing tax incentives are structured so they apply statewide, meaning that business in thriving areas or large multinational firms can take full advantage of them, and often get more of the total dollar benefits (because their economic activity is greater). A few provisions, however, are worth more in an economically depressed area. Texas lawmakers are increasingly structuring tax credits so that they offer more aid to areas most in need, as will be seen in Chapter 2.

For many of the spending programs identified by this analysis, data do not exist that would shed light on this question. However, in response to legislators' attention and criticism about funds distribution statewide, the Smart Jobs staff at TDED has begun to provide much more detailed tables and maps showing where training grants are going, by city and by various regions used by state agencies. For fiscal 1998, of \$53.4 million in total Smart Jobs grants, \$7.4 million (14 percent) went to businesses operating in enterprise zones, areas experiencing "economic distress" such as high unemployment or population loss. Business operating in a 19-county Texas-Mexico border region received \$5.2 million (or 10 percent of the total; this figure includes grants going to enterprise zones within the Border region, as well).

Tables showing regional distribution of new or existing jobs for Smart Jobs trainees are harder to interpret, because data on the region's share of total state employment is not provided in annual program reports. For example, about 25 percent of new and existing job trainees were in the Dallas-Fort Worth Smart Jobs service region, but without knowing the percent of the state's workforce located in that region, it is difficult to know how many workers are being reached by the program relative to other parts of the state. Statistics indicating which regions have the greatest workforce development needs—such as adult educational attainment data—would also be helpful.

The fiscal 1998 Smart Jobs report also lists awards by employer (including small or minority-owned business classification) and city. About \$22 million in Smart Jobs funding went to small businesses (41 percent of the total), and the number of grants to small business increased greatly from the prior year—from 76 in fiscal 1997 to 422 in 1998.²¹ Women- and minority-owned firms received \$5.7 million in Smart Jobs grants. However, the report also reveals that several large corporations received the biggest grants, such as Phillips Petroleum (\$2.8 million), Dayton Hudson [Target] (\$1.5 million), Samsung (\$1.4 million), Central Power and Light (\$1.2 million), and Mobil Oil (\$1.1 million). Tyson Foods, Beyer Corporation, Blockbuster Video, Citibank Data Systems, Dr. Pepper/Seven Up, Southwestern Electric, Northrup Grumman, Quaker State, and the SABRE Group are some of the other businesses each receiving Smart Jobs grants of at least a quarter of a million dollars in 1998.²²

Finally, the Smart Jobs program provides more information about average wages and wage improvements than do most other state ED programs. In 1998, the average hourly wage for completed Smart Jobs projects was \$14.90. However, reported wages ranged from a high of \$37.13/hour, to a low of \$6.42/hour (not enough to keep a family of three above poverty in 1998). Additionally, a wage follow-up study tracking Smart Jobs trainees at 16 companies (from 90 days

after training was completed to one year after the training) showed average quarterly wages falling at four of the firms. One of these companies actually closed its operations in Austin and moved some trainees to Indiana.

The availability of information similar to that provided in the Smart Jobs report could greatly enhance the assessment of other ED programs. Performance measures that better show the targeting of public dollars towards areas most in need would also be helpful.

Final Things to Consider when Evaluating Texas Economic Development Initiatives

The NCSL report mentioned earlier recommended that all states should evaluate their economic development offerings in light of the natural advantages they have in areas such as climate, geographical location, and natural resources, as well as the natural disadvantages they will be hard-pressed to change (being land-locked, for instance, or having severe water shortages in certain parts of the state). Economic development programs and incentives that work against these factors will be much more difficult and expensive to undertake; it is much more efficient to capitalize on strengths.

Programs that have existed for decades with no substantial changes should also be reviewed in light of national and international changes that will make any one state's ED efforts less effective. These include developments such as:

- increased economic globalization and technological improvements that have made large manufacturing plants and other employers more mobile,
- the increased likelihood that other states and localities will match any public subsidies offered for relocation or expansion,
- rising resentment of existing employers who see themselves bearing the burden of economic growth, including higher taxes for basic infrastructure and increased competition for skilled workers, and
- increased public scrutiny of “corporate welfare.”

Finally, Texas state ED programs and incentives should be evaluated with regard to how they complement or clash with local and federal economic development programs and goals. Local governments in Texas have a wide range of options available to them to attract business or encourage existing growth, including tax increment financing, an optional local ED sales tax, property tax abatements, development corporations, programs offered at community colleges, and other tools.²³ The ED sales tax alone raised \$174 million for local economic development corporations in fiscal 1997.²⁴ By one national estimate, local governments spend at least as much as states do on tax incentives and programs.²⁵ (Appendix C summarizes the range of incentives offered by state and local governments in Texas and other states.) The considerable amount of local resources invested in community development should be leveraged by the state wherever possible. Texas should also make sure it is maximizing the use of federal funds that can support community development, including grants that go directly to local governments.

¹ Corporation for Enterprise Development, *Managing for Higher Returns: What Does North Carolina Actually Spend on Economic Development and How Can These Investments be Better Managed?* (March 1997), p. 6.

² Senate Interim Committee on Economic Development, "Report on the Texas Business Climate," Report to the 76th Legislature (October 1998), p. 1.

³ Texas Department of Economic Development, "Texas facts and overview," <http://www.tded.state.tx.us/Txoverview/default.htm>.

⁴ Texas Department of Economic Development, "Texas facts and overview," <http://www.tded.state.tx.us/Txoverview/default.htm>.

⁵ Corporation for Enterprise Development, *Managing for Higher Returns*, p. 17.

⁶ This estimate was derived from an analysis of House Bill 1 (General Appropriations Act), 75th Legislature, Regular Session, 1997.

⁷ See, for example, University of Texas-Pan American, <http://www.panam.edu/acadres/centers.cfm>, or Texas Tech University, <http://www.ttu.edu/centers/>.

⁸ Texas Strategic Economic Development Planning Commission, "Texas Strategic Economic Development Plan 1998-2008" (October 1998), Austin, http://www.governor.state.tx.us/Business/Economic_Growth/gov_ec-1.pdf.

⁹ Career and technology education funding for public (K-12) schools is not included because it appears in the budget as part of the Foundation School Program, the major source of state aid to local school districts. The Windham School System for prison inmates is also excluded from these calculations.

¹⁰ The word "exemption" is used here to refer generally to various provi-

sions that are actually tax exemptions, exclusions, deductions, or refunds.

¹¹ Texas Comptroller of Public Accounts, *Tax Exemptions & Tax Incidence: A Report to the Governor and 76th Texas Legislature* (January 1999).

¹² The single most costly provision (\$15.7 billion for 2000-01) reported by the Comptroller is a sales tax exemption for materials used in manufacturing. This is excluded from the totals above because it is a type of provision commonly made in state tax codes to prevent "pyramiding" (in which sales taxes are paid on each component and service that is part of the manufacturing process, contributing to higher costs for the finished product). Another franchise tax provision which is clearly an incentive for exporters, such as refineries, allows 100 percent allocation by sales, but no reliable cost estimate is available for inclusion in this report. This analysis also omits business service exclusions from the sales tax (\$7.2 billion in 2000-01), sales tax timely filer and prepayment discounts (\$212 million), franchise tax exemptions (\$1.1 billion), and discounts for gasoline tax collection (\$90 million).

¹³ Corporation for Enterprise Development, *Managing for Higher Returns*, p. 16. Also, a recent study of California tax incentives carried out by students at the School of Public Policy of the University of California at Berkeley determined that more than half of that state's economic development spending takes place through tax provisions.

¹⁴ Corporation for Enterprise Development, *Managing for Higher Returns*, p. 17.

¹⁵ Senate Interim Committee on Economic Development, "Report on the Texas Business Climate," pp. 1-2.

¹⁶ For example, see "Firms pick sites based on logistics," *Logistics Management Distribution Report* (September 1998); Bob English, "Location is primary draw for suppliers," *Automotive News* (March 30, 1998); Robert G. Lynch, *Do State and Local Tax Incentives Work* (1996); or "Lower costs driving corporate relocations," *Building Design & Construction* (November 1992). Depending on the industry, the most important location factors are usually land/office costs, availability and wages for skilled workers, proximity to customers, or access to major highways and other transportation infrastructure.

¹⁷ Senate Interim Committee on Economic Development, "Report on the Texas Business Climate," p. 1.

¹⁸ Senate Interim Committee on Economic Development, "Report on the Texas Business Climate," p. 3.

¹⁹ Motorola, Texas Instruments, and other high-tech firms in Texas have consistently pushed for expansion of the federal H-1B visa program, which allows them to recruit foreign nationals for U.S. jobs. Without the H-1B visas, companies say they will have to open new plants overseas. Andrew Backover, "Gramm backs higher cap on high-tech work visas," *Fort Worth Star-Telegram* (June 2, 1999).

²⁰ National Conference of State Legislatures, "A Review of State Economic Development Policy," (March 1998), Introduction.

²¹ Total awards on the bottom of page 26 of the 1998 Smart Jobs Report, Table 5, appear to have been mistakenly reported for Small Businesses and Enterprise Zones, based on individual listings in the table and on Figure 9, p. 27.

²² Texas Department of Economic Development, "Fiscal Year 1998 Smart Jobs Report," Table 5.

²³ For an example, see Clear Lake Area Economic Development Foundation, "Clear Lake, Texas: Clearly the Best Incentives," <http://www.claedf.com/incent.htm>. Tax abatements, training and employee recruitment, fast-track permitting, promotion services, financing sources, out-of-state tuition waivers for relocating firms' employees, and reloca-

tion assistance are all offered as area incentives.

²⁴Texas Comptroller of Public Accounts, Local Government Assistance, “Economic Development Corporation Report: Fiscal Year 1997.”

²⁵Based on research by economist Kenneth Thomas, University of Missouri, cited in Corporation for Enterprise Development, *Managing for Higher Returns*, p. 16.

CHAPTER 2: INCENTIVES CREATED BY THE 76TH LEGISLATIVE SESSION

Why More Tax Cuts? The Budgetary and Political Environment in 1999

The 76th Legislature started with an unusually good fiscal outlook. The Comptroller of Public Accounts estimated in January 1999 that lawmakers would have an additional \$5.6 billion to spend in 2000-01, compared to the 1998-99 biennium. Even after budget increases needed to maintain current services, at least \$2.6 billion in “surplus” funds would remain to pay for enhancing existing programs, creating new programs, enacting business or consumer tax breaks, or making significant deposits to the state “rainy day” economic stabilization fund. Two weeks before the session ended, the estimate of extra revenue

was upgraded from \$5.6 billion to \$6.4 billion, giving legislators another \$807 million to include in their deliberations.

Despite Texas’ already low tax levels, several key officials and legislators weighed in on the side of state tax cuts, particularly tax breaks for small businesses, business research and development (R&D) spending, capital investment or job creation, Internet access, data processing and other information services, and school property tax relief for businesses and homeowners. The governor’s original budget proposal included many of

Exhibit 4: Business Tax Changes With State Budget Impacts in 2000-01 or Beyond

	Cost to State, 2000 and 2001
R&D franchise tax credit (SB 441)	\$67.7 million
Small business franchise tax exemption (SB 441) [for firms with annual gross receipts under \$150,000]	85.4 million
Targeted capital investment franchise tax credit (SB 441)	45.2 million
Targeted job creation franchise tax credit (SB 441)	22.7 million
20 percent sales tax exemption for data processing/info services (SB 441)	26.6 million
Internet access sales tax exemption (SB 441)	19.7 million
Franchise tax credit for employer-operated or subsidized child care (SB 441)	3.9 million
Franchise tax credit for corporate contributions to before- and after-school programs (SB 441)*	4.3 million
Timber industry property and general/motor vehicle sales tax cuts (SB 977)**	None
Extension of severance tax reduction for high-cost gas wells and inactive oil/gas leases (HB 2615)***	Cannot be estimated
Local school property tax relief (SB 4)	<u>At least \$675 million</u>
TOTAL	At least \$950 million

*SB 441 also provides for \$253.6 million in state tax breaks for consumers (including the Internet access provision) throughout 2001. Additionally, local governments could lose up to \$67.7 million in revenue in 2000-01 because of SB 441. The long-term (1999 to 2004) cost to the state of SB 441 is \$2 billion.

** Cost to the state estimated at \$53.5 million from 2002-04.

*** Cost to the state will be at least \$22.1 million in 2003-04; local revenue five-year loss is \$28 million, of which \$11.7 million will occur in 2000-01.

these business incentives, citing the need to cut state taxes as a “key fiscal priority” to improve the state’s economic health. The tax breaks that were eventually approved are summarized in Exhibit 4, along with their cost for the next two years.¹

Early in the session, the governor also urged legislators to provide emergency tax relief for the oil/gas industry in response to low oil prices. The relief program (SB 290), which took effect in mid-March and expired in September 1999, offered severance tax exemptions as long as prices remained below specified “trigger” levels for certain periods of time, and would have applied to production at 80 percent of oil wells in the state. The bill could have cost as much as \$45 million in the 1998-99 biennium, but prices eventually rose above the trigger in April, ending the program’s tax breaks at \$20 million.

Another item at the top of the legislative agenda was using extra state revenues to pay for temporary reductions in school property taxes assessed by local school districts. The final version enacted by legislators (SB 4) provided \$1.35 billion in property tax breaks to businesses as well as to homeowners, because the mechanism used involved the tax rate (rather than an increased homestead exemption, the tax cut method used by the 1997 Legislature). Businesses are expected to more than half of the \$1.35 billion in property tax cuts, getting a one-time benefit of at least \$675 million. The remaining \$275 million in tax breaks listed in Exhibit 4 will continue to grow, as these are permanent, ongoing revenue losses for the state.

The 76th Legislature also created more ways that local tax revenue can be used for economic development. For example, one measure (HB 1916) lets local industrial development corporations use tax revenue to pay for certain job training programs. Restrictions on eligible jobs for which training funds can be used are linked to certain wage levels to be paid to trainees; wage levels will vary based on the county’s unemployment rate. Another initiative (HB 1655) will allow Corpus Christi to charge higher hotel occupancy taxes to pay

for tourism-related items such as a new convention center and public beach clean-up. “Venue” tourism projects within city parks systems will be able to use local car rental and hotel tax revenue through the enactment of HB 1380. Finally, SB 456 authorizes the creation of trust funds using state and local taxes to help certain large cities be chosen to host the Pan American Games in 2007 (San Antonio) or the Olympic Games in 2012 (Houston or Dallas). Because the trust funds are set up in case the events incur financial losses, costs would not be incurred until the games have taken place, giving the legislation no fiscal impact in the coming biennium.

1999 Business Policy and Program Changes

In addition to benefiting from new tax breaks enacted in the name of economic development, businesses were also considered to be the “winners” on several other pieces of legislation, including a telecommunications competition/deregulation act, electric utility deregulation, legal protection for employers who give truthful but negative job references, and extended periods for employers to protest unemployment insurance benefit “chargebacks.”²

Other legislation, such as a proposal that would have provided one-time and future assistance to drought-stricken agricultural producers, failed to pass. However, the condition of agricultural industries and state programs designed to aid them is being studied by legislators. Legislation requiring this study (HB 2) also underscores a need to develop a state agricultural policy, similar to the comprehensive water policy enacted by the 1997 Legislature, to guide future government action.

Exhibit 5 shows that HB 2 and other legislation for state economic development programs (new or existing) had little or no cost in the 2000-01 biennium, especially when compared to new ED tax expenditures. One of the programs listed was vetoed by the Governor; the others took effect immediately or by September 1, 1999.

New Incentives: Long-Term Community-Building or Short-Term Private Benefit?

This section assesses the most recent round of economic development expenditures, using the questions raised earlier in this report:

- Do the public benefits outweigh the public costs?
- Will goods created through public investment remain public?
- What would companies probably do even if the incentive were not offered?
- Does the proposal subsidize an activity that would

actually harm society?

- Would another, less expensive proposal achieve the same amount of public benefit?
- Are decisions about the proposal being made in ways that are open to public scrutiny and debate?
- Are those communities with below-average economic activity receiving the assistance, or is help going to those already doing well economically?

In several instances, the state appears to be subjecting new programs or tax incentives to a higher level of scrutiny, or putting in place measures that will allow initiatives to be analyzed in the future to determine whether

Exhibit 5: Selected Economic Development Program Legislation, 1999

STATE	Cost to State
<ul style="list-style-type: none"> • Requires legislative study of agricultural economic conditions, including the state's role in supporting and preserving the agriculture industry (HB 2) 	No significant impact
<ul style="list-style-type: none"> • Would have created the community investment program to make low-interest loans to certain firms in economically depressed areas (HB 64) 	Vetoed by Governor (cost was \$5 million)
<ul style="list-style-type: none"> • Gives Rural Affairs and Small Business Assistance offices (within the Dept. of Economic Development) an additional 45 days to submit required biennial reports, giving legislators more up-to-date information (HB 1148) 	None
<ul style="list-style-type: none"> • Requires a report to the 77th Legislature, including a strategic plan, on Border region apparel industry development (HB 1517) 	No more than \$50,000
<ul style="list-style-type: none"> • Creates loan guarantee program for film industry, subject to Texas Sunset Act (September 2005); reports required on who gets guarantees, and for how much (HB 1687) 	None
<ul style="list-style-type: none"> • Creates the "Go Texan" agricultural products promotion program, to be funded with general revenue and license plate revenue (HB 2719) 	\$2 million in 2000-01
<ul style="list-style-type: none"> • Creates a business technology outreach program at the University of Houston to help commercialize technology developed by NASA (HB 2992) 	\$600,000 in 2000-01
<ul style="list-style-type: none"> • Reauthorizes Smart Jobs past its expiration in December 1999; changes wage requirements for qualifying jobs; and provides for a "rainy day fund," transfers to the Skills Development Fund, a biennial evaluation, and several other changes (HB 3657) 	None
<ul style="list-style-type: none"> • Makes technical and substantive changes to state enterprise zone program (HB 3658) 	None
<ul style="list-style-type: none"> • Requires Workforce Commission to operate a statewide campaign encouraging people to enter the technology workforce (SB 231) 	None
<ul style="list-style-type: none"> • Requires Workforce Commission to evaluate federal Trade Adjustment Assistance programs (SB 1507) 	None
LOCAL	
Requires that certain information on economic development assistance programs be provided to NAFTA-affected communities (SB 1107)	None
Allows municipalities to create neighborhood empowerment zones to increase the availability of affordable housing or the quality of social services, education, or public safety in the zone (HB 313)	None

or not they are worth continuing. However, many opportunities were missed to improve accountability for these programs and to target them to communities most in need of development.

R&D Tax Credit: The enactment of a state R&D tax break provides an example of legislators asking, “**Do benefits outweigh costs?**” before creating a new incentive, and of putting mechanisms in place that will allow the benefit vs. cost issue to be re-examined in the future. In fact, for one version of an R&D/capital investment/job creation tax cut (SB 5)—for which costs could be identified and compared to expected benefits—the resulting low benefit/cost ratio generated enough legislative opposition to temporarily derail the proposal.

According to a dynamic revenue analysis conducted by the Comptroller, SB 5 would have cost the state \$60,000 per job created. This high level of public subsidy was considered an inefficient use of state funds. (The dynamic revenue analysis for the R&D tax credit was a new development in the 76th Legislature; in prior sessions, the only estimates of anticipated benefits usually came from tax-cut supporters, who would generally want to make the public benefits sound as high as possible.) In the end, however, an even more expensive R&D credit made it into the final legislation (SB 441).

SB 441 also requires, for the R&D, job creation, and investment credits it authorizes, a Comptroller’s Office report on the geographical location of R&D, jobs, or new investments in Texas, as well as the tax breaks’ economic and tax effects. The first report will be made to legislators in 2001. Additionally, the Comptroller will report to the legislature in 2005 on the new small business tax break created by SB 441. The report will provide valuable information on the incentive’s economic impact on the state economy, along with a recommendation on whether the tax break should be eliminated, retained, or changed.

Child Care Tax Credit: SB 441 contains another provision allowing corporations to receive credits for

amounts spent on employer-operated child care facilities or subsidies of employees’ child care costs. Enactment of this child care tax credit may be a case where legislators failed to ensure that *goods created through public investment remain public*. Because the tax break will in most cases benefit only those children whose parents are employed by the firm getting the tax credit—not Texas working families in general—this amounts to a public subsidy for a private employer’s benefit package. On the other hand, the provision does have a very small cost to the state. It could also help reduce the demand (and the cost) for existing child care if it results in new facilities being built, offsetting the public subsidy somewhat.

R&D and Internet tax breaks: As evidenced by the final version of SB 441, high-tech companies and related trade associations were successful in convincing legislators that tax breaks for R&D and Internet access would greatly improve the Texas business climate, encouraging more high-tech growth and its continued creation of high-paying jobs. The question that was not raised often enough is, **What would companies do without the program or incentives?**

In the absence of either tax break, high-tech employment has been steadily increasing in Texas for several reasons that are far more important than state tax provisions. One critical factor is the large amount of engineering and other science graduates in the state who will work for lower salaries on average than those commanded by high-tech workers in other states with a higher cost of living.³ Another factor spurring high-tech growth is the presence of industry “clusters” in a few Texas cities, such as Austin’s concentration of chip manufacturers and computer hardware and software firms and the Richardson-Plano telecommunications corridor. As has been the case in other national “cluster” locations such as California’s Silicon Valley or the North Carolina Research Triangle area, these clusters grew around one or two large firms or a consortium, drawn to an area by federal or state research facilities or higher education institutions. Once these clusters exist, they will continue to draw related industries and skilled workers and generate spin-off businesses.⁴ The

new R&D tax break and other tax incentives aimed at attracting more high-tech firms will most likely allow firms to reduce their taxes even if taxes were not their prime concern or location-decision factor when conducting new R&D or other business activity in Texas.

Small Business Tax Breaks: The small business tax exemption in SB 441 provides a good example of why legislators should more often consider **if another, less expensive proposal could achieve the same amount of public benefit**. This question is critical, because it raises the distinction between the narrowly defined *effect* of a proposed tax incentive and the actual and much broader economic development *outcome*.

Tax “relief” for small businesses was a 1998 campaign pledge of various candidates for state office, and continued to be a priority once the 76th Session started. Most small business tax break supporters pointed out the large share of businesses in the state that are small businesses, the large number of Texans they employ, and in other ways, highlighted their economic contribution. A small business franchise tax exemption, they argued, would more than pay for itself by encouraging more small business development.

Supporters usually did not mention data showing that the small business failure rate is very high, wages paid by many small businesses are low, and employer-paid benefits (i.e., health insurance, pensions, paid leave) often are not offered by small firms. From the broad public perspective, targeted tax incentives that reward the creation of small-business jobs with a higher wages and/or benefits package would have produced a better economic development outcome than an incentive that merely rewards small businesses for having low annual revenues (as does SB 441). If the desired public outcome was a decrease in the failure rate for small businesses, this could have been accomplished by increased state assistance for small business development centers to help entrepreneurs acquire better management skills. Or, if the desired outcome was to improve small businesses’ ability to compete for good workers against large corporations that can more easily afford the cost of

employee benefits, the \$85 million going to small business tax relief could instead have been invested in mechanisms that help small employers provide health insurance other benefits to attract and retain workers.

Passage of Major Tax Cut and State Finance Bills: As stated earlier in this report, the legislature’s deliberations have become more open to public and media scrutiny over the years. The language and estimated costs of proposed bills can be viewed on legislative Internet sites, and the public is allowed to testify for or against any proposed bill. (Texas has not yet made use of other technological advances, such as remote video hook-ups, that would allow citizens in remote cities such as El Paso to submit testimony without traveling to the state capitol.) But deciding **whether programs are open to public scrutiny and debate** should take into account not just the potential for public scrutiny, but also the actual extent of such scrutiny and any factors that tend to impede public involvement.

First and foremost, the session’s short duration (meeting for only five months, once every two years), combined with the sheer volume and complexity of legislation to be considered, continues to have a dampening effect on more constructive debate and public testimony. The final details of the most significant pieces of legislation, including HB 1, SB 441, and SB 4 (the school finance bill), were worked out in “conference committee,” a process that usually involves a very small number of legislators meeting in private or with chosen representatives of different viewpoints, such as lobbyists or other advocates.

In the 76th Legislative Session, the general public might have been able to follow through the media a very general discussion of the business tax incentives being considered, but the important details of SB 441 and SB 4 could and did change frequently in the final days before legislative deadlines took effect. Scrutiny and debate might have increased if more individuals had a better idea of consumer gains from tax breaks compared to businesses’ benefits from tax breaks, and what the cost to the state as a whole would be. The late re-

lease of the revised revenue estimate (after the state budget had been largely finalized) also made it easier for newfound money to be used for tax cuts instead of other investments or programs.

Targeted capital investment/job creation: Of the tax incentives in SB 441, only the capital investment and job creation measures (with a combined price of \$68 million) were targeted to help economically depressed areas. While limited, this targeting shows legislators considering **whether communities with below-average economic activity receive assistance, or whether help goes to areas already doing well economically.** However, with the availability of highly skilled workers, public research facilities, and other factors being much more important in determining where R&D will take place, SB 441's doubling of the R&D credit for research conducted in targeted areas will probably not provide much of a stimulus in helping depressed areas lacking those activities. And the 20 percent sales tax reduction in SB 441 for data processing/information services is likely to help areas that are doing well already: EDS in Plano and SABRE Group in Fort Worth lobbied hard for the provision and will be among its chief beneficiaries.

Several of the bills listed in Exhibit 5 would create new programs or change the operation of programs in economically depressed areas, including enterprise zones, the Border region, and areas losing jobs due to NAFTA. Other programmatic changes would target industries that are not doing well, such as agriculture and apparel manufacturers. SB 231, while authorizing an outreach campaign that will operate statewide, directs the Workforce Commission to target "populations that are traditionally economically disadvantaged and underrepresented in the technology workforce."

Some final comments on new tax incentives as a way of maintaining a "competitive business climate": For many tax incentive proponents, none of the questions discussed above or the issues they raise seemed to matter much if "many" or "most" other states were offer-

ing an incentive that Texas lacked, or if the state's tax treatment of a particular industry was markedly different from that of its chief competitors. However, when such differences really do exist, and Texas is urged to make the tax climate more like its competitors, legislators should consider not just the taxes that need to be eliminated, but also those which might be added (i.e., taxes imposed in other states that Texas does not levy). For example, supporters of the timber industry property tax cuts pointed out that competing states tax timber land at much lower rates. But it was left to opponents to suggest using a severance tax instead, as most other states do for timber production. Legislators chose to enact the property tax changes without creating a severance tax for timber.⁵

In attracting targeted industries, legislators should also try to determine where taxes rank on the list of relocation or expansion criteria. Tax incentives offered to businesses that will make their location or expansion decisions primarily for other reasons—such as the presence of highly skilled workers—are probably not going to deliver the benefits promised, and will reduce the amount of revenue that could have been invested in workforce development or other services and programs.

¹ The sales tax reduction for Internet access will also benefit consumers, but the measure was frequently promoted as a way to improve the Texas business climate for high-tech firms.

² Consumers Union, Press Release, "76th Legislature Wrap-up: Consumer gains clouded by long-term effect of industry subsidies," (June 2, 1999); Jennifer Files, "Business agenda fares well in Legislature," *Dallas Morning News* (June 2, 1999), and Robert Elder Jr., "Tallying Up Who Won and Lost in the Legislature This Past Session," *Wall Street Journal* (June 2, 1999).

³ Andy Dworkin, "Texas No. 2 in high-tech jobs: State leads U.S. in growth, but wages lag, survey finds," *Dallas Morning News* (June 2, 1999).

⁴ House Research Organization, 76th Legislature, Bill Analysis for CSSB 5 (May 24, 1999).

⁵ House Research Organization, 76th Legislature, Bill Analysis for SB 977 (May 19, 1999).

CHAPTER 3: RECOMMENDATIONS

From the analyses of existing and new economic development (ED) efforts presented in the preceding chapters, several findings emerge that suggest ways these programs and the processes leading to their creation or renewal could be improved.

Develop an integrated economic development budget for Texas.

Improving the cost and outcome information for existing and new programs is a critically important first step in identifying the most efficient uses of public funds for economic development. This could be accomplished through the creation of a state economic development budget.

An integrated budget would bring together in one place three very important sets of information related to economic development:

- All state economic development activity would be presented in a single document, regardless of the state agency involved.
- All fiscal support for economic development, whether through direct appropriation or through tax incentives, would be brought together for direct comparison.
- Performance measures would be assigned to each program, so that the effectiveness of state efforts could be accurately determined.

Such a budget could be prepared before the 77th Legislative Session from existing sources and could be used by budget and tax committees in their deliberations. In addition to the lack of performance measures and full cost information for ED programs and tax incentives (addressed below), other difficulties and major information gaps encountered while producing such a budget could be remedied by legislation in the next session, in 2001. Statutory language requiring the biennial preparation of an integrated economic develop-

ment budget would guarantee that this important resource would be available to guide future legislative budget writers.

Include the cost of all business tax incentives in an integrated ED budget. As seen in this report, ED tax incentives have a greater fiscal impact than direct ED program spending, but the costs to the state in lost revenue of these tax provisions are almost never compared directly to the costs of budget items.

A number of states analyze tax provisions through “tax expenditure budgets” that list **all** tax provisions and estimate the fiscal impact each has on state revenue. If Texas required a similar report, the information from the tax expenditure budget concerning economic development provisions could be incorporated into an integrated development budget.

The State Comptroller is required to report on expenditures for major taxes (those generating more than 5 percent of state tax revenue), but this expenditure report does not provide a complete picture. Several important ED tax provisions are not detailed in the Comptroller’s report. For instance, the natural gas and crude oil tax codes contain several incentives aimed at stimulating production. The incentives target gas production from high-cost gas wells, gas production from an oil lease that was vented or flared, production from both oil and gas wells that have been idle over a specified period of time, oil production from enhanced oil recovery programs, and incremental oil production from low-producing oil leases.

Develop improved performance measures and require them to be used for all economic development programs and tax incentives. The final assurance of accountability in an integrated ED budget comes from complete and accurate performance measures. A comprehensive evaluation system would demonstrate the public benefits from the use of state funds and how effectively the funds were used.

The state budgeting system currently requires output measures for each goal of each state agency, measures which are intended to gauge the effectiveness of state programs. The Legislative Budget Board and the State Auditor have worked to improve this system, but many of the programs that would be included in an ED budget currently report only simple output indicators that do not reflect the actual results achieved by the program.

For example, the Texas Workforce Commission has measured the number of persons receiving employment services and training and the percentage of recipients entering employment. But it has not reported the median starting wage of new workers, how that wage compares to their prior employment, their retention in the job after one year, or their advancement within a company. The new federal Workforce Investment Act requires wage and retention performance measures to be collected by Texas and other states, but TWC could also collect and report these measures to legislators for non-WIA-funded employment programs. More comprehensive measures of the actual outcomes of ED programs would have to be developed so that the state could make more informed and strategic spending decisions and concentrate resources on programs that efficiently provide the desired results.

No performance measures are currently associated with tax incentives. The new requirement for a report on the effect of tax provisions permits (but does not require) the Comptroller to include an assessment of the intended purpose of each tax provision and whether the provision is achieving that objective; the Comptroller chose to make no recommendations concerning exemptions in her recent report. A more detailed analysis of the effect of tax expenditures, similar to outcome measures for appropriations, would be needed to permit the Legislature to fairly judge the relative impact of direct budget appropriations and tax provisions.

Periodically assess all economic development expenditures and continue only those programs and incentives that represent the most efficient and effective use of state resources.

An integrated economic development budget would not just provide information that is currently lacking; it would create a tool that helps focus resources on programs with the highest returns. It would help weigh all ED expenditures against one another and against other relevant areas of state spending to determine the most efficient and effective use of state resources. Programs offering fewer benefits in relation to their costs, or addressing problems that are less critical than others, could be redesigned, receive less funding, be targeted to those areas or firms on which they show the greatest impact, or be eliminated entirely.

To guarantee periodic review, the sunset process used for state agencies could be used for existing and new ED programs and tax incentives.¹ Various studies provide more information on how sunset reviews specifically designed for state ED programs and tax incentives could be conducted. Also, recent Texas history (i.e., the comprehensive tax hearings conducted by the 75th Legislature) suggests that thorough reviews of tax incentives would be easier to undertake if they were done in “batches.” Tax incentives and programs could be divided by category (the primary ED goal, for example, or primary industry targeted), or by how long the incentives have been in existence (using the original date of creation, not subsequent re-enactments). All newly created ED programs or incentives should include sunset provision language, including reasonably short sunset dates.

Develop a coordinated, deliberate economic development plan for the state, with goals and benchmarks to measure progress and accomplishments.

Once an integrated budget has been prepared and the most cost-efficient ED incentives have been identified, the state could tackle another problem raised in this report: the current lack of a statewide economic plan to guide and improve long-term community development. Such a plan would establish clear, realistic short- and long-term goals and objectives for state ED investments, and would incorporate regional and other local development priorities. It would also take into account the different long-term needs of rural and urban areas, for example, or of areas experiencing significant changes in population.

Goals and benchmarks would measure how state efforts are helping to create sustainable communities and equitable growth. Rather than just tallying job creation, for instance, more detailed information would illustrate real effects that state programs are having on strengthening educational systems, improving per-capita income and income distribution, raising worker skill levels, and increasing wages and the availability of health insurance and child care, to name just a few.

State-developed goals and benchmarks and other related performance measures and standards for state ED programs would also be shared with local governments, who would be encouraged to use the standards voluntarily to improve local allocation and use of ED resources. For local ED efforts that produce a cost to the state, use of the goals and benchmarks could be required.

As part of an overall state plan, Texas should take a comprehensive approach to improving economic conditions in underdeveloped areas of the state.

Not all areas of the state are currently getting the same amount of attention or benefit from state ED incentives. Nor are they experiencing the same rates of development or encountering identical barriers to community development.

Where considerable resource gaps exist, state funds and other assistance should be focused on areas least able to strengthen their own communities. This targeting would require better information about where state funds are currently being spent, both for ED programs and for state operations in general. It would also require the development of related budget and planning documents, such as a statewide, coordinated infrastructure plan for capital projects that are critical to regional economic development. Examples include highways, universities and two-year colleges, teaching hospitals, prisons and other state facilities with significant employment or other economic impact. Instead of letting each institution and agency develop plans independently that are then approved by legislators or governing boards, the state should have a process that takes into account the long-term economic effects of state infrastructure investments.

If tax expenditures are used to offer targeted economic development incentives, care should be taken to structure them so that communities immediately outside the targeted zone, but not doing much better economically than those inside the zone, are not put at a severe disadvantage by the new state subsidy. Otherwise, they might feel compelled to match the state incentive with local funds, reducing the amount of community resources available for other needed services.

The state needs to strike a better balance between economic development program spending and tax incentives, and investments in workforce development and other capacity-building measures.

Direct economic development program spending and tax incentives take resources away from other basic government functions—including K-12 and higher education, major highways and other transportation infrastructure, and health and human services—that improve the quality of life for Texas families. Quality

of life issues (such as clean air and water, less congested highways, and excellent schools) will especially be important for relocating businesses and employees accustomed to higher-quality public services in other states with higher taxes. But Texas, which ranks last among states in per-person spending, cannot provide better public services and infrastructure without raising taxes for everyone or reallocating money currently paying for ED programs and tax incentives.

Direct ED programs and business tax expenditures also use up resources that could be invested in addressing the long-term obstacles to economic development, such as adult illiteracy, excessive high-school dropout rates, low skill levels for many current workers and job-seekers, and other workforce issues. The state needs to monitor and control growth in tax expenditures relative to the size of the state budget overall and to specific investment areas such as public and higher education and other workforce development efforts. Tax incentives could also be eliminated or reduced without significantly raising the state's relative tax burden, especially compared to other state leaders in the economic development race.

Conclusion

This study originally set out to determine if Texas state government was getting a good return on public funding for economic development incentives, and to see if the results of state ED spending were sustainable, equitable, and reaching communities throughout Texas.

First, however, an estimate of total ED spending had to be derived, revealing at least \$4.5 billion in economic development program and tax expenditures for the 2000-01 biennium. These significant levels of public investment—by no means the complete spending picture, but the best that can be estimated with currently available data—are certainly large enough to warrant additional investigation. They are also large enough to merit a more systematic review as part of the biennial budget process, and to be directly linked to the state's strategic plan for economic development,

as recommended in this study. At the same time, ED program spending is relatively small enough compared to the overall state budget to warrant a targeting of state ED initiatives to those communities that are most in need.

In addition to yielding a more comprehensive picture of the amount of public resources committed to ED incentives and a plan for a more strategic use of those resources, implementing this report's recommendations would also produce the kind of information needed to answer the more critical questions about long-term outcomes of the state's current economic development offerings—not just the amount and way in which ED resources are being spent, but what Texas' communities are getting in return. Legislators have already taken steps to improve the amount and kind of information available about the short-term results of more recently enacted ED programs and tax credits; making the same kind of information available for *all* ED incentives will help decision-makers determine if state economic policies and expenditures in promoting that growth are benefiting all Texans.

Future analyses should also identify ways in which ED and workforce development policies need to be changed so that new business tax incentives do not impair the state's ability to invest in a better trained and skilled workforce. Strengthening the links between state economic development spending and workforce development, and finding ways to truly involve communities in guiding and shaping their own development, will be especially critical in ensuring the state's long-term growth.

Finally, further research on what local governments are doing and on how workforce development investments fit into economic development strategies will provide a more complete picture of what remains to be done.

¹ See, for example, the Corporation for Enterprise Development's *Using Sunset Reviews to Reform Incentive Policies*.

² Texas had per-capita general spending of \$2,270 in 1997. U.S. Bureau of the Census, *State Government Finances 1997*, at <http://www.census.gov/govs/www/st97.html>.

APPENDIX A: METHODOLOGY USED TO IDENTIFY DIRECT SPENDING

Data Source Used: The most comprehensive source of data on Texas state agency spending is the general appropriations act enacted in odd-numbered years, when the Legislature meets in regular session. When this report was finished, the latest available version of the appropriations act, House Bill (HB) 1, was the House-Senate Conference Committee report, as modified by SB 4 and the governor’s veto proclamation. For 1998-99 spending, the report used HB 1 from the 75th Legislature.

How Direct Spending Was Identified: The Appropriations Act actually has an Article VII, appropriating \$12 billion to “Business and Economic Development” for 2000 and 2001. However, Article VII includes funding for unrelated activities, such as operation of the state lottery and bingo regulation, as well as budgets for the state highway department, unemployment insurance system, labor law enforcement, and child care for welfare recipients and other low-income families. These contribute to the state’s business climate but would not be considered “economic development” by most analysts or other observers.

Therefore, the Center for Public Policy Priorities reviewed all appropriations for state agencies and public universities, identifying entire agencies or funding strategies with obvious economic development purposes. Some examples:

TEXAS AEROSPACE COMMISSION

	For the Years Ending	
	August 31, <u>2000</u>	August 31, <u>2001</u>
<p>A. Goal: EXPAND AEROSPACE INDUSTRY Maintain and expand aerospace industry resources, investment and jobs while enhancing business and public awareness and recognition of the space and aviation industries and their benefit to the people and economy of Texas.</p> <p>...</p>		
Grand Total, TEXAS AEROSPACE COMMISSION	\$ <u>211,880</u>	\$ <u>211,880</u>

TEXAS DEPARTMENT OF TRANSPORTATION

	For the Years Ending	
	August 31, <u>2000</u>	August 31, <u>2001</u>
<p>A.2.2. Strategy: TRAVEL INFORMATION Support and promote tourism.</p>	\$ 19,470,847	\$ 19,879,276

In many cases, riders following an agency’s appropriations provided more information about how funds could be spent, or indicated that funds were being appropriated to one agency but would actually be spent by another:

Texas Department of Transportation Rider 31

Interagency Agreements. Out of funds appropriated in Strategy A.2.2., Travel Information, \$670,000 through interagency contracts with the Commission on the Arts and \$500,000 through interagency contracts with the Texas Historical Commission each fiscal year, shall be used to showcase the arts, culture, and historical diversity in Texas to promote tourism.

Where riders provided for transfers such as those shown in the example above, adjustments were made to spending amounts by strategy and category to prevent double-counting or mis-identification.

Finally, because the Texas budget is prepared on a biennial basis, funding for some strategies appears in HB 1 in the following way:

TEXAS DEPARTMENT OF ECONOMIC DEVELOPMENT

	For the Years Ending	
	August 31, <u>2000</u>	August 31, <u>2001</u>
A.2.2. Strategy: DEFENSE DEPENDENT COMMUNITIES		
Provide economic development assistance to defense dependent communities.	\$ 1,000,000	\$ U.B.

“U.B.” stands for “unexpended balance,” meaning that the agency can spend any funds remaining from the first year’s appropriations in the second half of the biennium. Sometimes agencies divide the first year’s amounts evenly when preparing their annual operating budgets; other times, all or most of the funds are spent in the first year. For this reason, spending figures used in this report are reported as biennial figures, to avoid making additional assumptions about actual year-by-year spending.

Why These Should be Seen as Conservative Estimates: For several reasons, the spending identified in this report underestimates the actual amount of public funds being used for state economic development programs, in total and by category.

First, only in those cases where economic development could be identified as the primary or major goal of a strategy or line-item were programs and spending included in the total. This means that occasionally, funding for a small program, buried in a larger strategy that includes non-economic-development activities, had to be excluded from the total.

In many instances, smaller programs (such as the Department of Economic Development’s Small Business Assistance programs) were part of a larger budget strategy and could not be identified separately. In most cases, these had to be put in the “other” category.

Furthermore, even where a strategy could clearly be identified as an economic development activity, related expenses such as state employee fringe benefits could not be identified. For higher education and other research spending, applied research (many times focused on a specific industry) was included, while basic research was not, even though it could lead to products that are further developed and marketed by a single private firm. Programs that assist business but have another primary goal, such as environmental protection, were also excluded from the figures.

A final reason for viewing these as conservative estimates is the fact that the appropriations act does not capture all economic development uses of public funds by state and quasi-state agencies—for example, river authorities with economic development programs, or programs that allow state pension funds and permanent endowments for education to be used for venture and development capital.

Other Information That Could Be Used to Analyze Economic Development Spending: A different state-level estimate of Texas spending on ED programs could be generated by using the “service categories” that are part of the state’s budgeting system (ABEST, Automated Budget and Evaluation System of Texas). Developed by the Legislative Budget Board (LBB, the primary state government budget office) and the governor’s budget office, these 38 categories are used so that cross-agency reports on strategy-level spending can be prepared. Service categories relevant to the goals of this analysis include business development, workforce development, community and housing development, transportation infrastructure, transportation support, and public and higher education instruction. ABEST also includes categories for populations served, by income (low-income, all other) and age (children, elderly, and all other).

However, these categories do not appear in the General Appropriations Act; compiling these numbers requires looking through at least 175 individual agency budgets, not counting judiciary, regulatory, and legislative agencies. The LBB or other agencies with access to ABEST could also generate these data in response to legislative or open records requests, once the governor has signed HB 1 and the final spending figures are determined. Because many ED programs are part of a larger budget strategy, ABEST figures will be subject to some of the same methodology limitations described above.

Individual agencies can also provide more detailed information on ED program spending by state region, county, or other, more detailed geographic level. For instance, the Department of Economic Development issues an annual report for the Smart Jobs customized training program showing grants and workers trained by city, as well as by:

- 11 Smart Jobs service regions,
- 28 workforce development board regions,
- 24 state planning regions,
- 10 economic regions used by the Comptroller’s office; and
- Border region location.

The level of information found in the Smart Jobs report, however, is unusually detailed, and will probably not be available for most of the programs identified in Appendix B. The Comptroller also prepares an annual county-level state expenditure report, but the spending categories used do not allow ED spending to be identified.¹

¹The categories are intergovernmental payments, labor costs, public assistance, highway construction and maintenance, operating expenses, capital outlays, and miscellaneous.

APPENDIX B. STATE ECONOMIC DEVELOPMENT PROGRAMS AND TWO-YEAR FUNDING, BY CATEGORY

CATEGORY AND SPECIFIC PROGRAM

WHERE IN HB 1:

SMALL BUSINESSES: \$8.8 MILLION

- Small Business Development Centers at Angelo State University, Lamar Univ-Beaumont, Lamar Univ-Port Arthur, Sul Ross State, Sul Ross State—Rio Grande College, Texas Tech, Univ of Houston, Univ of Texas at San Antonio, and Dallas County Community College Education
- Univ of Texas—Pan American—Video Conferencing for Local Small Businesses Education

FOREIGN MARKETS/TRADE: \$4.0 MILLION

- Department of Economic Development (TDED): Strategy A.1.2, Internatl. business Business/ED
- Texas A&M International University: Institute for International Trade Education
- Texas Tech University: International Trade Center Education
- Laredo Junior College: Regional Import/Export Training Center Education

AGRICULTURE (INCLUDES RESEARCH): \$115.6 MILLION

- Department of Agriculture (TDA): Strategy A.1.1, Generate markets for farmers, ranchers, and agribusiness Natural Res.
- TDA: "Go Texan" Partner Program (promoting state agricultural products) Natural Res.
- TDED: Agritech Corridor Partnership Business/ED
- Agriculture Experiment Station: research on livestock, plants and crops, renewable resources, product quality, socioeconomic research, agricultural marketing, value-added product research Education
- Food and Fibers Commission Education
- Texas A&M Kingville: Citrus Center Education
- Texas Tech: Strategy A.2.1, Agricultural research Education
- Texas Tech: Feed Institute Education
- Stephen F. Austin University: Applied Poultry Studies and Research Education
- Tarleton State University: Agricultural Center Education

OTHER TARGETED INDUSTRIES: \$85.9 MILLION

- Aerospace (Aerospace Commission) Business/ED
- Travel/tourism (Historical Commission, TDED, Department of Transportation) Gen. Govt.
- Film/Music Industries (Governor's Trusteed Programs; Loan Guarantee Program) Gen. Govt.
- Natural/LP Gas (General Land Office, Railroad Commission) Natural Res.
- Recycled Products (General Land Office) Natural Res.

INDUSTRIAL/CUSTOMIZED TRAINING: \$80.5 MILLION

- TDED: Smart Jobs Business/ED
- Texas Workforce Commission: Skills Development Fund Business/ED
- Engineering Extension Service (TEEX): Pre-Employment and Industrial Sector Training Education

CATEGORY AND SPECIFIC PROGRAM

WHERE IN HB 1:

RESEARCH AND DEVELOPMENT: \$174.9 MILLION

• Univ of Texas (UT) at Austin: Bureau of Business Research, Bureau of Econ. Geology	Education
• UT Arlington: Automation/Robotics Research Institute	Education
• UT Dallas: Center for Applied Biology	Education
• UT Permian Basin: Center for Energy	Education
• Texas A&M: Real Estate Research Center, Cyclotron Institute	Education
• Texas Engineering Experiment Station	Education
• Texas Tech: Strategy C.2.3, Research in emerging technologies and econ development	Education
• University of Houston: Superconductivity Center, Center for Commercial Development of Space/Space Vacuum Epitaxy Center	Education
• UH-Clear Lake: High Tech Laboratory	Education
• Stephen F. Austin University: Center for Applied Studies in Forestry	Education
• U. of North TX: Institute of Applied Sciences	Education
• Higher Ed. Coordinating Board: Advanced Technology Program (and program admin)	Education

ASSISTANCE (FINANCIAL, TECHNICAL, AND EDUCATIONAL): \$224.9 MILLION

• General Services Commission-Private Activity Bonds	Gen. Govt.
• Housing and Community Affairs (TDHCA): Strategy B.2.1, Development Projects Grants (to distribute federal HUD funds for water, sewer, housing, and other economic development projects; provide technical assistance)	Business/ED
• TDHCA: Colonia Service Centers	Business/ED
• TDHCA: Training small-town local officials	Business/ED
• Historical Commission: Heritage tourism	Gen. Govt.
• Sec. Of State: Colonia Initiatives Coordinator	Gen. Govt.
• Agricultural Extension Service: Strategy C.1.1, Economic Competitiveness (educational programs)	Education
• TEEK: Technology Transfer	Education

OTHER BUSINESS DEVELOPMENT: \$34.5 MILLION

• UT System: Austin Technology Incubator	Education
• UT El Paso: Institute for Manufacturing and Materials Management	Education
• UT Pan Am and UT El Paso: Centers for Entrepreneurship and Econ Development	Education
• UT Pan Am: Center for Manufacturing	Education
• Sam Houston State: Center for Business and Economic Development	Education
• University of Houston System: NASA Programs [new]	Education
• Office of Rural Affairs (TDED, Agriculture Dept.)	Business/ED
• TDED, Strategy A.1.1: Productivity improvement, expand customer base, access financing	Business/ED
• TDED, Strategies A.2.1-2: Aid for small businesses and defense-dependent/other communities	Business/ED
• TDED, Strategy A.1.3: Market/recruit businesses	Business/ED
• TDED, Strategy A.3.1: Economic data collection	Business/ED

TOTAL: \$729 million for the 2000-01 biennium

SOURCE: CPPP Analysis of House Bill 1 (Conference Committee Report), 76th Legislature (1999).

APPENDIX C. STATE AND LOCAL BUSINESS INCENTIVES, 1996

	Offered in Texas?	How many other states?
FINANCIAL INCENTIVES FOR BUSINESS		
State-sponsored industrial development authority	Yes	41
Privately sponsored development credit corporation	Yes	38
State authority or a agency revenue bond financing	Yes	43
State authority or a agency general obligation bond financing	Yes	20
City and/or county revenue bond financing	Yes	48
City and/or county general obligation bond financing	Yes	36
State loans for building construction	Yes	41
State loans for equipment, machinery	Yes	42
City and/or county loans for building construction	Yes	45
City and/or county loans for equipment, machinery	Yes	45
State loan guarantees for building construction	Yes	27
State loan guarantees for equipment, machinery	Yes	29
State financing aid for existing plant expansion	Yes	43
State matching funds for city and/or county industrial financing programs	Yes	25
State incentives for establishing industrial plants in areas of high unemployment	Yes	40
City and/or county incentives for establishing industrial plants in areas of high unemployment	Yes	35
TAX INCENTIVES FOR BUSINESS		
Corporate income tax exemption	Yes*	36
Personal income tax exemption	Yes*	32
Excise tax exemption	No	23
Tax exemption or moratorium on land, capital improvements	Yes	36
Tax exemption or moratorium on equipment, machinery	Yes	41
Inventory tax exemption on goods in transit (freeport)	Yes	48
Tax exemption on manufacturers' inventories	No	45
Sales/use tax exemptions on new equipment	Yes	46
Tax exemption on raw materials used in manufacturing	Yes	48
Tax incentive for creation of jobs	Yes	43
Tax incentive for industrial investment	Yes	38
Tax credits for use of specified state products	No	5
Tax stabilization agreements for specified industries	No	7
Tax exemption to encourage research and development	No**	35
Accelerated depreciation of industrial equipment	No	40

*Texas uses a corporate franchise tax and has no state personal income tax.

** Added by 76th Legislature (1999).

SOURCE: Council of State Governments, using information in *Site Selection* (October 1996).

