TCCRI

Texas Conservative Coalition

Research Institute

A Review of Select Texas Economic Incentives

Policy Whitepaper

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Introduction

A superior economic development policy rests on a foundation of low, broad, transparent and easily-compiled taxes. Grounding economic development on these principles is especially necessary with increasing economic competition among the states. Other states are beginning to follow the Texas model, enacting policies that make them more competitive and attractive to business. Wisconsin enacted collective bargaining reform; Michigan is now a right-to-work state, as is Indiana. Pennsylvania has pursued development of the Marcellus Shale. Kansas and Louisiana are considering the elimination of their personal income taxes, with Louisiana also considering the elimination of their corporate tax. This is a positive development in an otherwise dreary fiscal and economic climate:

> State competition for jobs should be a good thing that promotes fiscal stability, low tax rates, dynamic labor markets, balanced regulatory environments and responsible investment in infrastructure and human capital. These—and not one-time tax breaks—are the factors that are most likely to attract employers and drive good jobs policy.[i]

As a general matter, lower taxation promotes economic growth, and so a growth-minded government should always implement low taxes on a broad base of taxpayers. Governments may also choose to incentivize or dis-incentivize specific behaviors with a targeted tax policy. It is axiomatic that whereas an increase in taxation tends to discourage the behavior taxed, a decrease in taxation or, still more, the provision of government resources as by grant or subsidy, will tend to encourage the behavior in question. Governments may incentivize behavior in this manner for a variety of reasons, including to increase employment through higher economic growth, and to attract capital investment.

There are inherent dangers in government assigning itself such a role. Typically, the free market will encourage growth-oriented behavior, and the heavy hand of government interference rarely, if ever, tips the scales in a positive manner. There is a danger to "corporate welfare," both fiscally and politically, and many subsidy, grant, or incentive programs have failed. That is especially true at the federal level, most notably -- but hardly exclusively -- through the $535 million Department of Energy loan guarantee that funded Solyndra. An article by the Heritage Foundation puts many of these programs in perspective:

> [S]ubsidies change the behavior of businesses. An economist once quipped: "I don't know whether the government is better at picking winners rather than losers, but I do know that losers are good at picking governments." When the government starts handing out money, businesses with weak ideas get in line because the businesses with the good ideas can get private funding. Enron, for example, was able to grab huge federal support for its disastrous foreign investment schemes.

Because of these well-reported troubles, the public has a very negative view of subsidy programs. In a survey of likely general election voters commissioned by TCCRI in late October 2012, a strong sixty-eight percent majority expressed support for eliminating business subsidies. With rare exceptions, this point of view was consistent across disparate ideological, regional and ethnic demographics.

The best economic incentive is a system of low taxes, minimal regulation, and small government. However, all states – including Texas – have, to one degree or another, instituted highly targeted economic incentives. Because of this, informed entities doing business in Texas (or considering such) will consider the incentives provided not only by this state, but by other states and foreign countries, and choose to operate where the greatest advantage exists. Furthermore, since states will continue to amend their policies to increase their competitiveness, constant review is necessary to ensure that Texas incentives remain effective or should be abolished otherwise.

Criteria for Review

The purpose of this paper is to review six of the most prominent economic incentives that Texas has created in statute. This represents only a portion of the whole number, of which the Texas Taxpayers and Research Association ("TTARA") in September 2011 found sixty-six (a situation worthy of a separate discussion). Each of the programs reviewed here will be considered by noting the original intent of the program, and the extent to which this intent has been realized. Where possible, this will include the consideration of the cost of each program to the state, and the benefit produced, as by jobs created or capital investment generated.

The Connecticut Policy Institute has identified three useful criteria for determining the relative success of business incentive programs:

- Does the total cost of the incentive exceed the amount that would be paid back through incremental tax revenues over 10 years?
- Do the incentives provide only for jobs that would not otherwise come to the state, or would otherwise leave?
- Do the incentives promote jobs that will remain viable and stay in-state after the incentives expire?

Under these criteria, most of the programs reviewed here have had a positive impact, but all could be improved for greater effect and less waste. Carefully considering which policies have achieved their purpose and which have not, Texas' incentive package can be adjusted to ensure that the maximum amount of investment and jobs can be attracted to the state for the lowest cost.

In addition, many of Texas' economic incentives could be improved by additional auditing, data gathering and reporting. This is particularly true given that the granting of government incentives sometimes creates the image of unfair advantage provided to politically-connected entities. This criticism has been raised especially with regard to certain programs discussed infra. To a large extent, the media has overstated this problem, although putting these targeted favors in the hands of government officials will always create some risk that winners and losers will be chosen inappropriately. The best counter to these charges is to increase the transparency of the various incentives with an increase in reporting and/or auditing. An additional benefit of such review is that the provision of more comprehensive economic data will allow state policymakers to more finely tune each incentive to accomplish its desired goal.

Of the programs considered:

* The best job promoter is the Texas Enterprise Zones Act, with one job created or retained for every $649 in state tax refunds. It is also the best program at attracting capital investment, having attracted $1,000 in capital investment for every $5.82 in state tax credit.

* The most inefficient job creator has been the Texas Economic Development Act, Chapter 313, with only one job produced for every $306,086 in tax revenue lost with qualifying renewable energy projects being the worst of all. As measured in 2009, wind farms had only created 572 jobs for an estimated total gross tax benefit of $712,376,734 through the length of the agreements – that is, a $1,245,413 cost to the state per job created.

* The least effective at attracting capital investment has been the Texas Moving Images Incentive, with $1,000 of spending in Texas for every $117 of grant money. In addition, the Moving Images Incentive has been the poorest at attracting jobs that remain viable and long term, due to the mobile and temporary nature of the industry.

* The program most lacking in transparency and adequate reporting is the Freeport Exemption, which does not track jobs or capital investments associated with the exemptions granted.

I. Texas Economic Development Act: Chapter 313

In 2001, the Texas Legislature passed the Texas Economic Development Act, which was subsequently written into law as Chapter 313 of the Tax Code. This legislation allows a school district's board of trustees to attract investment and jobs by offering a tax credit and an eight-year limitation on the appraised value of a property for the maintenance and operation portion of the school district property tax. The property in question must be devoted to manufacturing or to various renewable energy resources. Unless waived by the school district, the project in question must create a minimum number of new jobs.

Property owners must submit a biennial progress report to the school district, which is then forwarded to the Comptroller of Public Accounts (CPA) and used to compile a report assessing the progress of all agreements. School districts must also submit a biennial report to the Comptroller's Office detailing the property value and tax data for each agreement. Chapter 313 includes a sunset date of December 31, 2014, ensuring that the policy will be subject to periodic review.

Based on a 2010 report to the Legislature, the Comptroller's Office determined that Chapter 313 has generated 6,239 qualifying jobs, and $47,327,208,274 in estimated capital investment. The cost to the state consisted of an estimated total gross tax benefit to recipient companies through limitation and tax credit of $1,909,723,490. Based on these numbers, the Chapter 313 program has cost the state $40.35 of limitation and tax credit for every $1,000 of estimated capital investment for the life of the active projects.

As applied, Chapter 313 must be understood as a generator of capital investment, not as an effective job creator. In fact, since 2007, more than sixty percent of projects have waived the minimum job requirement. Indeed, for every job committed to in the original application for active projects as of 2010, the state lost $306,086 of limitation and tax credit. As noted in the introduction to *Report of the Texas Economic Development Act (January 2013)*, "while the program continues to succeed in attracting large scale capital investment, projects are committing to fewer new, high-paying jobs in their Chapter 313 contracts." Illustratively, the cost per job to the state for jobs created under Chapter 313 agreements is approximately forty times higher than the cost per job for the Texas Enterprise Fund.

Arguably, Chapter 313 attracts investment to the state that otherwise would locate elsewhere. According to TTARA, the biggest tax paid by the business community is the property tax—levied by 1,024 independent school districts, 254 counties, over 1,000 cities, and more than 1,600 special purpose taxing units throughout the state. Approximately fifty-five percent of all these property taxes are assessed by school districts.

Because of Texas's heavy reliance on property taxes, capital-intensive industries like transportation, manufacturing, and petroleum extraction account for roughly sixty-eight percent of all business taxes paid, yet account for only twenty-eight percent of the state's private sector employment.[1]

After the ability of school districts to offer tax abatements was repealed in the mid-1990's, Texas fell from the nation's top industrial location in 1996, as ranked by Site Selection Magazine, to 37th in 2000 (whether the decrease was *caused by* the repeal is debatable). Over those years, Texas lost twelve major facilities to other states (underscoring the significant adverse consequences of ad valorem taxation). Thus, until the property tax is significantly changed (revenue caps; lower appraisal caps applied to all real property) and/or substituted for consumption taxes, the tax abatements that school districts are authorized to offer under Chapter 313 are vital for attracting manufacturing plants and other capital intensive business operations to the state. Nevertheless, something has gone badly amiss when a job-creation incentive produces only one job for every $306,086 in tax revenue lost. Chapter 313 was passed as an economic development tool to provide property tax benefits in return for large scale investments and new, high-paying jobs, but it is increasingly used to incentivize projects that create few or no jobs.

> **Recommendation:** To ensure greater job creation, Chapter 313 should be amended so that school districts cannot waive the minimum job requirement.

An endemic problem with Chapter 313 is that the incentive of school districts to enter into agreements will not always be aligned with the legislature's interests. Each limitation agreement must include a provision that project owners will make up any school district revenue shortfalls out of their tax benefits. Many agreements also provide for additional amounts termed "payments in lieu of taxes." These supplemental payments are paid outside the school funding formula, and incentivize the districts to enter into agreements that may not be beneficial to the state: In some cases supplemental payments are as much as forty percent of the overall tax benefit. These excess payments have cost an estimated $457 million over the life of the various agreements, according to information provided to the Comptroller's Office by the districts. Although education is generally perceived to be a local issue, a certain level of state involvement is warranted when school districts are effectively spending against revenue remitted to the state.

> **Recommendation:** To discourage the school districts from entering into Chapter 313 agreements that are not beneficial to the state, amend state law so that the supplemental payments by companies to school districts are prohibited.

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1 The argument for significant property tax reduction and reform is made in a recent TCCRI report "Be Bold Texas" (2013).

An unintended consequence of Chapter 313 has been its tremendous utility to renewable energy generally and wind farms in particular. Renewable energy represents only eight percent of job commitment and 27.6 percent of committed investment under the incentive, but represents fully thirty-seven percent of gross tax benefits. Of the projects that have waived the job creation requirement since waiver was authorized, eighty-seven percent have been in the renewable energy industry.

Wind farms have been an especially poor job creator. As measured in 2009, wind farms had only created 572 jobs for an estimated total gross tax benefit of $712,376,734 through the length of the agreements – that is, a $1,245,413 cost to the state per job created. In addition, the rate of supplemental payments by renewable energy projects generally has been twice that of manufacturing projects. Chapter 313 is thus increasingly an instrument of social policy in favor of renewable energy, in a deviation from its original purpose to encourage manufacturing investment and bring jobs to Texas.

In removing Chapter 313's applicability to the renewable energies industry, TCCRI recommends careful consideration of all existing state renewable energy requirements. For example, by act of the Legislature in 2005, the Public Utility Commission was mandated to increase the renewable energy used to meet the state's electric needs, which it has done by designating five Competitive Renewal Energy Zones ("CREZ") for the generation of wind power, and defining the required transmission upgrades to deliver wind generated energy to Texas consumers. The interaction between state-mandated renewable projects like the CREZ's and Chapter 313 tax abatements must be considered to ensure that Texas can meet or appropriately revise its extant commitments.

> **Recommendation:** Chapter 313 should be retooled by amending current law so that renewable energy projects do not qualify, as they are already heavily subsidized through other means, including the federal income tax code, most notably the Production Tax Credit.

II. Texas Enterprise Fund

The Texas Enterprise Fund ("TEF" or "the Fund") was created in 2003 and is funded by state budget allocation. It is considered to be a "deal closing" incentive and is used in combination with other incentives to attract businesses to the state and to encourage existing businesses to expand their Texas presence. The applicants submit a request to the Economic Development Office of the Governor, and the Governor negotiates the grant with the applicant. The Governor, Lieutenant Governor, and Speaker of the Texas House must unanimously agree for a grant to be extended.

In addition, the TEF grants are monitored and enforced. The Fund employs clawback provisions so that money is returned to the state if the recipient fails to meet the benchmarks the contract requires. It is also flexible in that it receives contracts on a rolling basis. The program has been a success in attracting jobs and investment to the state, but has been erroneously criticized for a perception of improper influence.

As of August 31, 2010, the TEF has generated the commitment of 54,259 Texas jobs, and attracted the commitment of $14,614,082,727 in capital investment. All of this has been achieved for a total state grant expenditure of $411,669,196. This means that the TEF has achieved one job committed for every $7,587 spent, and $1,000 in capital investment committed for every $28.17 awarded. As noted previously, on a cost-per-job basis, the TEF is forty times more effective than Chapter 313 agreements. The TEF, then, has succeeded in its intended purpose of bringing jobs and investment to Texas for a low cost to the state.

The unfortunate flip-side of this economic success story has been the sharp criticism that the TEF has received by groups that see it as an agent of undue political influence leading to favors for campaign donors. The *Texas Observer*, a decidedly leftist publication, has reported that a combined $174.2 million of TEF dollars was awarded to companies and executives that gave campaign donations totaling $2.2 million to Governor Perry or to the Republican Governors Association.

This criticism is jaundiced. Those corporations which are politically connected are most likely to be aware of and take advantage of incentives like the TEF; furthermore, most large corporations, including some which have received TEF funds, donate to politicians of both parties. For example, according to the Center for Political Accountability, from 2002-2011, Caterpillar, Inc., gave $75,000 to the Republican Governors Association but also gave $20,000 to the Democratic Governors Association. Similarly, according to ABC News, the U.S. subsidiary of Toyota donated $50,400 to the Democratic Governors Association in November and December of 2009, but also gave $50,000 to the Republican Governors Association in April and November of 2009.

Furthermore, the economic success of the TEF indicates that the Fund has led to real growth rather than greasing palms, as the gross mischaracterization of some criticism suggests. Nevertheless, in tarnishing the image of a proven program, this criticism has made the TEF less popular with the passage of time.

Recommendation: The Texas Enterprise Fund should increase reporting to combat the perception that the process is opaque. In addition to the biennial report that the Governor's office completes, state law should require the TEF to prepare quarterly reports summarizing new and amended contracts, and TEF should be subject to regular audits by SAO.

III. Texas Enterprise Zones

In 1993, The Texas Enterprise Zone Act created the opportunity for areas characterized by acute distress to encourage private investments by removing regulatory barriers and providing tax incentives and economic benefits. (Eligible counties must be those (A) that have a poverty rate above 15.4 percent; (B) in which at least 25.4 percent of the adult population does not hold a high school diploma or high school equivalency certificate; and (C) have an unemployment rate that has remained above 4.9 percent during the preceding five years.) However, projects may actually be located either inside or outside of an Enterprise Zone characterized by acute distress. If located within a Zone, the company commits that at least twenty-five percent of their new employees will either be economically-disadvantaged or Enterprise Zone residents; if located outside a zone, thirty-five percent of new employees must meet these criteria. These projects may apply for state sales and use tax refunds on purchases made for use at the qualified business site. The project's expenditures and employment records are then audited by the Comptroller's Office.

In fiscal years 2008 and 2009, the Enterprise Zone program generated 51,761 associated jobs, consisting of 13,068 new jobs committed and 38,693 jobs retained. This is in fact the only incentive geared toward job retention. In addition, the program attracted $5.77 billion in capital investment. The cost to the state – the gross tax benefit received by the companies through tax refunds – was only $33.6 million. Accordingly, the Enterprise Zone projects have attracted $1,000 in capital investment for every $5.82 in state tax credit, and have created or retained one job for every $649 in state tax refunds. For both job creation and capital investment, this is by far the most efficient incentive considered in this report. One flaw in the current reporting is that performance is reported in the aggregate, rendering individual performance impossible to determine.

> **Recommendation:** To increase transparency and ensure effective use of the program, the state, working with local authorities where necessary, should be required to compile data on the individual performance of each Enterprise Zone project.

Due to the high number of applicants and limited number of projects authorized, the Comptroller's Office in 2010 estimated that all designations would be met by the second fiscal quarter of 2011. This means that companies seeking the advantages of the Enterprise Zone in the last two quarters of the biennium would be without recourse, whatever their merits.

> **Recommendation:** Consider amending state law to allocate Enterprise Zone designations annually or semi-annually, rather than biennially, to reduce the period in which designations are unavailable.

The Texas Economic Development Bank may only authorize 105 enterprise projects during a given biennium. This small number of designees increases the program's competitiveness and limits the state's potential cost. However, given the tremendous success of the program in generating both jobs and investment for a very limited contribution of taxpayer resources, the Enterprise Zones program should be expanded to a larger number of projects [and should be reflected in state law generally for all companies]. Even if the expanded program were only half as efficient, it would still rate among the most cost-effective incentives.

Recommendation: Amend state law to double the biennial allocation of Enterprise Zone projects from 105 to 210.

IV. Texas Moving Images Industry Incentive Program

In 2005, the Texas Legislature created the Film Industry Incentive Program, which was amended in 2007 to include the entire Moving Images Industry. This incentive supports the production of films, commercials, TV programs, and video games, with grants to producers based on eligible expenditures within Texas. The program is intended to boost economic activity and create Moving-Images-related employment in-state. Initially, the incentive was funded by gifts, grants, and other donations received by the Texas Film Commission ("TFC"), but since 2007, the Legislature has also appropriated funds specifically for the program.

In the period of April 23, 2009 to August 31, 2010, the TFC approved a total of $48,367,343 in grants under the program. In the same period, the applicants receiving grants committed to spending $414.9 million within Texas, and generated an estimated 3,790 full-time equivalent ("FTE") jobs, and thousands more part time jobs. The applicants thus committed to $1,000 of spending in Texas for every $117 of grant money, and the average FTE job was created for a grant expenditure of $12,762. The incentive, then, is an efficient encouragement of investment and a relatively successful generator of FTE jobs.

The Comptroller's Office noted in a 2010 report that the information reported by the TFC is not reported by fiscal year or calendar year, making it more difficult to compile data on a regular basis. The Texas Film Commission now states that it reports relevant information on a fiscal biennial basis. Accurate and timely information is vital to the state government in continuing to adjust the incentive in a highly-competitive and quickly-changing interstate market. The TFC's reporting on the basis of a fiscal year or biennium should be written into statute.

> **Recommendation:** Statutorily require the Texas Film Commission to standardize its Moving Industry Incentive reporting methods and report relevant information on a regular basis.

For better or worse, the Moving Images Industry is highly mobile. Bringing the Moving Images Industry to Texas, as well as the requirement of the incentive program that applicants show Texas in a positive light, creates intangible benefits to the state that are hard to quantify but that have some impact by promoting the state's image nationally and internationally. However, most of the jobs created will tend to be temporary or part time, and at the end of production most full-time employees will generally relocate out of state.

Over time, Texas is building up its own Moving Images infrastructure, particularly in Austin and the Dallas-Fort Worth area, which should create an anchor drawing more investment to the state. For example, TNT's production of "Dallas" has employed between 150 and 200 crew members and spent up to $20 million in Texas. A program like "Dallas" creates relatively stable local FTE jobs, builds up the Texas film infrastructure, and increases the state's attractiveness for future production.

Where Texas is being used only as a filming location, however, and little or no permanent local infrastructure is being built or FTE jobs created, the Legislature should consider ending its subsidy of the industry, especially since all economic development incentives should be geared to permanent job creation or retention.

Recommendation: Repeal the incentive for motion pictures that do not contribute substantially to creating a locally-based Motion Picture infrastructure or create a substantial number of full-time, long term jobs in Texas. Instead, increase funding for software (including video game) developers who are laying long-term roots in Texas.

Not all sectors of the industry performed equally in the period measured. The video game sector, making up only nineteen percent of the grant receipts, is responsible for forty-one percent of the spending and forty-five percent of jobs created. In addition, the cost per FTE in the gaming industry was only $5,332, less even than the TEF. Unlike other Moving Images projects, the video game sector is more likely to create a permanent infrastructure with ongoing production capacity. In fact, according to Texas Film Commission Director Heather Page, Texas is now second only to California in video game production.

Similarly, the FTE's created by the sector are more likely to remain permanently employed in Texas. In truth, the business model of the video game industry more closely resembles that of its fellow software developers than that of its fellow producers of Motion Pictures in the film and television worlds. While Austin may never have the film establishment of Hollywood, it already rivals Silicon Valley as a center for high technology – with jobs and investments meant to last. A strong targeted incentive geared toward software generally, not just video games, would further boost the growth of this local industry.

Recommendation: Consider incentivizing software in Texas broadly, rather than just video game development, with an eye to promoting high-tech investment and job creation in Texas.

V. Freeport Exemption

By constitutional amendment in 1989, Texas recognized a property tax exemption for “Freeport property,” which designates tangible personal property and non-petroleum ores which are detained or warehoused in Texas for short periods of time (up to 175 days) before being transported out-of-state. Unusually, the exemption is self-enacting unless local taxing units affirmatively act to tax the property; if a taxing unit initially acts to tax but later chooses to exempt Freeport property, this type of property remains exempt forever.

In 2009, $23,038,672,674 in value was removed from local taxing units’ appraisal rolls statewide under the exemption. The tax exemption is granted by school districts, but all revenue losses are made up with state funds through the school finance system. The cost to the state is the amount of general revenue that must be paid to school districts that lose money due to the exemption. Multiplying the approximately $23 billion in dollars lost by the average of Maintenance and Operations taxes for participating school districts, the Comptroller’s Office arrives at a cost to the state of $240,339,433. This means that the Freeport exemption is by far Texas’ largest economic development incentive program in terms of total dollars.

The exact benefit to the state is harder to determine, since the program does not track jobs or capital investments associated with the exemptions granted. Furthermore, oversight and monitoring responsibilities largely lie with the County Appraisal Districts, even though the state ultimately bears the cost through the school funding formula. The Comptroller’s Office sensibly urges the Legislature to evaluate the program and creative effectiveness metrics to determine its success. Although the Freeport Exemption is commendable as general tax policy, it cannot be quantified at the present time as a specific tax incentive.

> **Recommendation:** Amend state law to establish a framework to evaluate the jobs produced and investments attracted by the Freeport Exemptions.

Although there is significant potential for waste, as a general matter of tax policy the Freeport Exemption is very sensible. It limits the danger that goods will bear double-taxation merely for the privilege of passing through Texas. The exemption attracts the shipping and storage of goods, which is truly vital for Texas with its major seaports, airports, and rivers, and its extensive international and interstate borders. It encourages business activity, and spurs job growth in such industries as shipping and warehousing. Indeed, the ability of local authorities to tax Freeport goods is unfortunate, in that it allows proactive local entities to apply double-taxation, potentially discouraging trade to the locality in question and undermining the purpose of the Exemption.

> **Recommendation:** Consider repealing the authority of local officials to affirmatively act to tax Freeport property.

According to the Select Committee on Economic Development's February 5, 2013, Interim Report to the 83rd Legislature, testimony from aerospace industry leaders indicated that the Freeport Exemption does not adequately provide for the long lead time involved in the storage and manufacture of major aerospace components. As a result, aerospace companies in Texas are often at a significant tax disadvantage when compared to other states, which has led many to consider out-of state options for the storage of inventory, thus removing jobs and investment from Texas and threatening Texas's preeminence in the aerospace industry. As the home of NASA Mission Control and the leading contender for SpaceX's proposed commercial spaceport, Texas must remain a uniquely attractive destination for aerospace investment.

> **Recommendation:** Amend state law to extend the Freeport exemption from 175 days to 365 days for aerospace companies in order to maintain Texas' competitive advantage.

Not included in the Freeport Exemption are oil, natural gas and other petroleum products. Petroleum products are defined in the Texas Constitution, Article VIII, Section 1-j, as "liquid and gaseous materials that are the immediate derivatives of the refining of oil or natural gas." A great quantity of these resources is transported through Texas, and is subject to taxation merely for passing through. The oil & gas industry is already an immensely positive contributor to the state economy. In 2011, the industry represented 15.5 percent of the Texas gross state product which is four to five times greater than the share of oil and natural gas in the nation's economy according to an industry overview published by the Comptroller's Office. Eliminating an additional impediment by extending the Freeport Exemption to fossil fuels may encourage even more petroleum to be shipped through Texas, encouraging the development of more pipelines, refineries, and other energy-related industry.

Due to an absence of current analysis, it is currently impossible to determine the jobs and investment that would be generated by expanding this exemption to oil and gas. Given the central role of Texas in the North American petroleum industry, the reduction in tax revenue could be significant – but this would be offset by the large volume of jobs and investment generated. By establishing a framework, as recommended above, to determine the effectiveness of the Freeport Exemption, it will be possible to determine with more precision the economic benefit of extending this exemption.

> **Recommendation:** Consider extending the Freeport Exemption to oil, natural gas, and other petroleum products.

VI. The Events Fund Programs

Created by the Legislature, the events fund programs encompass four separate programs. The Events Trust Fund (ETF) is one of four programs designed to encourage specific events – both sporting and non-sporting events such as conferences and conventions – to take place in Texas. Two of the others, the Major Events Trust Fund (METF) and the Motor Sports Racing Fund, are more specifically tailored to specific, very large events. The last, the Special Events Trust Fund (SETF) – whose projects are approved by the Governor, Lieutenant Governor, and Speaker - is similar to the ETF but more limited in the scope of the incentive that can be applied, and requires no local matching funds. All of the events fund programs require that the event in question have chosen a location in Texas out of a competitive process that included at least one potential location outside of Texas.

Three of the four events fund programs allow state and local taxes generated from sales and use, auto rental, hotel and alcoholic beverage taxes generated over a defined period, which varies by program, to be applied toward various costs associated with the event. These include improving, constructing, renovating, or acquiring facilities, and acquiring equipment for the event. Up to one hundred percent of the allowable expenses may be funded by the trust fund if sufficient tax receipts are deposited therein. The fourth program, the SETF, is similar, but only up to fifty percent of the costs can be funded, and with state sales taxes only. According to statute, at the conclusion of METF and ETF events, the Comptroller's Office may request publicly available information about the event; however, this has proved to be insufficient to adequately measure the event's performance.

Ideally, the events fund programs will draw out-of-state visitors and customers that would not otherwise have been brought to Texas. Unfortunately, in some instances, it is very difficult to determine exactly what benefit a given event accrues for the state. Many smaller events which may qualify for the EFT – say, the convention of a small social club – will generate such a limited quantity of additional revenue that it will hardly register in the tax accounts.

Even with a large event, the benefits can be less clear than might be anticipated. The 2010 NBA All-Star Game was held in Dallas and participated in the METF. However, there was little growth or even a *reduction* in spending on alcohol and hotels from the previous February, despite the game drawing thousands of fans to Texas. Of course, in the intervening year, the economic downturn had dramatically reduced leisure spending nationwide; but this shows that even a major event may produce a mere blip as far as aggregate revenue goes.

> **Recommendation:** Amend current statute to require events fund program sponsors to gather data on the number of attendees at participating events and the percentage of those attendees who are from out of state. Although inexact, this will aid the state in determining which events are worth incentivizing in this manner.

The policy issue that Texas faces now is that theoretically, an infinite number of events could apply and qualify for ETF status. Although this will draw tourism to the state and increase out-of-state customers, it could also artificially redirect state funds that would already have been generated, as from state sales taxes, away from general usage and toward local improvements.

> **Recommendation:** Consider changing current law to reduce the number of events, particularly small events, that may qualify for ETF status each year.

The events fund program distribution can generally only occur after the completion of the event in question, since until that time the revenue has not yet been generated by the event and deposited into the fund. There is an exception in the METF statute allowing for the prepayment of funds to events that the Comptroller's Office determines will generate at least $15 million in local revenue.

The purpose of the ETF (and the other three related programs) is to generate new revenue in Texas. However, the amount of the revenue is estimated *prior* to the event. If distribution is prevented by statute from occurring until after an event occurs, and a post-event estimate of the revenue generated is completed, the Comptroller's Office can ascertain with a higher degree of accuracy the actual revenue drawn by the event, and award funds accordingly.

> **Recommendation:** The four events fund program statutes should be amended so that monies cannot be disbursed until after the event in question occurs and an after-the-fact estimation of the revenue generated by the event is completed.

Conclusion:

Over the past decade or more, Texas has set an example of good governance to the nation. The Legislature has enacted a succession of balanced budgets without a major tax increase. The state has maintained its generally favorable regulatory climate that has encouraged business investment. Civil justice reforms have curtailed frivolous lawsuits and abated a physician shortage in the state. A willingness across the public and private sectors to extract natural resources has helped the state maintain its position as the nation's leading energy producer and employer. As a consequence of this good fiscal and economic governance, according to the Bureau of Labor Statistics, Texas' unemployment rate of 6.1 percent[ii] is the lowest of the ten most populous states and is significantly lower than the national average of 7.9 percent.[iii]

Economic development incentives have played a role in that success. However, as this brief report shows, there are strengths and weakness to each program, which argues for a combination of repeal and reform. Ultimately, the Legislature should give the highest priority to substantial, across-the-board tax reform and reduction as the best means to keep Texas the nation's jobs leader. Meanwhile, improving existing economic development programs will ensure that Texas continues to be a leader not just in jobs growth but in governance.

Summary of Recommendations

Texas has a set of economic incentives that have brought capital investment and jobs into the state at a low cost to the taxpayers. Nevertheless, there are areas in which the economic incentives reviewed in this paper could be improved for greater effectiveness. Notably, there are several cases where the state would benefit from additional reporting. This would generate better-informed policy choices, and increase the transparency of the various programs. In addition, some programs need to be more closely tailored to obtain their desired impact.

1. To ensure greater job creation, Chapter 313 should be amended so that school districts cannot waive the minimum job requirement.

2. To discourage the school districts from entering into Chapter 313 agreements that are not beneficial to the state, amend state law so that the supplemental payments by companies to school districts are prohibited.

3. Chapter 313 should be retooled by amending current law so that renewable energy projects do not qualify, as they are already heavily subsidized through other means, including the federal income tax code, most notably the Production Tax Credit.

4. The Texas Enterprise Fund should increase reporting to combat the perception that the process is opaque. In addition to the biennial report that the Governor's office completes, state law should require the TEF to prepare quarterly reports summarizing new and amended contracts, and TEF should be subject to regular audits by SAO.

5. To increase transparency and ensure effective use of the program, the state, working with local authorities where necessary, should be required to compile data on the individual performance of each Enterprise Zone project.

6. Consider amending state law to allocate Enterprise Zone designations annually or semi-annually, rather than biennially, to reduce the period in which designations are unavailable.

7. Amend state law to double the biennial allocation of Enterprise Zone projects from 105 to 210.

8. Statutorily require the Texas Film Commission to standardize its Moving Industry Incentive reporting methods and report relevant information on a regular basis.

9. Repeal the incentive for motion pictures that do not contribute substantially to creating a locally-based Motion Picture infrastructure or create a substantial number of full-time, long term jobs in Texas. Instead, increase funding for software (including video game) developers who are laying long-term roots in Texas.

10. Consider incentivizing software in Texas broadly, rather than just video game development, with an eye to promoting high-tech investment and job creation in Texas.

11. Amend state law to establish a framework to evaluate the jobs produced and investments attracted by the Freeport Exemptions.

12. Consider repealing the authority of local officials to affirmatively act to tax Freeport property.

13. Amend state law to extend the Freeport exemption from 175 days to 365 days for aerospace companies in order to maintain Texas' competitive advantage.

14. Consider extending the Freeport Exemption to oil, natural gas, and other petroleum products.

15. Amend current statute to require events fund program sponsors to gather data on the number of attendees at participating events and the percentage of those attendees who are from out of state. Although inexact, this will aid the state in determining which events are worth incentivizing in this manner.

16. Consider changing current law to reduce the number of events, particularly small events, that may qualify for ETF status each year.

17. The four events fund program statutes should be amended so that monies cannot be disbursed until after the event in question occurs and an after-the-fact estimation of the revenue generated by the event is completed.

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Applicable Texas Constitution References

Article VIII Taxation and Revenue

Section 1-j Certain Tangible Personal Property Exempt from Ad Valorem *Taxation*

Applicable Texas Government Code References:

Chapter 481 Texas Economic Development and Tourism Office

Section 481.078 Texas Enterprise Fund

Chapter 485 Music, Film, Television, and Multimedia Industries

Chapter 490 Funding for Emerging Technology

Chapter 2303 Enterprise Zones

Applicable Texas Tax Code References:

Chapter 11 Taxable Property and Exemptions

Section 11.251 Tangible Personal Property Exempt

Section 11.253 Tangible Personal Property in Transit

Section 11.437 Exemption for Cotton Stored in Warehouse

Chapter 313 Texas Economic Development Act

Applicable Texas Utilities Code References:

Chapter 39 Restructuring of Electric Utility Industry

Section 39.904 Goal for Renewable Energy

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