



# An Overview of Local Economic Development Policies in Texas

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## Key Points

- Economic development incentives benefiting individual businesses are used more than ever before in Texas.
- Negotiations between local governments and businesses are completely exempt from open meetings and open records requests.
- The widespread use of economic development incentives creates an environment in which businesses expect to receive handouts.

## Introduction

Economic growth is a win-win; low unemployment, rising incomes, and a strong local economy help everyone. It is no surprise, then, that most local policymakers want the economy to grow in their community. It is also no surprise that many think that government should play an active role in this expansion.

The desire to foster economic growth has spawned a range of local policies collectively referred to as economic development. Broadly defined, economic development simply means anything designed to improve the economy. In Texas, economic development policies generally entail targeted incentives designed to attract new businesses to within a government's taxing jurisdiction.

This paper represents the first part of a much larger discussion about the use of economic development policies by Texas' local governments. To examine the specifics of a particular policy, it is necessary to understand the entire landscape. What follows is an overview of which economic development policies are commonly used in Texas, and why their use has increased in recent years.

## Background

Modern economic development policy traces its roots in Texas to 1979, when the Legislature passed the Development Corporation Act of 1979. It allowed municipalities to create nonprofit economic development corporations to support economic growth. However, because the Texas Constitution prohibited state and local government funds from sup-

porting private business entities directly, they were privately funded.

The floodgates for local economic development really opened in 1987 when a state constitutional amendment, Proposition 4, passed allowing for expenditures related to economic development. The amendment stated that "the legislature may provide for the creation of programs and the making of loans and grants of public money ... for the public purposes of development and diversification of the economy of the state."<sup>1</sup>

Thus, governments in Texas were allowed to give public money to private interests. This included the public funding of economic development corporations and other local incentives. In 1989, Chapter 380 of the Local Government Code was passed, allowing for cities to engage in a wide variety of economic development incentives.<sup>2</sup>

Economic development policies have been incredibly popular with Texas local governments ever since. The majority of Texas cities have employed economic development policies, as have many counties and special districts. Their usage continues to grow with proponents extolling the many supposed benefits and reassuring doubters that checks and balances are in place to ensure the policies are effective.

However, the question should be asked: Why do many local governments in Texas attempt to grow the economy by providing public benefits to private businesses as Texas leads the nation in promoting free-market policies?

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## Overview of Texas' Economic Development Toolkit

Texas' local governments have a variety of economic development policies at their disposal. Economic development officials often refer to these policies as “tools” within an economic development “toolkit.”<sup>3</sup> The most common economic development tools used by Texas local governments to attract outside firms are:

- **Chapter 312 (City, County, Special District) Property Tax Abatements** — Usually employed by cities, counties, and special districts under Chapter 312 of the Tax Code, tax abatements are policies whereby a local government reduces a portion of a business prospect's property taxes over a period of up to 10 years. Only increased value above the original taxable value may be abated, and the reduction may be either a fixed or variable amount.<sup>4</sup>
- **Chapter 313 (School District) Property Tax Abatements** — Chapter 313 of the Tax Code allows for school districts to engage in the abatement of property taxes. School districts were given “the ability to attract new taxable property and create jobs through the offering of 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.”<sup>5</sup>
- **Tax Increment Financing (TIF) Districts** — TIF districts are reinvestment zones created by counties and cities that capture the tax “increment,” the increase in value within the district, over a certain period. Although this usually refers only to the property tax increment, cities are also allowed to capture a portion of increased sales tax revenues generated within the TIF if they so choose.<sup>6</sup> Each TIF has a special fund into which this increment flows, and the fund may only be spent on projects within the boundaries of the district intended to help its resident businesses.<sup>7</sup> Boards appointed by the governing body, whose primary job is to make recommendations regarding the use of the funds, oversee the districts.<sup>8</sup> TIFs are commonly created by local governments looking to redevelop an area into a distinct place with a unique identity.
- **The Economic Development Sales Tax** — The Development Corporation Act of 1979 allows cities to create economic development corporations (EDCs) whose purpose was encouraging new growth in the local economy. Before the 1987 constitutional amendment, these entities had to seek private funding. Not long after its passage, the Legislature created what are now referred to as Section 4A and Section 4B sales taxes. Essentially, these are each half-cent sales taxes intended to fund economic development activities overseen by the board of a corresponding EDC. Type A sales taxes are mostly restricted to spending for economic development purposes, whereas Type B sales taxes have much more flexibility. Cities may adopt either of these taxes or both, as long as they meet the criteria and do not exceed the 2 percent local sales tax cap.<sup>9</sup>
- **Infrastructure Projects** — Local governments can use enhanced infrastructure to incentivize development. This is an extension of the authority of local entities to construct public projects, in addition to being allowed under Chapter 380 of the Local Government Code.<sup>10</sup> Localities may choose to extend public infrastructure necessary to develop a property above and beyond a level that would normally be provided to other landowners.
- **Business Parks and Land Transfers** — Many local governments in Texas build business parks, which are large parcels of land purchased by the governing body with the intent to locate businesses there. Sometimes, land within a business park will be conveyed to a business as an economic development incentive. Chapter 272, which covers the sale and transfer of real property in Texas, usually requires a competitive bidding process for the sale of land. However, certain exceptions from the competitive bidding requirement may be applied to economic development activities. In addition, land may be given away, or sold at less than fair market value, as long as the governing body deems the purpose for doing so as in the public interest.<sup>11</sup>
- **Streamlining Development Standards, Processes and Permitting** — Cities usually have many codes that regulate the use of private property. As a result,

most have some kind of planning department to apply these regulations to development, in addition to reviewing and approving building permits and the like. A relatively simple way for cities to “sweeten the pot” for business prospects is to simply relax or even waive some of these standards. If a city has a standard turnaround time for permitting and development plan review, those processes can also be expedited as an incentive to the business.

- **Chapter 380 Economic Development** — Chapter 380 of the Local Government Code has been called the “crown jewel of incentives for local economic development” by its proponents.<sup>12</sup> The statute permits local governments to spend public money for economic development so long as the expenditure constitutes a “public purpose.”<sup>13</sup> As virtually anything can be construed a public purpose, this statute grants extremely wide latitude to localities to do essentially whatever they want in the pursuit of economic development. Even the Office of the Attorney General suggests in their Economic Development Handbook that “it is outside the scope of the opinion process to determine... whether a particular incentive or combination of incentives...” are in line with the statute.<sup>14</sup> The law would seem to be too broad to place limits on the use of incentives.

While many other policies are used for the purposes of economic development, these represent the major policy tools used by local governments in Texas.

## The Proliferation of Economic Development

The lack of public scrutiny and the competitive nature of local economic development has ensured their continued widespread use in Texas.

### *Confidential Economic Development Negotiations*

Economic development deliberations are not public information. Under Section 551.087 of the Government Code, which covers the Open Meetings Act, economic development negotiations are excluded from the public meetings requirement.<sup>15</sup> Local governments may not only consider information presented regarding a business interested in relocating, but also fully deliberate. As long as no vote is actually taken, all other aspects of the economic development negotiation process are exempt. The only thing the

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public will ever know during the process of negotiation is that economic development discussion is posted for closed session.<sup>16</sup>

The only other exemptions provided under the Open Meetings Act that apply to cities, counties, and special districts are the discussion of licensing examination results, medical records of public employees, issues relating to security, discussion of personnel matters related to public employees, donations to government bodies, deliberations regarding real property, and consultations with the governing body’s attorney. If a local government runs a hospital or public utility, competitive matters are exempt as regard those entities. Economic development, one of the few matters exempt from public meetings, enjoys special privileges not given to other routine matters of local governance.<sup>17</sup>

In addition, all information about economic development negotiations, including any and all offers made by local governments to business prospects, are completely sealed from public view at least until an agreement between the government and the business is reached.<sup>18</sup> Not even an open records request can reveal the details, or even the existence of a particular economic development negotiation. If no agreement is reached, any information about the economic development negotiations, even the fact that they ever occurred, may never be disclosed to the public. The only thing the public has the right to know is that the negotiations are ongoing, because closed session will be posted invoking the 551.087 exemption.<sup>19</sup>

The ability of local governments to conceal the proceedings of economic development negotiations effectively keeps voters from seeing any part of the decision-making

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process. Elected officials tout when a deal is worked out, proclaiming the new growth that has been created in the community thanks to the governing body's action. What is not seen by the taxpayers, of course, are the negotiations over how much of their money is spent, or what special treatment the business receives. This disconnect significantly lessens any outside scrutiny of the issue, allows elected officials to take credit for whatever jobs or investment are promised, and generally ensures that the public doesn't really know what is going on.

It should be noted that the hidden nature of economic development negotiations also benefits businesses looking to receive economic development handouts. By not having to endure a public process, these businesses avoid much of the negative perception of "crony capitalism" because no one knows the negotiations are going on until the deal is done. Even then, the deal takes a backseat to the promised number of jobs and new capital investment.

### ***The Never-Ending Cycle***

We often regard competition as a good thing, especially competition between governments. What of competition between localities in Texas using economic development incentives?

The widespread existence and use of economic development tools has the opposite effect of what is intended by its users. Rather than empowering local governments to have a hand in supercharging their local economy, it shackles those who frequently employ them by tipping the balance of power in favor of the businesses they negotiate with.<sup>20</sup>

Economic development competition among local communities tends to create even more economic development activity, as localities each aim to outdo one another. In an environment replete with economic development

activities, rent-seeking businesses have the upper hand. When looking to expand in Texas, they can generally depend upon local governments to bend in giving them development or job growth incentives. Even while following the market in choosing where to grow their business, companies know that it never hurts to ask for handouts. There is a decent chance in Texas that some locality in the vicinity of where they are expanding will give them additional perks.

As a result of the tremendous demand for economic development incentives, local governments in Texas face a difficult choice: drop out of the market for incentives and seemingly lose all that potential business growth in their community? Or forge ahead and offer ever greater levels of incentives in the battle to beat competing local governments?

According to the Texas Comptroller, the use of economic development incentives is as strong as ever. New economic development corporations continue to be created, even as many cities have maxed out on their local sales tax cap. In 1997, there were only 336 economic development corporations. In 2011 there were 697, a 105.7 percent increase over that period, with the number having increased every year.<sup>21</sup>

In addition, tax abatement agreements are also being enacted at a steady pace, and the total number of tax abatements grows every year. From 2006 to 2011, a total of 758 tax abatement agreements were entered into by local governments in Texas, an average of 126 per year.<sup>22</sup> The most used agreement period is 10 years, and as a result, a large number of these agreements are still in effect. Perhaps the most telling statistic, however, is that the size of businesses receiving abatements is getting smaller. In 2006, 14 percent of the businesses benefiting from tax abatement were classified by the Comptroller as "Micro", meaning they had 19 or fewer employees, but by 2009 that had grown to 37.7 percent.<sup>23</sup> Businesses employing fewer than 100 people made up 46.5 percent in 2006. By 2009, that had grown to 77.4 percent.<sup>24</sup>

That smaller businesses are receiving economic development agreements tells us two things. First, the number of firms who have access tax abatement agreements has

increased. Big companies have long been lured with incentives, but now businesses that are far smaller can get in on the action. Second, allowing smaller companies to reap the benefits of incentives heralds a shift away from a policy emphasis on job growth and towards capital investment.

These two trends indicate that the net of investment that economic development policies is meant to capture has grown wider and wider in just a few short years, and that the use of economic policies generally has grown. The increased competition in attracting business prospects has resulted in a much lower threshold for offering incentives. As a result, the use of economic development incentives has persisted and even grown, in spite of questionable effectiveness.

## Conclusion

The use of economic development programs is widespread in Texas, with local governments frequently offering direct incentives to outside firms to relocate. Localities and businesses alike are enticed by policies that allow for special deals to be negotiated in secret. As the popularity of these policies has grown over time, so too have the number of businesses benefiting from them, and the fierce competition that has caused more local governments to offer incentives to small firms.

The public has become increasingly wary of “crony capitalism,” and it is well past time that a serious discussion about the efficacy, transparency, and accountability of Texas local governments’ economic development policies was begun. ★

## Endnotes

- <sup>1</sup> Greg Abbott, "Economic Development 2013," Office of the Attorney General. (2013) 1.
- <sup>2</sup> Tex. Local Gov't Code § 380.001.
- <sup>3</sup> "Tools of the Trade." American Planning Association (2008).
- <sup>4</sup> Tex. Tax Code § 312.
- <sup>5</sup> Susan Combs, "An Analysis of Texas Economic Development Incentives – 2010," Office of the Texas Comptroller (2010).
- <sup>6</sup> Id. § 311.0123.
- <sup>7</sup> Id. § 311.014.
- <sup>8</sup> Id. § 311.010.
- <sup>9</sup> Greg Abbott, "Economic Development 2013," Office of the Attorney General (2013) 1-7.
- <sup>10</sup> Tex. Local Gov't Code § 380.
- <sup>11</sup> Greg Abbott, "Economic Development 2013," Office of the Attorney General (2013) 163-165.
- <sup>12</sup> Drayovitch, Debra A. "A Hitchhiker's Guide to the Galaxy of Economic Development Entry 593" Texas City Attorney's Association.
- <sup>13</sup> Riley Fletcher, "Chapter 380 of the Texas Local Government Code," Texas City Attorneys Association.
- <sup>14</sup> Greg Abbott, "Economic Development 2013," Office of the Attorney General (2013) 243.
- <sup>15</sup> Section 551.087:(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 (1).
- <sup>16</sup> Tex. Gov't Code § 551.087.
- <sup>17</sup> Greg Abbott, "Open Meetings Handbook 2014," Office of the Attorney General (2014) 41-53.
- <sup>18</sup> Tex. Gov't Code § 552.131.
- <sup>19</sup> Id. § 551.087.
- <sup>20</sup> Mark K. Cassell and Robert C. Turner. "Racing to the Bottom? The Impact of Intrastate Competition on Tax Abatement Generosity in Ohio," State and Local Government Review, Vol. 42, No. 3 (Dec. 2010).
- <sup>21</sup> Susan Combs, "Economic Development Corporation Report 2010-2011," Office of the Texas Comptroller (2010-11) 9.
- <sup>22</sup> Calculations of the author from "Biennial Reports of Reinvestment Zone for Tax Abatement Registry, Tax Abatement Agreement Registry, Tax Increment Financing Zone Registry, Refund for Economic Development," and "Biennial Registries of Reinvestment Zones for Tax Abatements and Tax Increment Financing," the 2010 and 2012 versions of the Office of the Comptroller's report on these economic development policies.
- <sup>23</sup> Susan Combs, "Biennial Reports of Reinvestment Zone for Tax Abatement Registry, Tax Abatement Agreement Registry, Tax Increment Financing Zone Registry, Refund for Economic Development," Office of the Texas Comptroller (Dec. 2010) 13.
- <sup>24</sup> Ibid.





## About the Author



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