

AN OVERVIEW OF GOVERNMENT-RUN ECONOMIC DEVELOPMENT PROGRAMS IN TEXAS

WRITTEN BY **John Bonura**, Policy Analyst, Taxpayer Protection Project
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KEY POINTS

- Evidence suggests that the use of current government run economic development tools does not produce the desired result of increased economic activity.
- Tax incentives and abatements given to large businesses disincentivize startup of smaller businesses.
- Tax abatement and incentives are rarely considered as the factor that tips a business's decision where to locate.

EXECUTIVE SUMMARY

The purpose of this research is to describe the landscape of economic development policies directed by the state, to examine current tax policies, and to offer recommendations on how to create an environment more friendly for market forces to guide economic development. Utilizing economic reports and analyzing scholarly research on the subject, the evidence suggests that the use of current economic development tools does not produce the desired result of increased economic activity; rather, such economic development programs are a costly burden to taxpayers in the end.

Instead of piecemeal abatements or other incentives to individual businesses, it would be preferable to implement policy that leads to an elimination of all property taxes or to amend the Texas Constitution to remove the authority from taxing entities to grant individual businesses incentives. If eliminating property taxes or revoking incentive-granting authority is beyond the political will, then it is recommended to mitigate the burden on the taxpayer by increasing accountability through mandatory clawback provisions in agreements and increasing transparency by allowing the public full access to information regarding the agreement process.

INTRODUCTION

State and local governments often dole out incentives (like grants and tax abatements) to lure businesses to Texas over other states. While it can be tempting to think that government intervention in economic development is effective, the

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truth is that the economic cost to the taxpayer far outweigh the benefits. In practice, government-directed economic development programs grant favors on the basis of political connections rather than productivity or value. This practice creates an un-level playing field, both in the macro-level context (i.e., all taxpayers in a community, region, or state) as well as on the micro scale (i.e., similarly situated businesses competing within the same industry). These policies shift the tax burden from businesses to consumers in the form of higher prices and are rarely the factor that tips the decision for a project to locate in a particular place.

Viewing government-run economic development through this lens while also examining academic research leads one to conclude that keeping these programs and policies in place is not ideal. As a more holistic approach, policymakers should begin winding down various government-run economic development schemes and systems. The next Texas Legislature should consider meaningful reforms, such as increasing transparency around the agreements reached and those already considered, allowing for greater public input and strengthening accountability mechanisms for projects that fail to meet their promises.

PHILOSOPHICAL CONCERNS

In a capitalist society, the government is not supposed to be in the business of picking winners and losers in the marketplace. Doing so is not in the overall public interest, but rather done to “benefit a small, favored interest at the expense of everyone else”

(Bakst, 2021, para. 6). The concept of the free market largely disappears when the government decides to put its thumb on the scale. Playing favorites with certain businesses by granting something of value to one business but not to the rest ultimately deprives the market of capitalism’s unique advantages, such as competition and innovation.

Furthermore, government-run economic development is at direct odds with the fundamental American ideal of justice and fairness. American society has largely organized itself around the principle that “good law should treat people in similar situations similarly” (Henderson, 2012, p. 6). However, if similarly situated individuals or businesses are not subject to the same rules, regulations, or public provisions, then our foundational principles have been violated, and the function of government marred.

Of course, these are not the only philosophical problems plaguing government-run economic development. When the government plays favorites and meddles in the free market, it creates extra costs for consumers by increasing prices and uses taxpayer money to bet on the success of the crony enterprise. Government-run economic development can also affect the quality of goods and services as businesses invest resources into lobbying for tax incentives and are rewarded for doing so. The choice of the consumer is diluted, and instead of competing for market share by creating something that consumers want, businesses that should have gone under actually survive.

Government-run economic development also displays attributes of socialism since it entails a forced redistribution of wealth through government action. Because of this wealth redistribution, it is entirely possible that crony enterprises receive tax subsidies and items of value at the expense of their competitors.

Chapter 312

Under Chapter 312 of the Texas Tax Code, cities, counties, and special districts are able to enter into an

agreement with a current or prospective taxpayer to exempt “increases in the value of the property from taxation for up to 10 years” ([Comptroller, n.d.-a](#)). The purpose of these abatements is to “attract new industries and to encourage the retention and development of existing business” ([Comptroller, n.d.-a](#)). The exact extent to which this tool has achieved its stated goal is unclear.

One of the more controversial issues surrounding Chapter 312 abatements is the misconception that these tools impose no cost on existing taxpayers. The expansion of a property through investment brings costs concerning transportation, public safety, infrastructure, and other core government services. Because these projects have much of their property taxes abated and receive government services to financially support the projects, an even heavier burden is placed upon the taxpayer to pay for these services, resulting in higher taxes.

Opportunity costs are another overlooked factor. A publicly supported project is presumably justified on the basis that tax abatements will improve the immediate and surrounding area and will create the highest value possible for that property. The only problem is that it is impossible to predict what the highest value of the property would be if all projects were allowed to take advantage of these tax abatements. The maximum value of a piece of property is better determined when the unfettered market decides whether the goods or services a business operation provides are in demand by consumers. Without politically motivated favoritism, natural competition would produce the best business or project that would maximize the value of a property.

The lack of transparency surrounding how these decisions are made also negatively impacts the taxpayer. While public hearings are required before a municipality can make an abatement agreement, Section 551.087 of the Texas Open Meetings Act ([Texas Government Code, 1999/2001, Section 551.087](#)) and Section 552.131 of the Texas Public Information Act ([Texas Government Code, 1999/2020, Section](#)

[552.131](#)) have been used to protect proprietary information. Simply speaking, most meetings take place behind closed doors, keeping the public in the dark about what exactly these projects are set to accomplish and how much of the tax burden taxpayers will take on in the name of economic development. Eliminating both of these sections of the code will arm the taxpayer with the information they need to make informed decisions about how governments spend public funds.

JETI

Another economic development tool was created when the 88th Texas Legislature passed HB 5, which created the Jobs, Energy, Technology, and Innovation (JETI) Act ([HB 5, 2023](#)). JETI was passed to succeed the Texas Economic Development Act (also known as “the Chapter 313 tax-incentive program”) ([Elkins & Grubbs, 2024](#)). Similar to the policy it replaced, JETI offers “limits on the taxable value for a school district’s maintenance and operations (M&O) property taxes over 10 years” ([Elkins & Grubbs, 2024](#)). JETI differs from Chapter 313 in a few different ways: it disallows the option to waive the job creation requirement (which had been previously abused); it requires applicants to prove that there is competition between a Texas site and a non-Texas site; and it requires applicants to show that the JETI program is a compelling factor for choosing the Texas site ([Elkins & Grubbs, 2024](#)). The changes enacted by JETI made the program more palatable than the prior Chapter 313 program. However, the ideal course of action would have been to allow the latter to fully expire and replace it with nothing. Letting the subsidies expire entirely could help prevent avoid taxpayers’ prior experience with ISD-driven economic development programs, like windfarms which in 2009 which created only 572 jobs for a total tax benefit of \$712,376,734 which was a cost of \$1,245,413 per job created ([Greer, 2018, p. 3](#)).

The Chapter 313 program had several issues, necessitating its transition into JETI. First, under the program known as Payments in Lieu of Taxes (or PILOT), most Chapter 313 agreements with school districts required projects to supplement the loss of

Renewable energy accounted for more than 50% of the projects benefitting from Chapter 313 abatements in 2019, while contributing to fewer than 10% of the total jobs created that year by those same projects.

tax revenue ([Texas Taxpayers and Research Association, 2021](#)). Critics claimed that allowing businesses to make direct payments to schools “caused an inequality in school funding” ([Rubin, 2024, para. 6](#)). Abatements under Chapter 313 were also disproportionately granted to renewable energy firms, yielding very little by way of return. Renewable energy accounted for more than 50% of the projects benefitting from Chapter 313 abatements in 2019, while contributing to fewer than 10% of the total jobs created that year by those same projects ([Fields, 2019, p. 6](#)). Furthermore, “most if not all the renewable energy projects” in the Chapter 313 program were granted job requirement waivers ([Elkins & Grubbs, 2024](#)). This means that school districts’ stated purpose for engaging in economic development activities—being job creation—did not even occur. The shortcomings, once highlighted, led to the overhaul in 2023 regarding how projects are awarded school district property tax abatement through the new JETI program.

TIRZ

Local governmental entities have another economic development tool available in the form of Tax Increment Reinvestment Zones (TIRZs), which are governed by Chapter 311 of the Texas Tax Code ([Tex. Tax Code, Chapter 311](#)). In theory, a city or county creates a TIRZ to redevelop a blighted or depressed area. An area is considered to be blighted or depressed if it has a substantial number of substandard, slum, deteriorated, or deteriorating structures; if there is a faulty lot layout in relation to size, adequacy, accessibility, or usefulness; or if there exist conditions that endanger life or property by fire or another cause ([City of Houston, n.d.](#)). Once a TIRZ has been established,

“property taxes generated in the district are frozen as the baseline level of revenue. These baseline revenues continue to fund local government services over the life of the district” ([Mathew, 2017, p. 2](#)). A county may by order create a geographically contiguous area within its boundary and designate it as a TIRZ, while a municipality may by ordinance create a geographically contiguous or non-contiguous TIRZ inside its corporate border or in its extraterritorial jurisdiction ([Comptroller, n.d.-b](#)). To meet the requirement needed to be designated as a TIRZ, an area must not just be underdeveloped but be a detriment to the economic growth of the county or municipality. Unfortunately, local governmental entities have often taken advantage of the loose criteria to designate an area as a TIRZ, even though the area may not meet all the criteria. For example, in Houston, middle-class neighborhoods and downtown areas have been designated as TIRZs so that the city can take advantage of the fact that “TIRZ revenue is exempted from the property tax revenue cap” ([Mathew, n.d., p. 1](#)). In addition, a TIRZ that outlives its original purpose may trap tax revenue within its corporate boundaries, thereby preventing money from going to necessary city services funded by all residents.

Economic Development Corporations

While some government-directed economic development programs utilize tax abatements or valuation limits to lure new businesses and expand existing facilities, Economic Development Corporations (EDCs) derive their revenue directly from taxpayers and have a great deal of discretion in how they operate. When the Texas Constitution was amended to allow the use of public funds to finance economic development projects, EDCs began to utilize sales tax revenues to finance their development projects. EDCs are split into two categories based on the types of projects they undertake. A Type A EDC project is used for “manufacturing and industrial development” ([Comptroller, n.d.-c](#)). Cities located in a county with a population of less than 500,000 are able to levy a Type A tax, so long as the “new combined local sales tax rate would not exceed 2 percent” ([Comptroller, n.d.-c](#)). Cities in counties that have a popula-

tion of 500,000 or more may also levy Type A taxes (Comptroller, n.d.-c). Type B EDCs can include “sports and athletic facilities, tourism and entertainment facilities, convention facilities and public parks; related street, water and sewer facilities; and affordable housing” (Comptroller, n.d.-c). All cities are eligible to levy a Type B sales tax so long as it does not cause the total local sales tax rate to exceed 2%. Type B taxes may also be used for projects eligible under Type A, along with “quality of life improvement” projects (Comptroller, n.d.-c).

Considering the Research

The central argument for keeping these tax incentives in place is that businesses choosing to locate or incorporate in Texas would stimulate the state’s economy by creating jobs, increasing commerce, and adding to the tax base. Supporters of tax incentives also say that if cities, counties, and state governments lose the ability to incentivize businesses, then businesses will leave Texas. Theoretically, businesses pay close attention to the amount of property taxes that they would have to pay wherever they decide to locate, as property taxes play a significant role in how businesses calculate prospective costs and returns. Because states have different tax codes, some place a higher burden on businesses than others, so having lower taxes would make a state or region more appealing to businesses who are deciding where to invest.

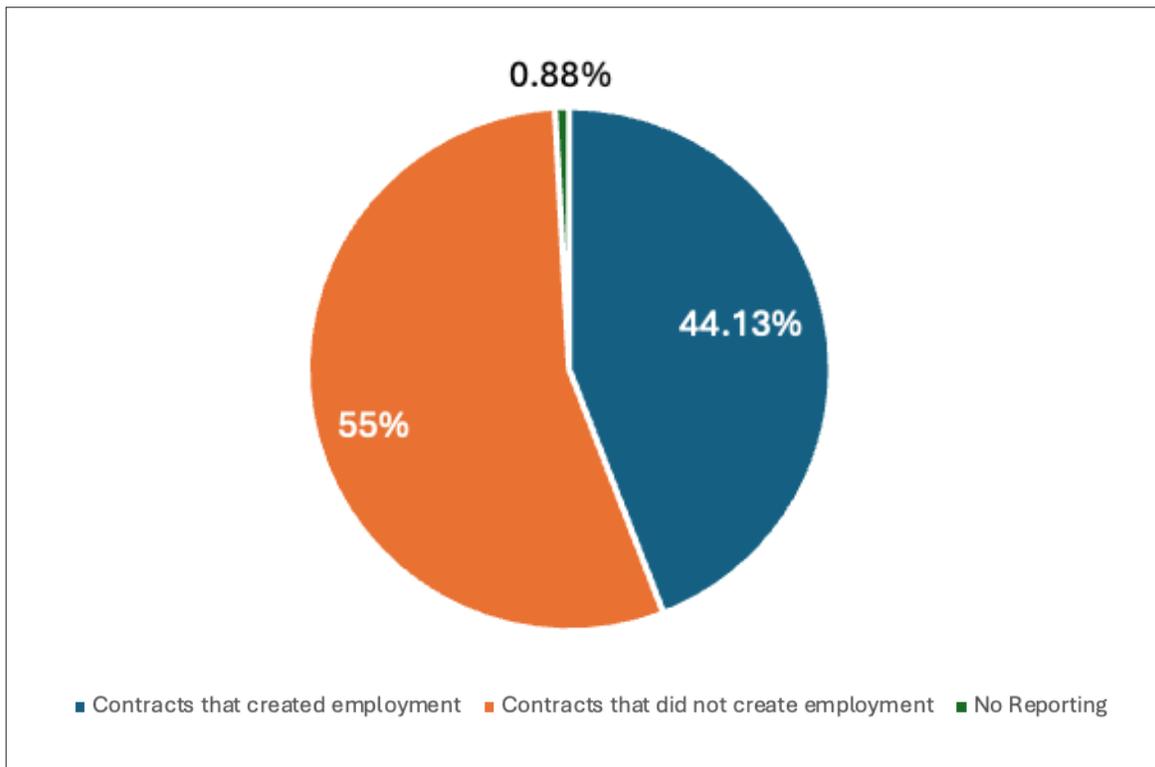
However, as is often the case, the reality does not match the theory. An article published in the Upjohn Institute for Employment Research in 2018 surveyed 34 studies that measured the effect that tax incentives had as the deciding factor for businesses in choosing a location for a project. The research found that across the country “typical incentives probably tip somewhere between 2 percent and 25 percent of incented firms toward making a decision favoring the location providing the incentive” (Bartik, 2018). To put this data another way, between 75% and 98% of companies would have chosen a particular location regardless of the incentives granted to them.

Government incentives also tend to favor large corporations at the expense of small businesses. According to a 2020 study, “more than 30% of all establishments with over 1,000 employees receive discretionary subsidies, while the percentage is less than 0.2% for establishments with under 250 employees” (Bartik, 2020, p. 95). Choosing to incentivize certain businesses over others has a negative effect on business startups. A study by Partridge et al. (cited by Bartik) found that “increases in incentives over a 3-year period are associated with decreases in overall start-up activity” (Bartik, 2020, p. 98). Because smaller businesses have less political and financial capital than larger businesses, it is more difficult for them to make appeals for incentives, so they are often left out of the conversation in favor of better-equipped and better-connected businesses.

If tax incentives have a negligible impact on where businesses choose to locate, are skewed towards larger companies, and decrease overall start-up activity, then do these incentives at least create jobs? Not really. A study in 2020 found that “overall, property tax abatement incentives were not associated with employment changes at the state level” (Leonard et al., 2020, p. 217). The method used by Leonard et al. to determine the effects of tax incentives on employment at the state and city level was examined, employment for each industry located in a city. Property tax abatement was used as the “primary variable of interest” along with controls for taxes and other economic incentives (Leonard et al., 2017). Cities with newly adopted tax abatements do see an increase in employment—but only in the first few years of the agreement. Over time, the effects of the tax abatements are diminished on the city level because the competition between jurisdictions teaches cities to use their own abatements, thus minimizing their overall effect (Leonard et al., 2017, p. 212). Further reviews of the research on this subject demonstrate that abatements are typically used as a reactionary measure after other jurisdictions use them, or are used as talking points by politicians who want voters to know that they care about creating job opportunities (Bartik, 2020).

Figure 1

Chapter 311/312 Job Creation



Note: Data from *Chapter 312 Abatement Reports*, by Glenn Hagar Texas Comptroller of Public Accounts, n.d. <https://comptroller.texas.gov/economy/development/search-tools/ch312/abatements-simple.php> and author's calculations.

THE NEED FOR REFORM

Property taxes burden every Texan. According to a 2024 analysis of U.S. Census Bureau data on property taxes, Texans pay the seventh highest property taxes out of all 50 states (Kiernan, 2024). Abating taxes on businesses merely shifts the tax burden from the business to individuals. Close examination of incentives show that there is no statistically significant effect on the state, and that the effectiveness for cities wanes over time as “competition among jurisdictions may drive away any long-term benefits of these policies” (Leornard et al., 2020, p. 219). Furthermore, data from the Texas Comptroller shows that less than half of active Chapter 311/312 investment zones and tax abatement agreements fail to create jobs.

Tax abatement as incentive for economic development is not only unnecessary but can also be harmful to taxpayers. Because optics are so important in politics, elected officials do not want to be seen as being responsible for losing out on jobs in their district. Businesses understand this and often use the threat of leaving a city to receive incentives to stay. In early October of 2014, CST Brands, which operates the Valero chain of convenience stores, openly considered moving from San Antonio to Schertz a few miles outside of San Antonio. Officials were so worried about losing jobs that San Antonio and Bexar County approved over \$2 million in incentives (Fields, 2014).

Unlike when the free market creates healthy competition between businesses, government inter-

ference with the market has produced intrastate competition between cities, in turn costing taxpayers unnecessarily. In 2006, the City of Corsicana entered into a tax abatement agreement with Home Depot to build a distribution center, which was estimated to create 250 jobs. In 2011, the City of Dallas entered into a tax abatement agreement with Home Depot for the distribution center as well, and because Dallas was able to offer greater incentives, Home Depot moved its operations out of Corsicana. This led to the loss of potential jobs and the benefits that come with new revenue. Ultimately the two cities were pit against each other in a lawsuit between all at the expense of the taxpayer (Fields, 2014).

Cities will often justify creating investment zones and entering into tax abatement agreements as a way to create employment. However, these incentives and agreements do not necessarily result in job creation; in fact, often agreements and incentives did not lead to the creation of new employment. As represented in **Figure 1**, of the 800 active 312 agreements, 440 of them (55%) reported no jobs created; 353 (44.13%) reported job creation; and seven agreements (less than 1%) did not report at all.

A number of these economic development tools have little or no mechanisms to hold governments and businesses accountable if either party does not fulfill the expectations of the economic development project. There are plentiful policy prescriptions that can help these economic development tools be more transparent and can strengthen the ability for districts to claw back some of the money invested in the incented project. Additionally, adopting policies that would eliminate a significant amount—if not all—of property taxes across the state would be the best move for Texas, as it would do away with needing to meddle with and constantly reform tax abatements.

POLICY RECOMMENDATIONS

The first method of fixing Texas economic policy is to eliminate government-run economic development programs altogether. As this research has shown, Texas' economic development programs are ineffective and deviate from the principle of the laissez-faire approach to the market. Many of these agreements have sunset clauses, which set expiration dates on these projects (unless reauthorized), and these economic development programs could be as simple as allowing the agreements to expire without reauthorizing them. Repealing or revising Article III, Section 52a, of the Texas Constitution would limit the authority of the state or local governments to direct economic development. This would require a statewide ballot and would place the decision to change this policy in the hands of Texas voters.

If the political will to subject Texas' economic development programs to sunset is found lacking and these mechanisms do remain in place, there are smaller changes that can be made. Economic development projects should at least be reformed to address the lack of transparency that surrounds the abatement process. Currently, there are exceptions that allow meetings to be confidential under the guise of protecting proprietary information. This information is considered privileged and cannot be made available to the public. In this instance, the Texas Legislature can make a statutory change to Section 551.087 of the Texas Government Code to eliminate this exception. This section presently states that a governmental body is not required to conduct an open meeting

- (1) to discuss or deliberate regarding commercial or financial information that the governmental body has received from a business prospect that the governmental body seeks to have locate, stay, or expand in or near the territory of the governmental body and with which the governmental body is conducting economic development negotiations; or

(2) to deliberate the offer of a financial or other incentive to a business prospect described by Subdivision. ([Texas Government Code, Section 551.087](#))

Another section of the Texas Government Code that keeps citizens in the dark on economic development agreements is Section 552.131. This section is titled “Exception: Confidentiality of Certain Economic Development Information.” According to this section, the exception pertains to information that is

- (1) a trade secret of the business prospect; or
 - (2) commercial or financial information for which it is demonstrated based on specific factual evidence that disclosure would cause substantial competitive harm to the person from whom the information was obtained.
- (b) Unless and until an agreement is made with the business prospect, information about a financial or other incentive being offered to the business prospect by the governmental body or by another person is excepted from the requirements of Section 552.021. ([Texas Government Code, Section 552.131](#))

Eliminating Sections 551.087 and 552.131 would improve transparency in economic development agreements, in turn allowing citizens to act with all the information available instead of being left in the dark while the government negotiates with their tax dollars behind closed doors.

In addition to making the economic development agreement process more transparent, there should be a way to hold businesses and governments accountable for failing to live up to the conditions of their agreements. One method of accountability is the clawback mechanism. A clawback is a provision in an agreement wherein the municipality retains the right to seek damages in the form of the amount of taxes abated or money granted to a business that fails to meet its agreed targets for economic devel-

School district M&O taxes constitute “roughly half of the overall bill” when it comes to local property taxes, so targeting this portion of the property tax bill would provide a great deal of tax relief for every person or business that pays property taxes.

opment, like job creation, increased wages, or improvements made to the area. Clawback provisions should be mandatory in economic development agreements, in addition to being clearly defined and accurately reported in order to help prevent taxpayer money from being wasted on projects that are not producing a return on investment.

Instead of having to strengthen a few mechanisms surrounding policies that have a dubious net positive effect, a more holistic and ambitious approach could benefit every taxpayer across Texas and out-of-state corporations looking to relocate. This approach is one that would put Texas on the path to eliminate property taxes entirely. Because of the common-sense fiscal restraints built into the Texas Constitution and enshrined in state law, Texas has produced record budget surpluses. For example, when the legislature sets the budget for the biennium, they are limited to spend only what it estimates it will receive in revenue prohibiting a deficit to be carried into the following year ([Tex. Const. Article 3, Section 49](#)). Using a majority of the budget surplus, Texas could buy down the school district maintenance and operations (M&O) rate. School district M&O taxes constitute “roughly half of the overall bill” when it comes to local property taxes, so targeting this portion of the property tax bill would provide a great deal of tax relief for every person or business that pays property taxes ([Quintero, 2023](#)). Lowering taxes statewide equally would allow for free market competition to flourish, and in turn would make Texas more attractive to a wider range of projects—without having to rely on agreements made without public hearings or using tax dollars on

a venture that is not guaranteed to produce positive outcomes for the taxpayer.

Using incentives to develop the Texas economy is not a sound means of attracting business. These incentives do little to tip the decision of where a company would locate to start a project. Oftentimes, abatements are granted without a clear, long-term strategy and are turned to as a reactionary measure against neighboring municipalities. Essentially, this means that cities and counties enact economic incentives as a way to stay economically competitive with neighboring municipalities, as opposed to these incentives being part of a grand economic strate-

gy. This intrastate competition erodes the usefulness of the abatements over time. The key to the Texas Model is to create a business-friendly environment while keeping taxes low, and not just simply shifting the burden from businesses to individuals and families. The advantage that Texas has over other states—and the cornerstone of the Texas miracle—is the vast landscape of our state and access to the Texan workforce. Governments are the entities least suited to deciding which businesses will flourish and which will fail. Texas will be more economically successful by taking these decisions out of the hands of politicians and placing them back in the hands of consumers. ■

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ABOUT THE AUTHOR



John Bonura is a Policy Analyst for the Taxpayer Protection Project with Texas Public Policy Foundation.

Prior to joining TPPF John served in the University system as a Graduate Assistant until he was given the opportunity to teach Principles of American Government. John holds a Master of Arts in Political Science from Texas State University and a Bachelor of Arts in Political Science from Sam Houston State University.

As a proud Eagle Scout John is an avid camper and enjoys spending time in the outdoors as well as at home with his wife.

