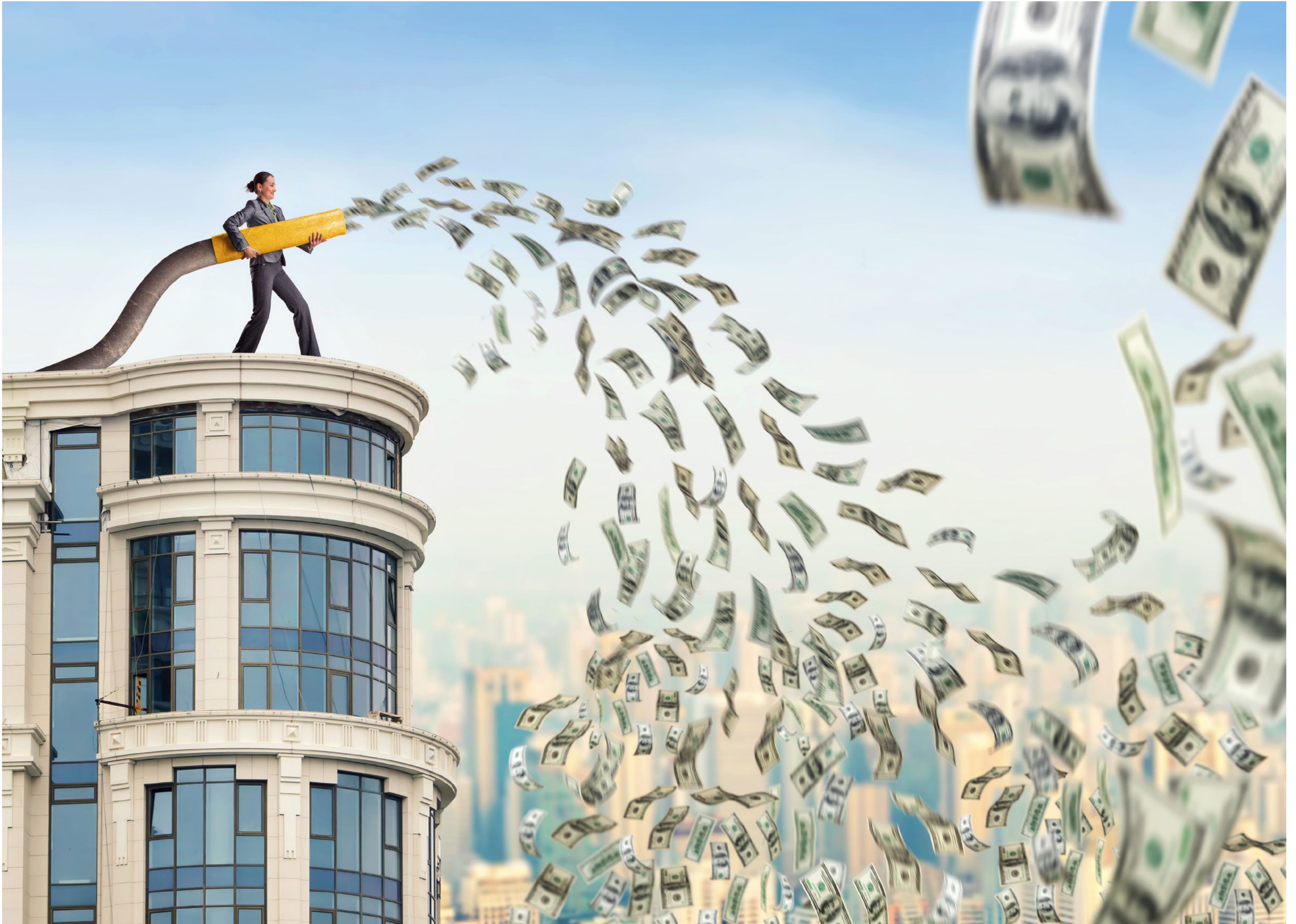
# Purpose-Driven Economic Development



# A Guide to Reforming Chapters 312 and 313

Updated May 2019

by the Honorable Jess Fields

Texas Public Policy Foundation

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### Key Points

- Transparency is lacking in how local governments report and handle Chapters 312 and 313.
- Some allowable uses for 312 and 313 do not create many jobs at all and should be eliminated.
- Reforms to 312 and 313 should empower local governments and the state of Texas to hold beneficiaries of 312 and 313 agreements accountable.

### Introduction

What is the purpose of economic development agreements? This question, above all else, must be answered by lawmakers this legislative session as the fates of Texas' Chapter 312 and 313 agreements are deliberated.

It is appropriate for legislators to acknowledge that local governments and school districts have many reasons to pursue economic development agreements. Local officials often bristle at the encroachment of state officials who, they feel, do not understand the challenges of growing local economies' tax bases to keep up with infrastructure needs. Most only wish to help their communities.

These local officials, meanwhile, must also understand that if we are going to have these agreements, the state has an obligation to create guidelines protecting taxpayers from poor agreements. Economic development agreements can and have been made out of political expediency. If local officials looking to expand their tax base can play by reasonable rules set forth by the state, taxpayers can be protected and lawmakers are more likely to continue the longstanding institution of economic development incentives.

Though the Texas Public Policy Foundation does not support the use of tax abatements and limitations for individual businesses—the best economic development tools are the Texas Model's lower taxes, less regulation, and fewer frivolous lawsuits—this paper offers several metrics if Texas decides to move forward with Chapters 312 and 313 with the ultimate goal, hopefully shared by all, of protecting the interests of our state's taxpayers.

### The Basics of Chapters 312 and 313

Chapter 312 is the Property Tax Abatement Act. Property tax abatements are agreements whereby local governments extend an abatement of taxes, expressed as a percentage of real property and/or business personal property for up to 10 years, to a business prospect. They may be used by cities, counties, and special districts (but not school districts) to lure business prospects with the hope of increasing their overall tax base, growing the local economy, and creating jobs.

Chapter 313 is the Texas Economic Development Act. It allows school districts to enter into economic development agreements with business prospects whereby the valuation of the property invested in by the prospect is limited for the purposes of maintenance and operation (M&O) taxes. Every school district has both M&O and interest and sinking (I&S) (taxes in their total property tax rate, with M&O representing the largest portion. These agreements are for 10 years.

Although districts may only limit value for M&O taxes, these are substantial. School district taxes are, in Texas, universally higher than the taxes of counties, cities, and all special districts individually, and very often higher than all of the rest combined.

These two chapters, meanwhile, are governed by two important public information chapters: Chapters 551 and 552 of the Government Code.

Government Code 551.087 allows for closed session meetings—meaning not public—to discuss economic development by the governing boards of various local entities. This is one of a few exceptions to the Texas Open Meetings Act, which generally requires that all meetings of public entities, such as school boards, cities, counties, special districts, and other agency boards be held in public.

Meanwhile, Government Code 552.131 covers an exception within this chapter, known as the Public Information Act, keeping the confidentiality of information pertaining to economic development negotiations. Basically, information that is deemed either a "trade secret" or that would cause "competitive harm" is allowed to be excepted from public information requests.

Experience tells us that, in practice, both 551.087 and 552.131 are construed rather broadly to shield most of what goes on with economic development negotiations from the public eye altogether.

## The Current State of 312 and 313 Incentives in Texas

According to the Texas Comptroller, as of January 22, 2019, there were 429 active Chapter 313 agreements (Comptroller 2019a). As of March 2018, there were 1,223 Chapter 312 agreements listed in the Comptroller's Tax Abatement List (Comptroller 2018a). A total of 337 of the Chapter 312 agreements had an expiration date before March 1, 2018, meaning that, barring other circumstances, there were approximately 886 active agreements. For the purposes of considering the data, however, all agreements will be examined.

Peering into the numbers underlying these agreements can be challenging, given the sheer size of the data set. Summary data, however, can be useful in providing some insight into how the respective types of incentives are used. Given the research, we will focus on jobs as a measure of effectiveness and economic impact. Policymakers should also.

***Chapter 312 Agreements***

First, let us consider Chapter 312. While the data set is larger, it also includes more information, such as required number of full-time employees, which the broader 313 spreadsheet does not.

| Employee Requirement | No. of Agreements | Percent of Total |
|---|---|---|
| 0-19 | 124 | 10.1% |
| 20-49 | 112 | 9.2% |
| 50-99 | 75 | 5.1% |
| 100+ | 153 | 12.5% |
| No Requirement Specified | 759 | 62.1% |
| **Total** | **1223** | |

While many 312 agreements specify a required number of FTEs in the agreement, the figure that jumps out is that 62.1 percent do not appear to (759 agreements do not specify a number of "New FTEs Required"). In fact, according to the spreadsheet, 764 agreements do not require job creation. Notably, this is actually more than the number of agreements which report FTEs as required—why some agreements specify a number of FTEs but are listed in the Comptroller's report as not requiring job creation is unclear. Twenty-eight agreements are listed in the report as not requiring job creation even while listing FTEs, while 23 agreements are listed as requiring job creation but not listing any FTEs. One agreement in the Corsicana Downtown Revitalization District requires job creation but specifies "0" as the number of required FTEs.

These technicalities are far from trivial, because they point to an important problem in reporting and how the data may be accurately assessed by Texas taxpayers. It is almost certainly not the fault of the Comptroller's office that these agreements are listed with such inconsistencies, leading one to wonder what circumstances created such discrepancies in the first place. Clearly, whatever the reasons, transparency would demand that broad-based reporting should not be confined to a single spreadsheet for Chapter 312 agreements—a problem not shared by the more easily accessed Chapter 313 resources on the Texas Comptroller website.

It is worth noting that in November 2018, the Texas Comptroller updated the Tax Abatement Spreadsheet by including "new" and "old" FTEs and Payroll Dollars Created (Comptroller 2018b). The March 2018 data is used for this paper because FTEs are lumped into a single field, thus allowing for accurate categorization.

Assessing the efficacy of the new reporting arrangement is beyond the scope of this paper; however, it is worth noting that the new mechanism may cause local governments to report FTEs rather differently than in the past in order to show "new" FTEs in the data.

What is clear from the data is that the vast majority of Chapter 312 agreements do not require job creation at all.

Some 854 of the 1,223 agreements report the type of business benefiting from the agreement. That breakdown is as follows:

| Business Type | Number | Percent of Total |
|---|---|---|
| Banking | 18 | 2.1% |
| Commercial | 99 | 11.6% |
| Energy | 72 | 8.4% |
| Hotel | 34 | 4.0% |
| Industrial | 205 | 24.0% |
| Manufacturing | 303 | 35.5% |
| Medical | 26 | 3.0% |
| Research | 18 | 2.1% |
| Retail | 65 | 7.6% |
| Wholesale | 14 | 1.6% |

As the data show, the vast majority of those reported are in manufacturing (35.5 percent) and industrial (24.0 percent). Some, however, appear to be misreported. For instance, one 312 agreement listed as "Industrial" was actually an agreement between Garza County and Red Hollow Wind Energy, LLC. Documents from Garza County indicate that the Garza County Commissioners Court approved the tax abatement agreement on November 8, 2010. Contemporaneous news reports indicate that the abatement agreement actually gives a 100 percent tax abatement to the wind project (McDonough). The report shows no base value for the project, but does show job creation is required—for only 3 FTEs.

Regardless of the reasons, such miscategorization calls into question the entire mechanism of reporting by which the public may supposedly be informed of these agreements. While the amount of information in the 312 report is laudable, the confusing nature of it—and sometimes outright inconsistency of it—begs for a better solution.

We will return to some specific examples of 312 agreements shortly. For now, however, let us consider the state of 313 agreements.

***Chapter 313 Agreements***

There is less data to parse in the Comptroller's data set containing all Chapter 313 agreements, but a few things stand out as worth mentioning.

For instance, there are fewer categories under which current 313 agreements fall. These include manufacturing, nuclear electric power generation, renewable energy electric generation, and research and development. Other categories exist in statute but are not reported as having any current agreements.

Here is the breakdown:

| Category | Number of Agreements | Percent of Total |
|---|---|---|
| Manufacturing | 182 | 42.4% |
| Nuclear Electric Power Generation | 2 | 0.5% |
| Renewable Energy Electric Generation | 241 | 56.2% |
| Research & Development | 4 | 0.9% |
| **Total** | **429** | |

As these numbers show, a large majority of 313 agreements go to renewable energy electric generation, and almost all of the rest go to manufacturing. Only six projects are for nuclear or research and development.

In practice, even the manufacturing category shows a number of projects in the energy sector. A few examples include Sweeney ISD's 313 agreement with ConocoPhillips Company for the ultra low sulfur diesel unit, with a value limitation of $30 million, or Glasscock County ISD's 313 agreement with Crosstex Permian, LLC, for the Crosstex Permian gas processing plant, also with a $30 million value limitation.

To dive into the data, the best broad-based resource available is actually the biennial Report of the Texas Economic Development Act issued by the Comptroller every two years (Comptroller 2017).

When this paper was first drafted, the latest report available was from January 2017. Recently, however, the 2019 report was released, including up-to-date data (Comptroller 2019b). This allows us a unique opportunity to compare and contrast how the data has changed from the 2017 to the 2019 reports.

Keep in mind that the 2019 data includes the 2017 data. They are both included here for comparison purposes.

**Figure 1** shows the relevant data from, respectively, the 2017 and the 2019 reports. Please note that "Nuclear" was not included in the 2019 totals.

What the data clearly show is that manufacturing projects create many more jobs than renewable projects. In spite of this, the number of renewable projects as a percent of the total agreements under Chapter 313 is on the rise.

**Figure 1**

| 2017 Report of the Texas Economic Development Act | | | | |
|---|---|---|---|---|
| **Category** | **2017 No.** | **Percent of Total** | **Jobs Created** | **Percent of Total** |
| Manufacturing | 139 | 44.7% | 10,130 | 82.1% |
| Renewable (Wind) | 144 | 46.3% | 1,193 | 9.7% |
| Renewable (Non-Wind) | 22 | 7.1% | 69 | 0.6% |
| Research & Development | 4 | 1.3% | 952 | 7.7% |
| Nuclear | 2 | 0.6% | 0 | 0.0% |
| **Total** | **311** | | **12,344** | |

| 2019 Report of the Texas Economic Development Act | | | | |
|---|---|---|---|---|
| **Category** | **2019 No.** | **Percent of Total** | **Jobs Created** | **Percent of Total** |
| Manufacturing | 163 | 41.9% | 14,093 | 88.8% |
| Renewable (Wind) | 188 | 48.3% | 1,424 | 9.0% |
| Renewable (Non-Wind) | 34 | 8.7% | 98 | 0.6% |
| Research & Development | 4 | 1.0% | 257 | 1.6% |
| **Total** | **389** | | **15,872** | |

**Figure 2**

| Agreement Breakdown from 2017 to 2019 Reports | | |
|---|---|---|
| **Category** | **2019 No.** | **Percent of Total** |
| Manufacturing | 24 | 30.8% |
| Renewable (Wind) | 44 | 56.4% |
| Renewable (Non-Wind) | 12 | 15.4% |
| Research & Development | 0 | 0.0% |
| **Total** | **80** | |

By analyzing the numbers in the reports, we can see that 78 new agreements were created under Chapter 313. The breakdown of those agreements by type is shown in **Figure 2**.

Although they are worst at job creation, renewable projects, which comprise only about half of the total agreements outstanding, have been the vast majority—71 percent—of agreements pursued in the last couple of years.

Use of Chapter 313 agreements for renewables is growing more than any other category.

This finding should prompt lawmakers to ask why renewable projects seem to be increasing at a more rapid clip than manufacturing, which is clearly responsible for the majority of jobs reported as created under Chapter 313.

Texas does not have an income tax, and local communities derive the majority of their revenue from property tax and, to a lesser extent, sales tax. If the jobs are merely located in the county but the workers live elsewhere, a great many of the potential benefits of the project associated with job creation fail to materialize.

Indeed, what is to stop a rural county's wind farm from merely contracting with firms in big cities a few counties over? The examples that will be offered later will show that contracted jobs are quite common, especially in agreements with renewables.

Lawmakers cannot know for certain whether or not wind farm jobs, especially those contracted to third parties, are located in the rural communities that offer the incentives. What can be said with a higher level of certainty is that manufacturing jobs, by and large, have a more significant impact on the local job market of smaller communities.

## A Few General Points About Economic Development From Research

A good place to start understanding existing economic development programs is by reviewing some of the available research on economic development agreements and, specifically, the kinds of communities and jobs they often interact with.

For instance, the Brookings Institution produced a report in March 2018 entitled Examining the *Local Value of Economic Development Incentives: Evidence from Four U.S. Cities*. This report goes a long way to helping us answer the question of what lawmakers should seek in drafting the future of Chapters 312 and 313 (Parilla and Liu, 2).

Worth noting is that the report states two major findings about the state of local incentives: first, that they continue to be a major policy priority at the local level in the United States, and secondly, that both the public and academia have taken a greater interest in incentives in recent years.

The report finds that "these policies contribute to significant public expenditures, ranging between $45 and $90 billion per year" in the United States. It further highlights how the national competition to land Amazon's corporate headquarters has helped to renew public interest in these policies.

The report suggests that incentives should "invest in people and skills" because of "deep evidence that links the skills and capabilities of a region's workforce to the productivity of its economy and the well-being of its population." This, of course, is a bedrock principle of building strong local economies. It is the reason why policymakers seek to develop good education infrastructure for youth and job-training programs for those who have served time in prison. The report adds that "it also reflects that a key goal of providing economic development incentives is to create jobs that provide workers with middle-class incomes and living standards."

What the data clearly show is that manufacturing projects create many more jobs than renewable projects.

Then it draws from the work of Timothy Bartik, senior economist at the Upjohn Institute for Employment Research, who argues that jobs should go to those who are not employed currently or are underemployed.

Bartik's work finds that "newly created jobs must result either in employment of local non-employed, or employment of in-migrants" (Bartik, 8). In other words, when economic development incentives are offered, a company relocates employees or hires from the local population. For this reason, he concluded in a separate report, incentives are most effective when the local unemployment rate is highest (Carinci).

A summary of the report notes: "If the new jobs go to local residents, local residents have higher earnings, and local government finances improve. If the new jobs go to in-migrants, local governments have higher costs, and residents face higher prices" (Carinci). It goes on further to note that the effect is so great as to yield a 50 percent local resident hire rate in a high-unemployment area when new jobs are created, versus only 20 percent local residents when unemployment is low.

This finding is significant because Texas law does not stipulate how new jobs are created by economic development incentives (though it does require numbers), but where the workers come from has a great impact in how incentives affect a local community. If unemployed local workers are not hired by incentivized employers, localities continue to bear the numerous social and economic costs of unemployment while simultaneously making new expenditures to expand services for new residents. If taxes are not being collected in the amount necessary to provide those services, a negative imbalance exists which is not presently measured by current reporting standards.

It may also be said that whatever new investment or jobs incentives may help bring, measuring their costs can be challenging. It is on this matter that the Brookings report highlights another serious problem: disparity in the background of employees.

The report finds a substantial racial disparity, in particular, in incentivized industries: "black and Hispanic workers remain underrepresented in industries that receive economic development incentives. Across the four cities [studied by the report], black and Hispanic workers make up about one-quarter of the overall workforce, but only 14 percent of the workforce in the incentivized industries" (Parilla and Liu, 3). Broadly, the report goes on to find that job training represents a tiny share of incentives' expenditures in the studied cities.

Another major point of the report is to "connect place," by which it means focusing on "neighborhoods that struggle to benefit from broader local and regional growth" (Parilla and Liu, 25).

The importance of this cannot be understated. Texas, a "majority-minority" state, is one of the most diverse states in the nation, and Houston is regularly cited as the most diverse large city in the United States. Any policy aimed at economic development must properly consider the role it plays in communities of color, especially those which are lower-income in the urban core of Texas' largest cities and

the poorer rural communities that dot the landscape of most of our state's geography.

Texas has a good track record of producing better results for these communities, as the Texas Public Policy Foundation's Chuck DeVore noted in a 2014 *Forbes* article comparing poverty in minority communities in California, Hawaii, New Mexico, and Texas. DeVore concluded that "relative to the nation, America's four largest racial and ethnic groups do better in Texas" (DeVore).

Understandably, Texas policymakers are sensitive to the needs of Hispanics, African-Americans, Asians, and other communities of color that make up our diverse state. This is why a note of concern should be raised by the existing research on how economic development incentives interact with minority communities.

One of the largest pieces of research to date is a 2006 Good Jobs First report entitled *The Geography of Incentives: Economic Development and Land use in Michigan*. The report studied nearly 4,000 incentives granted in Michigan from 2001 through 2004.

"Instead of encouraging growth in places with existing infrastructure, services and business networks," it says, "incentives have directed jobs and industry away from Michigan's core areas" (Leroy et al., 1).

The report makes a startling conclusion: "Job subsidies have fueled a mismatch, fostering job creation and retention where it is needed least—shortchanging the central cities while favoring more affluent outlying areas." It provides reams of data to back up this conclusion, proving that in Michigan, incentives tended to favor suburban and rural areas over the economically poorer, and racially more diverse, urban cores. Although it makes many recommendations related to land use which are outside the scope of this paper, its basic finding of incentives concentrating in wealthier, less-diverse communities is quite relevant.

Indeed, the experience of economic development in Texas unfortunately mirrors some of these findings, to the detriment of racially diverse, higher-unemployment areas throughout our state. This will be explored in greater detail later in this paper.

The Brookings report makes several specific policy recommendations that are relevant to our forthcoming discussion in Texas. These are:

- Situate incentives within broader economic objectives.
- Embrace incentive transparency and evaluation.
- Target incentives to enhance productive, inclusive growth.

In the first recommendation, the report notes that various political stakeholders often influence incentive policy at the local level in such a way that broader considerations, such as local goals of job creation and targeted industry growth, are ignored. Such political incursions into the economic development process, we note, may be curbed with effective state-level policy that define the borders of proper incentive agreements.

On the second point, the report says, "States tend to be further along in evaluation and transparency than municipalities" (Parilla and Liu, 31). Texas' experience of the Comptroller's office spearheading transparency efforts in numerous areas, including economic development, would generally comport with this statement. The report does note, however, that in several cities it cites which did conduct large-scale evaluations of economic development policy, "evaluations were motivated either by internal economic development department concerns that incentives were not competitive as compared to peers or by external pressure from city councils or community groups" (Parilla and Liu, 31).

Therefore, the report's conclusion—which our experience agrees with—is that internal evaluations of economic development policymaking are most often undertaken with the goal of comparing policies with other competing communities. It hardly needs to be stated, but "Are we competitive" is not a replacement for "Is this the right thing to do." Transparency and evaluation should be done for its own sake, for the protection of taxpayers, not because of a fear of missing out.

The final recommendation from the report, to "target incentives to enhance productive, inclusive growth" (Parilla and Liu, 34-35), is in fact an umbrella for many recommendations, summarized below:

- Incentivize opportunity-rich firms—for instance, by using wage thresholds and the consideration of whether firms are exporting something outside of the region.
- Incentivize firms to provide more opportunity—incentive agreements can stipulate that marginalized groups are beneficiaries, and provide customized service plans including, but not limited to, job training, technology use, and mentoring.
- Incentivize firms with place in mind, from region to neighborhood—local governments can work together to prevent poaching of jobs from one nearby area to another, and localities can emphasize proper site selection to enhance the effects of incentives. Further, neighborhood-based incentives can benefit distressed areas specifically.

One important conclusion we may draw from these recommendations as pertains to Texas' discussion on incentives is that economic development incentives are not in any sense party to the rules of the free market. This must be acknowledged and repeated often. When a government engages a company to relocate, it is providing a particular benefit to that firm it would not otherwise receive.

## What Are Texas' Objectives?

There are two major areas in which the discussion over economic development policy takes place. First is the discussion around the incentives themselves—how to craft them, what they should achieve, and what the boundaries are.

Second, and equally important, is the process that these agreements live in as policymaking decisions. We should never divorce the goal of a policy, no matter how noble, from the process by which it is achieved.

In reconsidering Chapters 312 and 313, lawmakers face both areas of policy at once. They intersect and yet are distinct enough to merit some discussion separately.

With regards to what objectives should be achieved by economic development incentives, we will focus on several areas of concern, as follows:

- Grow high-wage employment in the local community, especially for unemployed and underemployed individuals.
- Create opportunities in distressed and marginalized communities, especially those stricken with poverty and high unemployment.
- Ensure equal opportunity for employment regardless of background or socioeconomic status.
- Minimize or prevent the poaching of companies from nearby communities within the same region.
- Ensure that firms are investing not only in their economic interests but also the interests of the communities helping them via the incentives in the first place.
- Create opportunities for industries that export products and value elsewhere, while simultaneously importing wealth into local communities.

It is no coincidence that "importing wealth," i.e., expanding the tax base, is the last point of concern, for while this is often cited as the major reason for economic development by local officials, it is far from the most important one. In fact, the well-being of the community should come first—a higher tax base, while quite relevant to the policy, naturally flows from a community that is better off in the first place. It is important but cannot be the sole impetus for an incentive agreement, lest it ignore the concerns of the community itself.

We will also deal with process. That encompasses several concerns itself, as follows:

- Ensure that all stakeholders, including local businesses, organizations, and taxpayers have adequate time to review and consider the agreements on the table.
- Notify the public well in advance of agreements under consideration.
- Provide specific opportunities for input from the public.
- Create comprehensive evaluations of economic impact for each agreement under consideration, placing the burden of proof on firms seeking incentives.
- Ensure accountability through requirements placed on firms.
- Provide checks and balances in the process.
- Create end-to-end transparency for the public, stakeholders, and lawmakers to know what is going on with agreements during their creation.

In order to evaluate these concerns as they apply to the present state of economic development agreements, we will consider the use of these incentives as heretofore applied by local governments. From this, we can draw meaningful conclusions about how the practice of economic development in our state matches with the research previously cited and how lawmakers can best address these matters.

## Shell Companies Create Liability and Accountability Concerns for Chapter 313

While all economic development agreements demand accountability and transparency, renewable energy agreements under Chapter 313 are a particular concern, especially for wind power.

Almost without exception, wind energy 313 agreements are made with what are, in effect, shell companies. A larger company develops and pays for a wind farm under a company that exists for the specific purpose of running that wind project. Or, as is often the case, the larger company "assigns" the project to a company named for the project itself.

Given that the deal then becomes not one with a large multinational company, but one with a firm created just for that project, what happens if the project declares bankruptcy? What happens if the school district attempts to hold the project accountable for anything whatsoever?

It becomes difficult to imagine how, in a situation such as the bankruptcy of a shell company that "owns" a wind project, the taxpayers and local entities who contract with such firms would get their money back. The counter-claim, it might be said, is that this has not actually happened on a large scale yet.

However, it must be said that the Texas Economic Development Act which created Chapter 313 is only 16 years old. Wind farms, however, are known to have a lifespan that may not exceed two decades in most instances.

A landmark study from the United Kingdom entitled *The Performance of Wind Farms in the United Kingdom and Denmark*, which studied over 8,000 wind turbines from both Denmark and the United Kingdom concluded that "… any economic assessment of wind generation should not be based on an expected life which is longer than 15 years" (Hughes, 16).

This has astonishing implications for Texas when one considers that tax value limitation agreements under Chapter 313 are good for 10 years, or the vast majority of the expected life that the U.K. study recommends policymakers use for decision-making.

It is even more astonishing when one considers that, for the purposes of holding projects accountable, economic impact studies are done for a period of 25 years. What happens after these wind farms are no longer viable or productive assets?

A recent article from the *Texas Law Review* by William S. Stripling raises that question and cites evidence showing that there are thousands of abandoned wind turbines in California and Hawaii, where wind power got an early start in the United States. He further points out that Texas, the largest producer of wind energy in the U.S., has no law governing decommissioning of wind turbines. As a result, Stripling notes, the decommissioning process is left to private agreements between companies and landowners (140).

The problem of decommissioning Texas wind projects established using Chapter 313 becomes clear. Most of the entities in these agreements are created for that purpose, meaning that a landowner, local government, or school district concerned about what happens after the wind farm has reached the end of its usable life has little to no recourse against the large multinational corporations who actually set up the farms in the first place. This is a substantial regulatory problem that may be a few years off yet but will most certainly come into play as the existing wind infrastructure continues to age.

How to regulate the types of entities that operate wind farms under these agreements, however, is an open question. This paper does not purport to offer a specific solution—only to highlight the problems that it poses. Lawmakers considering how these agreements are structured should avail themselves of the regulatory tools at their disposal when incentives are offered to shell companies and purpose-created entities.

## Why Regulation Is Appropriate: Where All Parties Can Agree

In the past, there has been significant disagreement over the proper use of economic development incentives. Some have argued that there is no place for such incentives at all, while others take a free-for-all approach.

Any economic development incentives proffered by a public entity that collects and uses taxpayer dollars are, by their very nature, outside of the capitalist system. Many policymakers argue for economic development without realizing the inherent contradictions they espouse, confusing being "pro-business" with being "pro-market." In fact, the firms party to these deals are not the local plumbers, restaurants, or legacy mom-and-pop stores. Instead, they tend to be very large companies who can hire representation and go through the process of lobbying numerous local entities for agreements to lower their tax burden and, in some cases, receive other benefits also.

Firms party to economic development incentives are not local plumbers, restaurants, or legacy mom-and-pop stores. Instead, they tend to be large companies who can lobby for lower tax burdens and other benefits.

What is necessary, however, is for policymakers on both sides of the aisle to cast aside any pretense of free market economics or equanimity in the distribution of these agreements. That is just not the case. Whenever an economic development deal is struck, the firm receiving the deal wins, the local entity striking it may or may not win, and the taxpayers, community stakeholders, and other firms on the sidelines are largely bystanders, even if they "participate" in public discussions beforehand.

As a result, we should also dispose of the notion that regulating these agreements is somehow improper. Countless policymakers at the local and, at times, the state level have deferred to the economic development process as if it were somehow part of the marketplace. It is not. Public officials who are negotiating these deals have a duty to meticulously craft and rigorously enforce tenets that hold the firms seeking them accountable to what they promise.

Is that "free market" in any sense? No, it is not. Neither, however, is the entire process. As long as economic development incentives continue to be offered by local and state governments, and they will, taxpayers have a right to expect results.

This being the case, absent the complete abolition of economic development agreements, the regulation of rent-seeking firms is an appropriate and necessary part of their use, whether those be Chapter 313 in use by school districts or the more common Chapter 312 used by local governments.

Before we proceed, let us be clear on terms. *Encyclopedia Britannica* defines rent seeking, as the term is used in the field of economics, as "competition for politically protected transfers of wealth" (Mazzuca). In its common usage, rent seeking refers to how firms seek out special favors from government that benefit them and, in some cases, even undermine their competitors.

In our atmosphere of economic development incentives, rent seeking takes on an entirely new dynamic still: competitiveness between localities and school districts for "the next big thing."

None other than Paul Krugman, a well-known, left-of-center economist and columnist for the *New York Times*, finds this competitiveness alarming and has written extensively about it, particularly as it pertains to how national governments and their leaders espouse competitiveness as an argument for making national policy toward the global economy.

In an article entitled "Competitiveness: A Dangerous Obsession," Krugman writes: "Thinking and speaking in terms of competitiveness poses three real dangers. First, it could result in the wasteful spending of government money supposedly to enhance U.S. competitiveness. Second, it could lead to protectionism and trade wars. Finally, and most important, it could result in bad public policy on a spectrum of important issues" (Krugman 1994, 41).

Elsewhere, Krugman writes about how economic fallacies such as the fear that Asia's growth could somehow undermine the West is just bad economics (Krugman 1996, 24).

In an article applying these insights to cities, Iain Begg of South Bank University writes: "… Krugman's view is that competitiveness is an attribute of companies, not of cities, regions, countries or continents" (Begg 1999, 2).

It is hard to disagree with Krugman's fundamental insight. The fear of missing out, to use a common term that he does not use, can lead to really bad policy. This leads to "competitiveness" at the local and state level. And, in our economic development debate, perhaps to the misapplication of these tools for politically expedient purposes.

In crafting policy on economic development, state lawmakers must first accept that if the program of incentives continues, it must carry with it strong checks on the firms seeking them and a well-defined sandbox in which local officials can operate.

It is in this spirit, then, that this paper humbly proposes restrictions on the process that allow economic development to continue while honoring the many real concerns of the myriad stakeholders who are affected by it.

Public officials who are negotiating these deals have a duty to meticulously craft and rigorously enforce tenets that hold firms accountable to what they promise.

## Recommendations for Moving Forward: Chapters 312 and 313

The Texas Public Policy Foundation does not support the use of tax abatements and limitations for individual businesses; the best economic development tools are the Texas Model's lower taxes, less regulation, and fewer frivolous lawsuits. The Texas Legislature should let Chapters 312 and 313 expire in 2019 and 2022, respectively. However, this paper offers several metrics if Texas decides to move forward with Chapter 312 and 313 with the ultimate goal, hopefully shared by all, of protecting the interests of our state's taxpayers.

### *Transparency*

The first area in which we shall suggest changes to the policies pertaining to Chapters 312 and 313 is both simple and meaningful. Residents of taxing jurisdictions that are considering offering tax abatements and reductions to private

companies should be able to obtain information about these potential offers. However, currently this information is hidden from the public in two ways. First, deliberations about economic development deals by local government officials are exempted from the Texas Open Meetings Act. Thus, a city council, county commissioners court, or a school board can meet behind closed doors to "deliberate the offer of a financial or other incentive to a business prospect…" (Sec. 551.087 Government Code). Second, "information about a financial or other incentive being offered to the business prospect by the governmental body or by another person" (Sec. 552.131 Government Code) is exempted from disclosure under the Texas Public Information Act until after an agreement has been made. Both of these exemptions make the 312 and 313 processes less transparent and result in less citizen input. They should both be eliminated.

***Public Participation***

In addition to hiding information about economic development deals from the public, the current processes for 312 and 313 often keep the public from having any meaningful input into the decisions made by local governments. Local governments, using the exemptions in the Public Information Act and the Open Meetings Act, are often able to keep the public from knowing anything about tax abatements and reductions until 72 hours before they vote on it.

The first thing the public often knows about these agreements is when the governing body posts for the meeting where they will act on the issue 72 hours in advance. This usually consists of a notice on a bulletin board, buried in a local newspaper, and on the website of the governing body. Often only a handful of residents learn about the deal and show up for the public hearing and deliberations. This is rarely enough to stop the process from moving forward or change the agreements since these deals are essentially already agreed to before they are brought to the public.

However, the 313 process provides a glimpse into how the process can be changed to allow for more public participation. Unlike the 312 process where the initial vote by the governing body is also the final vote to approve an agreement, the initial 313 vote is only a vote by the school board to accept an application for tax limitation. After that, the district forwards the application to the Comptroller of Public Accounts for review. It is only after the Comptroller's review, which takes a minimum of 90 days—and usually 150 days or more—that a school board can vote to approve an agreement.

During this time, many more citizens become aware of the existence of a proposed agreement than during the 72-hour notice of the 312 process. This allows more citizens more time to get involved. And citizens have taken advantage of this added time to successfully oppose 313 agreements that had seemed on their way to approval. This recently occurred in Wharton County in both the Louise and El Campo independent school districts.

The 312 process should be changed to more closely reflect the 313 process. Governing bodies should be required to vote to first accept an application for an abatement. After the abatement, all information about the abatement should be made public and all discussions by the governing body should be held in public. The governing body would not be able to vote to enter into an abatement agreement until at least 90 days have passed from the date of accepting the application.

***Agreements May Be Canceled for Any Breach***

Any agreement should be able to be canceled for any breach of a previously agreed requirement. This may seem obvious, but if it is not written expressly in statute, localities will rarely do so for fear of being taken to court. State lawmakers need to back up local officials' ability to cancel agreements, clawback tax revenue, and otherwise hold firms accountable by placing strong language in statute that shields localities, to the extent possible, in the pursuit of these duties (assuming that everything else has been done properly).

***Usage Restrictions***

The data is clear: renewable projects under Chapters 312 and 313, especially if solar or wind, do not create jobs and also contribute to the growing reliability problem in Texas' electric market. Manufacturing, meanwhile, consistently creates more jobs and, for common sense reasons, seems to be more likely to stick around for their communities in the long run. Wind and solar farms have simply become means to improve revenue for local governments, not to increase jobs or economic growth. They should not be eligible for either 312 or 313 agreements.

## Recommendations for Chapter 312

Chapter 312 has few rules governing how tax abatements may be offered to business prospects considering relocation. A lack of transparency and clear process pervades Chapter 312 agreements and often leads to confusion from local stakeholders about what, exactly, is going on when their governing body decides to move forward with one. Herein, we suggest several guidelines whereby Chapter 312 may be revised to ensure that its aims are clear and that the business prospects seeking these incentives are held accountable.

***Require Minimum Levels of Job Creation***

Job creation should emphasize higher-wage jobs unless there is a pressing reason for lower-wage jobs to be created.

However, one of the principal mechanisms by which economic development incentives can assist a community, as per the research, is through high-wage job creation.

Therefore, all Chapter 312 agreements should be required to create at least some jobs, no fewer than 25 in urban areas and 10 in rural areas—mirroring the 313 requirements.

***Vigorous Clawback Mechanisms***
If a firm does not meet its obligations, the public entity should be required to clawback the amount that was abated.

## Recommendations for Chapter 313

Chapter 313's requirements need to be slightly different than Chapter 312, even if the two agreement types find their way into a single section of statute, because the public entities involved are different and the firms seeking incentives are different also.

***Amendments Proposed by Prospects Should Go Through the Process Again***
As the Apex Midway example showed (see related case studies paper), changes to the agreement can occur in a fashion that does not yield the ideal of either public transparency or policymaking. In any instance where an existing agreement is proposed to be amended by the business receiving the benefit, they should have to pay a new fee for a new economic impact study, and the Texas Comptroller should have to re-approve.

## Conclusion

Lawmakers must consider what the point of economic development in Texas is. Are these tools given to cities, counties, special districts, and school districts so that they can compete with one another? Are they provided for the enrichment of local governments? Should they be used politically?

Experience teaches that lawmakers at all levels are apt to talk about economic development in terms of bettering neighborhoods, improving communities, and so forth. Sadly, the policies do not always jive with these goals.

State lawmakers alone are empowered to draw the rules for economic development as practiced by local public entities, who are, after all, creations of the state. Texans deserve in the 86th Legislature for their lawmakers to promote common sense and good public policy in this arena as in others also.

They would do well to remember, if nothing else, what these policies are supposed to do—and not what they have in fact become—when reforming these significant statutes. ✯

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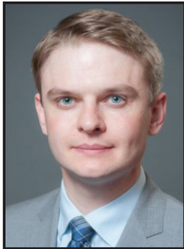
## ABOUT THE AUTHOR



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## About Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute. The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

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