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PICKING Losers

Why the majority of North Carolina's incentive projects end in failure

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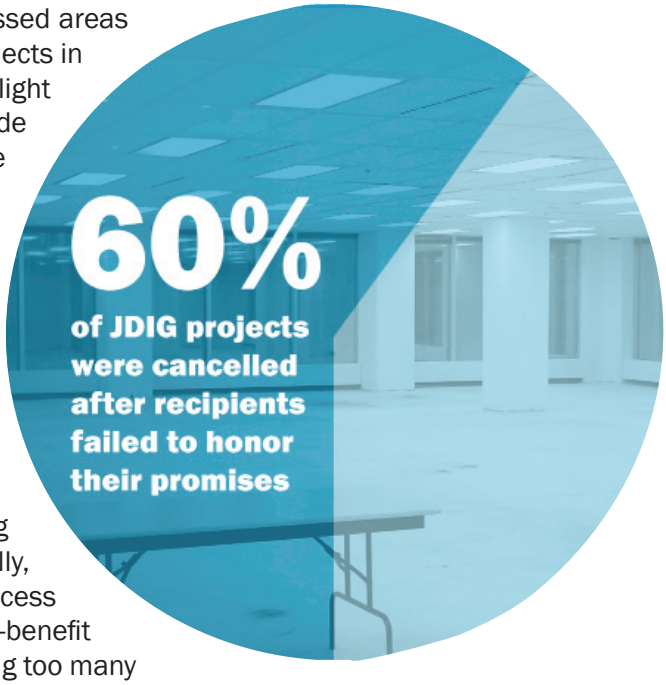
If North Carolina continues to use incentives to pick winners and losers in economic development, the state needs to do a much better job of picking winners. More than half of all firms receiving incentive awards from the state's Job Development Investment Grant (JDIG) program since its inception in 2002 have failed to live up to their promises of job creation, investment, or wages.[1] These failed projects have forced the Department of Commerce to cancel those grants and even occasionally take back funds already given to these underperforming firms, according to an analysis of program reports.

Given the troubling number of failed projects, now is not the time to accept recent proposals to expand JDIG and create a new "catalyst fund" for closing new incentive deals. All told, the state has cancelled 60 percent of JDIG projects after recipient firms failed to honor their promises, with even higher rates of failed projects in the rural and most economically distressed areas of state. The disparity in performance between projects in urban and rural counties is even more striking in light of the significantly lower incentive investments made in those rural areas—rural counties are seeing more project failure despite having fewer and smaller investments.



To address these problems, legislators should resist adding to the state's incentive programs and instead focus on strengthening the performance standards that hold recipient firms accountable for the promises they make. Without these critical accountability measures, each one of these unsuccessful projects would have continued to receive millions in public subsidies, despite failing to create promised jobs and investment. Additionally, policy makers should improve the evaluation process for prospective JDIG projects. Currently, the cost-benefit analysis every project must undergo is clearly letting too many bad projects slip through the cracks. Future incentive grants should go to firms in targeted industries that are poised for robust growth rather than those that are in decline, and grants should be designed to bring infrastructure development and job training resources to the rural counties that most need assistance. Lastly, there is no need to create a new "closing" fund because there is already a similarly designed incentive program that governors have traditionally used to help close projects—namely, the OneNC program.

THE JOB DEVELOPMENT INVESTMENT GRANT

Originally created in 2002, JDIG provides annual cash grants to new and expanding businesses for periods up to 12 years. Long considered a national model for incentive accountability,[2] these grants are "performance-based" in that they require companies that are awarded incentives to live up to their promises of job creation and investment levels in order to actually receive the dollars from the state. If companies fail to live up to their promises after an initial five-year or seven-year "base period,"[3] then the Department of Commerce is required to cancel the grants and even take back any funds that have already been given—a policy known as a "clawback."

Additionally, each prospective JDIG project is subject to initial analyses assessing both the prospective economic impact of the proposed project and whether the costs of the project outweigh its benefits. If either of these analyses falls below a certain threshold, then the state is prohibited from granting a JDIG the prospective company. Although this is rightfully intended to ensure that the state is not wasting taxpayer dollars on incentive projects unlikely to generate meaningful economic benefits, the reality of testing these potential projects has not lived up to its promise, as the majority of JDIG projects have failed and been cancelled by the Department of Commerce.

The reality of cost-benefit testing potential projects has not lived up to its promise.

In terms of the geography of JDIG award-granting, since 2007, the program has used a unique targeting system that takes a percentage of incentives from projects in wealthier counties (Tier 2 and 3) to help pay for infrastructure development in the state's poorest counties (Tier 1). Specifically, 15 percent of the JDIG money awarded to projects in Tier 2 counties and 25 percent of JDIG money going to Tier 3 counties goes into the Industrial Development Fund Utilities Account, which funds rural industrial infrastructure development. (All of the money from JDIG grants in Tier 1 counties stays in Tier 1 counties). In this way, the state is trying to ensure that more distressed counties receive benefits from JDIG, even if those benefits don't directly involve additional job creation—a strategy that previous research has found generally successful.[4] Unfortunately, the JDIG grants themselves fail more often in rural areas than in urban areas.

JDG grants fail more often in rural areas than in urban areas.

Taken together, these two factors demonstrate both the critical importance of performance and accountability measures and the necessity of reforming how Commerce chooses its incentive grant awardees before expanding the program.

■ RECENT INCENTIVE PROPOSALS

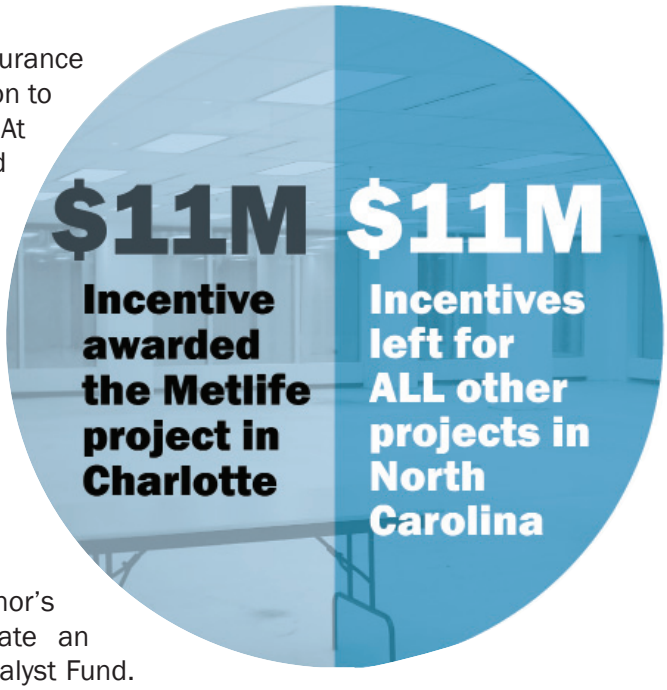
Over the past year, the legislature has considered two major economic development incentive proposals, neither of which would improve the state's troubling track record of picking losers and failed incentive projects.[5]

First, in the waning days of the 2014 legislative session, Governor Pat McCrory made a surprising announcement to the General Assembly—JDIG, the state's flagship incentive program designed to create jobs and grow the economy, was about to run out of money and desperately needed expansion. Contrary to the governor's urgent announcement, however, the JDIG program didn't just suddenly stumble into insolvency. Rather, the shortage of JDIG funds was the direct result of the administration's grant-making decisions and the legislative cap on JDIG dollars.

Under a statutory requirement in existence since the program's original enactment in 2002, the state capped the total amount of public dollars that JDIG could spend on all projects combined in each year. In 2014, this fiscal cap was $22.5 million.

Unfortunately, the governor ate up about half of the available JDIG funds below this cap

with a single project—the 2013 award to insurance giant MetLife as part of the company's decision to locate its corporate headquarters in Charlotte. At the time, Governor McCrory proudly described the project as the largest JDIG award in state history, coming in at $110 million over ten years (or about $11 million per year). The practical effect has been to significantly curtail the amount of money available for other JDIG projects in 2014 and 2015. As a direct result of this decision, the governor proposed raising the cap from $22.5 million to $36.5 million—a request that the legislature rejected in the 2014 session and should do so again this year.



The legislature also considered the governor's second major request—a proposal to create an entirely new incentive program called the Catalyst Fund. This fund would help "close" particularly competitive business attraction and expansion projects by allowing the state to add incentive dollars during the final stages of negotiations with prospective firms. In terms of cost, the administration suggested seeding the fund with between $20 million and $30 million, which the legislature would have to appropriate each year.

In terms of program design, the new fund would be a curious hybrid of the state's existing incentive programs. Much like the OneNC Fund, the Catalyst Fund would provide grants to local governments, which in turn would have to match portions of the catalyst award from their own funds and then re-grant the combined amount to the recipient firm. The catalyst grant would also include the same performance and accountability requirements built into JDIG and would be designed to piggy-back directly onto prospective JDIG awards.

Perhaps most worthily, the new catalyst program includes statutory wage requirements mandating that recipient firms pay an average weekly wage that exceeds 100 percent of the average wage in Tier 1 counties and Tier 2 counties and 110 percent of the

The OneNC Fund—North Carolina's *original* closing fund

The proposed "deal closing" fund is unnecessary and duplicative because the OneNC program already plays this role. The OneNC program operates in almost exactly the same way as the proposed "Catalyst Fund"—it provides matching grants to local governments so they can increase their incentive offers to prospective firms, and more distressed counties receive larger awards. In fact, North Carolina governors have used OneNC as a deal-closer 26 times over the past ten years by piggy-backing OneNC awards on top of JDIG awards—spending a total of $90 million since 2002.

Giving away more money actually would do nothing to ensure that these projects succeed at creating jobs.

average wage in the state's 20 most prosperous counties, designated as Tier 3. Lastly, the proposal also includes several provisions designed to target more incentive-granting to Tier 1 and Tier 2 counties by making more projects in those counties eligible for incentive awards.

However, because catalyst awards would be paired with JDIG awards, the state would be putting more money into projects with a high failure rate. Making more projects eligible for awards and giving away more money would do nothing to ensure that these projects succeed at their stated goals of creating jobs and spurring private investment. As a result, this new catalyst program could exacerbate the failings of the JDIG program.

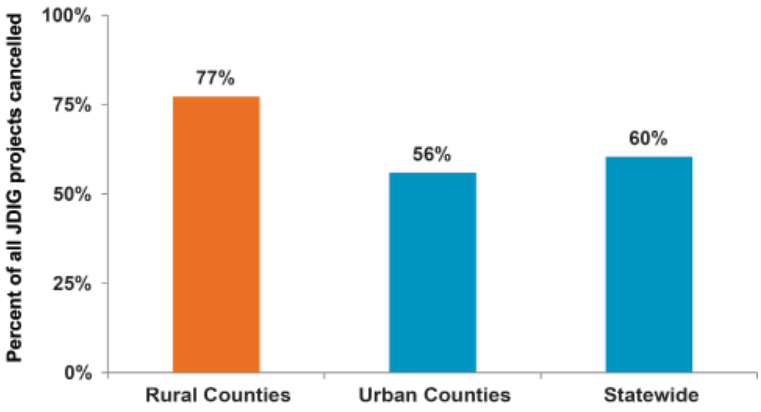
Even more troubling, the catalyst proposal would weaken a core pillar of JDIG effectiveness—the requirement that all prospective deals undergo a cost-benefit analysis that shows the benefits of the prospective deal outweigh its projected costs to the state. As proposed, catalyst fund awards would not undergo this cost-benefit test, and if adding a catalyst award on top of a JDIG award would result in the project failing this test, the project could proceed regardless.

The new catalyst fund would be duplicative and unnecessary, and would weaken core accountability requirements that have protected taxpayer dollars when JDIG projects have failed.

JDIG PICKS LOSERS MORE OFTEN THAN WINNERS

In the years between the creation of the JDIG program in 2002 and 2013 (the last year for which the program's performance data is available), North Carolina gave incentive awards to many more losers than winners. Under JDIG's accountability requirements, project failure occurs when a company receiving a JDIG doesn't live up to its promises of job creation, investment, or wages, and the Department of Commerce cancels the grant. Over this 12-year period, the Department of Commerce was forced to cancel 62 out of the 102 JDIG awards due to companies' failures to fulfill their promises[6]—a 60 percent failure rate for all JDIG projects across the state.

FIGURE 1: Rural counties see highest rates of JDIG failure, 2002-2013



SOURCE: Author's analysis of JDIG annual reports, N.C. Department of Commerce, 2002-2013.

Governor McCrory often talks about JDIG as an essential tool in recruiting new businesses from outside North Carolina to locate here, yet almost 60 percent of the 58 recruitment projects that received JDIG awards failed to generate the benefits promised by the recipient firms and were cancelled. This suggests that while JDIG may be a useful tool in securing the promises of new jobs, it falls short in securing the reality of new jobs.

A major contributor to the high rates of project failure is the fact that the

48%
failure rate for projects in *target* industries

60%
failure rate for all projects

70%
failure rate for projects in *declining* industries

state has granted more than half of all JDIG awards to firms in industries experiencing decline, rather than in industries that are poised for growth. Declining industries like wood pulp manufacturing and certain textiles are losing employment, shuttering facilities, and moving out North Carolina, and as a result they do not make good prospects for long-term investment in North Carolina. The data bears this out—projects in declining industries have a 70-percent failure rate, while just half of projects in growing industries have failed.

But even among growing industries, some sectors have better long-term prospects than others. Ten years ago, the state conducted intensive research to identify a range of "target" industries with high growth potential for North Carolina, based on their strength, resilience, and ability to compete in the global economy.[7] Off and on over the past ten years, Commerce has sought to focus its economic development efforts in these targeted industries, incorporating these criteria as a key method for selecting those prospective firms most likely to locate, remain, and grow in the state.

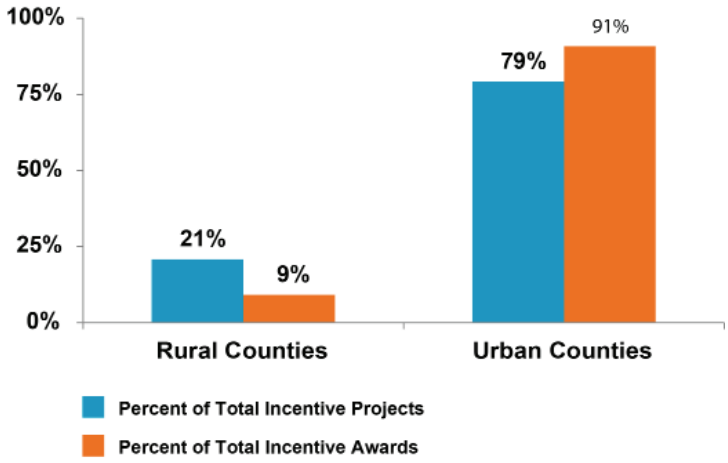
Given that targeting has long been recognized for its effectiveness in generating long-term industrial growth and job creation,[8] it is no surprise that JDIG awards in the target industries identified by Commerce are more successful. Only 48 percent of JDIG projects in target industries failed, compared to the 76-percent failure rate for projects in non-target industries and the state's overall 60 percent failure rate.

Although the state's accountability standards have protected the bulk of taxpayer dollars from being given away to failed companies, the state has still lost money in terms of staff time and resources committed to the jobs recruitment process. Certainly, no state should tolerate a 60 percent failure rate in its job creation programs.

■ INCENTIVES NOT WORKING FOR RURAL NORTH CAROLINA

The state's incentive programs are not meaningfully benefitting rural North Carolina. Rural counties have received a fraction of the JDIG awards urban counties have received, while experiencing significantly worse project failure rates. Since 2002, only 9 percent of all JDIG dollars have gone to rural counties, while more than 90 percent have gone to urban counties. Meanwhile, even those dollars haven't

FIGURE 2: Urban counties win lion's share of JDIG grants, 2002-2013



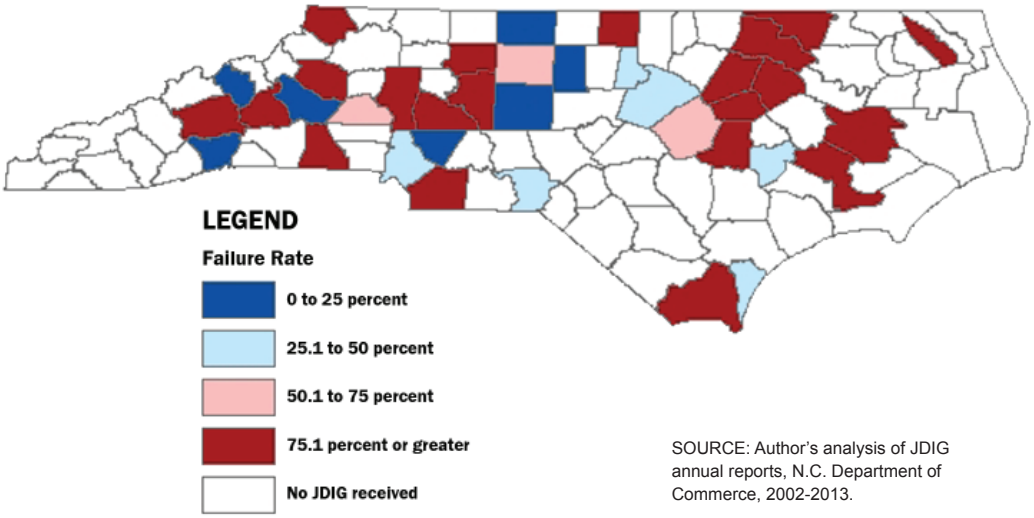
SOURCE: Author's analysis of JDIG annual reports, N.C. Department of Commerce, 2002-2013.

The state's incentive programs are not meaningfully benefitting rural North Carolina.

translated into the reality of more jobs in rural North Carolina—more than 77 percent of JDIG projects in rural counties have failed, compared to just 56 percent of urban county projects (see Figure 3).

In perhaps the most troubling trend in the state's targeting mismatch, just three counties account for almost 60 percent of the total JDIG dollars granted statewide since 2002—Durham, Wake, and Mecklenburg. These are the counties with the fastest employment growth in the state—more than 70 percent of the state's job creation since the end of the Great Recession has occurred in these urban, prosperous counties.[9] In other words, the state is investing the majority of its incentives resources in the counties that need it least. JDIG projects in urban counties experience a 55-percent failure rate, much lower than the rates of project failure in rural counties.

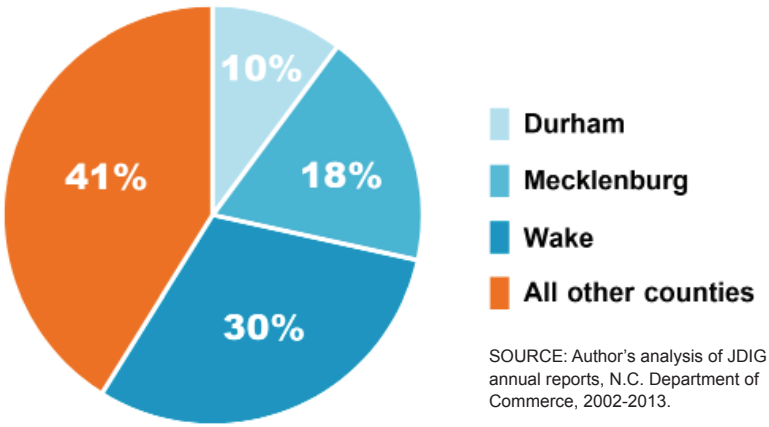
FIGURE 3: Percentage of JDIG projects that failed by county, 2002-2013



SOURCE: Author's analysis of JDIG annual reports, N.C. Department of Commerce, 2002-2013.

Durham, Wake, and Mecklenburg account for almost 60 percent of the total JDIG dollars granted statewide since 2002.

FIGURE 4: Percent of all incentive awards given to each county, 2002-2013



SOURCE: Author's analysis of JDIG annual reports, N.C. Department of Commerce, 2002-2013.

■ RECOMMENDATIONS

Given that JDIG picks more losers than winners and the closing fund is unnecessary, legislators should take the following steps:

- **Refuse to expand JDIG or enact a new Catalyst Fund.** Lawmakers need to understand why the state's incentive programs are experiencing such excessively high rates of project failure before spending any more of the state's shrinking revenues on these failing programs. Otherwise, the state will continue to invest in programs that are proven to be ineffective at creating jobs—this is not a recipe for generating economic success in an era of persistent joblessness and income stagnation.

- **Maintain the existing standards that hold incentivized firms accountable for their promises of job creation and investment.** Without these critical accountability measures, each one of these unsuccessful projects would have continued to receive millions in public subsidies, despite failing to create promised jobs and investment. These standards should be maintained and extended to all infrastructure projects accompanying JDIG awards. The minimum wage paid by each project should be no less than 110 percent of the average county wage.

- **Improve the evaluation process for prospective JDIG projectsbefore the state agrees to grant the award.** Currently, the cost-benefit analysis every project must undergo is clearly letting too many bad projects slip through the cracks. The Department of Commerce needs to improve its pre-project analysis to better capture the likelihood of project failure, especially by better accounting for industry decline.

- **Focus on giving incentives to firms in industries most likely to experience robust growth.** Rather than giving incentives to firms in industries that are shrinking, the state should grant incentives to those firms in targeted industries that are most likely to pay good wages and experience growth in a competitive global economy—aerospace, biotechnology, advanced textiles, and others. Subsidizing industries in decline makes little sense for building a successful, growing 21st century economy.

- **Ensure that infrastructure development and job training resources flow to the rural counties that most need assistance.** Currently, a small portion of JDIG awards in the most prosperous Tier 3 counties is craved out and given to the Industrial Development Fund Utility Account to help finance infrastructure development in Tier 1 counties. These small carve-outs need to be dramatically expanded and used to support job training resources as well as infrastructure development in these hard-hit areas of the state.

No state should ignore a 60 percent failure rate in any of its programs. Taking these steps will ensure that state government protects scarce taxpayer dollars from the inefficiency and waste associated with failed economic development projects.

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1. The findings in this report are all based on the author's analysis of JDIG Annual Reports released by the N.C. Department of Commerce, 2002-2013.
2. Pew Center for the States. (2012). Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth.
3. Following the completion of the five-year base period for an under-performing JDIG recipient, Commerce has the authority to provide an additional two-year grace period if it is determined that the company will meet their performance benchmarks within the additional time period.
4. Freyer, Allan. (2014). Mismatching Money and Jobs. BTC Reports, NC Justice Center.
5. Both of these proposals were included in HB 1224, which failed to pass both chambers of the legislature last session.
6. This includes all JDIG projects that whose base periods ended before 2014 or were terminated at any point during their grant period.
7. Goldstein, HA, Feser, EJ, Freyer, AM, Gordon, BJ, and Weinberg, MI. (2008). Regional Vision Plan Integration and Implementation: Phase II Final Report. Report to the North Carolina Department of Commerce.
8. c.f. Goetz, S., Deller, S., & Harris, T. eds. (2009). Targeting Regional Economic Development. Routledge: London.
9. Sirota, AF, et al. (2014). The State of Working North Carolina, 2014. NC Justice Center.

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APPENDIX

County	Percent of Total Projects by County	Percent of Total Award By County	Total JDIG Dollars Awarded by County	Percent JDIG Projects Failed by County
Alamance	1%	0%	$1,984,178	0%
Ashe	1%	0%	$2,863,287	100%
Beaufort	1%	0%	$2,706,723	100%
Brunswick	1%	1%	$4,897,527	100%
Buncombe	1%	1%	$3,467,387	100%
Burke	1%	0%	$2,187,240	0%
Cabarrus	1%	0%	$2,898,644	0%
Caldwell	2%	1%	$8,600,864	100%
Catawba	4%	3%	$20,121,941	75%
Cleveland	2%	1%	$8,737,815	100%
Craven	1%	0%	$1,803,041	100%
Davidson	2%	1%	$3,391,331	100%
Durham	9%	10%	$67,138,851	50%
Edgecombe	1%	0%	$1,146,869	100%
Forsyth	1%	3%	$17,388,008	100%
Guilford	8%	7%	$46,891,963	75%
Halifax	1%	0%	$1,973,107	100%
Henderson	1%	0%	$2,340,301	0%
Iredell	1%	0%	$2,382,475	100%
Johnston	3%	2%	$10,913,749	67%
Lenoir	2%	4%	$29,711,180	50%
McDowell	2%	1%	$4,725,590	100%
Mecklenburg	17%	18%	$121,274,916	50%
Nash	1%	0%	$1,079,763	100%
New Hanover	4%	7%	$48,843,719	50%
Northampton	1%	0%	$1,722,136	100%
Pasquotank	1%	0%	$1,282,795	100%
Person	1%	0%	$2,889,755	100%
Randolph	1%	0%	$2,196,012	0%
Richmond	2%	1%	$3,912,650	50%
Rockingham	2%	0%	$3,306,094	0%
Rowan	1%	1%	$6,241,297	100%
Union	3%	1%	$8,991,823	100%
Wake	18%	30%	$201,317,854	37%
Wayne	2%	1%	$6,681,004	100%
Wilson	1%	0%	$1,831,288	100%
Yancey	1%	0%	$2,343,065	0%
Grand Total	**100%**	**100%**	**$662,186,241**	**60%**