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GETTING IT RIGHT:

Three accountability challenges in Governor McCrory's proposal for partially privatizing the Department of Commerce

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INTRODUCTION

North Carolina lawmakers need to ensure that a new, partially privatized effort to attract and retain businesses, proposed by Governor Pat McCrory, has strong safeguards against conflicts of interest and is accountable to the public if it fails to deliver on job creation goals and other promises underwritten by taxpayer dollars.

Although much remains publicly unknown about the precise organization of the proposed "Partnership for Prosperity," a review of the proposal's enabling legislation (Senate Bill 127), public statements and memos by administration officials, and the track record of other states with privatized economic development initiatives reveals three accountability challenges in the current proposal. These three accountability challenges include:

- Possible conflicts of interest in the prospect-selection and incentive-granting processes;
- The importance of holding the Partnership accountable for performance through concrete outcome measures on an individual project basis and on overall economic conditions;
- Concerns about the ability of Prosperity Zones to adequately fulfill regional coordination and planning requirements outlined in the enabling legislation.

Lawmakers need to address these accountability challenges now, before the new Partnership launches, in order to ensure it protects scarce public dollars and does not compromise the state's reputation as a national leader in accountability measures for public economic development activities.

North Carolina's Partnership for Prosperity

In the face of persistently high unemployment and weak job creation, the governor and Secretary of Commerce, Sharon Decker, have proposed turning significant portions of North Carolina's state-directed economic development effort over to a public-private partnership. They contend that this approach can be more effective than the current Department of Commerce in promoting job creation, investment, and long-term economic growth. Given the very mixed record of similar efforts in other states, the likelihood of the Partnership for Prosperity actually achieving

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these goals is an open question. As a result, it is imperative that lawmakers put in place strong accountability standards for the partnership's performance—before it begins operating.

The proposal would create a nonprofit economic development corporation called "North Carolina's Partnership for Prosperity," which will assume primary responsibility for the state's business recruitment, retention and expansion efforts, currently overseen by the Commerce Department's Division of Business and Industry.[1] In addition, the new economic development corporation is also likely to administer a range of other programs currently managed by other divisions within Commerce, including the state's small business development, tourism, film, and marketing programs.

At the same time, the Commerce Department will continue to oversee initiatives that involve federal funds— job training and other workforce development, community assistance, including Community Development Block Grants, and employment security, including unemployment insurance.[2] Perhaps most importantly, Commerce will continue to formally administer the state's publicly funded economic development incentive programs—the Job Development Investment Grant (JDIG), the Jobs Maintenance and Capital Development Fund (JMAC), and the OneNC Fund—in an effort to ensure that taxpayer dollars are distributed in an accountable manner to companies the state wants to attract or retain. At the same time, however, the Partnership is expected to raise additional funds from private companies and individuals, either through voluntary contributions or membership fees, raising the possibility of co-mingling public and private economic development funds on a scale previously unknown in North Carolina.

Additionally, the proposal would significantly overhaul the state's approach to regional coordination and planning by eliminating the 16 Councils of Government (COGs) and the seven regional economic development partnerships—nonprofits originally chartered to ensure planning and economic development activities between state, county, and municipal governments within each region. Under the proposal, these organizations would be replaced by eight "Collaboration for Prosperity Zones," which would be administered by the Department of Commerce and would take over the role of regional coordinator. Staff from the Department of Transportation (NCDOT), Department of Natural and Economic Resources (DENR), and the Department of Commerce would share office space and would work together in each zone. This proposed overhaul of the state's regional planning efforts is intended to reduce duplication and overlap, ensure tighter coordination between these state agencies, and provide one-stop customer service for businesses seeking incentives or other assistance.

ACCOUNTABILITY CHALLENGES:

Lessons Learned from Partnerships in Other States

Over the past 20 years, 16 states have experimented with a range of approaches to privatizing economic development—some similar to North Carolina's proposal, and some different. Yet many of them have experienced similar accountability challenges to those listed here—especially those related to conflicts-of-interest and failures to properly evaluate partnership performance. Similar troubles are likely to occur in North Carolina unless lawmakers add more safeguards to the state's partnership.

Recent policy reports reveal that states ranging from Wisconsin and Utah to Texas and Florida have experienced scandals arising from conflicts of interest and pay-to-play politics involving the incentive granting conducted through their partnerships. For example, Florida's partnership—Enterprise Florida—allows its board members to benefit directly from the incentives they oversee[3] (a practice formally banned in North Carolina's enabling legislation).[4] Likewise, the Texas Emerging Technology Fund has disbursed more than $16 million in public funds over the past five years to companies with investors or officers who made significant campaign contributions to the Governor.[5]

Additionally, many of these states also failed to provide concrete outcome measures by which state officials might assess the performance of their economic development partnerships. For example, Enterprise Florida spent $1.7 billion on grants to businesses

from 1995 to 2005, but could only report 103,000 jobs created—less than half the original promise.[6] Michigan's partnership gave $45 million to a film project that created no jobs and ended in criminal prosecution of the firm that received the incentives.[7] In Wisconsin, Wyoming, Florida, Utah, and Indiana, legislative probes or state audits criticized their state's partnerships for failing to meaningfully evaluate the economic results of the projects they supported.[8]

While the enabling legislation takes several positive steps in avoiding these mistakes, lawmakers must add additional safeguards to properly address these accountability challenges.

CHALLENGE #1:

Possible conflicts of interest in the incentive-granting process

Perhaps the greatest area of concern in the proposed Partnership for Prosperity is the potential for significant conflicts of interest in deciding which companies should receive state economic development incentive dollars as part of business recruitment, retention, and expansion projects. While the legislation formally gives state officials the final say when offering incentives and other services to businesses,9 by itself such a "firewall" does not provide adequate accountability for the expenditure of public dollars on private companies.

In practice, the Partnership will likely have almost complete control over the incentive-granting process. It will determine which firms are identified as prospects, which firms are selected as recruitment or retention targets, and which firms will be recommended to Commerce and the General Assembly to receive incentives. Given that the Governor is both chairman of the Partnership board and chief executive of state government, Commerce and the General Assembly will likely accept the Partnership's recommendations. As a result, the supposed firewall may well be made only of paper.

This presents a serious accountability challenge because—for the first time in state history—private companies would be able to financially contribute to the very economic development efforts from which they benefit. This creates the opportunity for pay-to-play incentive-granting, in which the Partnership favors those companies that favor the Partnership with financial donations (as has happened in Florida and Indiana), or in which a Governor rewards campaign contributors with incentive recommendations that his own Commerce Secretary may agree to provide (as in Texas).

On the plus side, North Carolina's legislation specifically bars Partnership board members and their families from directly benefitting from state incentives. The legislation also retains the state's widely acclaimed performance and accountability mechanisms for its main publicly funded economic development programs (JDIG, OneNC, and JMAC), including "clawback" provisions that strip companies of their incentives if they fail to make good on their promises of job creation. These strong measures should not be undermined by pay-to-play incentive-granting by the Partnership.

CHALLENGE #2:

Ensuring measurable accountability for overall Partnership performance

It is critical that lawmakers hold the Partnership accountable for its overall performance, in order to ensure that taxpayer dollars are being spent in the most effective manner and not frittered away for uncertain returns, as seen in other states. While the enabling legislation mandates detailed reporting requirements for the jobs expected and actually created by each project or program administered by the Partnership, these requirements do not go far enough, partly because the bill neglects to specify performance measures beyond job creation.10

As a result, the Partnership needs to clearly identify and publicly report the performance measures it intends to use—and to do so before starting its work so that projects can be judged on an ongoing basis. Specifically, the Partnership's performance should be measured in terms of individual projects (actual jobs created, investment generated,

wages paid and services delivered) as well as the impact that all of its projects together have on the broader economy (total employment growth, average wages, unemployment, and poverty rates in each region and the state as a whole). And perhaps most importantly, they should include a wide range of measures that can fully capture the health of the state's economy, including regions that may be lagging behind the state average. Such measures include poverty, health insurance rates, child mortality, and other indicators of well-being.

CHALLENGE #3:

Maintaining accountability for regional planning requirements in Prosperity Zones

The final accountability challenge involves the need for lawmakers to ensure that the new Prosperity Zones live up the statutory requirements to effectively coordinate local economic development across the county and municipal governments within their boundaries. As envisioned, these Prosperity Zones are intended to replace the regional planning and coordination functions currently filled by the COGs and Regional Partnerships.11 Although these organizations have provided only a small percentage of prospects for recruitment by the state Commerce Department over the past five years,12 they have played a critical role in coordinating economic development activities at the local level, including regional planning efforts, joint business development programs, regional marketing, and infrastructure development projects.

RECOMMENDATIONS FOR ENSURING A MORE ACCOUNTABLE PARTNERSHIP

BASED ON THESE accountability challenges and the record of other states in dealing with them, officials in the administration, the General Assembly, and the soon-to-be Partnership for Prosperity should pursue the following steps in order to best protect the investment of public dollars in the state's economic development efforts.

RECOMMENDATION #1:

Eliminate conflicts of interest in the incentive-granting process

The enabling legislation should be amended to prohibit those businesses that contribute private funding to the Partnership from also being eligible for recommendation for and receipt of state-funded incentives. While the Partnership would continue to exercise significant influence over the recruitment and incentive process, this prohibition would eliminate the possibility of pay-to-play incentive-granting by severing the connection between business contributions and the possibility of benefitting from public subsidies.

RECOMMENDATION #2:

Strengthen accountability requirements for the Partnership's overall performance

The enabling legislation should amended to require the Partnership to report specific performance outcomes for each individual project and for the overall economy. Additional project-level outcomes should include the wages, benefit levels, and comparison of both to state and county median levels. Overall economic outcomes should include impacts on household incomes, poverty, unemployment, infant mortality, and other quality of life indicators determined by the Partnership.

All of these evaluative frameworks should be in place prior to the effective date of the start of Partnership operations.

RECOMMENDATION #3:

Hold Prosperity Zones accountable for fulfilling statutory requirement to promote regional coordination and planning

Each Prosperity Zone should be required to provide performance measures related to their regional coordination and planning efforts. Specifically, they need to determine and report on the extent to which the scope, scale, and effectiveness of regional economic development coordination among local jurisdictions has changed from current levels. If, as seems likely, the Zones cannot play this critical role adequately with the resources provided, the General Assembly should appropriate additional funds for this purpose.

These coordinating functions have been extremely valuable to county-level economic development efforts. In fact, a 2009 survey conducted by the UNC School of Government revealed that 82 percent of county economic development professionals have used services provided by the Regional Partnerships and 52 percent from the COGs.[13] Perhaps in recognition of this reality, the Senate bill provides the statutory requirement that the Prosperity Zone support and coordinate local economic development efforts for the communities within their boundaries.[14] Lawmakers must hold the new Prosperity Zones accountable to these local coordinating requirements—and, if necessary, appropriate sufficient resources to do so.

Despite the key role regional coordination has played in effective local economic development, the new proposal would reduce the staff devoted to these efforts—to three per Prosperity Zone from the current 10-to-15 per region. While the co-location requirements for DOT, DENR, and Commerce will likely improve efficiencies in coordinating various units of *State government*, there will likely be significant capacity constraints on the ability of each Zone office to coordinate the economic development activities and planning of the various units of *local government* within each Zone. Given these staff reductions, it's hard to see how the Prosperity Zones can provide the same level of regional intergovernmental economic development coordination currently provided by the COGs and Regional Partnerships. Lawmakers should require the Zones to measure regional coordination efforts and if, as expected, they have fallen from current levels, provide the Zones with more staff and other resources.

Conclusion

North Carolina's proposed Partnership for Prosperity presents several critical accountability challenges that lawmakers need to address in order to achieve the ambitious economic development goals set out by the Governor and Secretary of Commerce in the most cost-effective manner available. To get it right the first time and avoid the mistakes of other states that tried this approach, policy makers should strengthen the existing accountability standards around conflicts of interest in incentive-granting, require measurable progress reports, and ensure economic development efforts can continue to work effectively at the regional level across the state.

1 Almeida, Tony et al. (2012). A case for Moving State Economic Development Functions to a Public Private Partnership. Private memo produced by Governor-elect Pat McCrory's Transition Team.

2 Decker, Sharon. (2013). Decker – Let's kick-start North Carolina's economy. Fayetteville Observer. June 24, 2013.

3 Wilcox, Ben and Krassner, Dan. (2013). Enterprise Florida: Economic Development or Corporate Welfare? A report by Americans for Prosperity Florida and Integrity Florida.

4 SB 127 Part 1. Section 1. Mattera, Phillip, et al. (2011). Public-Private Power Grab: The Risks in Privatizing State Economic Development Agencies. A report by Good Jobs First.

5 Wilcox, Ben and Krassner, Dan. (2013). Enterprise Florida: Economic Development or Corporate Welfare? A report by Americans for Prosperity Florida and Integrity Florida.

6 Mattera, Phillip, et al. (2011). Public-Private Power Grab: The Risks in Privatizing State Economic Development Agencies. A report by Good Jobs First.

7 Ibid.

8 SB 127 Part I

9 SB 127 Part I.

10 SB 127 Part III.

11 ED Oversight Committee report

12 Morgan, Jonathan. (2009). The Role of Local Government in Economic Development: Survey Findings from North Carolina. UNC School of Government.

13 SB 127 Part IV. Section 4.2

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