LFC HEARING BRIEF

DATE: May 17, 2013

PURPOSE OF HEARING: The Role of State Government in Job Creation and Income Growth

WITNESSES: Garrey Carruthers, President, New Mexico State University; Del Archuleta, President, Molzen Corbin; Jon Barela, Secretary, Economic Development Department; Steve Vierck, President, NM Partnership; Gary Tonjes, President, Albuquerque Economic Development; Kathy Keith, Executive Director, Regional Development Corporation

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EXPECTED OUTCOME: General Information

BACKGROUND INFORMATION / PROBLEM STATEMENT

New Mexico's current employment growth lags most other western states, and the state has the ninth lowest per capita gross domestic product (GDP) in the country. By most measures, New Mexico's job and economic growth compare poorly to those of its peers, yet the state does not have a comprehensive economic development strategic plan to guide the efforts of the Legislature, the Economic Development Department, or the numerous other economic development organizations across the state. The Economic Development Commission (see References and Resources for a list of members), statutorily tasked to create this plan, met for the first time in two years in November 2012 but has no additional meetings scheduled.

An LFC hearing brief presented in May 2009 identified a variety of economic development programs and incentives, but noted the state suffers program fragmentation and duplication. The brief also decried the lack of a universally accepted, comprehensive strategic plan. Four years later, New Mexico still does not have such a plan.

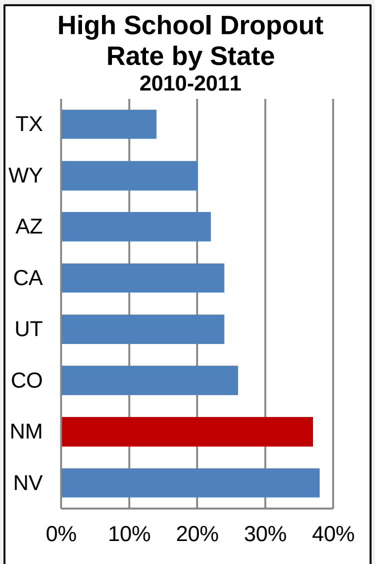
An LFC evaluation presented in August 2012 examined select economic development tax expenditures and found incentives can make New Mexico more competitive. However, the evaluation also found incentive programs weak in terms of accountability, reporting, and assessing program value. Based on a sample analysis of companies receiving incentives, it costs the state on average an estimated $31 thousand to attract a job with an average salary of $43 thousand.

When a governmental entity decides to take an active role in economic development and job creation, it typically focuses on creation of economic base jobs. Economic base jobs bring outside dollars into the area to increase the overall wealth for the community, combating dollars flowing out of the local economy from sources such as online sales, federal taxes, and travel outside the state. Other types of jobs recirculate existing dollars within the community. Without economic base jobs, a community would gradually become increasingly poor until most people leave and many of those choosing to remain require living assistance. Most manufacturing companies add to the economic base by exporting most goods outside of the immediate region, but some service companies also qualify if the majority of their customers are located outside the state. Most incentive programs in New Mexico and other states specifically target economic base companies, but some areas define economic base more broadly.

An expanded definition of economic base would also include those companies that stop outflows of dollars. For example, Albuquerque would not qualify a grocery store as an economic base operation because it is simply competing with existing grocery stores in the area for business. However, Vaughn could conceivably qualify a grocery store as an economic base company if residents began shopping there instead of travelling to another community to purchase groceries.

POSSIBLE GOVERNMENT ROLES IN JOB CREATION AND INCOME GROWTH

States and municipalities across the country differ greatly in approaches to assist job creation and income growth. Some areas enhance the local infrastructure, workforce, and taxation policies; other communities actively promote themselves and provide direct financial assistance (see Appendix for a chart of economic development programs and tax expenditures and the combined cost to the state).



Source: U.S. Department of Education

Indirect Roles

Taxation policies. Tax rates, structure, and complexity contribute to the desirability of a location for a business. New Mexico ranked last in a 2009 Ernst & Young study with an effective tax rate of 16.6 percent. The national study did not consider New Mexico's numerous incentive programs, which lower the effective tax rate for economic base businesses but add to the complexity of the tax structure. The New Mexico Tax Research Institute worked with Ernst & Young to study the effect of incentives, and the revised 2012 report ranked New Mexico the fourth best out of nine regional states after applying incentives.

Infrastructure development. When seeking a location for operations, most businesses prefer to avoid the time and cost associated with building infrastructure to a site. Some states and communities leave commercial- and industrial-zoned properties in a raw state rather than invest to bring infrastructure to the sites. Other states invest in roads, sewer, water, and other forms of infrastructure to make sites "shovel-ready" and encourage local companies to start up in the area and outside companies to relocate to that area. Apart from the expense, the time to build the infrastructure sometimes precludes raw sites from consideration during a company's evaluation. New Mexico, with its numerous rural communities, often struggles to compete for projects with neighboring states that have far greater numbers of available shovel-ready sites and suitable buildings. Additionally, with no economic development professionals in many of these rural communities, it is often difficult for a company to determine if a site or building matches their needs. The Economic Development Department (EDD) and its nonprofit marketing contractor, the New Mexico Partnership, assist with site discovery, but with few employees engaged in this activity spread across the vast state, the task is difficult.

"You've got all these governors who are offering tax incentives to businesses to move from one state to another. What a lousy economic strategy that is. You are just moving the chairs around on the Titanic."
- former Michigan governor Jennifer M. Granholm

Workforce development. Workforce development includes traditional elements such as public education and universities, but some states also excel at incorporating supplemental training, often customized for specific employers. Many states offer some type of worker training program, but some require companies to pay the full cost of the training while others absorb the cost to provide companies with a trained workforce and reduce startup expenses. New Mexico's community colleges are adept at training employees to meet company requirements, and the Job Training Incentive Program (JTIP) offers eligible companies partial reimbursement of wages during classroom and on-the-job training. The JTIP program is lauded by site selectors as one of the best programs of its type. However, training new hires is not always sufficient to overcome educational shortfalls. New Mexico's high school dropout rate concerns some businesses, including a site selection company in Texas that shows New Mexico sites to call center clients but not to companies planning headquarters relocations.

University research and business development. New Mexico's three research universities – New Mexico Institute of Mining and Technology, New Mexico State University (NMSU), and the University of New Mexico (UNM), including the Health Sciences Center – receive significant state, federal, and private funds to pursue their research mission. Some state-funded programs at UNM and NMSU support joint engineering and business college efforts to help entrepreneurs develop manufactured equipment, prototypes, draft business plans to make and sell products or services, and secure business funding. New Mexico Tech has a record of using state funding to satisfy matching or partnership requirements for federal or private grants and contracts. These projects, like the Petroleum Research and Recovery Center, result in efforts to support business and industry growth in New Mexico. Most university-led projects involve faculty, professional staff, and graduate and undergraduate students as employees or interns who gain valuable, relevant experience.

Forbes: New Mexico is a "fiscal hellhole." The state tops the Forbes 2012 list of "death spiral states" with 1.53 people dependent on government for every independent private sector worker. Forbes excludes federal employees from the dependent person count, but New Mexico still garners the worst ratio in the country.
- Forbes.com, November 2012

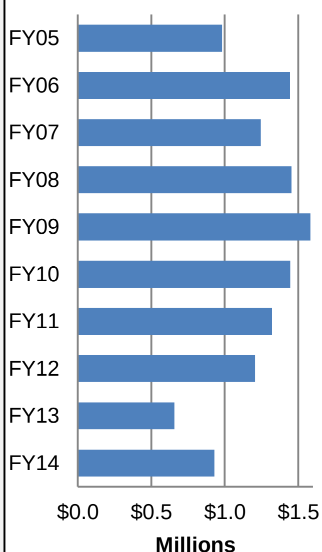
Direct Roles

Incentives. In addition to general tax policy, most states and some municipalities offer direct incentives to encourage growth in particular industries. These incentives primarily apply exclusively to economic base companies. Incentives are a tradeoff between a short-term loss of tax revenue and projected gains in jobs, investment, and potential long-term tax revenue. If properly designed and administered, incentives can offer states and communities the ability to encourage job and economic growth at a lower cost than simply lowering or eliminating overall tax rates. However, governments should evaluate incentives to determine if they adhere to the "but for" rule, which posits that companies using the incentives would not take the desired action but for the existence of the incentive. Additionally, in recent years, states across the country greatly expanded incentive programs to an unprecedented degree, competing against each other in what some experts and political officials term a "race to the bottom." The concern is that some incentives might be so lucrative that for every "win" of an expansion or relocation project, the result is a larger net loss to the state. New Mexico does not have a detailed analysis to determine whether its incentives are lucrative enough to fall into this category, and a study of this magnitude would require either significant staff time in multiple agencies or the funds to hire a contractor. States that regularly evaluate incentives typically employ additional staff solely to perform this function.

Area Development 2012 top states for doing business:
1) Texas
2) South Carolina
3) Georgia
4) Alabama
5) North Carolina

Financial assistance and investment. Beyond the scope of incentives available to eligible companies, some governments provide direct financial assistance in the form of grants, loans, loan guarantees, and equity investments. Critics oppose such government endeavors that attempt to pick winners and losers and can point to numerous failures. Others advocate these efforts fill gaps in private sector investment capabilities and can point to successes on local, national, and international scales. New Mexico invests a portion of the Severance Tax Permanent Fund (STPF) in economically targeted investments (ETIs) that yield below market returns. However, the State Investment Council reports over-weighted asset allocation to ETIs and the poor performance of the ETIs resulted in a 0.5 percent decline in value added for the STPF in 2012.

New Mexico Partnership Budget



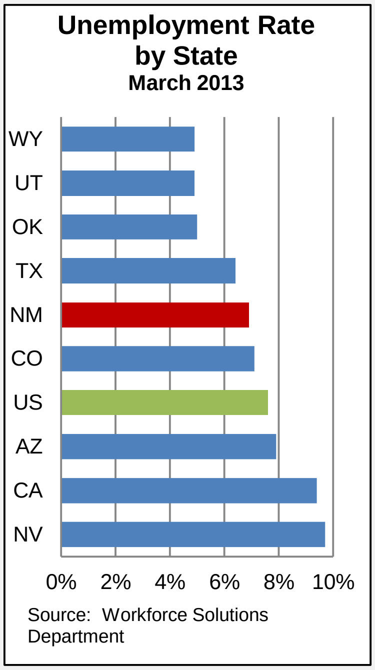
Source: LFC Files

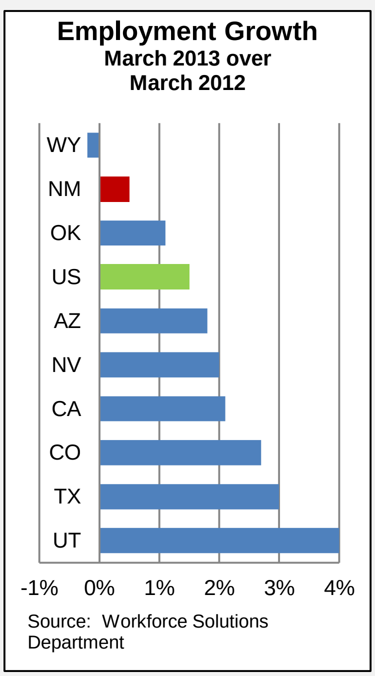
Closing funds. Beginning shortly after the onset of the recession, the number of states and municipalities offering cash "closing funds" increased, as did some of the fund sizes. Approximately half of all states now offer some type of closing fund. New Mexico cannot give companies direct grants due to an anti-donation clause in the state constitution, but it can provide Local Economic Development Act (LEDA) funds to assist with land, building, and infrastructure for the benefit of a specific company. The Legislature appropriated $3.3 million for the LEDA for FY14.

Business management assistance. Small Business Development Centers (SBDCs) and other, similar entities offer business management assistance, often using a combination of federal and state funds. Additionally, some states, including New Mexico, provide assistance directly through the economic development or commerce department. Many small businesses, old and new, benefit from management assistance, and a small investment in assistance can increase the likelihood a business will succeed and grow.

Business marketing and recruitment. States and communities increasingly recognize the need to market themselves to businesses and to site selectors that provide location services for other companies. Just as with tourism marketing, of which people are more commonly aware, marketing to businesses involves creating a brand image and convincing people to select a location they otherwise would not. This can take the form of traditional advertising methods or meeting company officials face-to-face. Increasingly, states embrace public-private partnerships to perform this duty. The EDD contracts with the statutorily authorized New Mexico Partnership to market the state and recruit qualified expansion and relocation projects. The Partnership's FY13 budget is $630 thousand, less than half the value before the economic downturn, but for FY14 the Legislature appropriated $930 thousand for the Partnership. The target industries for recruitment include advanced manufacturing, aerospace and defense, back office and technical support, digital media, emerging technology, energy and natural resources, transportation and distribution, and value-added agriculture.

Cluster formation. Industry clusters offer significant advantages to businesses and generally attract related companies. States without a significant industry cluster can choose to take a wait and see approach,





letting a cluster form naturally if it can, or actively assist and recruit businesses in particular industries. Often the effort involves providing special incentives to an entire industry, or multiple select companies within that industry, but it is sometimes possible to kick start cluster formation with the location of a single, large company that brings with it an entire supply chain. Betting heavily on a single company can be attractive because it might require just one success to start the cluster formation. However, if that one project fails it can represent a significant loss in terms of grant funding, foregone tax revenue, and other incentives. New Mexico bet more than $200 million when creating Spaceport America for its anchor tenant, Virgin Galactic. The spaceport now has a second tenant, Space Exploration Technologies Corp. or SpaceX, but cluster formation remains uncertain.

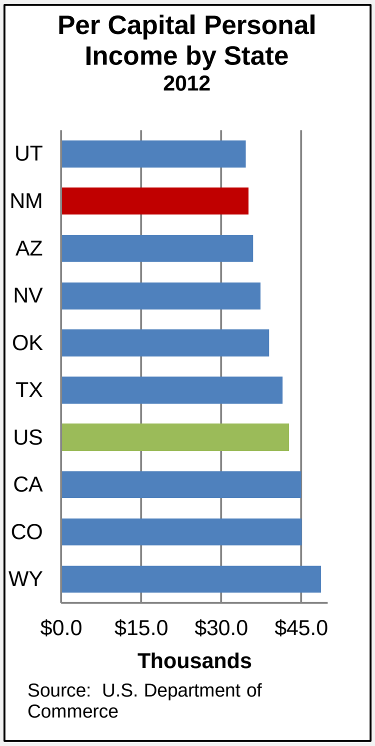
BUSINESS RELOCATION, EXPANSION, OR STARTUP SITING DECISION PROCESS

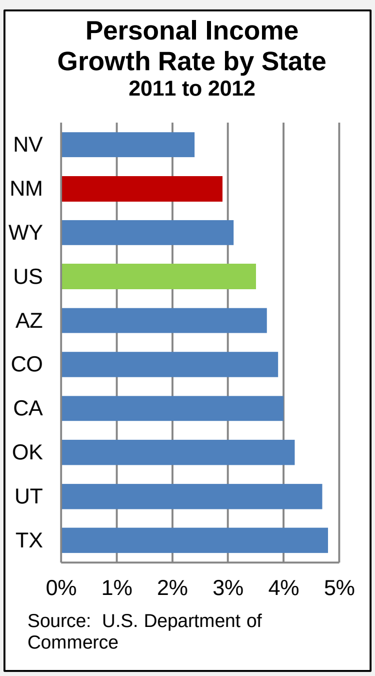
Strategic Locations. Most business relocation and expansion decisions start with a review of which locations fit strategically. This is also the case with startup companies not tied to a specific geographic area. For manufacturing and distribution companies, this often means locating near customers and suppliers and in close proximity to excellent transportation by highway or rail. For international businesses, strategic locations could be limited to those with a variety of direct flights to cities around the country and easy access to international flights.

Specific Site Factors. Once a business has a long list of potential sites that are a good strategic fit, the decision-maker then reviews more specific requirements and eliminates any sites that fail to meet the additional criteria. These requirements include items such as workforce size and education levels, proximity to higher education institutions, energy delivery, water availability, and quality of life factors. Quality of life can be very important for some companies, but it is a factor that tends to be overemphasized by the location that is marketing itself and valued less by the decision-maker. After evaluating all of these site factors, companies then consider costs for each of the sites on the remaining short list.

Labor Costs. Since labor costs are often a substantial portion of the total costs for a business, even a moderate difference in labor costs can result in a significant total cost differential. However, while lower labor costs can increase the likelihood a company would choose to locate in an area, higher wages are typically a goal for governments that take an active role in assisting job creation, as New Mexico demonstrates with its High-Wage Jobs Tax Credit.

Site Costs. The site-specific costs in addition to labor include transportation, energy and other utility, land and building acquisition, and permitting costs. The relevance and importance of these differ from one project to another but can be significant for large manufacturing or distribution facilities.





Tax Costs. The final costs associated with specific sites are the taxation costs. These are relevant for all projects, but the degree to which a specific tax or rate affects a specific project can differ substantially. For example, New Mexico has no inventory tax but Texas does. Some warehousing and distribution companies choose to locate in New Mexico versus Texas in part due to this one tax. However, an inventory tax would not concern a professional services company, but such a company might choose to locate elsewhere because New Mexico has a gross receipts tax. Economists traditionally advocate broader tax bases and lower rates, which tend to reduce the impact of any one tax.

NEW MEXICO'S COMPETITION FOR JOBS

Definitions of success. States use a wide variety of statistics to demonstrate their economic development efforts are successful, for example top rankings in industry publications. *Area Development* magazine annually surveys businesses and site selection companies and then rates the business climate of each state. However, while this is one possible indicator of future success, a better measure would be one that shows performance in job growth, income growth, or growth in the state's gross domestic product (GDP).

Comparison to peer states. New Mexico ranks in the middle of the pack with peer states for unemployment rates, and bests the national rate by a small margin. However, a low unemployment rate can mask individuals leaving the workforce or even leaving the state entirely. Employment growth measures the size of the workforce, and is therefore immune to those two data errors. With year-over-year employment growth of just 0.5 percent, New Mexico substantially lags the national average and every state in the region except Wyoming.

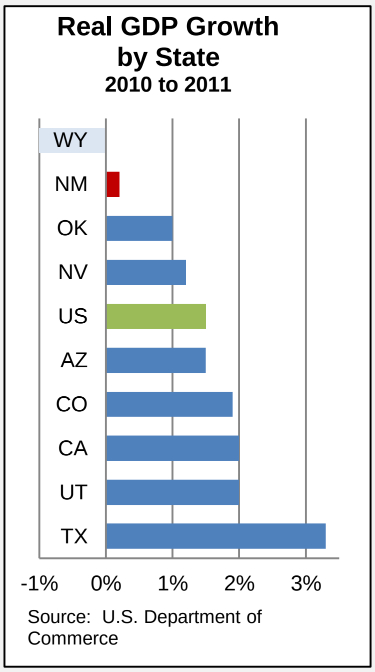
New Mexico also lags its peer states and the national average for per capital personal income levels, with Utah as the lone state ranking lower than New Mexico. However, Utah's personal income growth rate is the second highest in the region and is on track to surpass New Mexico's personal income level by the end of 2013. Only Nevada scores worse on income growth.

Real GDP growth rates show the increases in value of a state's economy and exclude the effects of inflation. By this measure, New Mexico's economy is sputtering, with just 0.2 percent growth year-over-year, while the national average is 1.5 percent. Again, Wyoming is the only state growing more slowly than New Mexico.

FUTURE LFC HEARINGS

LFC staff recommends the following additional hearing topics to explore job creation and income growth strategies in greater detail:

- Labor force dynamics and unemployment;
- Technology, capital, and business management assistance; and
- The impact of taxes, incentives, and regulation on job creation and income growth.



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www.nmlegis.gov/lcs/lfc/lfcprogevalall.aspx

Legislative Finance Committee, *Statewide Survey of Economic Development Initiatives, 2009*
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Workforce Solutions Department labor reports
www.dws.state.nm.us/News/MonthlyNewsRelease

Economic Development Department state comparisons
www.gonm.biz/50_State_Comparisons.aspx

Area Development Site and Facility Planning, *2012 Top States for Doing Business*
www.areadevelopment.com

Forbes, *Do You Live in a Death Spiral State?*
www.forbes.com/sites/baldwin/2012/11/25/do-you-live-in-a-death-spiral-state/

U.S. Department of Commerce personal income and state GDP data
http://www.bea.gov/

Economic Development Commission members.

Judi Sandoval	Administrator
Sharmyn Munoz	Member - District I
Donald Day	Member - District II
Alex O. Romero	Member - District III
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JC/svb

APPENDIX

FY14 Summary of State Appropriations and Tax Expenditures for Economic Development [1]
(millions)

	Description	General Fund	OSF	Total
Economic Development Dept.	Economic Development Department	$ 5.7	$ -	$ 5.7
Marketing and Business Recruitment	New Mexico Partnership	$ 0.9	$ -	$ 0.9
	Tourism Department marketing	$ 5.4	$ -	$ 5.4
	Cultural Affairs Department marketing	$ 0.2	$ -	$ 0.2
Infrastructure Development	MainStreet Program [2]	$ 0.5	$ -	$ 0.5
Workforce Development	Job Training Incentive Program (JTIP)	$ 3.0	$ -	$ 3.0
Closing Funds	Local Economic Development Act (LEDA)	$ 3.3	$ -	$ 3.3
Business Management Assistance	Small Business Development Centers (SBDCs)	$ 4.2	$ -	$ 4.2
University Research and Business Development	UNM Manufacturing Engineering Program	$ 0.6	$ -	$ 0.6
	UNM HSC Cancer Center	$ 2.6	$ -	$ 2.6
	NMSU Arrowhead Business Center	$ 0.2	$ -	$ 0.2
	NMSU Carlsbad Manufacturing Sector Development	$ 0.2	$ -	$ 0.2
	NMSU Manufacturing Sector Development	$ 0.4	$ -	$ 0.4
	NMTech Energetic Materials Research Center	$ 0.7	$ -	$ 0.7
	NMTech Geophysical Research Center	$ 0.8	$ -	$ 0.8
	NMTech Homeland Security	$ 0.5	$ -	$ 0.5
	NMTech Institute for Complex Additive Systems Analysis	$ 0.7	$ -	$ 0.7
	NMTech Petroleum Recovery Research	$ 2.0	$ -	$ 2.0
Tax Expenditures	Film production credit (cap)	$ (50.0)	$ -	$ (50.0)
	High-wage jobs credit	$ (24.1)	$ -	$ (24.1)
	Investment tax credit	$ (7.0)	$ -	$ (7.0)
	Construction-related GRT deduction	$ (14.3)	$ (7.2)	$ (21.5)
	Technology jobs credit	$ (6.3)	$ -	$ (6.3)
	Manufacturing GRT deduction [3]	$ (18.2)	$ (12.5)	$ (30.7)
	Tax holiday sales deduction	$ (4.1)	$ -	$ (4.1)
	Tax increment for development district tax (TIDD)	$ (3.8)	$ (1.6)	$ (5.4)
	Laboratory partnership small business credit	$ (3.2)	$ -	$ (3.2)
	Veteran employment tax credit	$ (2.5)	$ -	$ (2.5)
	Racetrack exemption	$ (2.0)	$ -	$ (2.0)
	Sales to film companies	$ (1.0)	$ (0.8)	$ (1.8)
	Small breweries & wineries liquor excise	$ (0.8)		$ (0.8)
	Rural jobs credit	$ (0.7)	$ -	$ (0.7)
	Military construction	$ (0.5)	$ (0.3)	$ (0.8)
	Angel investment credit	$ (0.2)	$ -	$ (0.2)
	Baseball stadium exemption	$ (0.2)	$ (0.2)	$ (0.4)
	Military transformation programs	$ (0.2)	$ (0.1)	$ (0.3)
	Double-weighted sales apportionment	$ (0.1)	$ -	$ (0.1)
	R&D small business credit	$ (0.1)	$ -	$ (0.1)
	Spaceport deduction	$ (0.1)	$ (0.0)	$ (0.1)
	Space test articles	$ (0.1)	$ (0.1)	$ (0.2)
	Space vehicle fuel deduction	$ (0.1)	$ (0.1)	$ (0.2)
	Software services in rural areas	$ (0.1)	$ (0.1)	$ (0.2)
	Boxing promotion	$ (0.1)	$ (0.1)	$ (0.2)
	Venture Capital Investment tax credit	$ -	$ -	$ -
	Industrial Revenue Bonds [4]	n/a	n/a	n/a
	Total State Cost	**$ (171.9)**	**$ (23.1)**	**$ (195.0)**

Notes: Sources: TRD and LFC Files

1. Estimated fiscal impacts for tax expenditures are preliminary and subject to revision.
2. The MainStreet Program also received a capital outlay appropriation of $0.5 million for FY14.
3. The manufacturing GRT deduction is phased in at 20 percent per year until fully implemented in FY17 at a cost of $80 million.
4. Estimates are not available at this time.
5. Highlighted expenditures were NOT updated by TRD in their 2012 New Mexico Tax Expenditure Report.

Performance Report Card
Economic Development Department
Third Quarter, Fiscal Year 2013

Performance Overview: The Economic Development Department (EDD) announced just 389 new jobs in the third quarter of FY13, but the job creation numbers for the first three quarters overall exceed both the agency's annual performance measure target and the results for the prior two fiscal years. However, while the performance measures reference jobs *created*, the EDD counts jobs *announced* in many cases, and companies often take months or years to fill the positions for which the department claims credit, leading to a mismatch between jobs announced and jobs filled. New Mexico total nonfarm employment grew 0.5 percent from March 2012 to March 2013 -- a slight uptick from the second quarter but trailing all other states in the region except Wyoming for employment growth. New Mexico ranks 38th nationally in employment growth.

	Economic Development Program Budget: $2,906,300 FTE: 26	FY11 Actual	FY12 Actual	FY13 Target	Q1	Q2	Q3	Rating
1	Total number of jobs created due to economic development department efforts *	1,922	2,684	2,500	1,089	1,215	389	G
2	Number of rural jobs created *	958	1,542	1,100	248	703	248	G
3	Number of jobs created through business relocations facilitated by the economic development partnership *	499	657	2,200	100	25	0	Y
4	Number of jobs created by the mainstreet program *	598	592	600	126	197	117	Y
5	Percent of employees whose wages were subsidized by the job training incentive program still employed by the company after one year *	47%	72%	60%	Reported Annually			-
6	Number of workers trained by the job training incentive program	553	1,015	1,000	450	66	256	G
7	Average wage of jobs funded through the job training incentive program	n/a	n/a	$16.00	$15.12	$35.02	$17.79	G
8	Number of international trade transactions	38	14	30	2	16	7	G
9	Number of business advocacy cases solved	n/a	n/a	30	10	11	14	G
10	Number of communities certified through the certified communities initiative (cumulative)	38	36	40	23	23	23	Y
11	Number of businesses provided technical assistance in creating a funding package request and referred to the appropriate funding agency	n/a	n/a	5	15	20	23	G
	Program Rating	Y	Y					Y

Comments: LFC staff recommends changing "jobs created" to "jobs announced" and adding a performance measure in the future to report actual jobs created during the prior year to provide historical context for the job announcements. The EDD now has a form to present to client companies requesting permission to gather data on jobs created to provide this historical perspective. The Economic Development Partnership continues to struggle with reduced funding and staff levels and performance measure results, but the GAA appropriates an additional $300 thousand for the Partnership for FY14. Additionally, the Partnership is attempting to raise $200 thousand in cash and $50 thousand of in-kind contributions. The MainStreet Program is almost on track to meet the annual jobs target; however, the EDD did not provide documentation of these jobs in the quarterly report because the information resides with local communities. LFC staff requested documentation of which companies created the jobs to provide transparency and accountability. The performance result for the number of certified communities should remain at 23 and miss the annual target due to no remaining funding for these certifications. The finance development team performance results show a very high number of businesses assisted with funding package requests -- more than eleven times the annual target after three quarters. However, the EDD reports few companies receive funding due to little remaining funding available for capital projects.

	Film Program Budget: $874,800 FTE: 9	FY11 Actual	FY12 Actual	FY13 Target	Q1	Q2	Q3	Rating
12	Number of media industry worker days *	181,366	143,046	150,000	43,770	31,570	15,725	Y

13	Economic impact of media industry productions in New Mexico, in millions	$696.6	$673.8	$300	$142.2	$93.9	$66.9	G
14	Number of films and media projects principally photographed in New Mexico	96	57	85	13	14	9	R
Program Rating		G	G					Y

Comments: Outcomes for the film measures indicate reduced performance compared to FY11 and FY12, with numbers down across all measures. The local industry maintains this is primarily due to the $50 million cap instituted for the film production tax credit. However, there is now a longer time-frame from when a project is produced to when the pay-outs occur for the credit; therefore, it is difficult at this time to fully assess the changes. The Legislature addressed the cap issue during the 2013 session by allowing a rollover of any unused funds under the $50 million annual limit, but not to exceed $10 million, to the next fiscal year. These amounts will not count toward a subsequent year's annual limitation.

Suggested Performance Measure Improvements

The Economic Development Department (EDD) continues to update and enhance its quarterly report. LFC staff recommends changing performance measure references to "jobs created" to "jobs announced" and adding a performance measure to report actual jobs created during the prior year. This would retain the current job projections while also providing historical context for those projections.

Additionally, LFC staff will work with the EDD and the DFA to revise measures and the performance monitoring plan to provide more accountability for reported job creation numbers. The primary issue is the need to track job numbers for the MainStreet Program so the EDD can at least provide a list of the companies creating the reported jobs.

* Denotes House Bill 2 measure