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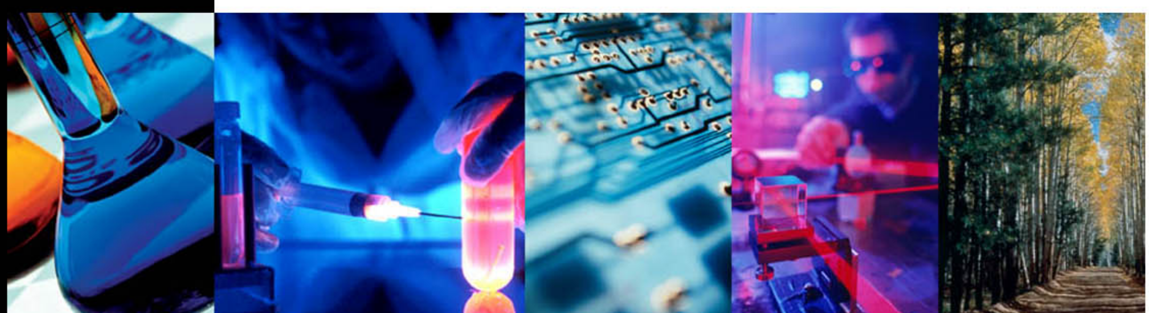

# Benchmarking Arizona Economic Development: Creating More Strategic Governance and Investment Policies

July 2005

Prepared by

Kenneth E. Poole, Ph.D.
Pofen Salem, Ph.D.
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**Peer reviewed by the Arizona Department of Commerce Economic Research Advisory Committee:**





This report was prepared for the Arizona Department of Commerce with funding from the Commerce and Economic Development Commission. Elements of this report may be presented independently elsewhere at the author's discretion. This report will be available on the Internet for an indefinite length of time at http://www.azcommerce.com. Inquiries should be directed to the Office of Economic Information and Research, Arizona Department of Commerce, (602) 771-1164.

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## Executive Summary

Arizona's economy is changing as it emerges from the economic recession that gripped the nation and churns simultaneously with continued business formations and downsizings. Numerous industries offer key opportunities for the state's future economic success, including computer software and systems; healthcare and biotechnology; industrial machinery; communication services; high-tech instruments; forest products; engineering services such as research and testing; transportation and logistics; agriculture/food processing/agricultural technology; and defense/aerospace/ avionics. [1] These technology-intensive, export-oriented industries will collectively serve to build on Arizona's existing industry base to offer opportunities for future prosperity. The challenge to state leaders is to take full advantage of those economic opportunities by ensuring that the state has critical foundations in place: investments in research and development, a world-class workforce, state-of-the-art infrastructure, a flexible capital system, and access to global markets. To build these foundations requires re-thinking the economic development institutions of the past, including those that have served Arizona well.

The purpose of this study is to examine the role and efforts of the Commerce and Economic Development Commission (CEDC) in the context of these economic challenges, proposed strategies for addressing those challenges, as well as the limitations facing state policy makers. This study compares the state's and the CEDC's strategies to those being implemented by Arizona's competitor states in response to the changing US economy. Through this analysis, the CEDC is seeking to clarify the Commission's role, Arizona's competitive challenges, and appropriate economic development investments. This research study compares Arizona's economic development efforts with those being undertaken by Arizona's 18 competitor states: California, Colorado, Florida, Georgia, Illinois, Maryland, Massachusetts, Minnesota, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oregon, Texas, Utah, Virginia, and Washington.

More specifically, ACCRA compared the institutional characteristics and programs of state department of commerce agencies (in their myriad forms) in these 18 states with those offered through the Arizona Department of Commerce and the CEDC. The research team also examined program functions and resource allocations to compare how Arizona allocates its economic development dollars with its competitor states. ACCRA researchers then examined the economic development policy boards or commissions in ten competitor states, and reviewed the role of these boards in providing policy guidance and monitoring business incentive or attraction fund activities.

Recognizing that incentives are a commonly used mechanism to attract firms, ACCRA reviewed incentive programs by type of program and policy goal to identify gaps in Arizona's existing incentive programs. Finally, ACCRA identified the most common features, describing "lessons learned" for future Arizona policy making. These lessons provided the framework for recommendations to state policymakers on how the Arizona Department of Commerce should structure its governance and programs to align with the findings of the Statewide Economic Study.

### Arizona Department of Commerce

Arizona has one of the smaller economic development agencies in terms of overall staff size among its competitor states. The agency employs 83 people, slightly less than Utah and slightly more than New Mexico. In part, the agency's small size relative to other states reflects the leaders' decision to separate tourism from economic development. About two-thirds of the competitor states combine these functions the same agency. Although Arizona is nominally a "commerce" agency, it does not manage some of the functions that other state Departments of Commerce have, including business licensing and regulation. Arizona Commerce operates very much like other state departments of economic and community development. Of the 18 competitor states, North Carolina, Washington, Utah and Oregon have the most similar structure

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[1] *Economy.com, "Arizona's Economic Future," prepared for the Arizona Department of Commerce, August 2002.*

to Arizona's Department of Commerce. In all of the other states, the economic development agencies invest substantially more resources in aid to local communities.

### *Arizona's Commerce and Economic Development Commission (CEDC)*

The CEDC serves as the state's economic policy and planning board, and it oversees the CEDC Fund, a portion of which is appropriated for Commerce agency activities. The authorized responsibility of fund allocation allows the CEDC to play a critical role in implementing portions of the state's economic development plan and policy. The CEDC was created as a governing body for the Commerce and Economic Development Fund. It is authorized by statute to allocate financial resources in order to help businesses sustain, expand or relocate to Arizona. However, more than 85 percent of the CEDC Fund is appropriated to specific activities even before it is allocated to the CEDC for uses on strategic state projects.[2] The CEDC has certain policy advisory functions, including the requirement to develop the state's comprehensive long-range strategic economic plans.

Comparing the ten competitor states that have similar boards or commissions, CEDC's dual purpose of managing a specific business attraction fund as well as setting development blueprints for the state appears to be quite unique. In general, most states established their economic development boards/commissions to provide oversight to the state economic development agency's programs and strategies as well as to make policy recommendations to the agency or the Governor. Only a few have any fiduciary responsibilities and their recommendations are advisory in nature.

In comparing state boards and commissions, we identified three basic types: (1) Governing Board; (2) Program Oversight and Management Board; and (3) Advisory Board. CEDC is unique because, for the most part, it is an amalgamation of these three types of boards. It has some governing and fiduciary roles, but they are limited to specific programs. It also has direct involvement in selecting the strategic priorities that will shape the state's future economic development direction; however, the Commission has limited responsibility for overseeing the implementation of those strategies. Because it does not oversee the entire agency, we have categorized the Arizona CEDC in this typology as a "Program Oversight and Management Board." The primary difference between the CEDC and other state boards of this type is the CEDC's role in framing the agency's strategy planning efforts. This involvement provides an opportunity for the CEDC to influence the broader agency functions. This dual function suggests that the CEDC may have an opportunity for expanding its role. The true strength of the CEDC depends on the willingness of the governor and the agency's leadership to depend on the CEDC for advice and utilize this input in shaping the state's broader strategic economic development direction and budget priorities.

### *Economic Development Budget*

In 2004, Arizona allocated $59.3 million for economic development and tourism activities, including about $5.5 million in federal funding managed by the Department of Commerce as well as an additional $16 million for the Office of Tourism. The state's tourism program complements the Commerce Department's efforts, especially business development marketing activities. It is for this reason that many other states integrate tourism within the economic development agency.

Arizona's economic development efforts are similar in scope but somewhat smaller than those of its competitor states. The 18 competitor states invested a total of $1.7 billion in economic development. This amount excludes any federal program funding. The average 2004 budgeted state investment in economic development and tourism programs in the 18 competing states was $95.1 million, nearly double Arizona's investment. On a per capita basis, the gap is slightly smaller. Arizona invests $9.73 per capita in 2004, six percent below the $10.38 per capita for the competitor states. Arizona places 14$^{th}$ among the 19 competitors in per capita spending, behind New Mexico (excluding that state's Invest New Mexico fund), Colorado, North Carolina, and

2 *Data provided by the Arizona Department of Commerce.*

Virginia. For Arizona, investments in workforce development, community assistance, and tourism account for 86 percent of the total state investment in economic development. If these categories of funding were excluded from our definition of economic development for Arizona and its 18 competitor states, Arizona's budget for core economic development is only $7.9 million or $1.42 per capita. Using this budget number for comparison, Arizona is 17th among the 19 states in per capita spending, ahead of Massachusetts and California (which terminated its state agency).

### *Arizona's Business Incentives*

Of 17 business incentives identified in Arizona, more than half are tax-based incentives that offer companies tax credits, exemptions or reductions, or refunds on income or property. These incentives aim to leverage business investment in the state. This tax-based approach responds to Arizona's development strategy of making the costs of doing business lower in the state for targeted investors. These incentives are designed to encourage research and development investment, construction activity related to qualified real estate development, purchases of equipment for manufacturing operations, and motion picture production in the state. Arizona implements several of its incentives in targeted geographic locations, including enterprise zones, foreign trade zones, and military reuse zones. The goal is to attract business capital investment and jobs to areas that might not otherwise appeal to private investors.

Because the state relies so heavily on tax-based incentives to implement its economic development efforts, its incentive programs may not be matched well with effective approaches to achieving the state's economic goals. In general, tax incentives tend to be more effective for traditional, mature industries and tend to be less valuable for emerging industries dominated by technology-intensive firms that may not yet earn adequate revenues to be taxable or may depend more heavily on worker inputs rather than capital investments.

Because of the focus on technology-based economic development and the challenges associated with using tax policy to direct public and private investment into new idea creation, direct and indirect financial assistance appears to be growing in importance as a mechanism for providing business incentives. This is evidenced by the tremendous growth in state economic development investments since 1998 and the increased usage of strategic opportunity funds in other states to seal large business deals. Arizona is funding workforce and tourism programs at a competitive level, but If Arizona is truly going to compete, it must reconsider the level of investment it currently makes in technology-based economic development initiatives.

Direct and indirect financial incentives may be more useful for the technology-oriented strategies emerging as critical elements of the Arizona's economic development future. Arizona's lack of incentives to encourage capital formation in the form of equity (including seed and venture) capital may be an important gap that needs to be addressed. Initiatives designed to encourage researchers to create new ideas, entrepreneurs to commercialize them, and investors to take a financial risk on them are all needed. Other states are creating sizable "deal closing funds" and equity investment funds to respond. Thus, Arizona should also consider an aggressive new strategic opportunity fund aimed not at investing in individual firms, but rather at fostering firms and researchers to collaborate with universities, nonprofit research institutes, and the private sector.

## *Findings*

Based on how economic development is being implemented across the US, there is clearly no single "best practice." However, there are a several key lessons learned that could be applied to an examination of Arizona's approach to economic development policy design and implementation. A few of those follow:

### *Resource Levels Drive the Approach*

Arizona's limited investment in economic development has driven it to focus on tax-based incentives, which may not be the most effective way to influence business behavior. To truly compete, the state must invest more.

### *The Strategic Fund Is Running Out of Discretionary Money*

The CEDC Fund depends on an erratic flow of gaming revenue at the same time that annual legislative appropriations from the fund is greater than the receipts from these gaming revenues. Based on current forecasts, the Fund could begin to run a deficit as early as 2008 unless its funding mechanism is restructured.

### *A Variety of Challenges Lead to an Array of Tactics*

Growing businesses face an array of issues. While Arizona has focused its attention on retraining its workforce and promoting investment in targeted areas, these do not respond to myriad challenges that businesses face in a globally competitive climate. Arizona's investments must be made in a flexible and diversified manner.

### *The Relevance of Incentives and Investments to the State's Economic Targets*

If Arizona's strategy is indeed focused on promoting technology-based development, each of its existing incentive programs should be assessed as to their relevance in achieving this fundamental mission. Many incentives will be found wanting and Arizona will need to consider new ways to encourage business investments in new technology, innovative products, and globally competitive processes.

### *The Emergence of "Deal Closing" Funds*

Competitor states are making substantial investments in flexible, discretionary funds. Rather than trying to build programs designed to meet pre-determined needs, these funds allow economic development professionals to customize the funding available to the project needs. These funds are invaluable for signature projects that can serve as the basis for forming new clusters or for taking an existing cluster to a new level. They are not without their own risks, however. States must be good financial stewards by establishing clear policies to guide their investment decisions.

### *Techniques for Determining Effectiveness of Incentives*

Parallel to the emergence of these deal closing funds and the struggles that states have endured with fiscal deficits, effective methods for assessing the impacts of economic development investments must be integrated into the program's initial design. States with effective systems do not wait to evaluate the program after the fact, but incorporate decision-making criteria and information gathering requirements as a pre-condition of making an award. These efforts require expenditure of resources aimed at ensuring the agency is upholding the public's trust.

## *Recommendations*

Building on research conducted as part of the Statewide Economic Study, Arizona has begun to hone in on a number of key targets built in part on the competencies of its university research activities and the emergence of key clusters such as biosciences, advanced communications and information technology, and "sustainable systems" technologies. Common strategies recommended in prior studies include:

- Developing an image for the state in each respective targeted technology,
- Investing in the state's research capacity associated with that targeted technology through university-based centers of excellence, industry-university partnerships, or demonstration projects,
- Fostering dialogue and networking among industry, university, and government officials on the challenges and opportunities facing each targeted technology,
- Ensuring that risk capital is available to aid in the development and commercialization of targeted technologies, and
- Helping the state's education and training institutions produce world-class workers ready to take the jobs to be created in the industries deploying these technologies.

The goal of the recommendations of this report is to translate these basic proposals into a framework for designing incentive policies that make a real difference in the Arizona economy.

## Investments

The state should depend less on trying to shape economic policy through its tax structure. With less than $8 million going to its traditional economic development functions, Arizona is skimping on its investment and has unilaterally disarmed in the global economic race to build a technology-based economy. If Arizona is to compete, its leaders must decide to invest substantial resources in creating a new economic future. The state's citizens have already said that Arizona should:

- Balance the business tax burden to encourage investment by export-oriented, technology-intensive firms;
- Foster stronger ties between industry and academia;
- Factor in the state's limited supply of water and private land in the state's strategic decisions; and
- Recognize the differences between rural and urban areas, including the dependence of rural areas on tourism for their economic base.[3]

Arizona should first eliminate legislative appropriations from the Commerce and Economic Development Fund (CEDC Fund) that are siphoning strategic resources to pay for otherwise important operational activities. Then, the state should increase the Fund's current annual income from approximately $3.3 million (projected for FY 06) to $25 million to place Arizona in a more competitive position to make critical investments in strategically important economic development opportunities. The expanded CEDC Fund would be used to provide:

- A deal closing fund aimed at supporting public-private collaborations related to the state's targeted investments,
- A fund to leverage federal dollars into the state, especially for efforts related to the targeted cluster or technology areas;
- A challenge fund for signature, "economy-defining"[4] initiatives in the state's rural areas,
- Leverage and support for the creation of an Arizona-oriented equity investment fund, and
- Resources for strategic research, regional collaboration, and continued policy development activities.

### *Measuring Success*

The CEDC already has an extensive set of statutory measures used to evaluate project effectiveness. The measures aim to assess the contribution of proposed projects to the state's strategic goals and overall economic well-being. While these measures are useful for traditional economic development efforts, they are limited in their application to many technology-oriented efforts. Additional measures, focused on leveraging non-state investment or improving the state's success in licensing, patenting, and commercializing technologies, may be needed to supplement those already being used.

Arizona has made minimal investment in economic development relative to its competitor states. If it is to create the kind of jobs that Arizonans need to support a family in the 21st Century, the state will need to be more aggressive and the Arizona Department of Commerce will need more

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[3] *Elliott D. Pollack and Company and Pat Schroeder, "Public Outreach, Local Plan Integration And Strategic Findings," Prepared for the Arizona Department of Commerce and the Commerce and Economic Development Commission, October 2003.*

[4] *"Economy-defining" initiatives may or may not be directly related to the state's strategic industry targets, but are of particular interest because they tend to be relatively large and offer the potential for reshaping the local economic base.*

resources at its command. As Arizona invests more public dollars in economic development, it should also continue to be concerned about having the most effective process possible for measuring success. Maintaining the public trust as the state expands its investment in economic development is vital to the CEDC's long-term viability and to ensuring that the state receives the highest return possible.

# Benchmarking Arizona Economic Development: Creating a More Strategic Governance and Investment Policies

## *Background*

The Arizona economy is well on its way to the road to recovery. But, the path is not a simple one as economic churning continues from new businesses forming and more mature ones downsizing. Some of Arizona's economic opportunities in this transformation include computer software and systems; healthcare and biotechnology; industrial machinery; communication services; high-tech instruments; forest products; engineering services such as research and testing; transportation and logistics; agriculture/food processing/agricultural technology; and defense/aerospace/ avionics. [5] Each is a technology-intensive industry, and collectively these industries will quite probably constitute the foundation for Arizona's future economic prosperity. This is not to say, however, that Arizona's traditional industries are no longer vital to the future, but rather that the state's long-term prosperity will depend greatly on how well it adapts to a changing world economy and the emergence of new opportunities. These opportunities will materialize, however, only if the state can foster public/private investments in research and development, prepare a world-class workforce, create state-of-the-art infrastructure, ensure a more flexible capital system, and offer greater access to global markets.

As the economy changes, Arizona is operating with an economic development support system developed for its traditional economy. The purpose of this study is to ascertain whether these institutions can continue to work as effectively in the current economic climate as they have in the past and whether the state's economic development system can contribute to a globally competitive, more technologically intensive Arizona economy. The state created the Commerce and Economic Development Commission (CEDC) in 1989 to (1) provide policy guidance through a 10-year statewide economic strategy and (2) manage revenues dedicated to the agency for strategic economic development investments (via the CEDC Fund). The CEDC also serves as a recommending body for the Arizona Department of Transportation's Economic Strength Projects fund. The Fund receives approximately $3.3 million annually, derived from lottery game revenues, loan repayments, capital markets securities fees, and investment income. However, instead of protecting this Fund as a discretionary strategic fund, the legislature appropriates more than 85 percent of those funds to the state's economic development operating activities including the Commerce department's advertising campaign, Main Street program, rural development efforts, and personnel costs. In 2004, less than $750,000 of the CEDC Fund could truly be described as available for discretionary "strategic" activities.[6]

The discretionary portion of the Fund provides a dedicated revenue stream to help fulfill the CEDC's mission of providing strategic economic development guidance to the state. As part of that effort, the Department of Commerce has completed an extensive Statewide Economic Study. At the same time, the CEDC has recently undergone significant membership changes as commissioner terms expire and the Governor makes new appointments. Furthermore, CEDC staffing has decreased significantly over the past several years, reflecting the state's budgetary realities and the overall fiscal constraints causing the legislature to divert the CEDC's revenues to other Commerce Department activities.

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[5] *Economy.com, "Arizona's Economic Future," prepared for the Arizona Department of Commerce, August 2002.*

[6] *Data provided by the Arizona Department of Commerce.*

In addition to the confluence of these changes and the resultant financial pressures on the CEDC Fund, the state is also experiencing tremendous economic growth[7] as well as new strains on the economy resulting from global competition and technological change. In particular, during the past 15 years, the business environment in the state has changed at the same time as our understanding of what constitutes a successful approach to economic development. The purpose of this study is to update an earlier analysis of Arizona's incentive policies[8] and examine the role of the CEDC in the context of the state's economic development challenges, strategies, and limitations. The study also compares Arizona's efforts with initiatives being implemented in other states. Through this analysis, the CEDC is seeking to clarify the state's challenges, relevant competitive pressures affecting state economic needs, and appropriate investments in state economic development efforts.

In order to manage the scope of this project, the study team was asked to benchmark the Arizona Department of Commerce and CEDC to 18 other states. The comparison states are listed in Table 1, and were determined to be competitors based the following four key factors identified by previous research[9]:

- Economic Diversity: Economic diversity represents the extent to which a state's industrial structure approximates the base industrial structure. Fifteen states were determined to be more industrially diverse than Arizona including: Texas, Illinois, Maryland, Colorado, Massachusetts, New Jersey, Minnesota, New York, Virginia, Georgia, New Hampshire, Oregon, Washington, North Carolina, and California.
- Educational attainment: Fundamental to the knowledge economy and technology sector, ten of the competitor states have larger proportions of population that have completed a high school or more education than Arizona. States with higher educational attainment levels include: Washington, Minnesota, Colorado, Oregon, New Hampshire, New Jersey, Virginia, Maryland, Illinois, and Massachusetts.
- Geography: Competitor states were also chosen based on their location in the western region of the United States, including: California, Colorado, New Mexico, Oregon, Texas, Utah, and Washington. Westward US population shifts and proximity to those states suggest that other western states competitors for firms and workers.
- Anecdotal evidence: New and emerging competitors, such as Georgia, Oregon, and Florida, were identified during interviews with economic developers and business leaders.

| **Table 1: Arizona's Technology Competitors** |
|---:|
| California |
| Colorado |
| Florida |
| Georgia |
| Illinois |
| Maryland |
| Massachusetts |
| Minnesota |
| New Hampshire |
| New Jersey |
| New Mexico |
| New York |
| North Carolina |
| Oregon |
| Texas |
| Utah |
| Virginia |
| Washington |

To compare Arizona's performance to that of its competitors, this study examines the following programmatic elements of business investment promotion strategies:

- State commerce agency organizational structure;
- State commerce agency budget and program functions, including the availability of strategic initiatives and attraction funds;
- Business development incentives; and
- Institutional characteristics of commissions or boards that provide leadership for the foremost economic development agency.

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[7] *Robert Franciosi, "Assessing Arizona's Economy: Boom or Bust?" Goldwater Institute, June 2002.*
[8] *This study builds on and updates prior research conducted by the Arizona State University Morrison Institute for Public Policy, "Comparative Analysis and Guidelines for an Arizona Incentive Policy," 1993.*
[9] *The states were primarily drawn from comparisons made in a study by Economy.com, "Arizona's Economic Future," prepared for the Arizona Department of Commerce, August 2002.*

By comparing these programmatic elements for Arizona and its eighteen competing states, ACCRA evaluated the institutional characteristics of state department of commerce agencies (in their myriad forms) in the 18 competitor states. The research team also examined program functions and resource allocations to judge how Arizona allocates its economic development dollars as compared with its competitor states. ACCRA researchers then examined the institutional characteristics of CEDC-like boards in competitor states, and reviewed their roles and involvement with business incentive and attraction fund activities.

Recognizing that incentives are a commonly used mechanism to attract firms, ACCRA reviewed incentive programs by type of program and policy goal to identify gaps in Arizona's existing incentive programs. Finally, ACCRA examined a number of best practices to identify "lessons learned" for future Arizona policy making. These lessons provided the framework for recommendations on how the Arizona Department of Commerce should structure its governance and programs to align with the findings of the Statewide Economic Study.

## *Approach and Methodology*

As part of this effort, ACCRA gathered data about economic development budgets, state agency governance structures, and business incentive programs for each of the 19 states being studied. This information was gathered for the study from both primary and secondary sources, including web sites, agency reports, and interviews with key personnel.

To gather information on state economic development budgets, ACCRA conducted a survey of state policy and research offices about their investments in economic development during 2004. In many cases, the policy and research office responded or they helped to gather data from budget officers within the respective agencies. For states not responding to the survey, ACCRA reviewed approved budgets for the agencies to determine budgeted expenditures. In cases in which ACCRA had questions about the approved budget, the consultants submitted the completed survey to agency staff for review and comment.

The primary challenge the researchers encountered was obtaining the cooperation of knowledgeable persons within each state. Since the survey form used for the data collection process was designed to provide standardized comparisons across states, it did not follow standard agency budget categories. Consequently, analysts had to make educated estimates of how funds should be allocated across functional areas. Some states were less cooperative than others due to staff limitations or various other reasons so judgments about activity allocations fell to ACCRA analysts. As part of the survey process, ACCRA provided each analyst a detailed description of what items should be included within the various functional areas and verified the data upon receipt from cooperating states. Wherever possible, data was gathered from all of the key agencies or quasi-public entities that provided statewide economic development services.

As for the analysis of competitor state boards and commissions, the project conducted extensive reviews of agency websites and interviewed policy and research directors to determine whether an agency had a board or commission of volunteers providing technical or policy input. Of the 19 states included the study, ten boards or commissions were identified as having sufficient similarity to the Commerce and Economic Development Commission for comparative purposes. ACCRA interviewed the chief staff person for each of these boards or commissions using a protocol designed to provide structure in gathering the most relevant data. To fill in the data for the protocol, ACCRA began by conducting an Internet search of state websites, including agency and legislative statutes, to gather as much information as possible about the board or commission from secondary sources.

Once the research of secondary sources was exhausted, ACCRA conducted telephone interviews with the chief point of contact or staff person for each of the commissions to validate data gathered and fill in missing data points. The interviews lasted from 20 to 90 minutes. Again, some interviewees were more cooperative than others and were willing to provide much greater detail about how their respective state economic development board or commission operates.

ACCRA gathered incentives data by starting with a set of several different incentives directories, including the 2001 National Association of State Development Agencies "State-by-State Guide of Business Development Incentives" and the recent summaries of the incentives in site selection magazines, including Area Development and Business Facilities. Using these as initial guides, ACCRA staff reviewed websites associated with relevant incentive programs, developing a list of more than 480 programs in the 19 states that provide financial assistance directly to a company or indirectly through an intermediary on behalf of a company. For each business incentive, ACCRA gathered information about the incentive program's purpose, description of activities, eligibility requirements, and application information (wherever available). ACCRA then classified the incentives based on several variables, including the status of the program (whether or not it is active), the program category (whether it provides direct financing, indirect financing, or grants to businesses), the type of program (whether it is a bond, a revolving loan, a grant, a loan guarantee, or one of several forms of tax-related incentives), the geographic focus of the program (whether or not it is targeted to a rural area, zone, redevelopment area, etc.) and the policy goal that the program intends to fulfill.  This database served as the basis for the analysis of business incentive programs.

Once the database was completed, it was submitted to policy analysts in each state to review and revise.  Some were more conscientious than others in their reviews.  Clearly, some programs may not be as effectively marketed on the web as others, and ACCRA could conceivably have missed programs in gathering the information.  Furthermore, many states market programs that are rarely used.  Data on incentive program use is very limited, thus comparisons of incentives have to focus on whether or not the incentive exists rather than on the state investment made in the program.

## *Managing State Economic Development*

The Arizona Department of Commerce is organized as a traditional line agency within state government. The Director reports to the governor as a part of her cabinet. The Director's senior management team includes the deputy director and the assistant directors who oversee the agency's five divisions: (1) Planning, Research and Policy, (2) Community Development, (3) Global Business Development, (4) Workforce Development, and (5) Administration.

The Planning, Research and Policy division provides the analytic work aimed at sharpening the agency's focus on its primary strategic targets. The division serves the invaluable function of providing guidance to the agency's senior management team on areas of emphasis and direction. The staff for the Commerce and Economic Development Commission operates as a part of this division.

Community Development is responsible for providing assistance to communities in the forms of infrastructure development and local capacity building. This is a major component for implementing "place-oriented" development approaches to ensure that localities are "ready" when opportunities arise by having appropriate zoning, prepared sites, and adequate infrastructure already in place.

Global Business Development is focused on providing the Department's direct services to companies. It is involved in implementing "firm-oriented" economic development services, including efforts aimed at the attraction of new firms to the state, retention and expansion of existing firms, and the formation of entrepreneurial ventures. This office leads the state's recruitment efforts, helps small and disadvantaged businesses, and builds linkages between Arizona firms and international businesses.

Workforce Development manages programs aimed at improving the quality of the workers employed for Arizona companies. These "people-oriented" approaches include policies crafted to support job training, apprenticeships, and training tax credits.

Supporting all of these activities is the Administration division. The Division ensures that the agency operates efficiently, managing its accounting, budget, personnel, technology information, financial management, and procurement activities.

Although Arizona is nominally a "commerce" agency, it does not manage some of the functions that other state Departments of Commerce have, including business licensing and regulation. Other states' agencies may oversee the banking regulation, utilities, and a variety of licensed professions. For instance, North Carolina's Department of Commerce oversees the administrative elements of these and other activities even though the various regulatory bodies operate fairly autonomously. Instead, Arizona Commerce is structured much more like other states agencies with names such as the "Department of Economic and Community Development."

Arizona has one of the smaller economic development agencies among the competitor states. Table 2 reflects that Arizona has approximately 83 employees working in the Department of Commerce, making the agency among the 10$^{th}$ largest economic development agency in terms of per capita employment among the 19 states. The agency employs slightly fewer staff than Utah's Department of Community and Economic Development and more than the New Mexico Economic Development Department. In part, Arizona Commerce's small size relative to other states is the state's decision to separate tourism and economic development. About two-thirds of the competitor states combine these functions into a single agency.

How the Commerce Department deploys these employees is quite instructive, especially as Arizona's efforts are compared with others states. Some of the states have broad-based programs while other states are much more limited in their scope. Certainly, the state's population is relevant to the size of the economic development organization, but the political philosophy and culture of the states also strongly influence the economic development organizational structure.

| Table 2: Economic Development Agency Staffing Levels for Arizona and Its Competitor States | | | |
|---|---|---|---|
| State | FTE Staff Positions | Estimated Population, 2003[g] | FTEs per 1,000,000 residents |
| Maryland | 340.7[a] | 5,508,909 | 61.8 |
| Washington | 306.4 | 6,131,445 | 50.0 |
| Utah | 110.0 | 2,351,467 | 46.8 |
| North Carolina | 360.0 | 8,407,248 | 42.8 |
| Minnesota | 197.0[b] | 5,059,375 | 38.9 |
| Oregon | 132.0 | 3,559,596 | 37.1 |
| New Mexico | 67.0 | 1,874,614 | 35.7 |
| Illinois | 445.0 | 12,653,544 | 35.2 |
| Georgia | 201.0 | 8,684,715 | 23.1 |
| Arizona | 82.9 | 5,580,811 | 14.9 |
| New York | 255.0 | 19,190,115 | 13.3 |
| New Jersey | 109.0 | 8,638,396 | 12.6 |
| New Hampshire | 16.0 | 1,287,687 | 12.4 |
| Colorado | 40.0 | 4,550,688 | 8.8 |
| Virginia | 61.0[c] | 7,386,330 | 8.3 |
| Texas | 55.0[d] | 12,365,455 | 4.4 |
| Florida | 70.0[e] | 17,019,068 | 4.1 |
| California | 21.2[f] | 35,484,453 | 0.6 |
| Massachusetts | data not available | 6,433,422 | |

Notes:
[a] Data includes 41.7 contract staff
[b] Data from 2003 for Dept. of Trade & Economic Development; data for Economic Development is not available for 2004
[c] Data is for Dept of Business Assistance; Data for VEDP is unavailable.
[d] Staff level provided for the Governor's Tourism & Economic Development Division.
[e] Number includes only Enterprise Florida employees, does not include staff in the state's tourism corporation or the governor's economic development staff
[f] All positions have been eliminated in the FY 2005 budget.
[G] Source: US Census Bureau

## Agencies with the Greatest Breadth of Services

State economic development agencies can take a variety of forms. At one end of the spectrum are the broad-based extensively integrated economic development functions that tie narrowly defined economic development activities with community, workforce, and tourism related activities. For instance, states like Illinois, North Carolina, Maryland, and Washington, have larger numbers of employees that manage community and workforce development functions within their economic development agencies. All incorporate tourism into their economic development function as well.

For example, Illinois represents a broad-based effort to address the wide variety of economic development opportunities. The Illinois Department of Commerce and Economic Opportunities is one of the largest economic development agencies in the nation. Its structure is geared toward supporting business development, economic development, local and regional activities, trade, and technology/industrial competitiveness issues. The agency has sizable programs to support coal development and marketing, energy conservation, and recycling and waste management. Tourism and industry-driven workforce development efforts are spearheaded through this agency as well. The key initiatives for the agency in 2004 include the creation of 20 entrepreneurship centers, investment in existing companies and incumbent workers to promote technology adoption to ensure more competitive firms in the state, an expansion of the state's tourism promotion efforts, and a stronger linkage for job training programs targeted to those eligible for Workforce Investment Act assistance.

In another example, Maryland has a traditional agency, the Department of Business and Economic Development, managed by a department secretary. It plays an active advocacy role for business as well as providing procurement assistance for small and disadvantaged businesses, assisting regions in their development efforts, and managing the state's tourism and film programs. For years, the Maryland Department's finance unit has been a national innovator in providing creative methods to foster capital formation and business lending. The state also has created a separate nonprofit corporation, the Technology Development Corporation, to foster innovation and commercialization within the state. In recent years, the agency has taken a more aggressive tact in fostering regional development, especially in the lagging rural parts of the state.

Somewhat uniquely, New Jersey's Department of Commerce and Economic Growth operates as a cabinet agency with leadership and expertise drawn from across the state's agencies, including a board structure that includes the state commissioners of Environmental Protection, labor, transportation, and higher education as well as the secretary (or director) for the agency. The agency serves as an advocacy unit for business and offers services aimed at attracting and retaining businesses to the state. Unfortunately, the agency has also encountered significant turmoil of during the past several months with the resignation of the state's Commerce Secretary and several senior managers as well as the arrest of the agency's controller for alleged financial improprieties.

## Linking Workforce and Economic Development

Integrating workforce and economic development has become a mantra of many state and federal officials. Minnesota recently merged its employment security and workforce development efforts with the state's economic development activities. Interestingly, Minnesota as well as Michigan, and Maryland, previously operated merged workforce and economic development agencies during the late 1980s and early 1990s. In each case, the agencies divorced again after a few years. The ultimate challenge facing many of these mergers is the differences in cultures between the two policy domains as well as the differences in the respective missions.

Last year, Minnesota decided to try the experiment again because state policy makers believe that the federal Workforce Investment Act (WIA) legislation is now much more conducive to economic and workforce development collaboration. The agency's 200 economic development employees represent about 10 percent of the 1,900 staff employed in the new Minnesota Employment and Economic Development agency. In addition to the challenges of merging programs, senior managers have learned that the two agencies had completely different cultures about revealing information to the public about their activities. While both agencies have a tradition of protecting the privacy of their clients, the old Employment Security Department was driven by federal funding priorities and the need to protect individual privacy. The federal funding makes the workforce agency more driven to respond to federal priorities rather than those of the state legislature. In contrast, the agency's economic development counterparts are largely dependent on state funding and more likely to receive demands from the state legislature to defend the agency's performance and investment decisions. Today, challenges abound in bringing these two agencies with ostensibly compatible missions together to meet the needs of business and worker customers.

Part of the challenge facing Minnesota's Commissioner (who previously served as Commissioner for the Employment Security agency) is balancing the increased demands (and inevitable time trade-offs) resulting from state legislative and other stakeholder interest in economic development programs with the federal focus on a much larger workforce development agency. This is especially problematic where federal performance requirements differ markedly from the state's policy priorities. In most states, the workforce development function is separated from economic development because of the recognition of these conflicts. Federal investments in workforce development, particularly at the state level, can dwarf the federal resources available for economic development activities. Even in Arizona, large amounts of federal dollars supporting workforce development programs may not necessarily translate into initiatives that are relevant to the state or provide sufficient resources to meet local needs.[10]

## Taking a Narrow Approach to Economic Development

On the other extreme from agencies such as Minnesota is the minimalist approach to economic development exhibited by New Hampshire and New Mexico. New Hampshire has the smallest agency of the competitor states with only 16 employees involved in economic development. Additional employees work for the tourism office. The development agency and the state's travel and tourism office both operate as divisions of the state's Department of Resource and Economic Development (DRED). DRED manages the state's forests, parks, and recreation activities as well as the state's capital planning and architectural and engineering activities. The economic development office concentrates on international trade, support for businesses seeking licenses or permits, and providing community and workforce development services to localities in the state.

New Mexico's economic development efforts also include a relatively small group separate from its tourism promotion efforts. The economic development office is responsible for the state's business recruitment and retention activities and border relations (including a "Border Authority" focused on improving development near the Mexican border as well as a Mexican Affairs and Trade office). An important part of the state's strategy is an effort to build on the significant federal lab presence through the efforts of its Space Commercialization as well as its Science and Technology offices. The state has also made a substantial investment in attracting film production. New Mexico appears to have made significant strides in building a national reputation in this regard, as exemplified by a 2004 article in the Condé Nast young men's magazine, *Details*, focused on New Mexico as the "hot" alternative to Canada or southern California as a film production locale.

New Mexico's economic development program is small, but it appears to be focused on a few areas in which the state feels that it has a competitive advantage – space and related sciences, film promotion, and Mexico trade. The state has also set aside $200 million from the Severance Permanent Fund (generated from taxes on resource extraction activities) to invest in a group of venture capital firms that have promised to foster New Mexico firms. For a state in which the economic development agency receives minimal investment, these efforts appear to concede other aspects of economic development opportunities to its rival states while focusing the agency's limited resources on entrepreneurship, innovation, and Mexico trade.

Other states have focused efforts, but their activities are geared toward a different, and perhaps more traditional, approach to economic development. Several states such as Georgia and Virginia opted to limit their economic development agency to traditional business recruitment activities. Other agencies are responsible for community development and existing industry programs. For instance, the commerce cabinet official in Virginia oversees a secretariat of agencies including the Virginia Economic Development Partnership (in which Partnership employees are not state employees) to implement business development programs while another agency, the Department of Business Assistance, oversees existing industry activities.

The most extreme example of the downsizing of an agency is in California. Until 2004, California had a traditional line agency, but the state's severe budget crunch victimized the Technology, Trade, and Commerce Agency. The state dismantled the agency and reassigned small remnants of programs to the multi-faceted Business, Transportation, and Housing Agency and privatized other parts of the agency to the California Infrastructure Bank (I-Bank). Since this is a recent development, no information exists as to whether "unilateral disarmament" (as one might describe the California situation) has an impact on the economic well-being of the state.

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[10] *Nancy Welch, David Berman et al, "Can't Stand Still: Issues and Ideas for Workforce Governance in Arizona," Arizona State University, Morrison Institute for Public Policy, 2004.*

## “Privatization” of Economic Development

As part of its efforts to reduce the amount of investment in the state’s Commerce agency, a couple of states have experimented with “privatizing” the economic development function. The most high profile example is Enterprise Florida, Inc., created in 1992. Enterprise Florida is essentially an effort to contract out the state’s economic development activities. After abolishing the state Department of Commerce in 1996, Florida opted to provide a multi-million grant to the nonprofit Enterprise Florida to operate international trade, marketing, and other business assistance programs. Tourism and technology programs are operated independently. Workforce programs are operated through a separate line agency, the Agency for Workforce Innovation.

Florida has not been the only state to explore “privatization” of economic development activities. While not a competitor states identified for this study, Michigan’s experience in privatization provides additional insights. The state created the Michigan Economic Development Corporation (EDC) in 1999 to oversee economic development. Part of the rationale for privatizing the state’s economic development agency was to bring continuity and professionalism to the senior management of the state economic development functions as well as to leverage private sector investment in the state’s economic development efforts. In both the Michigan and Florida cases, the private sector has been active, but it has not been a major boon to the organization’s finances. The bulk of the funding for these agencies continues to be taxpayer dollars. The private sector historically contributed approximately $1 million per year to each of the two organizations. The funds are used to help the organizations support activities that would not be possible with state funds.

Enterprise Florida passed the first true litmus test – the change of governors from one political party to another. The effort began with a goal of leveraging significant private investment in the state’s economic development efforts. Enterprise Florida has succeeded in attracting approximately 10 percent of its revenues from private resources, but it is very sensitive to the concerns of local development agencies that also seek to attract corporate investment. The organization receives about $11 million in state appropriations and an additional 10 percent in private contributions. The senior staff of Enterprise Florida need not be state employees, and the CEO is subject to the Board’s hiring and firing decisions. The Governor serves as chair of the Board, maintaining executive branch oversight of the state’s economic development function.

The jury is still out about the long-term prospects for the Michigan EDC. While MEDC has survived a change of political parties, there have been some significant changes. After the new governor hired her own director (a career economic development professional), she then reorganized the economic development function, merging it with workforce development activities into a newly formed Department of Labor and Economic Growth. The Michigan EDC director now reports to the Secretary of the new department. Thus, the newly reorganized MEDC operates much more like the Virginia Economic Development Partnership with perhaps a broader portfolio of activities to manage. Unlike the line staff of the EDC, senior EDC staff members are not state employees, serving at the pleasure of the director.

While it is not completely privatized, Massachusetts has opted to spin off much of the implementation of its economic development to outside entities. Massachusetts provides a unique example because it has a small line agency, the Massachusetts Department of Business and Technology that is supplement by state-chartered quasi-public agencies. These agencies oversee the implementation of business finance, technology, workforce, and other programs.

## Economic Development as a “Developer”

New York, another of the competitor states, has a model that builds on the experience of Massachusetts’ quasi-public agencies and the long tradition of New York localities getting directly involved in real estate transactions. The State has a traditional Department of Economic Development line agency, but that agency accounts for only a small portion of the state’s economic development efforts. The Commissioner serves as a governor’s cabinet official, and he has held that job during the full 10 years of Governor Pataki’s term of office to date–one of the longest running state economic development agency directors in the past generation. The agency is unique in that a small portion of the budget is appropriated through the state legislature. Most of the funding for economic development comes from revenues generated by development projects controlled by the Empire State Development Corporation (ESDC). The state's senior economic development team also serves in senior management roles for the Empire State Development Corporation (ESDC), a quasi-public entity that oversees a number of significant development projects completed across the state, including several large projects done in New York City.

Nearly 80 percent of the agency's budget (over $200 million per year) is funded through the proceeds of ESDC-controlled real estate and business development projects, funding a significant part of the agency's operations as well as its continued involvement in housing and community development. Much of the resources for this effort came from the creation of the Urban Development Corporation, the predecessor agency to ESDC, in the late 1970s and its success during the 1980s and 1990s of building a strong portfolio of business and real estate loans.

To some extent, New York's financing approach exemplifies – on a much grander scale – what Arizona might have envisioned with the Commerce Economic Development Fund when it was first created. The UDC and its successor ESDC were beneficiaries of an aggressive use of federal and state program investments – including the now-defunct Urban Development Action Grant and federal urban renewal programs. These investments made over time helped "endow" the state's economic development agency. Unfortunately, Arizona never created a large enough portfolio to generate sufficient revenue and, over the past several years, the legislature has appropriated much of the returns from past investments to the agency's basic economic development operations.

## Endowing Economic Development

Other states have created "endowments" for their economic development or technology development agency, providing some protection against the whims of unpredictable revenue cycles and budgetary constraints. During the early 1990s, Alabama created a $14 million endowment for technology-based efforts using oil and gas revenues. Unfortunately, that endowment was "raided" in the late 1990s by universities starved for cash.

Georgia and North Carolina have each created funds for rural development using proceeds from their tobacco settlement. Georgia created the "One Georgia Fund" that was originally managed by the state's Department of Industry, Trade, and Tourism and now by its Department of Community Affairs. The fund is designed to provide sizable grants for economic growth in rural areas. North Carolina placed a sizable portion of its tobacco settlement funds in the Golden Leaf Fund, which operates as a private independent nonprofit with headquarters outside the state capital. The board of that fund is appointed by the Governor, the Speaker of the House and the President Pro Tem of the Senate. While the Golden Leaf Fund is influenced by the state, it is not driven by North Carolina Department of Commerce policies.

## Unit of the Governor's Office

Some economic development agencies are operated as units of the Governor's office. Texas and Colorado provide prime examples of this. The agencies are small and focused primarily on international trade and overseeing "mega-deal" projects. Texas has even established a mechanism, the $295 million Texas Enterprise Fund, to better position the state in responding to these large deal opportunities. Many other states have such funds in place or their legislators are considering them.

The Texas Enterprise Fund is so large that it is difficult to ignore and simply represents the "next level" of a wave of states creating or increasing "mega-deal" incentive pots. In the past, these large projects often required the state legislature to make a special appropriation, sharpening the glare of the public spotlight on projects at times of sensitive negotiations, delaying the timing of those efforts, and creating significant uncertainty for the businesses. Governors, businesses, and economic developers uncomfortable operating in this environment have convinced legislators to set aside sizable amounts of state dollars – typically from general revenues – as discretionary funds for unusual economic development opportunities in the form of large scale projects. A number of states already have the funds, and the legislatures of several states are considering whether they need their own “deal closing” funds or whether their existing fund should be bigger.

## Local and Regional Support for Economic Development

In states such as Texas, Colorado, Florida, Georgia, and Virginia, localities are expected to handle the day-to-day activities of delivering economic development services except in the case of larger projects requiring state involvement. Texas localities have a local option sales tax that provides fairly sizable amounts of tax revenue to support local economic development organizations. North Carolina and Illinois have allocated state economic development agency grants in support of regional partnerships located across the states. These partnerships handle these day-to-day functions for their localities – especially those in rural areas.

In Texas, Colorado, Georgia, Virginia, and Florida, economic development efforts are operated completely separately from the state’s community development functions. In these cases, community development is managed by a housing and community development agency, except in Colorado where the Department of Local Affairs manages the state’s community development programs. In every case, the community development function has been well separated from economic development and has developed an entirely unique (and sometimes conflicting) culture than that developed in the development agency.

## The “Commerce” Agency Model

Of the 18 competitor states, North Carolina, Washington, Utah and Oregon have the most similar structure to Arizona’s Department of Commerce. In all of these cases, the states invest substantial resources in aid to local communities. Their community development units are fairly large, but these units are supplemented with efforts to integrate workforce and economic development.

North Carolina has a small community development unit, relative to these other states, and that unit actually operates at a separate location from the “downtown Raleigh” Commerce agency. Because North Carolina has created and funds seven regional partnership organizations to manage the state’s business recruitment activities, the Commerce agency focuses on providing Business Finance and International Trade support. The Commerce Secretary has also placed a great deal of emphasis on improving the quality of the state’s policy analysis and business development support. In general, NC Commerce is expected to feed project leads to the regional partnerships and provide much of the “back office” support for these partnerships, including support of economic development information services, and community “product development.” The agency manages the state’s business-driven workforce programs (including Workforce Investment Act funding) and oversees the state’s tourism development activities.

According to one legislative staff member, Washington’s Community Trade and Economic Development agency historically was as a “dumping ground” for programs or initiatives when the legislature was unsure of where it should go within the agency. Not surprisingly, the state frequently reevaluates the state’s economic development functions and the relationship between community and economic development. As a consequence, there have been significant efforts in the past several years to split the Community Development functions from the Trade and Economic Development office. While a complete separation of the functions was not achieved, an amicable arrangement was reached within the agency so that the director could focus more of her attention on Trade and Economic Development issues while the community development function operated semi-autonomously. A new director appointed in the past few months was formerly the economic development director for a local community so it is anticipated in the short-term that this arrangement might continue.

Utah has been a much more stable example of the merger of community and economic development. The state’s focus, in terms of economic development, has been largely on building its research and technology base. The agency has Science Advisory Council and operates a program to leverage industry support for university centers of excellence. The programs have emphasized the state's traditional leadership in the fields of agriculture and natural resources, information technology, biomedical and biotechnology, aerospace and advanced materials and processes.

Oregon is also dominated by its community development function as local growth management and development issues have historically dominated the agency's attention. In the early 1990s, growth management, particularly in the Portland metro area, was the leading policy concern for the states' Economic and Community Development Department (OECDD). However, as the state's economy improved during the 1990s, policy attention switched to job creation and retention with a special emphasis on the state's lagging rural areas. As a consequence of these historical trends, OECDD has devoted substantial resources to support community development, planning, development of local industrial sites, and financing for infrastructure projects. In addition to its support for communities, the agency also offers programs to help firms site new locations, recruit and train works, obtain financing and other agency incentives, and access small business and international trade assistance. The agency's research function does not include policy development, but instead focuses primarily on providing economic and market research for and about firms interested in an Oregon location. Oregon's governor recently announced the GROW Oregon's Future Workforce Initiative aimed at enhancing the link between economic and workforce development efforts in the state. Through this effort, the state is creating regional workforce response teams and a web portal with business and worker information. The agency is tapping businesses and labor unions to provide incumbent worker training programs.

## *Comparison of Economic Development Governance Structure*

State economic development agencies are frequently instruments of government so they ultimately must be responsive to the Governor as the chief elected official. While some agencies have boards that serve in an advisory role, others have boards that serve as a governing body. Still other agencies have no board at all, depending on the governor's office and the state legislature to fulfill policy making and oversight functions. The Arizona Department of Commerce has a unique governance structure in that part of the agency's funding and incentive policy decisions are made by the leadership of the state agency while a portion of those decisions are delegated to the Commerce and Economic Development Commission (CEDC), chaired by the agency director. The CEDC serves as the state's economic policy and planning board, and it oversees a Fund with some discretionary resources.

Specifically, the Arizona CEDC has three major responsibilities: (1) to develop the State's ten year economic strategy; (2) to assist the department in the coordination of the independent efforts of all state and local agencies involved in economic planning and economic development; and (3) to administer the lottery-financed CEDC Fund as a source of financial assistance for businesses locating or expanding within the state or other qualified project, including research project submitted by the Arizona board of regents or projects sponsored by the state, its political subdivisions, public or private universities, tribal governments or economic development agencies.

In executing this mission, the CEDC has been granted broad financial authorities, including the ability to:

1. Accept gifts, grants or loans and enter into contracts or other transactions with any federal or state agency, municipality, private organization or other source.
2. Purchase, acquire or hold by grant, gift, devise, lease or otherwise real or personal property or interests in real or personal property.
3. Improve, employ or use any real or personal property or interests in any real or personal property purchased, acquired or held for purposes of this article.
4. Sell, convey, lease, exchange, transfer or otherwise dispose of any of its property or any interest in its property, wherever situated.
5. Authorize, issue, sell and retire bonds for the operation of the Commission (this authority has never been implemented because of the appropriation of the Fund's lottery revenues, the only source available for debt service and retirement).

The combination of statutorily authorized responsibilities of fund allocation and flexible financial authorities allows the CEDC to play a critical role in implementing portions of the state's economic development plan and policy.
To determine how other competitor states structure their commissions or boards and assess their respective roles, the research team identified ten states among the 18 competitors that have an economic development commission or board serving the foremost state economic development agency. The ten states and their respective commissions or boards include:

- Colorado – Colorado Economic Development Commission;
- Florida – the Board of Directors of Enterprise Florida, Inc.;
- Maryland – Maryland Economic Development Commission;
- Massachusetts – Massachusetts Economic Assistance Coordinating Council;
- New Jersey – the Board of Directors of New Jersey Commerce and Economic Growth Commission;
- New York – New York Empire State Development Corporation Board of Directors;
- North Carolina – North Carolina Economic Development Board;
- Oregon – Oregon Economic Development Commission;
- Utah – Utah Board of the Division of Business and Economic Development; and

- Washington – Washington Economic Development Commission.

ACCRA researched the history of the boards and conducted phone interviews with representatives in each state to determine how the commissions or boards operated. We were particularly interested in learning whether any of the ten state commissions or boards was authorized to control and allocate state funding for business development. The following section compares the purpose of each Board/Commission, its role in governance, the makeup and selection of each Board/Commission, the staff support available, and the operation of the Board/Commission.

## Purpose of the Board or Commission

For most states, the purpose of creating an economic development board/commission is to bring political and business leaders together to promote and encourage economic development for the state. Such a board/commission is normally created within the state economic development agency by legislative statute. However, depending on economic conditions and the business needs facing each state, the mission or goals of each board and commission can vary significantly from state to state. Some state economic development boards/commissions are given the responsibility to develop and set economic development policy for the state, while others may be limited in their scope and their responsibilities to providing advice and counsel regarding the economic development agency's programs and activities. In Arizona, the CEDC was created as a governing body for the Commerce Economic Development Fund. It is authorized by statute to allocate financial resources in order to help businesses sustain, expand or relocate to Arizona. The CEDC has certain policy advisory functions, including the requirement to develop comprehensive long-range strategic economic plans for the state.

Comparing the ten selected competitor states with Arizona, CEDC's dual purpose of managing a specific business attraction fund as well as setting development blueprints for the state appears to be quite unique. In general, most states established their economic development boards/ commissions to provide oversight to the state economic development agency's programs and strategies as well as to make policy recommendations to the agency or the Governor. Rarely do they have any fiduciary responsibilities. Their recommendations are advisory in nature. In general, one could categorize the economic development boards/commissions in Florida, Maryland, New Jersey, New York, North Carolina, Oregon, and Washington in this way.

However, other states created their economic development boards/commissions with specific programmatic responsibilities in mind. We discovered that, as is the case with the CEDC fund, Colorado, Oregon and Utah have authorized their economic development boards/commissions to oversee a particular fund, often created to promote business attraction. For instance, the Colorado Economic Development Commission (EDC) manages the Colorado Economic Development Fund, which is appropriated from the state general fund to help sustain and create quality jobs for the state. Colorado's EDC is limited to framing policy decisions for the Governor's Office of Economic Development and International Trade while Oregon's EDC is responsible for developing the state's long-range strategic economic development plans. The Oregon Economic Development Commission (EDC) oversees the Oregon Economic Development Fund, financed by Oregon lottery proceeds, to provide funding opportunities for business and community development. This role makes the Oregon EDC similar in structure and philosophy to the Arizona CEDC. However, the Oregon legislature has directed a substantially larger proportion of lottery funds to the state's economic development agency's budget than has Arizona. Furthermore, the Oregon board has a more recognized role in the agency's planning and oversight.

As for the Utah Board of the Division of Business and Economic Development (DBED Board), one of its main responsibilities is to administer the state's $21 million Industrial Assistance Fund (IAF), a job-creation incentive fund established in 1992 from the state general fund. The IAF is available to companies who relocate to Utah and/or to existing Utah companies expanding their operations within the state. The IAF provides grants to companies creating jobs that pay more than prevailing wages within a locality. Proceeds may be used for any purpose as long as the firm meets job and wage commitments. DBED Board duties are to approve funding for the IAF projects and provide policy advice to the Division of Business and Economic Development, a unit of the state's Department of Community and Economic Development (Utah DCED).

Similarly, the Massachusetts Economic Assistance Coordinating Council is responsible for administering a specific program – the state's Economic Development Incentive Program (EDIP). Its responsibilities are strictly limited to issues related to the EDIP. The EDIP allocates the authority to localities to use tax increment financing and investment tax credits to projects that the Council certifies. Both the Utah DBED Board and the Massachusetts Economic Assistance Coordinating Council were created to oversee specific programs and not to provide general policy guidance to the state's overall strategic economic development plan.

## Role in Governance

The mission and purpose of each state economic development Board/Commission is reflected in how they are structured and their role in governance. The Arizona CEDC plays a direct governing role in important aspects of the Commerce agency's activities. The CEDC is actively involved in the state's economic development efforts through its coordination of the state plan and allocation of funds for businesses, local and regional governments and organizations.

In examining the role that other boards and commissions play, we have identified three basic roles: (1) Governing Board; (2) Program Oversight and Management Board; and (3) Advisory Board. Governing boards have an oversight role for the entire economic development function of the state (or at least the entire economic development agency). These boards tend to have a direct involvement in planning and review the agency's budget before it is submitted to the Governor or legislature. Program oversight and management boards tend to have fiduciary responsibilities over limited aspects of the agency. They may or may not be involved in the agency's strategic direction, but they oversee the direction of certain programs. Finally, Advisory boards provide business and technical expertise to the agency's staff. They may review policies and recommend priorities, but ultimately it is the agency director who is responsible for develop the organization's policy direction.

CEDC is unique because it is principally an amalgamation of these three types of boards. It has some governing and fiduciary roles, but they are limited to specific programs. It also has direct involvement in selecting the strategic priorities that will shape the state's future economic development direction; however, they have limited responsibility for overseeing the implementation of those strategies. Compared with the CEDC, we found that several state economic development boards/commissions (i.e., CO, OR, UT, MA) perform similar functions as the CEDC in that they review and approve funding decisions for certain financial incentives or economic investment projects. Some boards, (e.g., FL and NJ) have greater responsibility in overseeing the agency's direction. The boards in Florida and New Jersey, in fact, have the authority to approve the agency's overall budget. Some of the boards/commissions in other states (i.e., MD and WA) are structured to serve primarily in an advisory capacity. They make policy recommendations to the state economic development agency and the Governor without direct involvement at the program level.

A summary of duties and responsibilities for each state's board/commission is shown as below:

### *Agency Governing Board*

#### *Oregon Economic Development Commission*

- Develop and maintain an economic development policy for the state
- Oversee the Oregon Economic & Community Development Department and provide economic development policy direction for the agency
- Approve bond financing of economic development projects and making loans

#### *Enterprise Florida, Inc. Board of Directors*

- Establish, implement, and manage policies, strategies and programs for Enterprise Florida, Inc.
- Maintain fiduciary responsibilities for Enterprise Florida – a not for profit corporation
- Develop a strategic plan for the state, in conjunction with other state and local and regional partners.

#### *New Jersey Commerce and Economic Growth Commission Board of Directors*

- Provide links to business community and resources for the Commission
- Provide access to key business leaders in the state
- Provide policy recommendations and decisions for the Commission

#### *New York Empire State Development Corporation Board of Directors*

- Oversee the Empire State Development Corporation
- Create local subsidiary organizations to manage specific projects or economic development activities

### *Program Oversight and Management Board*

#### *Colorado Economic Development Commission*

- Develop and implement programs for the promotion of economic development in Colorado
- Approve loans and grants from the economic development fund to help existing businesses expand and new companies locate to Colorado
- Implement marketing programs to support ongoing business activities
- Make policy decisions concerning the state Enterprise Zone program

#### *Massachusetts Economic Assistance Coordinating Council*

- Administer the Economic Development Incentive Program
- Designate Economic Target Areas, Economic Opportunities Areas, and Certified Projects – the three steps required to be certified to participate in the Economic Development Incentive Program

#### *Utah Board of Business and Economic Development*

- Promote and encourage business development, attraction and retention.
- Advise the Division on business development, attraction, retention and expansion efforts within the state
- Administer any money or program for business assistance, retention or recruitment

### *Advisory Board*

#### *Maryland Economic Development Commission*

- Develop and update a statewide strategic plan for economic development
- Establish economic development policy and oversee the Department's efforts to attract and retain businesses and jobs
- Recommend to the Governor program and spending priorities necessary to implement the strategic plan
- Advise the Department Secretary on regulations for financing programs and on the allocation of financial incentives

- Raise funds from the private sector to supplement economic development programs and financial incentives to business

***North Carolina Economic Development Board***

- Provide economic and community planning for the state
- Make budget appropriation recommendations for economic development programs to the Governor
- Make policy recommendations to the Commerce Secretary, the General Assembly, and the Governor

***Washington Economic Development Commission***

- Develop and update the state's economic development strategy and performance measures
- Provide advice to and oversight of the Department of Community, Trade and Economic Development

Because it does not oversee the entire agency, we have categorized the Arizona CEDC using this typology as a "Program Oversight and Management Board." It has a limited fiduciary role somewhat similar to the governing boards of Florida and New Jersey, but it does not have responsibility for many aspects of the agency. In this way, it is very much like the Utah DBED board. It is different in its involvement with framing the agency's strategy planning efforts, similar in form to Oregon. This involvement provides an opportunity for the CEDC to influence the broader agency functions. This dual role suggests that the CEDC has an opportunity to expand its role. The true strength of the CEDC depends on the willingness of the governor and the agency's leadership to depend on the CEDC advice and utilize it in shaping the state's broader strategic economic development direction and budget priorities.

## Makeup and Selection of Board or Commission

As Table 3 illustrates, the CEDC consists of nine members; the agency director and eight others appointed by the Governor and confirmed by the Senate. The Commerce director also serves as the board chairman. Each appointed member serves three-year terms, and their professional backgrounds must be in the areas of finance, international trade, business management, environment, economics, or economic development. With a relatively small number of members, the commissioners work closely with the agency staff to offer their technical guidance to the state agency. Furthermore, because of the small size, it is critical that the Commerce director agree with the perspectives and opinions of the Commission members.

Other states, including Oregon, Colorado and Utah, also have a relatively small number of board/commission members involved in making funding and policy decisions for the agency. For example, Colorado's EDC has nine members, five of them are appointed by the Governor, two by the President of the Senate, and two by the Speaker of the House. Each member serves at the pleasure of the Governor with no fixed term. No legislative members are allowed to be on the Colorado EDC. The economic development director is also appointed by the Governor as one of the EDC's voting members.

Oregon's EDC consists of only five members appointed by the Governor and confirmed by the Senate. The Oregon's commissioners serve staggered four-year terms. The Oregon EDC members represent different regions of the state. No single political party may dominate the board, and at least one of the commission members must have substantial experience in international trade. The agency director is not a member of the EDC. Instead, he or she serves as the primary staff person to the EDC.

Utah's Board of Business and Economic Development consists of 15 members appointed by the Governor to staggered four-year terms of office. Their appointment requires the consent of the Senate. The Governor selects the chair, and board members are typically limited to a total of eight years service. The agency director is not a member of the board. The Board created five subcommittees to address specific policy needs and priorities, including an Incentives Committee, Business Development Committee, Best Practices Committee, Legislative Issues Committee, and University Centers of Excellence Committee.

Enterprise Florida is actually a non-profit organization that receives an annual renewable contract from the Governor's office to operate the state's economic development activities. The Enterprise Florida Board is a governing board in its purest sense. The 58-member board includes a number of funding partners as well as the 30 statutorily required seats. The board oversees the nonprofit's activities and approves its annual budget. The Governor serves as chair of the board with the Vice Chair representing the private sector. The Governor's office also retains significant control of the organization's funding as the Governor's economic adviser serves as the primary contract administrator for Enterprise Florida.

Those states with Policy Advisory Boards appear to have structured their boards quite differently from the CEDC. The common features among the boards in North Carolina and New Jersey are that they tend to have (1) a larger number of people serving on the board, (2) the chair is explicitly named by the Governor or the Governor himself serves as the chairman, (3) representatives from different state agencies involved in the state's economic development efforts frequently serve as ex-officio members, (4) state lawmakers serve as voting or non-voting members on the board, and (5) the Boards have organized subcommittees to address various economic development issues and make recommendations on their designated policy area to their respective Board for final action.

Maryland's EDC is somewhat different from the other advisory boards in that it is composed of 25 private sector members who serve in an advisory capacity to the agency. In 2002, the Washington Competitiveness Council, a 36-member blue ribbon panel recommended the creation of the Washington Economic Development Commission to serve a similar function for the Washington state Department of Community, Trade, and Economic Development (CTED). That state's legislature passed statutory language during the 2003 session establishing the 7-member EDC. While the goal of the Washington EDC was to provide policy oversight and direction, it has not yet gotten off the ground. Agency staff indicated that the EDC was being reorganized to serve as an advisory group beginning July 2004.

**Table 3: Makeup and Structure of Board or Commission**

| State | Size of the Board | Make up of the members | Member Selection Procedure | Role of ED director or Commerce Secretary | Terms of services |
|---|---|---|---|---|---|
| AZ | 9 | 8 public members and the ED director | Appointed by the Governor and confirmed by the Senate. Requires members to have experience in finance, international trade, business management, environment, economics or economic development | Serves as chairman | 3 years |
| CO | 9 | 5 appointed by the Governor, 2 by the Senate and 2 by the House | Appointed by the Governor, the President of the Senate, or the Speaker of the House | Serves as a voting member. Director of Local Affairs Department is also a member. | At the pleasure of their appointing authority |
| FL | 30 | 18 government officials and 12 members from the private sector; The actual number is currently 58 because business people who invest more | Of those 12 private sector members, 6 are appointed by the Governor, 3 are appointed by the President of Senate, and 3 are appointed by the Speaker of the House. All appointees are confirmed by the Senate. The private sector members should be diverse in race, ethnics, gender, and geographic distribution. Members should have experience in international business, with expertise in transportation, finance, | The Governor is the Chair of the Board. President of Enterprise Florida is not a member, but serves as record keeper for the Board. Other public officers serve as members include the state's Chief Financial Officer, Education | Appointed members serve for terms of 4 years |

| Table 3: Makeup and Structure of Board or Commission | | | | | |
|---|---|---|---|---|---|
| **State** | **Size of the Board** | **Make up of the members** | **Member Selection Procedure** | **Role of ED director or Commerce Secretary** | **Terms of services** |
| | | than $50,000 in the Enterprise Florida, Inc. are eligible to sit on the Board. | law, and manufacturing. | Commissioner, Workforce director, and the Secretary of the State. Two legislative members are ex officio. | |
| MA | 11 | 4 government officials and 7 members from the private sector appointed by the Governor. | 7 appointed members should be selected from different regions of the state. Members must have expertise in training, business relocation, and inner-city and rural development or they must be knowledgeable in public policy and international and state industrial trends. | The director of ED Dept and the director of Housing and Community Development Dept serve as co-chairperson. Other public officers include the director of Labor and Workforce Dev. and the president of the Commonwealth Corporation. | Serve at the pleasure of the Governor |
| MD | 25 | 25 members from the private sector and ED organizations | All members are appointed by the Governor with consideration given to geographic and industry representation. | The Secretary serves as a nonvoting ex officio member. The Governor designates a chairman from the voting members. | 3 years |
| NC | 37 | 14 members from government and the education system, and 23 from the private sector and ED organizations. | 14 public sector members include the Secretary of Commerce and Revenue (both are ex officio members), 8 state legislators, the President of the University of NC, the President of the NC Community College system, the Secretary of State, and the President of the Senate. Of the remaining 23 members, 1 should come from an ED non-profit organization and two from county ED groups. All of them should reflect the ethnic and gender diversity of the state. The Governor designates a chair and a vice-chair. | The Secretary of Commerce serves as ex officio and as the secretary of the board. | Appointed members serve for a staggered term of 4 years |
| NJ | 13 | 6 ex officio members, 5 public members appointed by the Governor, and 2 non-voting legislators | Of 5 public members, 3 members must have appropriate geographic representation from throughout the State, and should not all from the same political party. The remaining 2 members should be recommended by the Senate and the General Assembly respectively. | The Secretary of Commerce Commission is one of the members. The Governor serves as the chair. Other ex officio members include the Commissioner of Environmental Protection, Labor, Transportation, and Higher Education. | 3 public voting members serve a five year term. 2 remaining voting members appointed by the Governor serve at the pleasure of the Governor |
| NY | 9 | 7 public members and 2 ex-officio members | 7 public members are appointed by the Governor with the consent of the Senate. | The Commissioner of Economic Development serves as the chairman of the board. | N/A |
| OR | 5 | 5 members from the private sector | Members are appointed by the Governor and confirmed by the Senate with consideration given to geographic representation. Not more than 3 members may belong to one political party. At least one member should have substantial experience in international trade. | The ED director is not a member. | 4 years |
| TX | 9 | 9 public members | All members are appointed by the Governor with the consent of the | The director Texas Economic Development | Serve a staggered term |

| Table 3: Makeup and Structure of Board or Commission | | | | | |
|---|---|---|---|---|---|
| **State** | **Size of the Board** | **Make up of the members** | **Member Selection Procedure** | **Role of ED director or Commerce Secretary** | **Terms of services** |
| | | appointed by the Governor | Senate. Members should represent different geographical regions of the state. One member should be the resident of the county with a population of less than 30,000. | is not a board member. | of 6 years. |
| UT | 15 | 15 public members | All members are appointed by the Governor with the consent of the Senate. Should not serve more than two full consecutive terms except for the best interest of the state. The Governor selects a chair. | The director of the Business and ED is not a member. | Serve for a staggered term of 4 years |
| WA | 7-9 | At least 7 and no more than 9 members appointed by the Governor | Appointed members should provide geographic and ethnic representation. A minimum of 75% of the members should represent the private sectors. | The ED director is not a member. | 3 years |

## Staffing for the Board/Commission

The Arizona CEDC has two staff members, one is the executive director for the Commission and the other staff person serves as its portfolio manager. The staff members provide administrative support for the commissioners and manage projects funded through the CEDC fund. The CEDC also accesses other Commerce Department employees to provide research support and technical assistance. For instance, Commerce business attraction and service division staff helps in closing deals for the CEDC projects.

Like Arizona, some states, including Colorado, Maryland, and North Carolina, have designated development agency employees to staff the commission or board. In Colorado, the commission has three staff, one executive director and two other staff persons charged with program management and administrative work, including the production of annual report and marketing activities. In Maryland, the Department of Business and Economic Development assigns two staff to provide administrative support to the Commission. These staff persons also serve as liaisons for the Commission to coordinate with other state agencies and commissions on related economic development issues. The Commerce agency in North Carolina has dedicated two part-time staff to support the board, including organizing board meetings, managing the website, conducting research, and writing reports.

In the other states, the Commission does not have dedicated staff, but the agency provides staff support. In Florida, the president of Enterprise Florida is the statutorily designated staff person for the board. He or she serves as record keeper for the Board. However, as the process of developing strategic plans for the state continues, the board found an urgent need for employing its own staff to provide assistance in managing board activities and related communications. Currently, the organization is in the process of creating a director position for the board.

For those boards/commissions that do not have their own staff, most of their research and administrative work rely on various agency staff members as needed. The state agency normally assigns a staff to serve as a liaison to coordinate and manage various research and administrative needs within the department. This type of staff structure is illustrated in New Jersey, Oregon, and Washington. For those boards/commissions that are organized into subcommittees, the corresponding division staff from within the agency provides staff support to the board.

## The Operations of the Board

Most of the boards or commissions are mandated to meet at least four times a year, or as often as there duties require. The exceptions to this practice are the Arizona CEDC and Utah Board of the Division Business and Economic Development. The CEDC meets every other month, and the Utah Board meets monthly. For the Arizona CEDC and the Utah DBED board, frequent meetings are deemed necessary because they are responsible for reviewing financial assistance applications. In North Carolina, the full board meets quarterly, but the board's Executive Committee meets monthly to plan the agenda for Board meetings and address issues which may arise between quarterly meetings. Most board meetings are held in formal public sessions, requiring notice to the general public in compliance with state "sunshine" laws. The lone exception to this rule is the Arizona CEDC, which can go into executive session in order to maintain the confidentiality of information provided by applicants.

For some states the meeting location is typically held at the state agency (i.e., AZ, UT), while others tend to organize their board meetings in various locations around the state in order to encourage the participation and involvement of local community leaders (i.e., FL, NC, OR). All of the states indicated that board members receive no compensation but are entitled to reasonable travel and other expenses incurred in the performance of their duties. Most Commissions or Boards are required to produce an annual or biennial report to the Governor and the legislature.

### *Project application and review process*

In addition to the Arizona CEDC, only three states (Colorado, Oregon, and Utah) authorize their economic development commission or board to have control over money for funding businesses or communities. The Massachusetts Economic Assistance Coordinating Council certifies communities as eligible to receive special tax rates or tax increment financing, but it does not actually have a budget or allocate resources to individual projects.

It is instructive to compare how Arizona makes resource allocation decisions with the process used by other states. The CEDC has a specific process in evaluating the likelihood that proposed qualified projects will help to create jobs within the state through the retention, expansion or attraction of businesses or qualified projects. Those projects deemed most meritorious are funded. Applicants must deliver their proposals at least two weeks in advance of the monthly CEDC board meeting. In addition to posting business lending opportunities in the agency's website, some of the outreach activities include tapping the staff of the business attraction unit of the Commerce Department to disseminate the information about pertinent programs. As mandated in the statute, the staff must conduct a cost-benefit analysis on each application. The application must also be analyzed according to a set of criteria that include the estimated value of state and local tax returns, the number of jobs created/retained, wages, capital investment, and other economic benefits made as a direct or indirect result of such project.

Based on the analysis, the Department's management team makes recommendations to the Commission regarding the amount and type of assistance, and then forwards the application and the Department's recommendations to the CEDC for final review and approval. Primarily due to financial constraints, the CEDC only funded 16 projects through the Arizona CEDC Fund in during the period 00-03, with ten projects funded in FY 04. The size of funding ranged from $22,000 (for a research study related to venture capital development) to $250,000 (to support implementation of the recommendations of the Governor's Council on Innovation and Technology).

By comparison, the Colorado EDC has much greater flexibility in terms of the procedures of making financial assistance to businesses, local communities and economic development organizations. The Colorado Commission develops its own operating guidelines for financing projects. The general guiding criteria include the amount of grants or loans, the number of jobs created, the quality and wage level of jobs created, the number of local residents being employed, the intent to contract with local residents and companies, and the public benefits expected to result from such investment.

One difference is that the Colorado EDC requires matching funds from project applicants located outside the state's enterprise zones. The Colorado EDC provides grants or loans for local economic development projects while offering grants for business marketing or development projects. Colorado's EDC makes investments in response to the state's overall economic development strategy, which historically identified rural Colorado as an important focus. Many of the Colorado EDC-funded projects were in rural communities in 2001 and 2002. In 2003, the agency changed its development strategy to focus on retaining and creating quality jobs, and as a result, many more of the projects funded were located in urban areas.

The Colorado EDC funded more than 100 projects in last three years. Half of the projects funded were targeted to development activities in the state's Enterprise Zones. In 2003, the Colorado EDC invested nearly $2.5 million in 16 projects to support business attraction and expansion activities across the states. Almost every EDC applicant located outside an enterprise zone was required to provide a match of least 50 percent of the total project costs, and many exceeded that minimum match requirement. In fact, the EDC's $2.5 million investment leveraged $7.1 million in local investments, $1.2 million in private funding, and an additional $719,000 from the Colorado First customized training fund. In addition to these statewide activities, the EDC funded another $338,000 in projects targeted to for enterprise zones last year. The zones primarily used these grants for marketing purposes, and no funding match was required to leverage EDC investments for this purpose.

In Oregon, applications are handled using one of two procedures. One approach taps the network of small business service providers in the state. Oregon shares information about and accepts applications for funding opportunities through these organizations. The second approach is used on an as-needed basis in which the agency's regional officers work with businesses and local communities and organizations to apply for financial assistance. The agency relies on its regional officers to help applicants identify which funding sources are appropriate for their financial needs. The selection criteria vary from program to program, and each has its own administrative rules and standard application formats. Projects are funded based on which appear to have the greatest likelihood to achieve minimum performance goals. The key performance measures used include job creation and/or retention, wages, export sales, and investment.

The Oregon EDC adopted 27 performance measures in 2000, and since then the funding recipients have been required to make a quarterly report about their progress in achieving these measures. The Oregon EDC funded 339 projects last year, ranging from $9,000 (for consulting research) to $7.1 million (for an infrastructure project). The Oregon EDC's investments include projects in both rural and urban areas, infrastructure activities, sewer/water projects, business development (mostly small loans), industrial development bonds, and technical assistance grants. Nearly three-quarters (71%) of grants were directed to rural areas in 2002-2003. This exceeded the 65% target set by the agency. For instance, the community development and infrastructure programs are targeted to rural areas.

The Utah Board of Business and Economic Development holds monthly meetings to review and approve applications for the Industrial Assistance Fund (IAF). Companies interested in applying for the IAF are asked to contact the agency's staff. The staff screens applications using a pre-determined set of key criteria before the application is submitted for Board consideration. These criteria include the number of new jobs being created that pay higher than prevailing wages, the amount of capital investment in plant and equipment, and the purchases made from Utah vendors and taxable sales. The agency makes grant disbursements on a post-performance basis, meaning that the firm or project receives funding only after the promised jobs have been created and retained. If the new jobs indicated in the proposal do not exist after five years, companies may be required to pay back any investment that they have received or they may no longer be eligible to receive previously approved grant disbursements.

In Utah, the incentive commitments from the Industrial Assistance Fund range from $40,000 in rural areas to $3.75 million in urban areas. This particular funding stream was established in 1992 by the state legislature with $10 million, and over the years the fund balance has grown to about

$25 million.  In 2003, the Board approved incentive commitments to 11 companies from the Utah Industrial Assistance Fund and tax increment rebate funding to two companies in Aerospace/Aviation Development Zones.  The IAF actually consists of three basic programs. One of them is the Rural Utah Program, which has a focus on job creation in rural areas. The Fund's other two programs are aimed at encouraging corporate headquarters and investing in certain state-designated targeted industries.

While the Massachusetts Economic Assistance Coordinating Council does not allocate resources per se, one key responsibility is to designate the economic target areas eligible to receive assistance. While certain areas are targeted, these are selected based on a combination of distress and opportunity, and they include both rural and urban regions.

### *Delivering and monitoring assistance*

Among these strategic funds, most states have opted to make investments in traditional forms – via either grants or loans.  Several states have equity participation programs, but none of these equity investment programs are actually managed by the state's commission or board.  Most equity investment activities have been turned over to professional fund managers.  In fact, the majority of strategic fund investments are offered in the form of grants because even lending programs require financial analysis and management expertise that few commissions or boards have readily available.  At the same time, the lending programs that states do have in place are placed under the care of experts who have fiduciary responsibility for the fund.  Quite often, states have created financing authorities with expertise in commercial lending to oversee loan funds.  These lending programs do not qualify as strategic funds, but they are important to the economic development toolkit of many states.

Whether the program offers grants or loans, several states have established clawback provisions for some or all of their programs to ensure that the benefiting firm delivers on the promised job creation and investment.  Good Jobs First, a Washington, DC-based think tank focused on business incentive policy reform, tracks legislation that includes clawback provisions.  Table 4 summarizes that organization's most recent findings on state clawback provisions.

**Table 4:  States with Clawback Provisions**

| State | Program | Statute |
|---|---|---|
| Arizona | Eligibility for economic development assistance | 41-1505.07 |
| California | Economic Revitalization Manufacturing Property Tax | Rev. & Tax Code Sec. 5108 |
| Connecticut | All business incentives | 32-5a-1 |
| Georgia | Business Expansion Tax Credit | 48-7-40.21 |
| Illinois | Community Investment Recovery Act<br>Corporate Accountability For Tax Expenditures Act | 740 ILCS 30/5<br>20 ILCS 715/25 |
| Iowa | Good Neighbor Agreement<br>New Jobs and Income Act<br>Enterprise Zones | 15A.4<br>15.330<br>15E.193 |
| Maine | Jobs and Investment Tax Credit | 36-5215 |
| Maryland | Job Creation Tax Credit<br>Property Tax Credit | 83A-5:1102<br>9-230 |
| Michigan | Economic Growth Tax Credit | 208.37c |
| Minnesota | All subsidies | 116J.994 |
| Nebraska | Employment and Investment Growth Act<br>Employment Expansion and Investment Incentive Act | 77:4107<br>77: 27,188 |

| Table 4: States with Clawback Provisions | | |
|---|---|---|
| **State** | **Program** | **Statute** |
| Nevada | Business Tax Abatement | 360.750 |
| North Carolina | Job Development Investment Grant | 143B-437.59 |
| Ohio | Corporate Franchise and State Income Tax Credits | 122.17 |
| Oklahoma | Investment Tax Credit | 68 Sec. 2357.28 |
| South Carolina | Investment Tax Credit | 12-14-60 |
| Vermont | Economic Development Mortgage Loans | 10:12.264 |
| Virginia | Major Business Facility Job Tax Credit | 58.1:439 |
| West Virginia | Business Investment and Jobs Expansion Tax Credit | 11-13C-8a |

***Source: Good Jobs First, January 2004***

## Budget Comparisons

ACCRA gathered data on 2004 state economic development budget allocations for Arizona and each of the 18 competitor states. Comparing these investments across states is challenging for a number reasons. States organize their economic development agencies and functions in a variety of ways. For instance, some states combine economic and community development activities, business regulatory and development functions, tourism, or economic and workforce development efforts into a single agency. Others separate some or all of these functions from economic development into separate housing and community, workforce, tourism, and business licensing agencies.

To further complicate the issue, policy makers use a variety of relatively common terms to mean different policies. For some states, economic development is used as a synonym for business recruitment or attraction activities while others use this as a broader term referring to local investments in community facilities as well as direct assistance to firms. This effort aimed to examine the most common development related functions to create a combined economic development budget. A 1996 study[11] of federal economic development policies found more than 450 programs, and economic development efforts in 50 states are likely to be just as complicated. Our analysis targeted the most significant investments made by 39 different agencies providing economic development programs in the 19 study states.

In 2004, Arizona allocated $59.3 million for economic development and tourism activities according to data provided by the agency and the state legislature. Federal grants accounted for nearly $5.5 million of that amount so the state's investment in economic development and tourism programs totaled nearly $54 million. Of the $54 million state investment in economic development and tourism programs, Arizona Department of Commerce efforts accounted for $36.7 million, and almost all of the remainder was allocated to the state's tourism office. According to the state's Joint Legislative Budget Committee, Commerce received $3.6 million in General Revenue Funds, covering the basic operations of the agency, including personnel costs. Commerce also received $3.1 million through the Commerce Economic Development Commission and State Lottery Funds, $156,000 in oil overcharge dollars, and $120,000 in bond funding. The CEDC's lottery funds allocated to the Department of Commerce represented less than half of the total legislative appropriation for that fund as approximately $4 million was allocated to legislative appropriations. In addition, the agency received a $30 million allocation from the Job Training Fund, financed by the state's unemployment insurance program.

The state's tourism program complements the Commerce Department's efforts, but operates from a separate agency. The tourism office received $9 million in General Revenue Funds and $7.5 million from the Tourism and Sports Authority as well as tribal gaming revenues.

Arizona is not the only state in which special funds account for the majority of resources for economic development. Approximately 37 percent of Arizona's state economic development, job training fund, and tourism allocations are made from general fund dollars. This proportion is slightly lower than its competitor states. About 40 percent of other state investments are made from general funds. Certain states, including North Carolina and New Hampshire tap general revenues for 100 percent of their state's economic development funding. In contrast, Oregon and Texas allocate 1 percent or less of their economic development funding from general revenues. Oregon dedicated funding from the state's lottery to pay for economic development activities.

The Texas budget is composed almost entirely of the $295 million biennial appropriation for the Texas Enterprise Fund, a "deal closing fund" created in September 2003 to invest in several major projects including $40 million for the nonprofit Sematech research consortium, $3.6 million for the Texas Energy Center in Houston, $50 million for a semiconductor research facility at the University of Texas at Dallas in collaboration with Texas Instruments, and $25 million for a

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[11] *National Academy of Public Administration, "A Path to Smarter Economic Development: Reassessing the Federal Role," prepared for the US Economic Development Administration and the Annie E. Casey Foundation, November 1996.*

biomedical imaging research center at the University of Texas Health Sciences Center with General Electric Medical Services.[12] Florida's Economic Development Transportation Fund, Georgia's Economic Development Growth and Expansion (EDGE) Fund, New York's Economic Development Fund, Utah's Industrial Assistance Fund all invest more than $10 million for grants and loans. New Mexico created a $220 million Invest New Mexico revolving fund in 2003 aimed at providing equity capital for New Mexico businesses. The NM fund taps the State's Severance Tax Permanent Fund to provide capital for co-investments in businesses. These investments are made primarily through 13 existing venture capital funds. Other states have similar programs (including Colorado's now defunct $41 million capital access company – CAPCO – program aimed at fostering seed and venture capital investment in companies within their borders).

For 2005, the Florida legislature is considering a proposal to expand its $6 million "Quick Action Closing Fund" to $25 million. The North Carolina legislature is considering a $20 million "One North Carolina Fund," quadruple the amount of that program's historical funding level. New York already has increased its fund by half, from $40 million to $60 million in 2004.

Other states also have special trust funds for economic development. Florida receives 60 percent of its state economic development funding from several dedicated trusts, including separate funds for economic development, tourism, international trade, economic development transportation, and brownfield remediation. In addition to the EDGE deal closing fund, Georgia created the One Georgia Fund from its tobacco settlement money to provide assistance to local communities in diversifying their economic base. Massachusetts taps its workforce training and tourism funds to support economic development. New Jersey and New York also have special tourism funds to support their promotion and advertising efforts. In addition, New Jersey created an economic development site fund. New Mexico generates revenues from its tourism promotion magazine to support that publication as well as other tourism-related activities. California, Utah and Virginia have infrastructure banks, using bond proceeds to support their economic development financing efforts. Washington State uses its housing trust fund to support community economic development activities. When compared with its competitor states, Arizona's efforts are similar in breadth, but are significantly smaller in the amount of economic development resources available.

## The Federal Share of Economic Development Funding

In 2004, the 18 competitor states invested a total of $1.7 billion in state general fund or other state money for economic development purposes. This amount does not include federal funding, which is reported at an additional $1.5 billion for the study states. Arizona has a track record of under-capitalizing in the attraction of Federal funds.[13] Arizona's competitor states were able to attract $8.97 per capita in economic development-related federal funding as compared with Arizona's $0.89.[14] Nearly three-quarters of the federal funding consists of workforce and community development dollars. Both Virginia and Minnesota, for instance, report their entire Workforce Investment Act (WIA) federal grants as part of their agency budget. A substantial portion of WIA training funds is operated through the North Carolina Department of Commerce and the Illinois Department of Commerce and Economic Opportunities. For instance, the VA, MN, NC, and IL federal share of workforce dollars account for a combined $1.0 billion of the $1.5

*[12] The Texas Governor controls allocations out of the Enterprise Fund with the consent of the Lt. Governor and Speaker. The remainder of the agency, which is part of the Texas governor's office, is designed to support Texas cities and counties that are allowed to impose an optional 0.5 percent sales tax for economic development. These are among the publicly reported projects based on internal management documents provided by the Texas Office of the Governor.*

*[13] Tom Rex, "Federal Funds Received in Arizona," prepared by the Arizona State University Center for Business Research for the Citizens Finance Review Commission, September 2003.*

*[14] Note, as explained later in this report, several competitor states report large federal investments from Community Development Block Grants through the US Housing & Urban Development and US Department of Labor grants for workforce services and training, as well Community Services Block Grants. When these programs are excluded, the per capita federal budget for economic development declines to $0.44 per capita.*

billion of federal funding reported in the survey.[15] Community development accounts for an additional $330 million of that $1.5 billion amount, dominated by Washington, Illinois, Virginia, and North Carolina.

That leaves approximately $170 million to share across the 18 states for other federal economic development program activities. The most important of these include community services programs in Washington State, business finance programs operated through Georgia, Oregon, North Carolina, Arizona, and Colorado, and manufacturing extension services in Illinois. The US Department of Energy provides much of Arizona's $5.5 million federal funding in support of business grants to improve energy efficiency.

Because programs such as the Us Department of Housing and Urban Development (HUD) Small Cities Community Development Block Grant are allocated to a variety of agencies, the difference in the amount of federal funding across agencies is difficult to compare directly. For instance, the Small Cities CDBG program is operated through North Carolina's Department of Commerce office of community development while the same program is operated by Arizona's housing agency. This difference in where the funds go definitely can influence how the funds are used since NC DOC uses a portion of its state CDBG funds as match for US Economic Development Administration grants while Arizona does not have similar access. In addition, other agencies with programs supporting economic development, such as the US Department of Defense, the US National Institutes of Standards and Technology, and the Environmental Protection Agency, do not appear to provide significant funds to Arizona.

## State Funding for Economic Development

The remainder of this section focuses entirely on state investments in an effort to understand Arizona's policy priorities and their impact on state investments. The average state investment in economic development for these 18 states in 2004 was $96.1 million as compared with Arizona's $54 million. The investments of other states ranged from $9 million in California and Colorado to $271 million in New York. Due to a very serious budget crisis, California completely eliminated its Department of Technology, Trade and Commerce in 2003. Some elements of the agency continue to operate in 2004 as part of the Economic Development Program within the Agency for Business, Transportation, and Housing. However, no new funding is expected for these activities in 2005.

Arizona's 2004 budget for economic development and tourism represents a $9.73 investment for each state resident.[16] This investment is slightly below average and places Arizona near the bottom in comparison to its competitors. On average, the other 18 states invested $10.38 per capita in economic development activities. Table 5 places Arizona 14th among the 19 competitors in its investment behind New Mexico (excluding that state's Invest New Mexico fund), Colorado, North Carolina, and Virginia. States with relatively larger budgets tend to invest significantly in community assistance, workforce development, and tourism. They also tend to have large strategic economic development funds.

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*[15] Note: The survey conducted focused on economic development agencies. Federal funding for workforce development was only included in this discussion if it were allocated within the state economic development agency. Virginia and Minnesota represent the only two states among the competitors in which all workforce training programs were operated through the same cabinet level agency as the economic development agency. In other states, the same programs are separated, thus the Federal investment data is not precisely comparable across the states for the Federal portion of this activity.*

*[16] Of the total per capita amount, nearly 1/3rd or $3.01 per capita is invested in tourism.*

| Table 5: Ranking of State Economic Development Investments (including tourism), 2004 | | |
|---|---|---|
| Per Capita Rank | State | Per Capita Budget |
| 1 | Oregon | $ 47.55 |
| 2 | Minnesota | $ 32.69 |
| 3 | Utah | $ 29.85 |
| 4 | Maryland | $ 20.46 |
| 5 | Texas | $ 14.47 |
| 6 | New York | $ 14.12 |
| 7 | Illinois | $ 13.34 |
| 8 | Georgia | $ 12.13 |
| 9 | Washington | $ 11.92 |
| 10 | New Mexico | $ 11.59 |
| 11 | Colorado | $ 11.06 |
| 12 | North Carolina | $ 10.52 |
| 13 | Virginia | $ 9.83 |
| **14** | **Arizona** | **$ 9.73** |
| 15 | New Hampshire | $ 7.29 |
| 16 | Florida | $ 5.72 |
| 17 | Massachusetts | $ 5.24 |
| 18 | New Jersey | $ 3.69 |
| 19 | California | $ 0.27 |

For Arizona, investments in workforce development, community assistance, and tourism account for 86 percent of the total state investment in economic development. If these three categories of funding were excluded from our definition of economic development for Arizona and its 18 competitor states, Arizona's budget for core economic development is about $7.9 million or $1.42 per capita. The state's per capita investment ranking among the 19 competitor states is 17th, ahead of only Massachusetts and California (see Table 6). This amount is 24 percent of the average competitor state per capita investment of $6.00 and slightly more than 10 percent of the per capita investments made by the most aggressive states (Maryland, New York, Utah, and Texas) in these so-called "core" economic development functions.

| Table 6: Ranking of State Economic Development Investments in "Core Functions" (excluding Workforce Development, Community Assistance, and Tourism), 2004 | | |
|---|---|---|
| **Per Capita Rank** | **State** | **Per Capita Budget** |
| 1 | Maryland | $13.69 |
| 2 | New York | $12.98 |
| 3 | Utah | $12.84 |
| 4 | Texas | $12.52 |
| 5 | Colorado | $ 9.71 |
| 6 | Oregon | $ 8.77 |
| 7 | Washington | $ 8.39 |
| 8 | North Carolina | $ 8.06 |
| 9 | Illinois | $ 6.74 |
| 10 | Minnesota | $ 5.40 |
| 11 | Georgia | $ 5.01 |
| 12 | Virginia | $ 4.97 |
| 13 | Florida | $ 3.66 |
| 14 | New Hampshire | $ 3.02 |
| 15 | New Mexico | $ 2.24 |
| 16 | New Jersey | $ 2.04 |
| **17** | **Arizona** | **$ 1.42** |
| 18 | Massachusetts | $ 0.95 |
| 19 | California | $ 0.25 |

Clearly, other states are investing more in core economic development functions, but how are they investing their resources? In the following section, we look more closely at the types of state investments being made and the policy implications of those investments.

## Allocating State Investments by Program Functions

To organize the 2004 budget data collected, ACCRA categorized spending according to a typology created by the National Association of State Development Agencies. Current ACCRA staff members were the researchers who created this format for NASDA in the late 1990s. The typology offers a way to compare state expenditures in a standardized way. This typology identifies 14 functions that economic development agencies implement and more than 50 activities as subsets of those functions. Table 7 provides a summary of the functions that economic development agencies commonly implement.

| Table 7 – Economic Development Program Functions | |
|---|---|
| ➢ Business Finance | ➢ Entrepreneurial Development |
| ➢ Strategic Business Attraction Fund | ➢ Minority business development |
| ➢ Business Assistance | ➢ Community assistance |
| ➢ International Trade and Investment | ➢ Tourism/Film |
| ➢ Domestic Recruitment/Out-of-State | ➢ Special Industry Assistance |
| ➢ Workforce Preparation & Dev. | ➢ Program Support |
| ➢ Technology Transfer | ➢ Administration |

***Business Finance*** represents direct and indirect lending programs designed to address capital access issues. Business Finance activities encompass functions that help a company borrow money to invest or programs that provide access to capital. The use of the funds can be wide-ranging including leveraging existing capacity or expanding the business. In some cases, funds might be used for the merger, acquisition, or divestiture of a business. In surveying programs, ACCRA keeps current year allocations separate from prior year funding in order to understand the actual annual costs associated with a program and not overstate the actual annual investment in the program. Industrial revenue bond programs are frequently left out of this activity area because (1) they tend to have allocation caps and (2) public subsidies primarily come from federal tax exemptions provided to bond investors. Arizona invested $1.4 million in business finance programs (including $700,000 in carry over funds). The source of the funds for these programs was appropriations made from the CEDC Fund. By comparison, the 18 competitor states invested a total of $291 million (or an average of $16.2 million) in business finance programs. New York, Maryland, Florida, and North Carolina accounted for 83 percent ($241 million) of the state investment made in financing programs by competitor states. On a per capita basis, Arizona (at $0.25) rates tenth of 11 competitor states reporting business finance programs.

A ***Strategic Business Attraction Fund*** represents resources allocated to unique projects that may not be funded from an existing budgeted program. These funds are somewhat difficult to identify, in part, because they tend to be reported as "off-budget," meaning they do not show up in agency legislative appropriations bills. According to a March 2004 study of state "deal closing funds," 25 states have or have proposed 36 different strategic funds.[17] The report notes that these funds are used primarily to stem off competition from other states, use general fund or other legislatively appropriated revenue streams, provide grants rather than loans, can be used for a wide variety of activities (mostly focused on infrastructure and capital equipment), and can be awarded to businesses, governments, or public institutions. These funds do not typically include job training or other incentives offered through existing economic development programs.

Without access to a strategic business attraction fund, one might expect that a state (a) might not have been able to provide the incentive for a strategically important project OR (b) might have required legislative authorization to offer a competitive incentive package. States that have these funds are said to have the ability to act quickly to offer cash or infrastructure incentives that require incentives greater than those available in standard economic development programs.[18]

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*[17] Cindy Ellison, "Survey of State 'Deal-Closing' Funds and Other Incentive Grant Programs for Job Creation," Texas Legislative Council, March 2004.*
*[18] Stephen Moret, "Considering a 'Deal Closing Fund' for Louisiana," Public Affairs Research Council, April 2002.*

A Strategic Business Attraction Fund generally has basic eligibility criteria, but its use is left up to the discretion of the head of the agency or a governing body. These funds are known by many names and fund a wide variety of projects, but the resources are allocated at the beginning of the fiscal year and used for economic development projects that the agency might not have expected to happen.

The pre-authorization for these projects is done to provide the agency flexibility in responding to unique economic "opportunities." Frequently, states created these programs when they found that the legislative process required to get funding for "mega-deal" incentive projects was deemed burdensome. Based on statutory authorization, Arizona's Commerce and Economic Development Commission Fund (CEDC Fund) was clearly intended to be just such a program. However, the Arizona CEDC Fund no longer meets the definition we use for these funds because such a significant portion of the fund is subject to legislative appropriations related to existing Commerce programs or staff.

The average amount invested in Strategic Attraction (or "deal closing") funds for all 18 states was about $17 million per state. Twelve of the 18 competitor states boasted such programs, ranging in size from Washington State's $125,000 program to $147,500,000 Texas Enterprise Fund (one-half of the $295 million biennial allocation). New York, Utah, and Florida join Texas in having funds with greater than $20 million allocations. North Carolina and Georgia are considering changes that would boost their funds above $20 million. Only six competitors are like Arizona and have no Strategic Fund.

***Business Assistance*** programs are often focused on helping the firm's manager develop and improve his or her business management skills in the area of financial management and business strategy. These programs might include activities such as the efforts of small business development centers as well as counseling programs geared for small businesses. Business assistance programs might also include procurement technical assistance, small business ombudsmen, and related regulatory assistance. For the purposes of this analysis, equity investments or assistance to start-up firms are not included as "business assistance" programs. Any program that has an explicit or implicit age-of-firm requirement (focused on helping only "young firms") would be excluded from this general business assistance category. However, any program designed to develop and assist industry groups within the state would be included.

Arizona invests about $1.3 million for business assistance activities. That amount is comparable to the investment of competitor states. Thirteen of the 18 states invest a total of $20.9 million in these programs. The average investment for all 18 states is $1.2 million. Illinois and Virginia have the most well funded programs, investing more than $4 million each in aiding small enterprises. On a per capita basis, Arizona (at $0.23) ranks 7$^{th}$ among 14 states with funded business assistance efforts.

***International Trade*** programs are geared toward helping the firms compete in the global marketplace. Often, these programs focus on one of two strategies: (1) helping client firms find market opportunities in foreign counties or (2) helping foreign firms find investment opportunities within the state. Increasingly a third option is emerging – helping state and foreign firms find joint venture opportunities aimed at building long-term business relationships that will lead to new sales abroad or investment at home. Export development programs offer firms a way to diversify their customer base, expand their operations and become more profitable. Export services include: (1) assessing company capacity for exporting, (2) market research, (3) information services regarding exporting, trade regulations, transportation, etc., (4) international lead generation, (5) trade shows/exhibitions; and (6) promotional marketing trips. Foreign direct investment (or "inward investment") includes the recruitment of international businesses interested in relocating and/or expanding their operations in the state and/or community. To accomplish these trade activities, many states maintain overseas offices and develop sales and promotional materials for use in foreign markets. Table 8 provides more details about the use of overseas offices and representatives for each of the competitor states.

Arizona invests $1.3 million in its international trade and investment programs (including its Border Authority activities). That amount is slightly below average for its competitor states, which

| Table 8: Number of International Trade Offices and Trade Reps by Continent | | | | | | |
|---|---|---|---|---|---|---|
| **State** | **Europe** | **Americas** | **Asia** | **Middle East** | **Africa** | **Total** |
| Florida | 4 | 4 | 3 | 1 | 1 | 13 |
| Utah | 5 | 3 | 3 | 0 | 0 | 11 |
| Georgia | 3 | 3 | 2 | 1 | 0 | 9 |
| New Jersey | 2 | 2 | 3 | 2 | 0 | 9 |
| New York | 1 | 5 | 1 | 1 | 1 | 9 |
| Illinois | 2 | 2 | 3 | 0 | 1 | 8 |
| North Carolina | 1 | 2 | 3 | 0 | 0 | 6 |
| Oregon | 1 | 1 | 4 | 0 | 0 | 6 |
| Virginia | 1 | 2 | 3 | 0 | 0 | 6 |
| Washington | 1 | 1 | 4 | 0 | 0 | 6 |
| Arizona | 1 | 2 | 2 | 0 | 0 | 5 |
| New Mexico | 0 | 2 | 1 | 1 | 0 | 4 |
| Colorado | 0 | 1 | 1 | 0 | 0 | 2 |
| Texas | 0 | 1 | 0 | 0 | 0 | 1 |
| California | 0 | 0 | 0 | 0 | 0 | 0 |
| Maryland | 0 | 0 | 0 | 0 | 0 | 0 |
| Massachusetts | 0 | 0 | 0 | 0 | 0 | 0 |
| Minnesota | 0 | 0 | 0 | 0 | 0 | 0 |
| New Hampshire | 0 | 0 | 0 | 0 | 0 | 0 |

invest a total of $30 million or $1.7 million per state. By far, Florida invests the most in international trade programs, about $4.6 million in 2004. Georgia, Virginia, and Illinois all invest more than double what Arizona does in promoting international trade and foreign direct investment. At $0.24 per capita, Arizona ranks 9$^{th}$ among 17 states with dedicated international trade funding streams.

***Domestic Recruitment*** is economic development "marketing and sales" targeted to firms within the US. Domestic recruitment in most states has matured well beyond the traditional "smokestack chasing" of the past to a more highly targeted, focused proactive approach. Efforts to clarify a state's competitive position in changing economic conditions and identify those industries where they have (or will create) a competitive advantage should be included here.

Arizona has allocated approximately $500,000 for this activity. Of this amount, 85 percent was appropriated from the CEDC fund. The 18 competitor states invest approximately $28.4 million, or $1.5 million per state. Georgia, North Carolina, and Maryland invest $5 million or more each in domestic recruitment activities. New Mexico invests more than double what Arizona does, and Colorado's investment in marketing and recruitment is 50 percent greater than Arizona. Arizona invests $0.09 per capita, which is 10$^{th}$ among the 11 states with dedicated domestic recruiting programs.

***Workforce Development and Preparation*** is frequently cited as a critical issue facing dynamic and growing businesses. Workforce development focuses on the education, training and recruitment of workers. Workforce development programs tent to concentrate on improving the skill base and job placement of a state and/or community's labor base. When integrated effectively with economic development, these programs are almost always employer or firm focused. The 18 states invest a total of $105 million in state-funded customized training and education programs – representing $5.8 million per state.

In 2004, Arizona invested more than $27 million, more than four times the average investment of its competitor states. Arizona trails only Minnesota ($47 million) in its state investment in workforce development training and apprenticeship programs. This ranking holds up on a per capita basis as well. Illinois also invests about $27 million in its state-funded workforce development activities. For years, Texas boasted the nation's most aggressive workforce development program – Smart Jobs. However, that program was de-funded recently, and the state is investing only $4.1 million as part of its close-out. It is important to note that Arizona's funding stream for the Job Training programs is a dedicated payroll tax.

***Technology Transfer*** programs include a broad array of activities aimed at encouraging new research, promoting the commercialization of that research, or fostering the adoption of new technologies into firms. These efforts can take a variety of forms including the facilitation of patenting, licensing, and research, the development of research parks, investments in targeted research and development activities as part of cluster-based economic development initiatives, as well as the promotion of business modernization efforts aimed at improving the utilization of state-of-the-art processes, equipment, and techniques by the state's firms.

Arizona's technology transfer and innovation program is quite small, investing only $125,000. By comparison, the 18 states invest a total of $31.7 million or $1.8 million per state in technology-based economic development initiatives. New York led the way with nearly half the total for all states -- $14.7 million. Illinois allocated another $7 million for technology development and adoption programs. Arizona ranks 11th out of 12 states on per capita expenditures for technology transfer, outpacing only California's meager $91,000 investment.

It is important to note that the level of overall funding for technology transfer, as described here, may be understated. Unfortunately, for this analysis, strategic fund projects are not determined in the budgeting process so it is difficult to determine the exact share of the funds used for technology-related activities. Expenditure reporting requirements vary widely from state to state so making a detailed state-by-state comparison of the actual expenditures from those deal closing funds is beyond the scope of this report. However, based on a review of several state reports of past-year funding and year-to-date expenditures as well as interviews with state economic development program managers, one could conclude that a large portion of the funds allocated as "Strategic Attraction Funds" are indeed being invested in university-industry research centers, centers of excellence, and targeted industry innovation activities and other activities that would be categorized as technology transfer.

***Entrepreneurial Development*** programs are designed to nurture new business formation through a number of means including entrepreneurial education, incubators, and equity investments. The goals of these efforts are to help young firms find affordable space, obtain technical and management support, secure equity and long-term debt financing, and locate qualified employees.

Arizona has invested $125,000 in state funds from the Commerce and Economic Development Commission, to complement a $100,000 federal investment in entrepreneurship efforts. Investment in entrepreneurial programs can be quite risky and the payoff tends to be longer term. Not surprisingly, only five competitor states have invested in this activity, totaling about $55.5 million in direct assistance as well as loans and guarantees. Colorado has taken the most aggressive approach, authorizing a $41 million CAPCO (or Certified Capital Company). The Colorado Governor recently announced that he planned to terminate this program and invest the funds in a venture fund. Illinois is investing $9.8 million (including a $6 million venture capital fund) and Maryland has invested $4.5 million in entrepreneurial initiatives. At $0.02 per capita, Arizona's investment is ranked 6th of the 7 states investing in entrepreneurial development initiatives.

Not included in this category is the $220 million Invest New Mexico program in which a portion of the State's Severance Tax Permanent Fund is dedicated to investments in 13 venture capital funds as well as state bonds. The mission of this investment is to encourage venture capital formation in the state of New Mexico, but it is still too early to tell how much of that investment will be made in New Mexico enterprises. Like Arizona, other states are investigating approaches for leveraging equity investments in state-based companies using off-budget mechanisms, including small shares of pension funds or other special revenue accounts.

***Minority and Women-owned Business Assistance*** programs provide opportunities for underserved populations to take advantage of the benefits of business ownership. Many business development programs (such as the Small Business Development Centers) are structured to target a certain percentage of their overall services to minorities. However, there are additional programs that are designed to meet a wide variety of under-served needs that minorities (i.e. women, immigrants, Native Americans, etc.) may have – particularly in the area of contracting, business development and financing.

Arizona has invested slightly more than $100,000 in small disadvantaged business enterprise (SDBE) programs. Arizona's $0.02 per capita ranks the state fifth among the six competitors with programs. Those six states have invested a total of $6.3 million. New York at $3.5 million and Virginia at $1.2 million have the largest programs. Colorado is the only other western state with a SDBE budget although Utah has a Division of Ethnic Affairs that tracks issues affecting Native Americans, Hispanics, Polynesians, Blacks, and Asians.

***Community Development*** covers a broad range of issues aimed at enhancing the local communities or regions. These efforts include investments in community infrastructure – sometimes even targeted to specific business development projects. Most community development programs are aimed at helping localities invest in assets required for business growth. In addition to "hard" infrastructure investments, these programs also support regional or local organizations ("soft" infrastructure) that provide economic development services and provide resources to improve targeted geographic areas of the state (such as enterprise or technology zones). Federal investments in the small cities community development block grant program and other HUD-related investments frequently overshadow state investments in community assistance programs.

The 18 competitor states invest a total of $409 million in state dollars for these activities, representing an average of $22.7 million per state. Oregon, Minnesota, and Georgia invest about two-thirds ($278 million) of that amount. By comparison, Arizona invests $2.7 million in state funds on community assistance and development programs. Arizona's per capita ranking is 12th of 16 states reporting state-funded community economic assistance and development programs within their agencies.

***Tourism and Film Support*** activities are integrated into economic development efforts in many states. For these states, tourism is considered a basic (or primary) industry sector that attracts dollars into the state. The development of recreation, amenities and entertainment opportunities (along with supporting businesses) can also lead to the improvement of the overall quality of life and infrastructure of a state. For several states, tourism promotion and development also commonly operate independently from economic development as is the case in Arizona. In most states, tourism and film promotion are combined in the same office. However, in Arizona, these two activities are separated.

The combined budget for Arizona's tourism and film promotion efforts is $16.8 million.[19] The competing 18 states invested $219 million in tourism and film promotion, about $12.2 million per state. Illinois invests the most by far, allocating $44.4 million to tourism and film promotion activities – a great deal of which goes to local convention and visitors bureaus. Texas and Florida are the only other states that outpace Arizona's total investment. Texas allocates $19.7 million and Florida spends $18.6 million on tourism and film promotion. New York is close behind, spending $16.2 million on tourism and film promotion. On a per capita basis, however, a different group of states is investing more than Arizona. At $3.01 per capita, Arizona is 5th behind New Mexico, Maryland, New Hampshire and Illinois among the 19 competitor states in its investment in tourism and film promotion activities.

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[19] *Even though some states separate the functions from economic development, this analysis combines the budgets of State tourism and film offices, even if they are in another agency.*

***Special Industry Assistance*** represents funding allocated to support the development of a specific industry or cluster. These activities focus on developing and promoting new products in areas of specific interest to the state. In general, it includes special promotion efforts that are identified in an agency's budget targeted to helping a traditionally important or emerging new state industry. Appropriated economic development funds for specialized research & development (R&D) dedicated to a specific industry or research area that supports a specific industry are excluded here and counted earlier as part of the agency's technology transfer function.

Arizona invests $525,000 in special industry assistance efforts, of which $250,000 was appropriated from the CEDC Fund. The total Arizona investment is still well below the average investment made by competitor states of $3.8 million (or a total of $68 million for all of the competitor states). This average is skewed, however, because Illinois alone invests $47 million (or 69 percent of the total) in coal marketing, energy management/conservation, and recycling programs. New York has invested $10 million in environmental industries. North Carolina (in biotech), Washington (in energy and food distribution), New Jersey (in nanotechnologies), Texas (in energy and aerospace), and Massachusetts (in fisheries recovery) have all invested in their own targeted industry initiatives. On a per capita basis, Arizona places 7$^{th}$ of 9 states reporting investments in special industry assistance programs.

***Program Support*** activities help to sustain economic development efforts at a state, community or local level by providing specialized analytic and communications assistance for those efforts. Activities such as policy and planning, economic research, data dissemination and web site content management, public relations, intergovernmental affairs, regional offices, and even the secretary's or director's office are part of the "back office" activities that help individual program managers succeed.

Arizona invested approximately $1.5 million in these activities in 2004. The 18 competitor states invested a total of $43.2 million or about $2.4 million per state. Maryland and Illinois led the way, allocating $11.7 and $9.2 million respectively to this activity. Arizona placed 6$^{th}$ of 16 states in terms of the agency's per capita investment in program support activities.

***Administration*** activities are the overhead required to support all of the program activities of the agency. These might include information systems, accounting, personnel, and so forth. Arizona allocated $728,000 to this activity (or about 1.3 percent of its total budget). By comparison, the 18 competitor states invested $43 million, or $2.4 million for administrative activities (representing 2.5 percent of their total budget). On a per capita basis, Arizona's administrative services efforts was ranked 11$^{th}$ of 14 states reporting their administrative activities separately from other program activities.

Several agencies have ***Other Program Areas*** that do not fall into the above 14 categories. These activities account for $68.7 million in total investment, $3.8 million per state, or about 4 percent of all investments. Washington, North Carolina, and New Jersey assigned 90 percent (or $61 million) of the activities to this "other" category. Washington State's $38 million allocation includes community service programs such as early childhood education, violence reduction education, and public safety and education programs. No other state appears to have included these types of activities within their budget. North Carolina's other activities include $14 million for items such as management of the state's executive aircraft, aid to non-state agencies, and funding for the state's Rural Economic Development Center. New Jersey included about $9 million to an economic development site preparation fund, a recovery fund for the New York-New Jersey Port Authority, and an allocation to Prosperity New Jersey (a nonprofit organization that oversees the state's recruitment activities and cluster building initiatives). Arizona's budget has no items that were allocated to this other category.

## Trends in the Allocation of Economic Development Resources

Over the past seven years, Arizona's investment in economic development-related activities grew slightly faster than the national average, increasing by 68 percent.[20] This growth is due almost exclusively to the temporary expansion of the state's Job Training Fund, especially during the late 1990s. Data from 1998 was used as a benchmark because it is the most recent year for which similarly formatted data is available for the 19 states, and it also reflects a time immediately prior to the budgetary crises that recently gripped many states. Looking instead at 2001 as a benchmark year, however, the agency's budget has actually decreased by 53.3 percent.

During the 1998 to 2004 period, total state investment in economic development among all of the 19 states (including Arizona) increased by more than 40 percent from $1.2 billion to $1.7 billion. The largest increases resulted from added investments in Strategic Attraction (or "Opportunity Funds") and Community Assistance programs. The 19 competitor states reported only $30 million in these "deal closing funds" in 1998. Today, that number is nearly $300 million and growing rapidly. Although originally intended as a deal closing fund, the CEDC Fund has dwindled in size. Budget cuts combined with use of the fund for legislative appropriations have reduced the size of the available discretionary funds substantially. Nationally, nearly half of the $500 million national budget increase resulted from added state investments in community assistance programs. During the same seven-year time frame, state investments in job training programs declined, from $148 million in the 19 states in 1998 to $132 million in 2004 for those same states.

In the early 1990s, many states increased their job training investments. Likewise, the Arizona legislature increased the Arizona Department of Commerce budget for job training with resources from the state's unemployment insurance trust fund. However, while Arizona's job training funds continued to grow, other state investments declined. The continued increase in the workforce development program funding has fueled the agency's budget while other activities have not kept pace with increases in investment made by competitor states.

Today, half of the state's total economic development budget and three-quarters of the Arizona Department of Commerce budget (or $27 million) is spent on customized workforce development programs, apprenticeship programs, and incumbent worker initiatives. For comparison purposes, the agency's 1998 state investment totaled $22 million, of which $9 million was allocated to business finance programs and $4.5 million for customized and incumbent worker training. The state also reported a 1998 investment of $2.3 million in international trade and $1.6 million in community assistance programs. The policy changes and added investment in workforce development between 1998 and 2004 reflects the understanding that many businesses view a trained workforce as a necessary element of their success and training programs the most valuable incentive that a state can offer.

While there is no systematic evidence available to explain the national cuts in state investment in workforce development, one could reasonable attribute changes in federal policy. With the 1998 passage of WIA, the federal workforce training program has encouraged more demand-driven training and opened up the program for usage to build a competitive workforce in the states. As a result, it is possible that state agencies are diverting the resources that they traditionally used for customized training programs to other economic development activities, including discretionary programs (in the form of "deal-closing funds") aimed at technology-related investments and more flexible funding to meet business needs. The demise of the Texas Smart Jobs program with the simultaneous emergence of the Texas Enterprise Fund provides anecdotal evidence that states are swapping customized training programs for deal closing funds.

At the same time that investments in workforce development increased in Arizona, investments during the past seven years in other functions, especially business finance, have declined. The

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[20] *Kenneth Poole, Nancy McCrea, and Pofen Salem, "Survey of State Economic Development Expenditures," gathered for the National Association of State Development Agencies, 1999. All of the data reported for 1998 come from this source, including unpublished worksheets.*

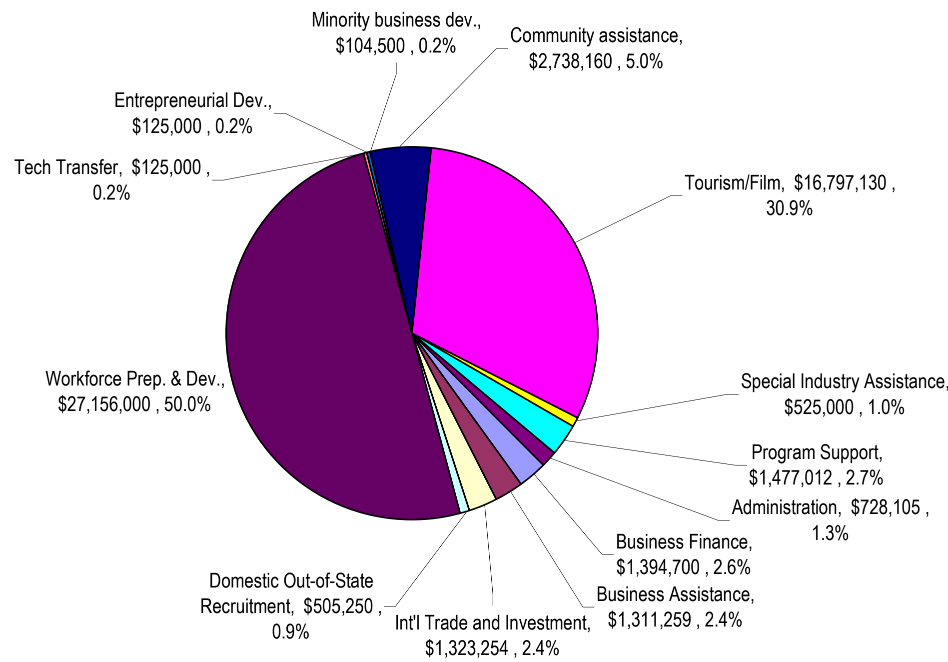
Arizona investment available for business finance programs dropped from $9 million in 1998 to $1.4 million in 2004. Today that amount is supplemented with $4.6 million in federal funds whereas the agency reported no federal funds allocated to finance programs in 1998. Thus, the state is turning to federal funding sources to fill part of the void left by declining state dollars. While Arizona has reduced its investment in business financing programs, the 18 competitor states witnessed an increase of about $100 million (to nearly $290 million) allocated in 2004 to loans and grants for companies.

Figure 1 provides detail on how 2004 state funding for economic development is allocated in Arizona across the 14 functional areas. About half (50 percent) of the $54.3 million that the state invested in economic development (including funding for tourism as well as the Arizona Department of Commerce's budget) was allocated to workforce development due to an upsurge in unemployed Arizonans and the need for emergency assistance to provide training, apprenticeships, and related workforce transition programs. The investment is not expected to continue at this level as the economy recovers and the trust funds are no longer available. Another 31 percent of the state's investment is in tourism and film, primarily invested through tourism promotion programs in the state's Office of Tourism. Community assistance programs account for an additional 5 percent of the state's investment, and these are distinct from federal investments made in community development through the state's housing agency. Meanwhile, the combined investments in business assistance, business finance, business recruitment, and international trade programs account for about 8 percent of the state's investment.

Figure 2 provides detail on how Arizona's competitor states allocate their resources. The funding is more diversified across the 14 functional areas. The competitor states invest an average of $96.1 million, or about $10.38 per capita. Of that amount, nearly one-fourth (23 percent) is invested in community assistance programs. Strategic business attraction programs are next, accounting for 18 percent of total state investment. Business finance programs account for 17 percent, and tourism and film promotions account for 13 percent of the investment. Workforce development, on average, is allocated 6 percent (or about $5.8 million) of the total budget.

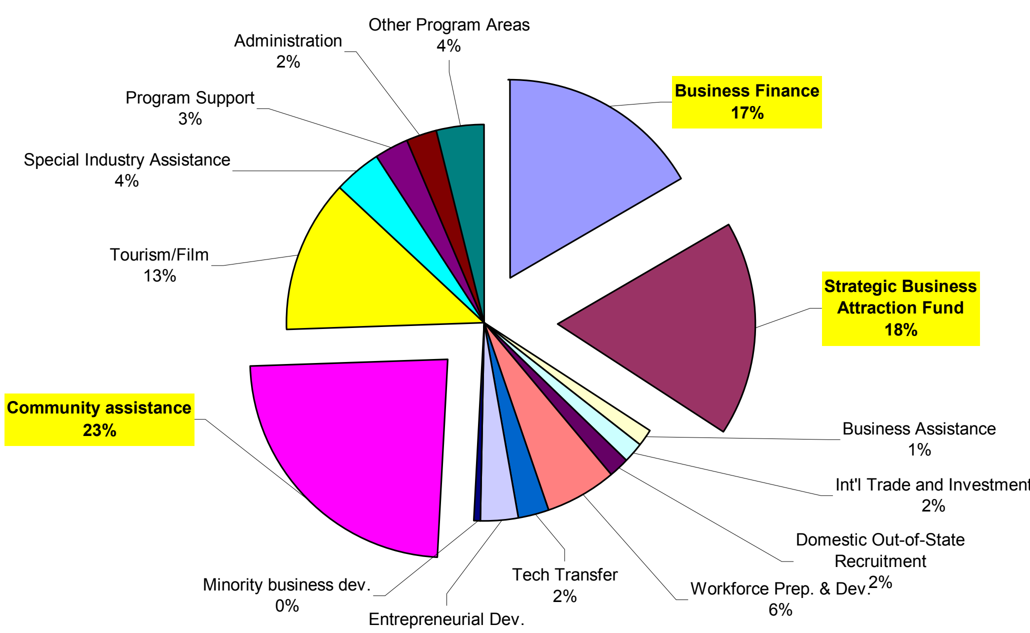
## Figure 1:

**STATE INVESTMENT IN ECONOMIC DEVELOPMENT, 2004, FOR ARIZONA**
**TOTAL BUDGET = $54.3 million**




## Figure 2:

**AVERAGE INVESTMENT IN ECONOMIC DEVELOPMENT, 2004,**
**FOR AZ's 18 COMPETITOR STATES, AVG. BUDGET = $96.1 million**



## *Comparing State Incentive Policies*

Economic development programs geared toward creating jobs for the state can achieve those goals through a variety of ways, including (a) business climate policies, (b) direct programmatic assistance, and (c) financial incentives. The scope of this analysis will focus on financial incentives, but it is valuable to examine briefly the scope of efforts beyond direct financial incentive policies. Using a broader definition of the oft-used term "incentives," one might legitimately examine business climate policies and programmatic assistance as part of an overall an analysis of incentives. However, they have been excluded from the working definition of incentives used for this report because the scope of such assistance is so broad and the analysis of business climate issues inevitably leads to a comparative assessment of tax policy – well beyond the scope of this effort.

***Business climate policies*** aim to enhance the general business environment, through reduced taxes, streamlined and predictable regulation, and the provision of high quality public services. The tax policies of states associated with rate reductions or abatements for all classes of a common tax, the rate of property valuation, the ability to accelerate depreciation, as well as other programs to assist business such as interest rate subsidies are often regarded as a form of "incentive" to firms to make investments. It is through these types of tax policies that Delaware has become a financial services center and that Florida has become a retirement mecca. Many suburban locales have been successful in attracting investment because they offer more green space and better schools in combination with relatively lower tax rates than their urban counterparts. Recent research suggests that Arizona's business tax burden is higher relative to its competition.[21] The research suggests that overall reductions in corporate tax rates combined with the implementation of a broader array of consumption taxes to include domestic (or personal) services would make the state more competitive while maintaining a stable revenue stream. These "business climate" policies are typically beyond the direct control of the state economic development agencies and quite frequently efforts to address them by agencies show up in the form of direct incentives to encourage preferred types of business investment.

Another way that economic development can be achieved is through ***direct programmatic assistance*** to individual or classes of companies. This assistance may be offered in the form of state staff assistance in troubleshooting problems, providing information about business or market opportunities, or advocating state or local governments to make appropriate investments in needed services – including highways, education, or public safety as examples. Furthermore, technical assistance and modernization services, access to research capacity and help with technology commercialization, subsidized higher education, and investments in public infrastructure also fall into this category of economic development program assistance. As states have become more aggressive in reaching out to their business clients, they have developed an array of services provided to their firms – through staff and contracted expertise. Generally, these programs offer technical expertise or knowledge to client firms rather than direct financial resources. While the specific programs are not necessarily captured, an analysis of the agency's expenditures on programs such as international trade, technology transfer, community development, business assistance, and special industry support begin to help to identify how the state compares with its competitors in terms of the resources allocated to the activity. Such a comparison does not evaluate the perceived effectiveness of such assistance, but again, such an evaluation is well beyond the scope of this effort.

A third and often the highest profile way that states ensure their businesses succeed or attract business investment is through financial aid that we describe in this report as "***financial incentives***." In some cases the incentives offered may be "discretionary." In other words, the state's executive branch has the ability to make important policy decisions about the investment. For instance, the executive branch can determine whether or not an investment will be made or may determine how much of an investment will be made. The greatest advantage that many

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[21] *Elliott D. Pollack & Company, "Optimizing Arizona's Tax Structure," prepared for the Citizens Finance Review Commission, August 2003.*

strategic attraction or "deal closing" funds offer is not so much the financial resources they offer, but the flexibility available to the Governor in using those resources. In other cases, incentives offered are "non-discretionary," meaning that they are provided based entirely on statutory requirements. The legislature often designs these statutory incentives and provides very specific instructions about how they are to be implemented. The executive branch has little authority to make changes to the program or to decide which firms most need the incentive. Non-discretionary incentives are generally available to all qualifying businesses, and the actual or in-kind value of the incentive is often fixed within the statute. The focus of this study of incentive policy is on this third class of economic development policies, which we describe as financial, or ***business incentives***.

## Further Categorizing Financial Incentives

Almost every business incentive is geared toward one or more aspects of a company's cost of doing business. Subsidies are provided through direct cash payments, assistance with relocation or expansion costs, income tax credits, or credits to the firm's payroll tax. Many incentives are designed to reduce specific business costs--taxes, cost of capital, land, facility financing, training, or up-front operating costs.

Using a typology developed for the US Economic Development Administration,[22] the researchers created a database of business development incentives for Arizona and its 18 competitor states. These financial incentives were organized into three major categories:

- direct financial incentives;
- indirect financial assistance; and
- tax-based incentives or rewards.

***Direct Financial Incentives*** provide resources directly to a business from the state or through a state-funded organization. There are a variety of ways to offer this financial assistance, including via grants, loans, equity investments, loan insurance and guarantees. Frequently, these programs help the company with access to capital, but they might also help the company to invest in workforce training, new market development opportunities, product innovation, or process modernization. Cash grants provide the greatest flexibility and immediate benefit to the company by reducing capital outlays. However, loans, bonds, and equity financing are commonly used to allow states to recoup these investments for future activities. Another important category of direct financial incentives is in the area of training subsidies provided directly to firms. Other forms of direct financial incentive include revolving loan funds and equity financing funds. These programs directly supplement market resources through public lending authorities and banks. In each case, the company receives a direct financial benefit as the loan, grant, or equity investment is made directly to the firm from the economic development intermediary organization.

***Indirect Incentives*** include grants and loans to local governments, community organizations, or service providers to support business investment or development. Funds are provided to the intermediaries in the form of grants, loans and loan guarantees. These are identified only if the assistance is firm-specific and the firm might otherwise have had to make the investment from its own resources. For instance, a road to a firm's facility built by the community would be included in this category if the firm required the investment for the site location to be successful. General road or infrastructure improvements would not be included. In many cases, training programs provide funding to a community college to provide training designed for an individual firm's employees. These types of programs are included because the firm benefits directly. The assistance from the state provides funds to a "third-party" on behalf of the firm. Typically, the recipients of funds for these types of indirect incentives include communities, financial institutions,

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[22] *The introduction to this section is adapted and updated from an earlier report prepared by the researchers. Kenneth E. Poole, George A. Erickcek, Donald T. Iannone, Nancy McCrea, and Pofen Salem;* Evaluating Business Development Incentives*; National Association of State Development Agencies; Prepared for the US Economic Development Administration; 1999, pp. 9-12.*

universities, community colleges, training providers, venture capital investors, and childcare providers. They may be used to leverage public or private financial participation in a project or to guarantee risk. In many cases, the funds are tied to one or more specific business location or expansion projects. Programs targeted toward addressing the general needs of the business community, including infrastructure, technical training, new and improved highway access, airport expansions and other facilities are typically excluded as they are in essence community assistance programs and not considered as incentives to individual firms.

***Tax Incentives*** are frequently used as a strategy for leveraging business investments. Firms seek these incentives out because they may reduce the cost of doing business for the firm. Policy makers utilize them because they can influence firm behaviors to invest in certain ways. Tax incentives can generally be classified into six subcategories: (1) deductions or credits, (2) abatements/reductions, (3) exemptions, (4) refunds, (5) deferrals, and (6) other preferential tax treatments to encourage business investment. Tax credits provide a reduction in state income tax, franchise tax or other state taxes to reward businesses for a variety of behaviors such as creating jobs, investing capital in equipment or research and development, training workers, recycling, or providing child care. Abatements reduce or decrease the assessed valuation of ad valorem taxes, which include real property and personal property, to foster investment by certain industries, such as “clean” manufacturing, or in certain activities such as holding business inventory. Tax exemptions provide freedom from paying corporate income, corporation franchise, state sales/use, or other taxes normally applied to related business activities such as purchasing air and water pollution control equipment or construction materials. Businesses are still required to pay deferred taxes, but the payments may be managed so that the tax burden is realized in future years or abated altogether if the firm meets specific requirements. Preferential tax treatments are offered for firms investing in targeted geographic areas (such as enterprise zones or distressed areas) or certain industries deemed of special interest to the state’s economic development.

## Structure for Analysis

To sort through more than 480 business development incentives identified from Arizona and its 18 competitor states, we developed a methodology of examining all of those incentives using two dimensions. The first dimension identifies the types of customers for which each incentive was created. Three groups of customers – firms, communities, and workers – ultimately benefit from incentives that address economic, community and workforce development issues. The second dimension examined the purpose or policy goals that the incentives are designed to achieve. We also identified major business needs or “policy goals” that the incentives are designed to address. These policy goals are illustrated in Figure 3, but the goals most relevant to financial incentive policies include:

- Capital access and formation – These incentives help firms finance capital investments and manage risk for new development.
- Workforce development and preparation – These incentives provide skill-specific training, upgrade the skills of existing workers, and meet the skill needs of employers.
- Infrastructure development – These incentives improve business climate by financing sewers, roads, and other major facilities specifically related to the firm’s location.
- Facility and site location assistance – These incentives encourage business investment in specific areas or provide assistance to firms in acquiring or improve their facilities.
- Sales and marketing – These incentives help firms develop new market opportunities designed to increase business sales.
- Technology and product development – These incentives encourage firms to find new technologies and adopt process or product innovations.

- Regulatory climate and issue – These incentives enhance the business environment by reducing the costs associated with tax burdens or by streamlining permitting processes for companies.
- Business management – These incentives help improve business planning and business operations.
- Product/process improvement – These incentives reduce business costs by encouraging firms to adopt more efficient business methods and new technologies, and otherwise reduce overall production costs.

## Figure 3: Economic Development Policy Goals


Certain policy goals are more critical to addressing the needs of economic development customers. Table 9 illustrates the relationship between the three major customers and the nine policy goals noted earlier.

| Table 9: Linkage Between Incentive Customers and Policy Goals | |
|---|---|
| **Incentive Customer** | **Incentive Policy Goals** |
| Worker-oriented | Workforce development and preparation |
| Community-oriented | Infrastructure development;<br>Facility and site location |
| Firm-oriented | Capital access and formation;<br>Sales and marketing;<br>Technology and product innovation;<br>Business management;<br>Product/process improvement;<br>Regulatory climate and issue |

In the following section, we compare the business incentives offered in Arizona and its competitor states by classifying different types of incentives as direct financing, indirect financing, or tax-based incentives. We then compared all the business incentives using the two-dimensional approach to better understand how states used incentives to further particular policy goals.

### *Summary of Arizona's Business Incentives*

Of 17 business incentives identified in Arizona, more than half are tax-based incentives that offer companies tax credits, exemptions or reductions, or refunds on income or property. These incentives aim to leverage business investment in the state. This tax-based approach responds to Arizona's development strategy of building a more competitive business operating environment. These incentives encourage research and development investment, assist construction activity and qualified real estate development, spur purchases of equipment for manufacturing operations, and boost motion picture production in the state. Arizona targets several of its tax incentives to specific geographic locations within the state, including enterprise zones, foreign trade zones, and military reuse zones.

In addition to tax incentives, Arizona offers a few direct financing incentives through its CEDC fund in the form of grants, loans or loan guarantees to help companies obtain necessary capital for business development and expansion, particularly for the development and growth of high-tech firms (i.e., the Direct Assistance to Business Program). Arizona offers revolving loan bonds with its Private Activity Bonds Program to ensure companies access to necessary capital for development projects. The Waste Reduction Assistance program reduces waste and promotes recycling efforts by providing funding for the purchase of equipment and machinery, research and development, and marketing activity.

Two incentive programs are specifically oriented to helping local communities in Arizona. One is the Private Activity Bonds Program and the other is the Economic Strength Project Program. Private activity bonds, or so-called industrial revenue bonds, reduce the cost of investment in industrial property and equipment by lowering the interest rate at which qualified firms can borrow capital. In Arizona, private activity bonds are issued by industrial development authorities on behalf of local governmental entities for the benefit of private users. The Economic Strength Project Program is a competitive program that offers grants to assist local communities in constructing new or upgrading existing roads in support of job creation and retention projects.

The state offers two incentive programs in support of workforce preparation and development efforts in Arizona. First, the Information Technology (IT) Training tax credit was designed to encourage Arizona employers to provide their employees with continuing technology skills training. The credit is available for companies training up to 20 employees in IT skills. The maximum tax credits allowed are limited to 50 percent of training cost, $1,500 per employee; or a total of $30,000 tax credits. Second, the largest state program, the Job Training Grants program, assists companies who provide customized training to upgrade their workers' skills. These grants are targeted to businesses expanding or relocating to Arizona. For any newly hired workers that meet the wage criteria, the program reimburses up to 75 percent of the company's training costs. For incumbent workers, the reimbursement can be a maximum of 50 percent of training cost. These two workforce development incentives are a direct response to a high-priority economic development strategy in the state – growing a high tech workforce in Arizona that ultimately raises per capita income in the state.

### *Comparisons to Competitor States*

Table 10 illustrates the distribution of business incentives by type comparing Arizona with its competitor states. As the table shows, Florida, Georgia, and New Mexico have a mix of programs by type that is somewhat similar to Arizona's with their greater emphasis on the use of tax-based incentive strategies. In particular, New Mexico stands out because it offers more tax-based incentives than any other state. Those tax incentives are mostly used to help firms improve their product and processes (encouraging cost reductions and firm investments in their own competitiveness), workforce training and development, attracting business investment and job creation activities in targeted geographic areas, and enhancing technology development and product innovation. Arizona's focus on tax-based incentives reflects the state's efforts to use tax policy as a tool for improving the outlook for business investment.

States that offer more direct financing incentives than other types of incentives include California, Colorado, Illinois, Massachusetts, New York, New Jersey, Maryland, Virginia, and Washington. This may indicate that, by providing direct grants and loans to companies, these states have

**Table 10: Distribution of Incentives by Type Among Competitor States**

| State | Tax-based Incentives | Direct Financing | Indirect Financing | Total No. of Programs |
|---|---|---|---|---|
| Arizona | 10 | 6 | 1 | 17 |
| California | 9 | 11 | 7 | 27 |
| Colorado | 7 | 8 | 3 | 18 |
| Florida | 15 | 5 | 5 | 25 |
| Georgia | 16 | 8 | 12 | 36 |
| Illinois | 5 | 26 | 17 | 48 |
| Massachusetts | 6 | 21 | 6 | 33 |
| Maryland | 5 | 11 | 4 | 20 |
| Minnesota | 3 | 5 | 3 | 11 |
| New Hampshire | 0 | 6 | 4 | 10 |
| New Jersey | 1 | 19 | 6 | 26 |
| New Mexico | 32 | 7 | 2 | 41 |
| New York | 10 | 17 | 7 | 34 |
| North Carolina | 14 | 13 | 2 | 29 |
| Oregon | 8 | 9 | 6 | 23 |
| Texas | 8 | 5 | 5 | 18 |
| Utah | 8 | 4 | 2 | 14 |
| Virginia | 6 | 9 | 6 | 23 |
| Washington | 10 | 17 | 4 | 31 |

more resources to leverage and attract private business investment. The policy goal of providing capital access to businesses is the most cited purpose for offering direct financing incentives. The most commonly used direct financing incentives include programs that offer revolving loans, industrial revenue bonds, bond financing, direct grants or loans to assist business expansion and relocation, promote the development of specific industry, finance infrastructure and secure specific economic development opportunities that provide significant returns to the state.

The next most frequently used incentives aim to achieve the policy goals of enhanced technology/product development and community development. New York, Illinois, North Carolina, Washington, and Maryland focused their efforts on assisting companies with technology development and innovation. Each state offers several direct financing incentive programs specifically targeted to technology industries with grants and/or loans. These policies are preferable for many younger technology companies that may not pay significant amounts of taxes, but are often cash starved.

Direct incentives used to meet community development needs frequently rely on funding designed for land acquisition, construction and infrastructure improvements. For example, the One North Carolina Fund was created to provide resources to local governments working with businesses expanding their operations or locating new facilities in their communities. Virginia's Governor's Opportunities Fund offers grant opportunities to businesses and local governments for on- and off-site utility improvements, site acquisition and development, transportation access, and construction or build-out of publicly-owned buildings.

Workforce development and cost reduction/production process modernization are other common policy goals that direct financing incentives aim to achieve. Similar to Arizona's Job Training Program, states like Illinois, Maryland, Massachusetts, New Jersey, New Mexico, and Washington all provide either grants or loans to qualified businesses for workforce training and child care support. Arizona does not offer a particular incentive geared toward the goal of product and process modernization, but states like Illinois and New York have offered several incentives to meet this particular purpose. These programs are geared toward helping existing enterprises identify opportunities for reducing costs and modernizing their enterprise. They offer cash grants or loans to pay for technical expertise or to finance capital improvements.

As for indirect incentives, the most cited eligible uses include assistance to communities for infrastructure improvements, facility/site location assistance, or promotion of industrial parks in distressed areas. For the most part, community development efforts are implemented through grants, loans or loan guarantees to fund public infrastructure and construction projects that lead to private sector expansion or retention, particularly in rural areas. Similar to Arizona's Economic Strength Project Program, states like California, Colorado, Florida, Georgia, Illinois, Maryland, Texas, Virginia, and Washington also invest substantial resources to support infrastructure (especially site-specific road improvements) that promote economic development and growth.

Indirect incentives are also commonly used to achieve workforce preparation and development goals. State agencies provide grants or loans to community colleges or other training providers that will assist business workforce development needs.

## Incentives Gap Analysis

Incentives are used to address both business needs and economic development policy goals. By assessing Arizona's incentives against likely public policy goals, it is possible to compare existing incentives offered in other states with existing state programs to identify potential gaps. Although evaluation of individual incentive effectiveness is beyond the scope of this report, identifying gaps in the types of incentives offered may help identify new policy approaches for Arizona to compete for technology-based business investments. This section compares incentives by recipient target (worker, community, and firm), and then also by the nine business-need categories:

- Workforce Development or Preparation
- Infrastructure

- Facility or Site Location
- Sales or Marketing
- Technology or Product Development
- Capital Access or Formation
- Regulatory Climate or Issue
- Business Management
- Product or Process Improvement

### *Workforce Development or Preparation*

Almost all of the 19 states in this study offered some kind of incentive program relating to workforce development or preparation. Arizona offers the "Arizona Workforce Development and Job Training Program," a direct incentive to firms designed to defray worker-training costs by providing short-term grants that supports the design and delivery of customized training. Businesses frequently complain about the difficulty in completing the paperwork requirements associated with Arizona's program. This drawback can limit the program's use and effectiveness. Other states, including Illinois, Maryland, Massachusetts, New Jersey, New Mexico, and Washington, also offer these kinds of broad direct assistance programs to businesses. These programs frequently require employer financial match, but seldom target specific industries.

Other competitor states address business concerns about the administrative requirements of workforce training programs by directing the funds to intermediary training providers who are responsible for administering the program and overseeing evaluation efforts. These indirect assistance programs often fund workforce training through grants given to community colleges or other workforce training providers. These programs are sometimes targeted to specific industries. As an example, the North Carolina "Industrial Training Program" offers free, customized training for industries that conduct manufacturing, high tech, warehouse/distribution, customer service, or data process operations. Programs targeted to specific industries offer a vehicle for states to implement specific economic development strategies that include growing target industries.

Arizona offers only one tax credit relating to workforce development. The "Information Technology Training Tax Credit" recognizes the need for a competitive workforce to have computer and IT skills. Most competitor states seem to offer a multitude of various tax credits relating to workforce development, child care provision, job creation, retraining, and industrial training. For example, New Mexico offers a litany of credits including tax credits for firms offering child care, hiring workers in enterprise zones, offering higher than average wages, job mentorship programs, employing rural residents, investing in technology in rural areas, higher technology workers, and offering welfare-to-work opportunities. Many states compete to offer many of the same credits in an effort to match their neighboring states. Rarely, do they emulate Arizona's focus on credits for training workers for a specific industry.

### *Infrastructure*

Arizona offers direct assistance for infrastructure-related business needs through the "Private Activity Bonds" program, and indirect assistance with the "Economic Strength Project" program. In Arizona, private activity bonds are issued by local industrial development authorities on behalf of local governmental entities for the benefit of private users. The Economic Strength Project, which offers grants for road construction, is a very competitive program, based on the economic impact of the jobs created and the capital investment of the applicant projects in the community in which they will be located. The state does not offer any kind of tax-based incentives that address infrastructure needs.

Other states seem to offer a much greater variety and number of incentives to meet this need, including direct, indirect and tax-based programs. Some direct incentives programs, like Illinois, offer direct assistance for rural development, and some, like New York, offer state incentive assistance for energy-related infrastructure development.

Arizona's indirect assistance program targets road construction projects, and most other states have indirect assistance programs that target a variety of public projects, including roads, water, sewer, rail, and other public systems. Many indirect programs utilize Federal community development block grants and match those resources with state funds to target development in distressed communities. In addition, other indirect infrastructure incentives are offered as part of the emerging class of "deal-closing" incentives being offered to businesses considering relocation and expansion to competing states. Some of the most high profile indirect infrastructure incentive programs include the Georgia EDGE Fund and New York's Economic Development Fund.

Oregon is the only state with a tax-based incentive, the "Advanced Telecommunication Facilities Tax Credit," which is specifically targets the development of telecommunications infrastructure in rural areas. These tax credits are intended to improve advanced telecommunications capability in underserved areas of the state, enhance individual and business access to advanced telecommunications services at an economically reasonable cost, and develop a fully competitive telecommunications marketplace in rural areas of the state.

### *Facility Site or Location*

Arizona addresses facility site and location issues primarily through its "Private Activity Bonds" program. Private activity bond programs have restrictions on their use to capital assets and equipment. Thus, many states use bond funding to help provide gap financing on industrial facility improvements, capital equipment, and related investments. Furthermore, the bonds are backed by the state's full faith and credit. This state backing is a stronger guarantee than that required for most revolving loan funds. In addition, revolving loan funds may also be used for a broader array of purposes.

Because of the federal restrictions and caps on the amount of exemptions that a state can provide, many states supplement their bond programs with other direct financing incentives. The most commonly found direct incentive programs target brownfields remediation and site assessments. Colorado's Brownfields Revolving Loan Fund offers financing with reduced interest rates, flexible loan terms, and flexibility in acceptable forms of collateral for cleanup of unused or underused contaminated properties. Eligible program activities include cleanup, removing, mitigating, or preventing the release of hazardous substances, and site-monitoring activities. Colorado, Maryland, Massachusetts, Minnesota, New Jersey, Oregon, and Washington all offer direct assistance for brownfields remediation. Colorado and New York offer tax-based brownfields remediation programs.

While Arizona joins a number of other states, including Colorado, Florida, New Mexico, and North Carolina, in using small cities community development block grants for revolving funds, its activities are otherwise limited. Other states have created site or location funds aimed at improving rural downtowns (Georgia) and financing local incubators (New Jersey).

### *Sales or Marketing*

Arizona does not appear to offer any direct or indirect incentives relating to business sales or marketing needs. Like many other states, Arizona does offer "foreign trade zone" tax incentives that enable businesses to increase sales of goods exported to other countries. The area is treated as though legally outside of the U.S. Custom's territory. Merchandise may be brought in duty-free for purposes such as storage, repacking, display, assembly or manufacturing, and imports may be landed and stored quickly without full customs formalities. Arizona is the only state that has enacted special legislation that makes businesses located in a zone, or sub-zone, eligible for an 80 percent reduction in state real and personal property taxes.

Oregon and New Jersey have direct incentive programs that specifically aim to increase export sales and assist firms attempting to enter new markets. Oregon's Trade Promotion Program provides reimbursement of up to 50% of a company's eligible direct expenses, up to $2,500 per pre-approved international trade show or trade mission. New Jersey's Export Financing Program provides up to a $1 million one-year revolving line of credit to finance confirmed foreign orders.

Funds can be drawn to buy raw materials, pay production costs and ship product. The borrowing is repaid when the account receivable is collected.

Massachusetts, New York, and Virginia have programs with similar objectives, but which are provided via indirect incentives. Massachusetts' Export Accounts Receivable Insurance program helps companies manage the risk associated with accounts receivable due from foreign companies, encouraging companies to offer vendor credit to foreign buyers. Massachusetts also offers Export Finance Guarantees of 70% and 90%, which helps companies access capital needed to increase export sales. New York's Global Export Market Service (GEMS) helps businesses expand through increased export activity, and can provide up to $25,000 in export marketing consultant services for individual companies and up to $50,000 for groups of companies or industry associations. Virginia's Export Financing Assistance Program assists qualified exporters with accessing federal export loan guarantees by packaging and submitting applications for these programs according to the federal guidelines.

Florida and New Mexico offer tax exemptions on sales in targeted industries, including semiconductor, space technology, and aircrafts. Florida encourages semiconductor, defense, and space technology-based industries through a sales and use tax exemption on related transactions. New Mexico's Aircraft Manufacturing Tax Deduction and the Aircraft Refurbishing or Remodeling Tax Deduction provide a gross receipts tax deduction for sale of aircraft by an aircraft manufacturer to encourage industry sector development.

### *Technology and Product Development*

Although Arizona does have one direct incentive that addresses technology and product development needs, its incentives are not as comprehensiveness as competitor states. Many states offer direct assistance with seed capital for technology based start-up companies, and special financing programs for specific technology sectors. North Carolina, for example, has both grant and loan programs targeting the biotechnology industry; Virginia has grant programs for solar photovoltaic manufacturing; and New York has programs aimed at emerging energy technologies. Competitor states also offer direct assistance programs that create technology business incubators and encourage technology commercialization. There are also a variety of indirect programs that create technology incubator facilities, increase the rate of technology transfer to private industry, and promote collaborative efforts between universities and industry.

Like many of its competitors, Arizona offers a tax-based incentive that offers income tax credits on research and development income. The state's competitors offer programs that target specific industries for growth, such as Minnesota's "Bio-Science Zones," New Mexico's "Aerospace Research and Development Deduction," and New York's "Qualified Emerging Technology Company Tax Credits." Use of tax-based programs for target industries usually reflects strategic growth plans aimed at encouraging the development of those industries.

### *Capital Access or Formation*

Arizona has a variety of direct and tax-based programs that address capital access needs of businesses. These include more generalized as well as industry-specific assistance programs. The "Direct Assistance to Arizona Businesses" program provides assistance to existing companies needing expansion capital. For projects in this category that create high quality jobs, and provide substantial leverage of CEDC dollars, part of the assistance may be in the form of a grant, subject to the achievement of certain economic development targets. The Intermediary Participation Program provides a mechanism for the CEDC to partner with existing economic development loan funds in the state and extend the reach of CEDC capital. The "Technology Sector Project Capital" program is directed at ventures in Arizona that support the development and growth of high-tech industries.

Arizona seems to lack some of the start-up venture fund capital and loan guarantee programs that other states have created to encourage capital formation. These venture capital and loan guarantee programs are usually aimed at existing businesses and small business start-ups, and are used to encourage business expansion and creation efforts. Examples include:

- Colorado's Certified Capital Companies (CAPCO) Program was created by the Colorado Legislature with the goal of making venture capital funds available to new or expanding small businesses throughout Colorado. This controversial program is funded by the state of Colorado providing $200 million for this program in the form of premium tax credits ($100 million for 2002 and $100 million for 2004). Each $100 Million in premium tax credits is given to insurance companies in exchange for the insurance companies giving $100 million in cash to the CAPCOs. The CAPCOs then use these funds to invest in qualifying Colorado businesses. Detractors of CAPCOs suggest that insurance companies receive hefty fees for taking little or no risk because of the state guarantees. Proponents suggest that CAPCOs provide an easy approach to expanding the private market for equity and near-equity capital among small firms. The governor recently announced the termination of the program for 2005.
- Illinois' Venture Investment Fund provides seed and early-stage equity financing that is often difficult to obtain. Private venture investments are leveraged by state investments in accredited venture capital investors. The resulting equity investments typically range between $150,000 and $300,000.
- The Massachusetts MTDC Venture Capital fund addresses the "capital gap" for start-up and expansion of early-stage technology companies in Massachusetts.
- New Hampshire's Vested for Growth is advertised as a "kinder, gentler" venture capital partner that does not require taking ownership in the company. It provides straight loans, plus an additional "equity-upside" feature.
- New Jersey's Seed Capital Program is a loan program offered by the New Jersey Economic Development Authority to provide seed capital for growing, technology-based enterprises. Loans typically range from $250,000 to $500,000 to businesses that have already established an emerging technology and require seed capital to bring the product to market.

Twelve of Arizona's 18 competitor states provide loan guarantee programs in the form of linked deposit programs, capital access programs, and small business guarantees.

- New Hampshire's Working Capital Line of Credit Guarantee is provided by the New Hampshire Business Finance Authority and allows participating banks or lending institutions to receive a guarantee of up to 75% for a working capital line of credit of as much as $2,000,000.
- Texas' Linked Deposit Program encourages lending to qualified businesses, which are historically underutilized businesses, child care providers, nonprofit corporations and/or small businesses located in an enterprise zone. Loan amounts range from $10,000 to $250,000.
- Washington State Linked Deposit Program provides access to capital for the development and expansion of minority and women-owned businesses.
- The Maryland Capital Access Program (MCAP) is a revitalization resource to support the growth and success of small businesses in Priority Funding Areas throughout the State of Maryland.
- The New Hampshire Capital Access Program (CAP) allows businesses, which are typically starting-up or expanding, to obtain loans of up to $100,000 through participating banks. The program is open to both existing and new companies with annual sales of less than $5 million.

### *Regulatory Climate/Issues*

These incentives intend to help businesses comply with environmental or permitting regulations. Few competitor states offer programs in this category. New Jersey and Virginia offer direct assistance programs, including:

- New Jersey's Petroleum Underground Storage Tank Remediation, Upgrade & Closure Program, which assists assist New Jersey businesses in necessary remediation due to a discharge from a home or business heating oil tank.
- Virginia's Small Business Environmental Compliance Assistance Fund provides low-interest rate loans to small businesses for the purchase and installation of replacement equipment needed to comply with the Clean Air Act; or to implement voluntary pollution prevention measures; or for the implementation of selected voluntary agricultural best management practices.
- Georgia offers an indirect incentive program with its Environmental Emergency Loan, which assists communities in financing improvements that are necessary to eliminate actual or potential public health hazards or violations of environmental regulations. California has a tax-based incentive to encourage development in "Local Agency Military Base Recovery Areas" and "Manufacturing Enhancement Areas," both programs provide fast track permitting within certain locations.

### *Business Management*

Massachusetts is one of the few competitor states with an incentive program aimed at business management needs with its "Turnaround Management Assistance" program. This program provides financing of up to $25,000 for a business management plan that restructures or repositions a business. Oregon's program "Business Retention Service" provides interest-free loans for consulting services for businesses in financial or organizational distress.

### *Product/Process Improvement*

Most programs in this category address industry cost reduction or modernization needs. Arizona has one direct incentive aimed at product/process improvement or cost reduction. The Waste Reduction Assistance (WRA) program funding is awarded to projects devoted to waste reduction, recycling, and composting. Projects may include capital improvements to recycling programs, research and development, and marketing. Funding may be used to purchase equipment and machinery. California, Colorado, Florida, Illinois, New York, North Carolina, Oregon and Virginia have all implemented direct incentives to help businesses adopt waste diversion or recycling strategies and equipment.

- California's Small Business Pollution Control Tax-Exempt Bond Financing Program (SBAF Tax-Exempt Bond Program) provides loans to creditworthy small businesses for the acquisition, construction, or installation of qualified pollution control, waste disposal, and resource recovery facilities in California. Loans are funded from the sale of tax-exempt bonds issued by the California Pollution Control Financing Authority on behalf of the eligible small business.
- The RENEW Colorado Loan Program has been created by the Colorado Housing and Finance Authority to provide financing for the development or implementation of waste diversion and recycling strategies.
- The Florida Recycling Loan Program, administered by Florida First Capital Finance Corp. (FFCFC) for the Department of Environmental Protection, provides below market financing for companies that manufacture products from recycled materials or convert recyclable materials into raw materials for use in manufacturing. The program offers funding for the purchase of machinery and equipment at a fixed interest rate as low as 2% below the Prime Lending Rate for the life of the loan (up to 10 years).
- Illinois' Recycling Industry Modernization (RIM) Program enables manufacturers to divert recyclable materials from landfills and to make companies more competitive. RIM projects increase the use of recycled commodities as manufacturing feedstock. The program also enables companies to make improvements to better manage manufacturing waste through innovative source reduction or waste reduction practices.

- New York's Industrial Process and Productivity Improvement Technology program supports feasibility studies and technology demonstrations that improve process energy efficiency, enhance productivity, and reduce waste and pollution.
- North Carolina's Business Energy Improvement Program funds activities that range from conventional building improvements such as energy efficient lighting, heating, ventilating and air conditioning to more specialized industrial process improvements using steam turbines. Other projects qualifying for funding include boiler efficiency improvements, on site electrical generation, or even alternate or renewable energy systems.
- Oregon's Small-Scale Energy Loan Program promotes energy conservation and renewable energy resource development. The program offers low-interest loans for projects that save energy, produce energy from renewable resources such as water, wind, geothermal, solar, biomass, waste materials or waste heat, use recycled materials to create products, or use alternative fuels.
- Virginia's Small Business Environmental Compliance Assistance Fund provides low-interest rate loans to small businesses for the purchase and installation of replacement equipment needed to comply with the Clean Air Act; or to implement voluntary pollution prevention measures; or for the implementation of selected voluntary agricultural best management practices.

States are also getting increasingly involved in trying to help their firms operate more competitively. New York's "Industrial Effectiveness Grants" provide indirect assistance to business through the state's manufacturing extension partnership program by paying for business management consulting services. Until 2003 when the program's funding was slashed, Minnesota provided 100 percent of the funding for all management consulting services provided to businesses through the non-profit Minnesota Technology, Inc. Frequently, these programs are tied to the state's manufacturing extension services program, a Federal-state partnership offering consulting assistance to firms. While the manufacturing extension program itself does not qualify as an incentive using our definition, these efforts are important support mechanisms for sharing technical expertise with firms. It is important to note that Arizona's manufacturing extension program currently receives no direct state funding support and is at risk of losing its federal investment.

Most states tend to offer related tax-based incentives aimed at helping firms reduce their overall production costs, especially in targeted areas. Arizona's Enterprise Zones, Foreign Trade Zones, and Military Reuse Zones are all examples of tax-based incentives that reduce costs for firms or result in process/product improvement. Most competitor states offer similar "zone" programs. In addition, competitor states offer product/process improvement programs to help companies control their costs through such mechanisms as tax credits to offset capital investments, manufacturing zones that offer additional manufacturing tax credits, elimination of construction-fees and building-materials sales tax refunds, reduced utility rates, sales tax exemptions, property tax exemptions, and tax increment financing.

## Implications for Arizona Incentives

In summary, the state relies heavily on tax-based incentives to implement its economic development efforts. Key tax incentives focus on promoting development of specific areas (through zone-based programs) and encouraging business investments in the information technology sector. Without additional data on the impact of these tax incentive programs, it is difficult to determine whether they are indeed helping Arizona achieve its strategic goals. Competitor states, like New Mexico, have implemented tax incentive programs targeted to a few critical industries, but tax policy tends to be more effective for traditional, mature industries. These tax incentives may be less valuable for emerging industries dominated by technology-based firms that may not yet earn adequate revenues to be taxable or may depend more heavily on worker inputs rather than capital investments.

Direct and indirect financial incentives may be more useful for the technology-oriented strategies emerging as critical drivers in shaping Arizona's economic development future. Arizona's lack of incentives to encourage capital formation in the form of equity (including seed and venture) capital may be an important gap to be addressed in future programs. These programs must address not only the need for capital, but they must also encourage the creation of new ideas that can be commercialized or deployed into the private marketplace. Thus, many of the most aggressive new strategic opportunity funds are aimed not at investing in individual firms, but at in supporting collaboration between firms and researchers – based in universities, nonprofit research institutes, and the private sector alike.

Workforce development efforts continue to be a critical element of future strategies. Because of the availability of unemployment insurance funds for this activity, Arizona's investment in incentives is dominated by its workforce development programs. Workforce training for incumbent workers is a critical element of a state's future economic success, and many states are figuring out how to better leverage federal workforce funds for customized, incumbent worker training. Arizona appears to rely more heavily on its Job Training Fund, a program dependent on payroll taxes for its funding stream.

Because of the focus on technology-based economic development based on the findings of the Statewide Economic Study and the challenges associated with using tax policy to influence public and private investment associated with new idea creation, direct and indirect financial assistance efforts appear to be growing in importance as a mechanism for providing business incentives. This is evidenced by the tremendous growth in state economic development investments since 1998 and the increased usage of strategic opportunity funds to seal large business deals. If Arizona is truly going to compete, it must reconsider its current level of investment in technology-based economic development initiatives.

## Findings

The above analysis of agency structure, board governance, expenditure investment, and incentive approaches provides critical insights about possible policy approaches to state economic development governance. States approach economic development in a variety of ways and there is no single best approach. The answers for Arizona depend on the state's specific goals and political cultures. From the best practices identified earlier, however, there are several key lessons learned that could be applied to an examination of Arizona's approach to economic development policy design and implementation. A few of those follow:

### Resource Levels Drive the Approach

States with the most resources dedicated to economic development tend to have a philosophy of active governance and a desire to address all aspects of economic development in their efforts. For instance, many Northeastern and Midwestern states, responding to the Rust Belt crisis of the 1980s decided that their governments had to take an aggressive leadership role in promoting economic development at state and local level. Their agencies have since built sizable portfolios of programs – reflecting the variety of issues facing those state economies. These states have been able to experiment with a variety of strategies and tactics. Unfortunately, these agencies also frequently still maintain legacy programs that had marginal effect but created strong local political constituencies.

In Sunbelt states, including Florida, Texas, New Mexico, and Arizona, investments in economic development have been somewhat more limited in scope. Several of these states have come to depend on strategic funds, controlled by the governor, to demonstrate an activist approach to economic development. One might argue that this approach has left the states dependent on current national trends of growth that favor metropolitan areas in these regions. The test for these states may depend on a future state in which policy makers learn if they are prepared for dealing with the inevitable slow-down after over-development, congestion, and resource limitations have their impact on metropolitan development, and if policy makers can encourage growth to distribute more equally to rural parts of the states. The true experiment being implemented today in this regard is California's decision to completely eliminate its economic development agency in the face of severe budget issues. Will this "unilateral disarmament" have a deleterious long-term effect on the state's economy as well as on the state's ability to balance growth?

Arizona has attempted to shape its economic development future based on the judicious use of highly targeted tax policies. It is uncertain how well this policy works, but the very limited resources available to the state Department of Commerce for economic development activities suggest that using tax policy is the only arrow available in the state's quiver of economic development tools.

Does the Commerce Department have sufficient resources to compete? How could some of the state's key economic challenges be addressed more effectively if the agency were to have more resources?

### The Strategic Fund is Running Out of Discretionary Money

When it was created in the late 1980s, the CEDC strategic investment fund represented another arrow that the legislature planned to be available to shape business investment behaviors. By definition, a strategic investment or "deal closing" fund provides discretionary dollars so that the state may take advantage of opportunities as they arise. Quite simply, the CEDC fund is no longer a discretionary fund. When it was initially created, the fund tapped state lottery games to provide resources for strategically important projects that were not anticipated in the budgeting cycle.

Today, the fund's survival is at great risk because of the way it is structured and utilized. Lottery gaming revenues have proven to be erratic, making the job of forecasting and budgeting for the Fund a challenge at best. Investments made by the program in early years were frequently made in the form of loans rather than grants – providing a revolving stream of funds. However, during more recent administrations, funds have been distributed in the form of grants and these grant funds are not being recouped.

While revenues from repayments are declining rapidly, the legislature is appropriating those funds for general agency operations. For 2004, only about $750,000 (or 20 percent) of the $3.75 million CEDC fund was available for discretionary investments. Even in one of its most "flush" years (2001) when a major loan repayment was made to the fund, only 30 percent of the CEDC fund was available for discretionary investments because such the legislature appropriated such a large proportion of the fund to Commerce Department operational activities. Because the fund's annual revenues have been inadequate, these appropriations have depended on loan repayment income from prior year investments as a revenue stream to balance the books since the mid-1990s. If repayments from prior year investments were excluded between FY 1999 and FY 2004, the legislature would have allocated a total of $1.8 million that was NOT actually available from the program's funding sources. Thus, in effect, the legislature has been appropriating funds for the program at a deficit since 1998 with earlier year loan repayments used to make up the difference.

In addition to unpredictable lottery revenues, the declining loan portfolio and appropriations that exceed revenues, in 1997 the percentage of lottery revenues received by the CEDC Fund was reduced 11%, from 32.5% to 21.5%. Over the period 1999 to 2004, it is estimated this reduced revenues to the fund, on average, by $1.05 million annually.

Based on current projections, if the legislature continues to appropriate from the Fund at the current level and lottery revenues continue at a pace equal to the average of the past five years, the fund may not have sufficient revenues (*even including past year repayments of CEDC Fund loans*) by the end of FY 2008. The legislature has already had to act once to keep the Fund from going into deficit, moving $1.125 million of $2 million in appropriations out of the CEDC Fund and back onto the general fund in 1997. Since then, the appropriations have again risen to an unsustainable level. This structural flaw in the current strategic fund's revenue base must be addressed immediately if the Commerce Department is to retain even its current level of service and the CEDC is to continue operating in any form.

What happens to the Commerce Department and to the agency's ability to support strategic initiatives when the Fund runs out of money?

### *A Variety of Challenges Lead to an Array of Tactics*

As the budget comparison demonstrates, the states tend to have spread their resources across a variety of functional activity areas. In other states, community assistance (or "product development") activities receive as much attention and public investment as business finance and strategic project investment opportunities. That has not been the case in Arizona where community assistance funding is limited and Federal community development block grant assistance is allocated to address the state's housing issues, but not its community economic development challenges.

Arizona's approach has focused the state's limited investments on a couple of politically sensitive challenges – ensuring that its workforce is retrained to respond to the changing economy and investing in its vitally important tourism industry. The workforce training funds are available because of the recent recession and the availability of funding to address dislocations caused from downsizing and outsourcing. This accounts for half the state's economic development investment.

Is Arizona investing in a sufficiently diverse economic development portfolio? Furthermore, is the level of investment in the areas other than workforce and tourism adequate to make more than a marginal difference to the state's economic well being?

### *Incentives and Investments Must Be Tied To the State's Economic Targets*

With several hundred incentive programs available in Arizona and the 18 competitor states, tax, direct financial, or indirect financial incentives are a mainstay of state economic development policies. In particular, states wishing to develop new technology, such as Arizona, are offering incentives to encourage investment in innovation, patience in achieving returns on capital investment, upgrading of business management and worker skills, and the development of the institutional infrastructure required to promote innovation and the commercialization of those new ideas.

However, if states are indeed developing targeted technology-oriented, cluster-specific strategies, one must ask whether this wide array of incentives is truly focused on the most significant issues facing each state's targets – or are states simply creating incentives merely to match their competitors?

### *The Emergence of "Deal Closing" Funds Cannot Be Ignored*

At the same time that Arizona has used its so-called strategic investment fund to fill the funding gaps needed to ensure that the Commerce Department continues to operate, other states have recognized the importance of making strategic discretionary dollars available to their economic development agencies. In the past few years, a number of states have created "deal closing" funds. For some critics, these funds are no more than economic development "war chests" that allow states to bid for mega-projects. Clearly, when these funds are proffered to individual companies, they can easily be construed as such. However, a closer look at funded projects offers a somewhat different perspective. While some of these investments are provided to individual firms, others use the funds to foster public-private collaboration. For instance in Texas, the Enterprise Fund is being used largely to fund major research initiatives of local universities in partnership with multi-national companies. North Carolina's fund is aimed at providing resources directly to local communities to help them prepare large sites for projects.

Certainly, individual companies are benefiting from these and other "deal closing" fund investments. However, frequently, the investment is going to public agencies and immobile capital (e.g., higher educational assets, infrastructure improvements, real estate developments, and fixed capital equipment) so these assets are not likely to be lost to the community even if the company were to move away or go out of business. More importantly, these "economy defining projects" have the potential to make a dramatic change in the places where the development occurs and to become critical assets for future development activities as well. Also, because these funds are for "competitive" and "one-shot" projects, they need not lead to the formation of new programs that build a constituency to be funded every year.

Are these deal-making funds emerging as the melding of the traditional economic development deal making model and the increased demand for technology institutional assets? How can this model be used, if at all, to influence how Arizona responds to its strategic thrusts toward targeted industry clusters and regional development?

### *Techniques for Determining Effectiveness of Incentives Must Improve*

The greatest concern of many detractors of economic development incentive policies is that these programs are wasteful and provided unnecessary benefits to individual firms. Often the programs are not effectively monitored. Furthermore, tax concessions are frequently considered an ineffective approach to influencing business behavior.[23] In addition, a substantial number of incentives (especially tax incentives) are not well monitored for performance – only for their estimated impact on the state's fiscal condition.[24] This effort did not try to address the issue of

[23] *Arizona State University Morrison Institute of Public Policy, "Comparative Analysis and Guidelines," prepared for the Arizona Department of Commerce, 1993, p. 36.*

[24] *Kenneth E. Poole, George A. Erickcek, Donald T. Iannone, Nancy McCrea, and Pofen Salem;* Evaluating Business Development Incentives*; National Association of State Development Agencies; Prepared for the US Economic Development Administration; 1999*

which incentives are effective – that is a much larger study for a later time. However, our efforts did uncover a number of performance monitoring and measurements systems that are worth examining more closely.

While every state must make an annual report to their state legislature as to their performance, most focus on measures of the success of the full portfolio. Oregon has been a national leader in this regard and it has developed probably the most comprehensive approach, most specific metrics, and the most sophisticated reporting system. Because of pressures from local grassroots organizations, Minnesota has developed the most transparent system for monitoring and reporting results for individual projects and programs. Texas, mid-way through its second year of operating the Texas Enterprise Fund, is still negotiating with the Legislative Budget Bureau on a formal report mechanism, including the specific performance measures that are expected. Maine, which has spent $5 million per year on technology-related investments, recently completed an extensive evaluation of its past investments, but its leadership is still not satisfied that it has the right set of measures for the program. Arizona's requirements for a projected cost-benefit analysis represents a best practice among the states as no other requires such extensive analysis of the public impact of investments being made.

How can Arizona assuage critics and develop an effective incentive policy that helps it achieve its goals of increasing technology-related investments while ensuring that these policies are monitored for legislative and management purposes? Does it currently have the mechanisms in place or does the agency need to spend more time on fashioning measures that reflect the realities of knowledge-intensive economic development investments?

## *Recommendations:  Alternative Scenarios for Moving Forward*

While the focus of this report is on the Arizona Department of Commerce's governance and investment policies, we would be remiss in offering ideas for future direction without first offering suggestions on what this analysis implies for the state's economic development policy direction. Building on research conducted as part for the Statewide Economic Study, Arizona has begun to hone in on a number of key targets identified in part from the competencies of its university research activities.[25] Among these targets include biosciences,[26] advanced communications and information technology,[27] and the "sustainable systems" industry.[28] Each of these studies offers suggestions for reshaping the state's incentive policies by investing state funds in efforts that foster collaboration between industry and higher education in support of research and workforce development in the respective target areas. Common strategies recommended in these studies can be summarized into five approaches:

- Developing an image for the state in the respective targeted technology,
- Investing in the state's research capacity associated with that targeted technology through university-based centers of excellence, industry-university partnerships, or demonstration projects,
- Fostering dialogue and networking among industry, university, and government officials on the challenges and opportunities facing each targeted technology,
- Ensuring that risk capital is available to aid in the development and commercialization of targeted technologies, and
- Helping the state's education and training institutions produce world class workers ready to take the jobs to be created in these industries.

The goal of the recommendations of this report is to translate these common proposals into a framework for designing incentive policies that could make a real difference to Arizona as it economy continues to develop.

### Investments

The first conclusion that one might draw is that the state should depend less on trying to shape economic policy through its tax structure. The state's dependence on tax policy to influence business behavior has been limited, and it misses two critical features important to the development of emerging sectors. First, public investments in education, training, research, transportation, and marketing are critical foundations for successful growth in these target sectors; however, these investments are seldom influenced by tax-based incentives. Second, state taxes account for a relatively small proportion of the cost of doing business for private export-oriented, technology companies. Tax incentives work for reinforcing corporate investment decision making, but overall tax structure is more likely to influence those decisions. Increasingly, states are finding that other factors, like the quality of the local workforce, the regulatory

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[25] *Battelle Technology Partnership Practice, "Positioning Arizona and Its Research Universities: Science And Technology Core Competencies Assessment," Prepared for the Arizona Commerce and Economic Development Commission and the Arizona Department of Commerce in association with Arizona's public research universities and the Arizona Board of Regents, April 2003.*

[26] *Battelle Technology Partnership Practice, "Arizona Bioscience Workforce Strategy: Preparing for the Future," prepared for the Arizona Department of Commerce, October 2003.*

[27] *Battelle Technology Partnership Practice, "Building from a Position of Strength: Arizona Advanced Communications and Information Technology Roadmap," prepared for the Arizona Department of Commerce, March 2004.*

[28] *Battelle Technology Partnership Practice, "Positioning Arizona for the Next Big Technology Wave: Development and Investment Prospectus to Create a Sustainable Systems Industry in Arizona," prepared for the Arizona Department of Commerce, March 2004.*

environment, and access to state-of-the-art ideas may well be more important in the investment decision making process of emerging technology companies.

With tax incentives aside, an assessment of the State's direct and indirect business incentives efforts suggests that the Arizona is skimping on public investment in economic development. While many other states are increasing their investment, even in times of fiscal restraint, Arizona has essentially decreased funding for many of the core program elements. With such limited resources, the Arizona Department of Commerce and the Commerce and Economic Development Commission can only make a difference at the margins on a small number of projects. Other states have determined that they need to make significant investments in large, high profile public-private ventures that have the potential to reshape their respective state's economy. Arizona policy makers continue to clamor over whether the public sector has a role in leading the state's economy while other states have come together – through state leadership – to invest in bold new ventures aimed at creating a new future.

## Investing in High Profile Economic Development

If Arizona is to compete, its leaders must decide to invest. If they opt not to invest, then they opt to accept the economic remainders from other states and settle for what would otherwise naturally come to Arizona as a result of overall national economic growth. Growth in Phoenix cannot continue unabated and the state's rural areas are falling further behind. Consequently, Arizona cannot afford to unilaterally disarm as California has. Instead, the fundamental question must be: how much should the state invest and what criteria should it use in deciding how to use its investments?

The answer to the second part of this question comes directly from the state's citizens. During the course of the past two years, the Commerce and Economic Development Commission commissioned a statewide economic strategy, culminating in an extensive public outreach process.[29]

The results of that strategy outreach are useful in that they offer several themes that ought to inform the state's economic development investment policies. Those themes include:

- Frame the state's tax structure to balance the burden on business and encourage investment by export-oriented, technology-intensive firms
- Foster stronger ties between industry and academia, helping higher education to develop new ideas and industry to commercialize those products in a few specialized areas in which Arizona has the potential to become world class
- Design initiatives that take into consideration the state's limited supply of water and private land.
- Recognize income and economic differentials across the state, especially in rural areas where tourism is a potent economic driver and political force

These themes suggest that Arizona's economic development policies should emphasize (a) lower taxes for business with fewer, more limited tax breaks, (b) investments in public-private research and commercialization collaborations, (c) innovations in environmental and energy use in the development or production process, and (d) incentives designed to raise rural wages and diversify the economy. These themes emerged from the Statewide Economic Study process and from the analytic work completed in support of that process. The analysts identified between $15 million and $25 million of immediate investments that need to be made.[30]

[29] *Elliott D. Pollack and Company and Pat Schroeder, "Public Outreach, Local Plan Integration And Strategic Findings," Prepared for the Arizona Department of Commerce and the Commerce and Economic Development Commission, October 2003.*

[30] *The Battelle studies of bioscience, advanced communications and information technology, sustainable systems, and Arizona's university research competencies combined to call for public investment at this level.*

The answer to the first part of the question – how much Arizona should invest -- will be the subject of much debate. Arizona should at least be willing to match its neighbors in their investment. To move from being 17th per capita to 9th per capita among its competitor states (moving it to the "middle of the pack"), Arizona would need to double its current investment in economic development (from $37 million for Department of Commerce programs, including workforce training, to $72 million). While we do not propose to increase the state allocation for economic development to quite that size, Arizona must take bold action. Other surrounding states, including Utah, are investing upwards of $25 million in their strategic funds. Current proposals under consideration in Virginia, North Carolina and Florida also ask those states to invest $20 million to $25 million in strategic economic development funds. Arizona must match these investments to meet the needs identified in its Statewide Economic Study and to demonstrate to itself (and the rest of the world) that it is serious about making economic development an important state priority.

First and foremost in this debate, the state should agree to eliminate legislative appropriations from the Commerce and Economic Development Commerce Fund (or the CEDC Fund), funding those appropriations through the General Fund or some other source. Without eliminating these appropriations and finding other sources of funds for Commerce operations, Arizona's economic development efforts could be out of business within the next two years.

Even then, the CEDC Fund at its current funding level is not adequate to meet Arizona's competitive challenges. To do so, the state should increase the CEDC Fund to $25 million from its current level of $3.6 million. By increasing the CEDC Fund substantially, Arizona makes a significant statement to its business community and to the rest of the world that it is serious about growing its economy and becoming a world class leader in growing successful entrepreneurial companies.

The proposed $25 million annual appropriation for the CEDC Fund would be used to:

- Create a deal closing fund aimed at supporting public private collaborations related to the state's targeted investments,
- Leverage federal dollars to achieve state economic development priorities,
- Offer challenge grants for signature, "economy-defining" initiatives in the state's rural areas,
- Create an equity investment fund, and
- Provide strategic research, planning assistance, and policy development support as the state continues to refine its strategy and use of resources.

The amount that goes to each of these five primary purposes would not be pre-defined, but would remain at the discretion of the Governor, the agency director, and the CEDC. The allocation of resources would be determined based on goals laid out in the Statewide Economic Study and on the opportunities that arise throughout the year. If sufficient opportunities are not identified in a single year, the funds would be retained in an account that would serve as an endowment for future economic development activities, including managing the fund's portfolio, supporting related economic development efforts such as strategic research, international trade promotion, and technology cluster building activities.

We envision various accounts within the fund designed to deal with each of these issues. All of these activities would remain a part of the single fund, and the CEDC would retain authority to make resource allocation decisions based on opportunities that arise or that the CEDC wishes to create. Of course, the CEDC would report to the legislature and Governor on investment activities and impacts. But, keeping the accounts together in a single fund ensures the current level of financial stewardship and fiduciary controls required to maintain the public trust are retained while achieving the program's public policy goals.

### *Deal Closing*

The state needs access to flexible resources that can be used to leverage substantial private investment. The CEDC Fund would allocate a portion of its appropriation to a deal closing account. This account would represent an amalgamation of the existing "Direct Assistance to Business" and "Technology Sector Project Capital" programs managed through the Fund. The mission of the proposed deal closing fund should be to help jump start investments in support of the targeted industries identified in the Statewide Economic Study. Preference should be given to projects that have public and private participation. For instance, the fund might be used to provide seed capital for one or more centers of excellence at state universities. In such a case, the state would only use this fund to make an investment if the center has industry collaboration in shaping the research agenda, a plan for commercializing resulting research, and a defined pay-off to the state in cases in which research or technologies are commercialized. More specific criteria for projects that stand to create substantial economic opportunities for the state should be put into place before making investments from this Deal Closing account.

### *Federal Matching*

A portion of the CEDC Fund should be allocated to leveraging federal dollars by providing state matching funds for key economic development projects. The agency also could attract additional federal funds to the state; however, there is inadequate capacity to identify opportunities or provide the state matching funds frequently required by federal programs. For instance, the state currently does not control nearly $800,000 in federal manufacturing extension services because there is no source of state match. As a consequence, this national program cannot operate as effectively in the state as possible and it is not necessarily responsive to the state's policy priorities. The state also does not attract its share of small business innovation research (SBIR) and small business technology transfer (STTR) awards. Part of the reason is that state firms do not know about the opportunities, or they need small amounts of capital to do basic research and/or proposal development activities.

Many other states offer grants and/or equity investments to help encourage firms to apply for these federal awards. Particular emphasis would be placed on projects aimed at advancing Arizona's capacity to conduct research, commercialize technologies, or increase industry investment in targeted areas related to: advanced communications and information technology (e.g., wireless telecommunications, embedded systems development, and photonics) and sustainable systems industry (e.g., water sustainability, solar and other renewable energy, pollution prevention/recycling, green construction materials, environmental and water sciences, and energy efficiency).

### *Rural & Regional Challenge*

Another portion of the expanded CEDC Fund would be allocated to addressing the needs of rural areas in innovative ways that foster regional collaboration through a Rural and Regional Challenge Initiative. Rural areas dependent solely on tourism cannot keep up in a 21$^{st}$ century knowledge-based economy. These areas must take risks in redefining their economic base and finding newer, more higher value-added economic activity. Currently, statute requires that 25 percent of the CEDC Fund be used to provide assistance to business or projects in rural areas, and 15 percent be used to provide assistance to businesses or projects in economically disadvantaged areas. In addition, the Fund operates an "Intermediary Participation Program" that helps to leverage local revolving loan investments. This proposed effort would modify the existing program by targeting investments to projects that would benefit rural areas, meeting the statutory mandate. While the participation program is currently a loan fund, this effort might include a mixture of loans and grants, depending on the project's need and the goals of the CEDC Fund managers.

The proposal would dedicate a portion of the fund's resources to "economy-defining" projects that foster regional collaborations among towns and counties in the non-metropolitan areas of Arizona aimed at creating new economic opportunity for local residents. Such "economy-defining" projects would be those that are deemed to have a profound effect in transforming a local economy. These might include projects that would help local leaders characterize their economy in a new way, such as: the building of an agricultural genomics research institute that significantly contributes to the development of a bio-tech sector. Some of these projects may involve building economic bridges between rural communities and metropolitan economic engines. These ideas could range from creating value-added manufacturing products in areas traditionally dominated by resource extraction to efforts by localities to participate in joint higher education-industry research initiatives. The resources would be used to help provide local match as part of larger investment projects.

### *Equity Investment*

A portion of the expanded CEDC Fund would be used to invest in private seed, venture, or other equity funds doing business in Arizona. This investment might also be tied to leveraging a small percentage of state investments into these equity funds. The Arizona Equity account would be modeled to some degree after New Mexico's Invest New Mexico initiative, which taps a portion of that state's Permanent Severance Fund. This model is useful, and Arizona should emulate it by investing an appropriately modest portion of a large state funds account, such as its pension fund, in certified seed and venture capital funds operating within the state.

The Arizona Equity investment account (dubbed "Arizona Equity") would have two goals: (1) to expand the availability of seed and venture capital in the state and (2) to prime the pump so as to encourage the expansion of the state's venture capital industry. Arizona Equity would be supplemented by resources from the CEDC Fund. CEDC Fund investments would not be made in the equity fund, but rather would be used to subsidize a portion of the extra costs that the venture firms might anticipate in performing due diligence and mentoring to Arizona entrepreneurs seeking to be financed through Arizona Equity.

### *Strategic Research & Evaluation*

A portion of the CEDC Fund should continue to be allocated for strategic research and policy development. This function is critical if Arizona is to stay abreast of the needs of citizens, changes in the economy, monitor the progress of the state investments, and maintain focus on the agency's policy direction. The Strategic Research & Evaluation account should be used not just to support DOC policy research, but also to encourage regional planning among localities and counties, linkages between economic development and community development, workforce development, education, and transportation. These resources would also be used to identify opportunities for fostering vital interagency, intergovernmental, or public-private collaboration. For instance, as resources from the unemployment insurance trust fund decline for job training, it will become even more critical that federal Workforce Investment Act funds become demand (i.e., industry) driven.

This fund could be used to sponsor joint workforce, education, and economic development strategic research and planning activities. In particular, the CEDC would offer an incentive to work with the state's Workforce Investment Board in developing a Workforce and Economic Development Strategy that builds strong ties between the workforce and economic development systems. In addition, as the state identifies and begins to support regional economic partnerships, the Strategic Research & Evaluation account could also be a vital tool for joint state-regional planning activities and for helping to convene or seed regional partnerships.

### *Measuring Success*

Because Arizona must invest more public dollars in economic development, it must do so in a way that builds public confidence. The CEDC already has an extensive set of measures that it utilizes to evaluate projects including:

- The value of taxes generated to state and local entities as a direct and indirect result of a project
- The number of jobs created
- The impact of the project on the standard of living and quality of life

- The ratio of economic benefit from wages and capital derived from the project relative to the amount of state assistance
- The wages and benefits (including the value of health care, retirement, child care, education, and training benefits) offered by the business or project relative to local median wage
- The proportion of products or services exported from the state in the first five years of operation
- The number and percent of new jobs being created or retained for state residents in the first five years

These measures are built on sound principles for judging whether projects help to improve the state's overall economic well being.[31] However, they measure traditional economic development activities. These measures are not entirely adequate because they do not fully consider that investment in technology-based economic development results in a different set of outcomes. Technology-oriented investments are more likely to result in outcomes such as increased licensing and patenting activity, changes in the amount of non-state (federal and industry) investment in research, development, or project activities, or greater investment and job creation activity in targeted industries. Traditional measures of job creation and tax generation may take some time to come to fruition.

Likewise, each of the five proposed accounts to be incorporated into an expanded CEDC Fund is aimed at achieving slightly different goals. Thus, additional measures or alternative measures should be used for different components of the fund. To encourage prudent risk-taking by fund managers, the measures should consider the impact of the entire portfolio of projects rather than the impact of each investment individually. By conducting a portfolio-wide analysis, policy makers can keep their focus on answering the question of whether the entire Commerce and Economic Development Fund is having the desired impact and in helping managers to make better decisions about the allocation of resources across the portfolio.

Currently, the Commission is required to make a quarterly report to the Governor, Speaker of the House and President of the Senate. This frequent reporting is useful as a monitoring mechanism and should continue, and reporting should not only summarize the results across the portfolio of funds but also examine the impacts and activities of the entire CEDC Fund. In addition, the Commission should examine its portfolio performance over a period of time with a three-year review that essentially audits the activities and reports in the form of a full-scale evaluation of the economic and fiscal impact of all of these investments.

Certainly, one caveat to this system of measuring the CEDC performance is that research and evaluation efforts should be measured differently from the Fund's other program activities. While they do not directly create jobs or foster investment, this work is critical in helping policy makers make decisions about state investments. Measures of research and evaluation efforts are important to ensure that they provide satisfactory information and meet the needs of policy makers. Measures of success for these efforts should focus on completeness, quality of the analysis or planning efforts, and the level of satisfaction that decision makers have with the information that they are receiving. One measure that might also be used is the perceived value to stakeholders and the resulting collaboration that might not otherwise have occurred. Clearly, these are a very different set of performance criteria than other program-oriented investments and should be treated differently.

Even though many policy makers argue the value of incentives, they are likely to remain an integral part of economic development policy making. Reformers call for improving the quality of information, establishing stronger job quality standards, and integrating performance and cost-

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[31] *Arizona State University, Morrison Institute for Public Policy, "Comparative Analysis and Guidelines," Prepared for the Arizona Department of Commerce, 1993.*

benefit requirements.[32] We call for these same improvements. Maintaining the public trust in this effort is vital and so the CEDC should continue its current efforts to monitor and manage CEDC Fund dollars as effectively as possible.

If the CEDC Fund is expanded as proposed, it is critical that the Commerce Department have a thoroughly vetted process for monitoring and measuring success that has the full confidence of the Governor, legislators, and citizenry. Before the first investment is made, the CEDC should sponsor a process to review its measures and ensure that they are agreeable. The Commission should go beyond the statute and examine what really matters in terms of public benefit expected from the program. Reviewing the above proposed suggested measures, refining the list further, and documenting the process, and communicating to the public about future monitoring and evaluation activities will be critical to the long-term success of the CEDC Fund.

[32] *Timothy J. Bartik, "Incentive Solutions," Upjohn Institute Staff Working Paper 04-99, W.E. Upjohn Institute for Employment Research, February 2004.*

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