Exit Options in Firm-Government Negotiations: An Evaluation of the Texas Chapter 313 Program

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Acknowledgements: Thanks to Cam Powell for excellent research assistance. Thanks to the staff at the Texas Comptroller's Office for providing their published data in an Excel format. The Comptroller's Office also promptly fulfilled an open records request that included all of original 313 applications. Seminar participants at the University of Texas International Relations workshop provided feedback. Numerous economic development professionals provided background information and participated in an elite survey. Research was funded by the Laura and John Arnold Foundation. The report is an independent work product of the University of Texas at Austin. The views expressed are those of the author and do not necessarily represent those of the funder.

Executive Summary

The Texas Chapter 313 program targets capital intensive investments for tax relief through a property tax limitation. This program requires this incentive to be a "determining factor" in an applicant's decision to invest in Texas. The program is unique in that local school districts, as opposed to economic developers, participate in the program, with the authority to veto a firm's petition for incentives. By participating in this program, school districts can legally request "supplemental payments" from firms, often amounting to more than 40% of the provided tax benefits.

I argue that this negotiation over supplemental payments provides a rare window into firm-government bargaining that allows us to evaluate this program's effectiveness. I then make the case that the legislation leads school districts to approve almost every application as a means to generate supplemental payments for their districts. But these supplemental payments vary across projects. Firms that can locate in other states or countries, such as automobile manufacturing or R&D facilities, negotiate substantially lower supplemental payments to school districts in exchange for the school districts' approval to participate in the 313 program. Firms that have few credible walk-away options, such as firms expanding an existing facility or oil and gas firms locating near the Gulf of Mexico, pay substantially higher supplemental payments to school districts.

These supplemental payments are an excellent indicator of which firms were going to locate in Texas without the program and which firms required Chapter 313 incentives to locate in Texas. I validate this measure of firm mobility by analyzing media reports as well as expert surveys. I find that supplemental payments are an excellent predictive measure of a firm's outside options.

I then harness supplemental payments to identify the percentage of projects for which Chapter 313 was pivotal in attracting investment. My estimates suggest Chapter 313 was pivotal in attracting between 10-15% of the 257 projects in my sample, while between 85-90% of Chapter 313 projects would have invested even without the incentive program. These findings suggest that a large majority of the 313 projects provide zero net benefits to the state (since they would have invested in absence of the program).

The major caveat in this paper is that the estimates for wind projects, over 40% of the 313 projects, are more uncertain given the limited experience of experts surveyed on these specific projects. Additional analysis would be required to identify the extent to which the development of Texas wind energy can be attributed to this program.

KEY FINDINGS

This program presents the analysis of 257 firms that located in Texas with the support of the Chapter 313 Program from 2002-2014. The main findings include:

- The program is concentrated in a very small number of industries. Wind generation and distribution account for 48% of the projects. The majority of manufacturing projects were related to oil and gas industry, comprising an additional 26% of the total projects.
- If this program is influencing investment decisions, it is merely shifting investments across U.S. states and not resulting in new investment in the United States. Only 35% of applicants indicated they were even considering international locations for their investment. Two applicants even indicated that they were only considering locations within the State of Texas.
- Over 90% of projects applied for additional incentives at the state and local level.
- Predictions from a statistical model indicates that between 85-90% of projects would have located in Texas without the 313 program.
- Estimates suggest that 80% of the program's dollars are lost revenue for the state's school finance system, amounting to at least $4.4 billion for these projects.
- Agreements with some school districts are limited by a 2010 cap on supplemental payments ($100 per student or $50,000 in total). Since 2009, many companies and districts have signed agreements that allow supplemental payments to rise automatically to 40% of the company's net tax benefit if this cap is lifted legislatively in the future. Thus, the analysis *overestimates* the number of companies that located to Texas due to this program and *underestimates* the lost revenues for the state

The Texas Chapter 313 program was created in 2001 by the State Legislature, allowing local governments to provide tax abatements to firms for economic development purposes. From 2005-2015, this program gave businesses over $1.4 billion in property tax breaks (Texas State Auditor 2016). The existing 311 Chapter 313 agreements are estimated to provide over $7 billion in tax abatements over the lifetime of these projects (Senate Committee on Natural Resources and Economic Development 2016, 50). The Comptroller now estimates that this program will cost $1 billion per year in 2022 (Texas Comptroller of Public Accounts 2017).

Central to debates around this program is how effective this incentive is in attracting new investment. In this brief, I estimate the likelihood of a company investing in Texas absent the program, and thus how effective the program is in attracting investment and generating new tax revenues for the state.

The Chapter 313 Program

This economic development program was created by the Texas Legislature in 2001 in response to large manufacturers reportedly spurning Texas for locations with lower property taxes. With a focus on attracting capital, the main requirement to participate in the program is the level of investment (as opposed to job creation). Firms' tax abatement benefits are not open to negotiation. Statute determines the abatement details based on the amount of capital invested and the location of the school district, subject to firms complying with the program's job creation requirements.

Central to this program is the role of school districts in both authorizing these incentives and being compensated by the state for participating in this program. According to Texas Comptroller of Public Accounts (2017):

> The Texas Economic Development Act (Chapter 313 of the Tax Code), allows school districts to attract new taxable property development by offering a value limitation on the appraised value of the property for the maintenance and operations portion of the school district property tax. The local tax revenue the school district forgoes in this manner is substantially replaced through the school funding formula.

The most controversial part of the legislation are the "supplemental payments" from firms to school districts to incentivize the district to execute Chapter 313 agreement. As part of the agreement, school districts can negotiate a "supplemental" payment from the company, transferring some of the company's tax benefits, in cash, to the school district. According to an audit of the program, "Supplemental payments are paid outside of the school funding formula, and incentivize the districts to enter into agreements that may not be beneficial to the state" (Texas Comptroller's Office 2010, 19).

This supplemental payment system provides a unique window into negotiations between school districts and firms. The school districts are not economic development agencies representing broad local interests, weighing job creation or other factors that could shape the negotiations. But, rather, they are the gatekeepers for this program, where the school districts can support or reject a company's application and decide whether to allow a firm to receive an abatement as allowed through the state formula.

In this paper I take this negotiation as an indicator of how willing the company was to relocate to another location. Companies that were willing to pay 40% of their tax savings to a school district had more location specific reasons to come to Texas than a company willing to only give back 4% of its tax savings.

Analysis of Program Effectiveness

Data on the 257 projects suggests that many of the supplemental payments approach 40% of the company's tax benefits, where mean supplemental payment is 31% of the company's tax benefits. The standard deviation of 18% suggests that these payments vary considerably across school districts and projects. Some school districts received supplemental payments smaller than 10% of the company's tax benefits (12.5% of the observations), while ten percent of school districts received over 48% of the benefits. In these last cases, firms were willing to return roughly half of their tax savings back to school districts.

This tax ratio is a key indicator of the ability of a company to relocate. To verify my contention, I first focus on a handful of firms that could obviously relocate. In 2007, Lynn Moak—of Moak, Casey and Associates—had negotiated the majority of the Chapter 313 agreements. According to a quote from the *Austin-American Statesman*, Moak claimed (Elder 2007):

> "Frankly, I can think of only four that really needed the incentives" to locate in the district, Moak said. He named Toyota, for its truck plant in San Antonio; Texas Instruments, for a chip plant in Richardson; Motiva Enterprises LLC, which is expanding its refinery in Port Arthur; and Samsung, which is building a semiconductor plant in Austin."

In this study I refer to these four companies above as the four swing projects in that 313 was necessary to swing the company's decision to relocate to Texas. By 2007, 35 of these agreements had been signed, and all included supplemental payments with firms "volunteering" to give school districts 31% of their tax benefits, on average. But these supplemental payments range from less than 1% to 62% of the agreed-upon tax benefit. Specifically, all four necessary projects of the agreements with walk away options listed above—Motiva, Samsung, Texas Instruments, and Toyota—offered school districts cash benefits of between zero and 7% of the company's tax benefits. Supplemental payments for these four projects are some of the smallest in the sample. Controlling for other factors, supplemental payments are between 24 and 28 percentage points smaller for these four swing projects.

My second validation check surveyed experts with knowledge of the 313 program to review the complete list of 257 projects. Given the detailed knowledge of the program that was necessary, only experts familiar with the program that had lobbied for or against the program or have been active in Texas economic development through a government agency or a consultancy specializing in incentives or economic development analysis were contacted. In total, five individuals provided a total of 106 responses on projects where they believed 313 wasn't necessary for the project to locate in Texas (82 projects) or that 313 was necessary (24 projects).[1] The findings again confirm that firms that had great ability to relocate outside of Texas paid substantially lower supplemental payments.[2] Both validation checks provide evidence that supplemental payments are considerably smaller for firms that had the ability to locate in other states.

This analysis uses this supplemental payment data along with data on 257 total projects from 2002-2014 using compiled data from the Texas Comptroller's Office, and research coding of the original 313 applications for all projects. The majority of these project application documents are located on the Texas Comptroller's website. An additional 82

[1] The University of Texas IRB determined that this was exempt research (IRB 2016-11-0008). Despite the high levels of expertise, a total of 11 projects produced mixed opinions on whether a Chapter 313 agreement was necessary.

[2] In my estimates, controlling for factors such as industry and the date of the incentive (reforms in 2010 capped supplemental payments to school districts) firms that were rating as having the ability to locate outside of Texas paid between 11 and 13 percent points lower supplemental payments. The 2010 cap on payments biases my estimates towards finding a greater percentage of 313 agreements as being necessary. Many of this agreements in districts that are capped in their payments include backstop language that provides the school district with 40% of the company's tax benefit if the Texas legislature lifts that cap. Thus a number of districts would be recoded at 40% if this the cap was lifted, and thus leading to even more companies being estimated as not needed the Chapter 313 program.

documents were accessed through an open records request on January 17, 2017. This data has been archived in PDF form.[3]

These applications also require companies to explain why the incentives they seek are necessary. A few companies admit in this application that they are only considering a location inside of Texas[4]. Most applications provide a vague explanation on their potential to locate elsewhere. But even these explanations are valuable information. For example, over 65% of the applications justify their participation based on the companies' ability to locate in another U.S. location. Only 35% of these firms state that Texas is in competition with other countries for this investment. This suggests that the program is largely seen as a program to compete with other states and has little impact on overall investment in the United States.

Finally, these applications include details on the industry (NAICS code), size of proposed investment, employment, and other details on the project. As documented elsewhere, a strikingly large percentage of these projects are wind farms (over 48%). Three sets of firms related to oil and gas account for an additional 26% of the program.[5] With the exception of some large manufacturing investments, such as Samsung, Hewlett Packard, and Toyota, this program is largely used by capital intensive energy-related investments. This data from the application is merged with data from the Texas Comptroller's Office and the Texas Education Association on school district enrollments and the status of the districts in the state's education financing system.

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[3] https://osf.io/qnw55/

[4] Sabina Petrochemicals in their initial application indicates Deer Park, Texas as the alternative location. This is reported in Sadasivam (2017).

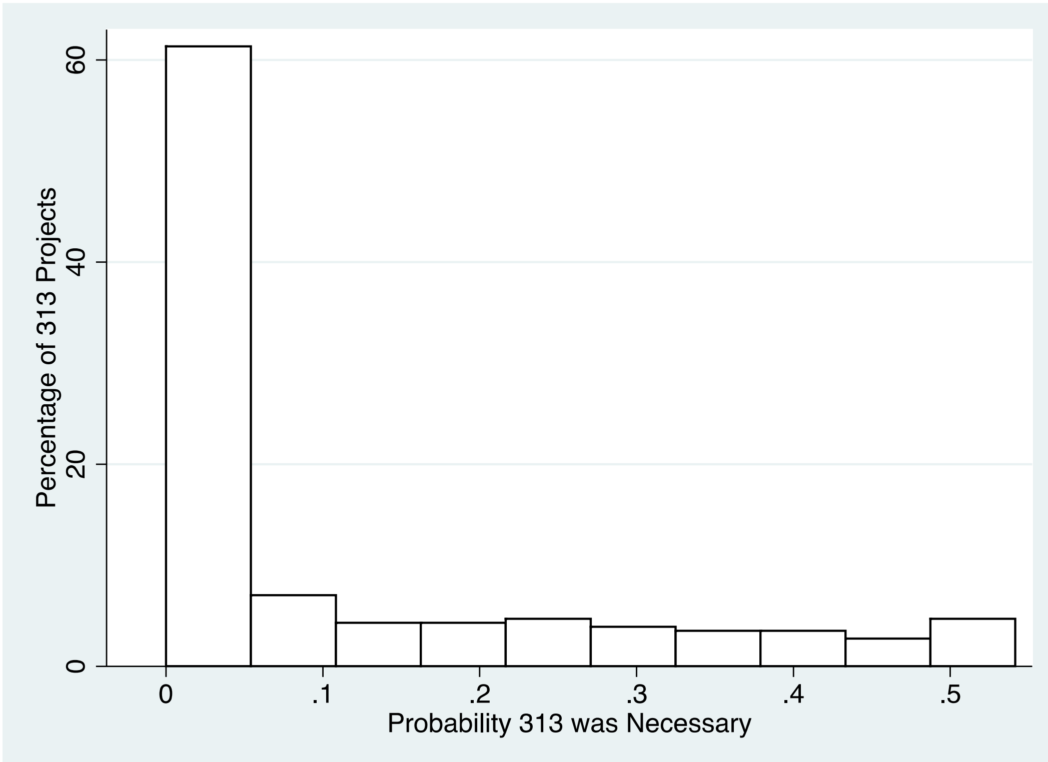
[5] This includes petroleum refineries (NAICS 324110), petroleum manufacturing (NAICS 325110), and industrial gas manufacturing (NAICS 325120).

Central to this paper is the use of negotiated supplemental payments as a measure of a firm's ability to relocate to another district, and thus the total investment value that the 313 program is responsible for bringing to Texas. This ratio is calculated as the total supplemental payments divided by the firms' gross tax benefit from the program, both taken directly from the Comptroller's estimates. I use this ratio, along with additional control variables to estimate the probability that a company will relocate to Texas due to the Chapter 313 program.

In Figure 1, I provided predicted probabilities for all 257 projects in the database using the four investments reported earlier as requiring 313 for this investment.[6] Thus, I estimated the logit model of 35 projects and used this model to generate predicted probabilities for the additional projects using supplemental payment data and the dummy. These estimated probabilities indicate that the vast majority of projects were very likely to have come to Texas even without the 313 program. Over 60% of the projects are estimated as having a 0-10% probability of needing a 313 agreement. Only for a total of 12 projects was the 313 program estimated as having a more than 50% probability of requiring the 313 program for their relocation.

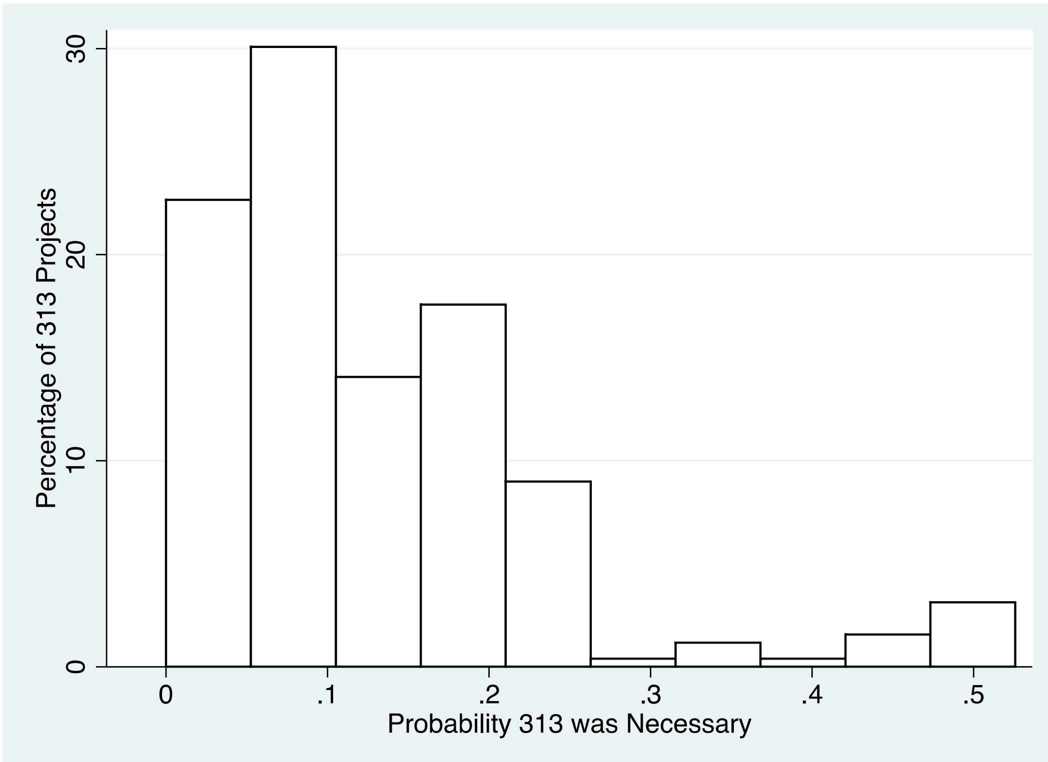
[6] To estimate these probabilities, I utilize a logit model using the measures of whether the incentive was necessary in Table 1. My baseline model takes the following form: 313 Necessary = $\alpha + \beta$(Supplemental Payment)+ β(Post 2010 Dummy)+ ε. The Post 2010 time dummy captures changes in 313 supplemental payment legislation limiting payments to $100 per student or $50,000 in total.

Figure 1: Effectiveness Estimates based on 4 Swing Projects



These estimates are driven by a very small number of observations. Thus, I turn to the survey expert opinions about the 313 program in Figure 2. Using the 82 observations with expert opinion data, I estimate a logit model and use this to generate predicted probabilities for all 257 projects. This model provides similar estimates and finds only 6 projects have the predictive probability of 313 being pivotal greater than 50%. For both models, the mean predictive probability was between 10-13%.

Figure 2: Effectiveness Estimates Based on Expert Survey



My estimates find that most of these projects would have come to Texas even without the 313 program, and in these cases 313 provides only costs and no benefits to the state (since the company would have come even without the program). Using these predicted probabilities, I estimate the total revenue forgone for the 257 projects to be $4.4 billion, or 80% of the value of the incentives offered.

These estimates must be interpreted with caution for three reasons. First, for projects for which 313 was not necessary, the 313 program provides zero tax (or employment) benefits to the state. However, for those projects to which 313 was pivotal, this program can generate economic development spillovers through employee payroll taxes and spillovers to upstream and downstream companies. For these companies, my estimates understate the net benefit to the State of Texas. But, as noted, a very small percentage of companies needed Chapter 313 to relocate to Texas.

Second, the large number of wind projects participating in the program elicited fewer responses from experts than many of the other projects. Experts expressed less confidence in their knowledge of these individual projects, but rather concern that additional factors such as federal incentives and state-funded energy distribution infrastructure were pivotal to the industry.

Finally, over 90% of projects in this database applied for additional state, local and sometimes federal incentives. My estimates only consider the costs and benefits of 313 to the state and ignore any additional costs from other incentive programs.

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