Economic Development Programs in Texas:
A Suggested Approach to Evaluation

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A Working Definition of Economic Development Incentives

In the broadest sense, economic development incentives could include:

- The Education System that prepares the state's workforce.
- The Transportation System that provides the ability to move people and goods from place to place.
- The Legal and Regulatory Systems that enforce the rules that govern economic interactions.

Such a definition would be too broad to allow this committee to conduct a meaningful review of the many programs that the state undertakes in the name of economic development.

A more manageable definition would be to limit your attention to those things that governments—state and local—do in order to achieve the state's economic development goals by attempting to influence private business decisions about the location of jobs and investment. Implicit in all of this is the assumption that the state should, and does, have economic development goals.

Specifically, we would suggest you limit your focus to:

"...those programs that are intended to promote private economic development directly by reducing the cost of opening or operating a business in order to attract, retain, or expand business activity, thereby resulting in increased economic activity, investment and employment."[1]

While broader issues of the state's economic climate are important, they are really beyond the scope of this committee. In the time you have, you would do well to insure that the state has a well-defined economic development strategy and that our economic development programs are working to achieve it.

[1] *TTARA Research Foundation, "Economic Development in Texas: Programs and Incentives", 2011.*

Maximizing Strengths and Minimizing Weaknesses

States are endowed with differing resources—natural and human—and have differing cultures and institutional structures.

The goal of economic development programs should be to maximize the state's strengths and to minimize or reduce its weaknesses in the eyes of the private decision maker.

Texas strengths:

- Large, growing and relatively young population
- Large and diverse natural resource endowments
- Institutions that promote entrepreneurship and business development
- An improving regulatory and judicial environment
- Stable and conservative fiscal systems that have historically supported efficient public services and infrastructure

Texas weaknesses:

- A state and local tax system that places heavy burdens on capital
- Aging and increasingly strained transportation, water and energy infrastructures
- Relatively large segment of the workforce with skills not matching the modern job market

A few words about interstate competition and comparisons:

- In today's economy, most businesses have choices about *whether, when, and where* to make investments that will lead to expansion.
- Competition between locales for economic development is real, it is intense, and it is growing.
- Over time, states have learned from each other and have expanded their incentive portfolios to include many similar programs.
- However, each state offers its own unique mix of assets and liabilities, and each offers its own unique mix of inducements to attract capital and economic growth.
- What fits in one state may not fit in another. For example:
    - A sales tax exemption for manufacturing would have no value in Oregon, but is extremely important in Texas.
    - An income tax credit may be valuable in North Carolina, but not Texas.

Categorizing Incentives

For purposes of study, we recommend grouping economic development incentives into four major categories:

- Tax Incentives:

  These are special treatments within the tax system that are used to lower the cost to a business of making certain investments or purchases within the state.

  - Some are broad entitlements which benefit any business that makes the specific type of investment or purchase.

  - Some require an application and approval before the benefit may be received.

  In general, tax incentives *reduce or delay* payments *from* the business receiving the incentive *to* government and *do not require* the direct *outlay of funds* previously collected by the government.

- Grant Programs:

  Grants are payments made *by* a government *to* a business that agrees to do certain things. Most of these programs include an application and approval process before the benefit may be received.

  Grants are typically made from fungible sources of revenue rather than revenues associated with the specific entity that receives the grant.

- Financing Tools:

  These are programs through which the government provides access to, or reduces the cost of, capital to a business. They may, or may not, require direct outlays of governmental funds.

  All of these programs include an application and approval process and are typically subject to appropriations constraints.

- Direct Provision of Services:

  These are programs that involve direct governmental expenditures *on behalf of* a business.

  These programs usually require prior application and approval, and are usually subject to appropriations constraints.

Evaluating Economic Development Incentives

Economic development incentives—like all other governmental programs—should be periodically evaluated according to their success in meeting the goals set out for them.

A careful evaluation should include both quantitative and qualitative considerations.

- Quantitative considerations should recognize that:
  - There is no *single* metric that is appropriate to <u>all</u> incentives.
  - There is no *single* metric that provides an adequate measure of any <u>particular</u> incentive.
  - There may be significant *temporal* differences between when an incentive is provided and when the desired outcome takes place.
  - The analysis of a particular incentive is extremely sensitive to the definitions of “benefits” and “costs” chosen.
  - There are both *micro-* and *macro-* aspects to a complete evaluation of incentives—that is, evaluations should consider both individual projects <u>and</u> the program as a whole.
  - There are both *direct* and *ancillary* impacts associated with many incentives that need to be included.
- Qualitative considerations would include:
  - Whether the incentives are consistent with the state’s overall economic development objectives.
  - Whether they are competitive with incentives offered by other jurisdictions.
  - Whether they appropriately reflect governmental priorities.

Evaluating Economic Development Incentives

There is little consistency in the methods used to evaluate different programs. Methods that are not appropriate to the particular incentive being evaluated are sometimes used resulting in confusion and misleading results.

- There are statutory requirements for evaluating and reporting on some of the state's economic development programs, but not others. Even where evaluations and reporting are required, there is little consistency in the calculation of costs and benefits—public vs. private, direct vs. ancillary, etc.
- Some incentive programs include statutory requirements calling for reporting of information that is misleading or of little value, while omitting relevant information.
- Some programs require extensive disclosure of information, while others provide little.

A few comments on the "But For" Question:

> "A core problem vexing states is that it is difficult to determine what would have happened ***but for*** the…incentives. In some cases, they might cause companies to create jobs or increase investment, but they might just be offering public dollars to reward businesses for what they would have done anyway."[2]

- "What are the odds?"
  - A proper evaluation will look at the way an incentive affects the decision process. Was the incentive enough to sway it?
  - How many "but for" projects does it take to outweigh the ones that would "come anyway"?

- Does the incentive "bend the curve"?
  - Sometimes an incentive is designed to speed up activity that would eventually take place—move future activity forward in time.
  - Has the incentive increased the amount of something the state wants to promote?

In the end, the "But For" question may turn out to be a "faith" question. If an investment or event would not have happened "*but for"* an incentive, the <u>cost</u> of the incentive to the government may actually be a net <u>gain</u>..

[2] *Pew Center for the States, "Evidence Counts", 2012*

Further Recommendations

Texas has a large and flexible array of economic development tools. Those tools are administered by a large number of different state and local entities. To a business considering making a decision about when and where to grow, the range of Texas economic development programs can be daunting and the proper place to begin can be difficult to choose.

While the Governor has made valuable strides in coordinating state level programs, it is still the case that a business wishing to expand or locate in Texas may need to deal with numerous different agencies, and sometimes provide the same or similar information, during the application and approval process for different incentives.

- Texas should consider making it perfectly clear that the Governor is the state's top economic development official and provide him with all necessary tools to carry out that role. This could include the development of a single "point-of-entry" for state applications and an enhanced role in the approval process for major state incentives. This would insure proper coordination with state economic development goals and minimize the amount of time and effort required by a business to access state programs.

- Texas should also consider implementing a regular process to review and evaluate economic development goals and programs—similar in scope to the charge to this committee.

    - Because economic development programs tend to be used together in "packages", the review should consider the whole range of incentives offered in the state to insure that they are adequate to the task and competitive with other states.

    - Unless there is a specific and overriding reason to establish expiration dates—"Sunset" dates—for major programs, they should not be used as the motivation for the periodic review. The existence of sunset dates is not required to insure regular reviews of programs, but they do create uncertainty in the minds of private economic decision makers about whether a particular incentive will be available when needed—particularly when planning and development cycles are lengthy. This has the potential to impose damaging "legislative risk" into the already risky decision process.