HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2002

A REPORT TO THE
HOUSE OF REPRESENTATIVES
78TH TEXAS LEGISLATURE

JIM SOLIS
CHAIRMAN

COMMITTEE CLERK
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Committee On
Economic Development

December 20, 2002

Jim Solis
Chairman

P.O. Box 2910
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The Honorable James E. "Pete" Laney
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Committee on Economic Development of the Seventy-Seventh Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Seventy-Eighth Legislature.

Respectfully submitted,

Jim Solis, Chairman

Jim Keffer, Vice Chair

Vilma Luna

Ron Clark

Ruth Jones McClendon

Joe Deshotel

Gene Seaman

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INTRODUCTION

At the beginning of the 77th Texas Legislature, the Honorable James E. "Pete" Laney, Speaker of the Texas House of Representatives, appointed nine members to the House Committee on Economic Development. The committee membership included the following: Jim Solis (San Benito), Chairman; Jim Keffer (Eastland), Vice-Chair; Ron Clark (Sherman); Joe Deshotel (Beaumont); Mark Homer (Paris); Vilma Luna (Corpus Christi);Ruth Jones McClendon (San Antonio); and Ken Yarbrough (Houston).

During the interim, the committee was assigned four charges by the Speaker: 1) Evaluate the attractiveness of Texas for business expansions and relocations, including considerations of the state's history of job creation. Determine which areas of the state have been more successful and which have been less successful, and whether additional programs or incentives are needed for some or all areas of the state. If new incentives are recommended, suggest funding sources. 2) Review the Development Corporation Act of 1979, including the 4A and 4B economic development tax. Conduct a thorough analysis of the historical use of this tax and determine success and failure in promoting job creation and business development. 3) Actively monitor the status of the unemployment compensation trust fund. Study the mechanisms in current law designed to keep the fund balance in the desired range. Review practices in other states t assess whether the effectiveness and fairness of the system might be improved. 4) Actively monitor the agencies under the committee's jurisdiction.

The committee has completed its hearings and research and has filed its report. The committee wishes to express appreciation to our staffs for their assistance and efforts throughout the interim. In addition, we would like to thank the speakers and citizens who provided testimony at hearings for their involvement the process. Finally, we thank the leadership and staffs of the Texas Department of Economic Development, Texas Workforce Commission, Texas Council on Workforce and Economic Competitiveness, Texas Aerospace Commission, the Texas House of Representatives for their time and efforts on behalf of the committee.

CHARGE Evaluate the attractiveness of Texas for business expansions and relocations, including considerations of the state's history of job creation. Determine which areas of the state have been more successful and which have been less successful, and whether additional programs or incentives are needed for some or all areas of the state. If new incentives are recommended, suggest funding sources.

CHARGE Review the Development Corporation Act of 1979, including the 4A and 4B economic development tax. Conduct a thorough analysis of the historical use of this tax and determine success and failure in promoting job creation and business development.

CHARGE Actively monitor the status of the unemployment compensation trust fund. Study the mechanisms in current law designed to keep the fund balance in the desired range. Review practices in other states to assess whether the effectiveness and fairness of the system might be improved.

CHARGE Actively monitor the agencies under the committee's jurisdiction.

CHARGE ONE

EVALUATE THE ATTRACTIVENESS OF TEXAS FOR BUSINESS EXPANSIONS AND RELOCATIONS, INCLUDING CONSIDERATIONS OF THE STATE'S HISTORY OF JOB CREATION. DETERMINE WHICH AREAS OF THE STATE HAVE BEEN MORE SUCCESSFUL AND WHICH HAVE BEEN LESS SUCCESSFUL, AND WHETHER ADDITIONAL PROGRAMS OR INCENTIVES ARE NEEDED FOR SOME OR ALL AREAS OF THE STATE. IF NEW INCENTIVES ARE RECOMMENDED, SUGGEST FUNDING SOURCES.

COMMITTEE WORK

The House Committee on Economic Development held three hearings to discuss Interim Charge #1. These included Austin on February 5, 2002, Nassua Bay on May 8, 2002, and Austin on August 27, 2002.

BACKGROUND

The climate for Texas' businesses to grow and compete is healthy. Much of this is due to the quality of the state's labor force. The Texas Department of Economic Development (TxED) reports that the state's civilian workforce is the second largest in the nation. In April 2001, it totaled 10.5 million and according to the state's demographer, was relatively young. The Texas Comptroller's office reports that Texas has the second largest tech workforce, with 551,000 high tech workers adding 152,000 jobs between 1990 and 2000. Furthermore, the Texas labor force increased by more than 345,000 between 1999 and 2001[1]. Texas also leads all states in net job creation since 1990, and this growth is wide-ranging. In fact, Texas ranks among the leading state in nearly all major economic sectors in job growth.[2] Texas has the workforce and must now work decisively to increase development of its labor resources as it continues to increase the number of new companies and grow existing ones in the state.

Texas is successful at attracting businesses to the state. Its record of job creation and business relocations over the past decade is strong. Even during the recent national economic downturn, Texas has continued to experience significant job growth compared to other states. However, it is the slowed pace of job creation and business relocations to Texas that has attracted recent concern among many. While still confident regarding Texas business development and optimistic of future performance, state economic development professionals point to industry performance analysis regarding the Texas business climate to highlight the need for a renewed and more concerted effort to address state economic development policy. Several research studies show that the pace of performance has significantly slowed down in Texas. Evaluation of this analysis is important for a state to remain competitive with other states for job creation and business relocations and to measure their overall economic development performance.

An analysis of Texas' business climate in comparison to other states' is important for determining the attractiveness of the state for business expansions and relocations. Several comparative research articles analyze the recent economic and business climate of individual states. With consultation from the staff of the National Conference of State Legislatures, the committee performed a brief review of recent literature utilized by researchers and economic development professionals to analyze Texas' business climate and its competitiveness for new corporate locations and expansions.[3]

Business Climate

Industry professionals refer to *Site Selection*, an influential trade magazine that represents a business perspective and is particularly geared to those involved in location and expansion decisions, to get an indication of states' national economic development performance. The magazine utilizes a New Plant Database that is considered the most exhaustive source of corporate location data available in the field. This information is used as the main criteria to analyze a state's current business climate which is the key factor critical to site locators' decision making.

Site Selection also uses this information to track state performance and recognizes the top performing states with the comprehensive and coveted "Governor's Cup" award. The award is given to the states that experienced the most new corporate headquarters and corporate expansions and their on nine other similar location criteria . The 2001 award for Most New and Expanded Corporate Facilities in the U.S. went to Illinois. Surprisingly, Texas did not rank in the top ten after placing fifth in 2000 and performing well in the previous consecutive years .[4] To many this proved to be not only a tremendous setback for economic development in Texas but also a wake-up call to revitalize economic development efforts and turn the state's performance around as it competes against other states.

In addition, *Site Selection* ranks the states' business climates based on the number of new and expanded corporate facilities plus the results from an attitude survey of corporate real estate executives. In their 2001 Business Climate Survey, Texas ranked as the third best state in the U.S. for doing business.[5] Texas' performance was bolstered by its 2001 first place finish in the survey of corporate real estate executives' attitudes and perceptions which counts for 50% of the ranking. This is an important and significant finding for economic development leaders. While not leading in the race of raw data numbers of locations and expansions, the survey revealed the interesting fact that Texas continues to make a strong overall impression on national corporate executives as a state they consider to be the most pro-business. The fact is corporations like Texas and they continue to have a strong opinion of the state as a business location.

Texas' Performance on *Site Selection's* Governor's Cup versus Business Climate Rankings Over Five Years (1997 - 2001)

	Site Selection Governor's Cup Rank	*Site Selection* Business Climate Rank
2001	*	3
2000	5	2
1999	4	2
1998	6	4
1997	3	3

* *Texas not ranked in the top ten*

The *Site Selection* rankings reveal the importance the number of relocations and expansions are to states as they market to potential businesses. Rankings add to a state's competitiveness which usually drives continued relocations and expansions for high ranking states and is an indication and measure of overall economic development performance.[6]

Another indication of competitiveness is found in *Forbes* Magazine's and the Milken Institute's ranking of the best places in the United States to do business. The 2002 *Forbes*/Milken list of Best Places for Business and Careers ranks 200 metropolitan areas based on the latest government data on salary and job growth, among other factors over one and five year periods.[7] Growth of technology output in the metro economy and diversity of tech industries were also factored into the rankings. California had the strongest performance with six of the top ten metropolitan areas on the list. Though not as formidable, Texas did have two metropolitan areas in South Texas among the top ten. The McAllen-Edinburg-Mission area ranked fifth and the Brownsville-Harlingen-San Benito area ranked ninth, toping other state metro areas such as Austin-San Marcos which ranked 19th overall. The Brazoria-Port Arthur area made the list with a respectable ranking at 62nd. However, on the opposite end of the spectrum, the Amarillo (181st) and Beaumont-Port Arthur (183rd) areas ranked near the bottom out of 200 metro areas.

Local business start-ups were the focus of *Inc.* magazine's online article, "Best Cities to Start and Grow a Company Now," which ranked cities based on the number of new business starts and young firms with high employment growth.[8] Texas performed well in both the large and small metro area categories. Dallas-Fort Worth was sixth in the 50 Best Large Metro Areas category with Houston (17th) and San Antonio (22nd) close behind. Both the Dallas-Fort Worth and San Antonio metro areas experienced significant increases from their previous year's rankings. Austin was the winner in Texas, ranking fifth in the category of 50 Best Small Metro Areas with El Paso (21st), Corpus Christi (40th), and Brownsville-McAllen (44th) rounding out the list.

Development Capacity

For the past 15 years, the Corporation for Enterprise Development in Washington, D.C. has performed an annual assessment of each state's economy and future growth. In their *2001 Development Report Card for the States* grades were assigned using 70 measures divided into three indexes: business vitality, development capacity and performance.[9] The *Report Card's* three indexes capture important economic development factors and trends for each state. In 2001, Texas received an A for business vitality and a C for resource development capacity but rated an F for performance.

The business vitality index focuses on the strength of existing businesses, diversity of business sectors, number of new companies, technology based companies and initial public offerings. Texas rated an A due to the competitiveness of existing businesses and the vibrancy of entrepreneurial energy that creates new business growth. The study showed that Texas' business climate is also effective in sustaining new and existing businesses.

The development capacity category emphasizes public and private investments that influence economic development. Measures such as education, skills attainment, quality of transportation, energy and housing costs, and R&D expenditures comprise this category. Education was the primary factor used to determine the C rating which Texas received in this category. The index revealed that Texas' investment in basic education is good but more must be done to improve high school graduation rates and educational attainment. However, the state fared well when considering research capacity factors that take into account the number of Ph.D. scientists and engineers, and of science and engineering graduate students.

Texas was only one of eleven states to receive an F in any of the indexes. The Performance factors used in this index rating include quality of life issues such as income, job quality, equity, poverty and overall employment. The index measures the disparity between the wealthy and the poor, poverty rate, percentage of working poor, and lack of employer based health coverage and reveals whether the state is a good place for people to work and make a living.

The *Report Card* data indicates that it is not just the quantity of economic growth but, also, the quality of growth that has a significant impact on that state's overall economic performance. This study stresses that economic impact assumptions cannot be made by simply using raw numbers regarding the number of jobs created, new businesses attracted, or industry closings. Instead, the types of businesses a state has and the manner in which they operate have a significant impact on the state's economy. Those companies that do business outside the state have the ability to attract investment to the state and the means to invest in higher wages and benefits. These are all factors that influence a company's decision to expand their operations in their current location or relocate to a new one.

State Competitiveness

A state's competitiveness is critical to its ability to attract and sustain business development. A study by the Beacon Hill Institute in Boston defines "competitiveness" as the ability to ensure and sustain a high level of per capita income and its continued growth.[10] Researchers produced the *State Competitive Report 2001* by examining all aspects of a state's economy and devised nine indexes and combined them into an overall index and ranked the states according to their overall competitiveness. Texas ranked 33rd overall due in part to a strong 13th place performance in the government and fiscal policy index. However, Texas performed extremely low in the number of people with health insurance (49th) and its high school graduation rates (46th). The conclusion is by improving competitiveness Texas will be better positioned to attract business investment and develop a skilled workforce to improve state productivity.

Workforce Development Programs

Researchers believe that an investment of job training dollars has a regional "spillover effect" whereby the entire region benefits from the training provided. The theory is that the training investment is not limited to a specific company. The person gaining a new skill is not only a trained employee for an individual company but also one having valuable portable skills which can be taken to the next job an so on. As skilled employees gain more proficiency, they continue contributing to the economy with each successive job opportunity. Therefore, training should not be viewed as solely a business incentive to an individual company but as an investment in the state's workforce as a whole.

Skills Development Fund

The Skills Development Fund proves to be a solid investment of state funding for workforce development leading to job creation and business development. The linkage of the Texas Workforce Commission with local community and technical colleges and the Texas Engineering Extension Service to deliver job training works effectively overall to meet the demands of statewide workforce development while successfully providing the necessary accountability to ensure the integrity of the program. Committee testimony revealed that the program's administrative system provides accountability without overburdening companies or training providers in bureaucratic processes. This administrative framework is a proven strength that alleviates problems for companies who do not have to hire personnel to manage paperwork or worry about the need to refund training dollars.

The Skills Development Fund is administered by the TWC and assists businesses and labor unions by designing, financing, and implementing customized job training programs in partnership with public community and technical colleges and the Texas Engineering Extension Service for new or existing jobs in local businesses. This fund successfully merges business needs and local job training opportunities into an effective formula for people to work. This program is designed to assist businesses throughout the state with their job training needs. In partnership with our public community and technical colleges and a higher education extension agency, the Skills Development Fund will assist in financing customized job training programs to fit the express needs of our Texas businesses.

During Fiscal Year 2001, TWC awarded 39 grants totaling over $12.5 million, which served 241 businesses, 19 business consortiums, a commitment to create and train 6,612 jobs and retrain just over 6,500, with an average hourly wage of $12.55 per hour. The Employers' Customized Training unit oversees the administration of the Fund.

The 77th Legislature appropriated $25 million during the FY 2002-2003 biennium. TWC has requested a based budget of $12.5 million per year of the FY 2004-2005 biennium. Their first exceptional item requests an additional $12.5 million per year for the biennium which TWC estimates provide training for and additional 9,450 trainees per year.

Businesses and labor unions that form partnerships with local community colleges and technical colleges or the Texas Engineering Extension Service may apply. They should have a training plan and jobs, which pay the prevailing wage for occupations in their local labor market. A Skills Development Fund proposal submission is required and will assist the Executive Director of the Texas Workforce Commission in determining grant funding.

TWC will enter into a contract with the public community college, public technical college, or Texas Engineering Extension Service that is to provide the job training. Under such a contract, a grant recipient must serve as the fiscal agent, administer the contact, and submit quarterly financial and performance reports to the TWC. Additionally, the grant recipient must maintain data on the expenditure of grant funds for at least three years after the contact has ended. Finally, payment of the full contract amount is contingent upon the TWC's determination that the project has met the requirements of the contract.

Self-Sufficiency Fund

The TWC also administers the Self-Sufficiency Fund Program which assists businesses by designing, financing and implementing customized job training programs in partnership with public community and technical colleges, the Texas Engineering Extension Service and community-based organizations for the creations of new jobs and/or retraining of existing workforce. During FY 2001, TWC awarded 24 grants totaling approximately $12 million which served 195 businesses. It is estimated that these funds created and/or retrained 3,607 individuals at an hourly rate of $8.36 per hour. The 77th Texas Legislature appropriated $6 million in the 2002-2003 biennium.

Adults who receive Temporary Assistance for Needy Families (TANF) and/or Food Stamp recipients with dependent are eligible to participate in the Self-Sufficiency Fund Program. Since the funded training must prepare trainees for jobs with specific employers, those employers must participate in the application process. The Fund also provides money for support services that are necessary to enable participates to take part in training activities and to make transition from training to work.

In order to receive funding under the Self-Sufficiency Fund two more entities must file a joint application with the TWC. One of those entities must be a public community college, a public technical college, a private, non-profit organization that meets the requirements set forth by the TWC, or be the higher education extension service. At least one of the joint applications must be a private employer. Before this application is submitted to the TWC, it must be submitted to the appropriate Local Workforce Development for review, comment, and approval.

Once a grant is approved, TWC will enter into a contract with the public community college, public technical college, non-profit corporation, or the Texas Engineering Extension Service that is to provide the job training. Under such a contract, a grant recipient must serve as the fiscal agent, administer the contract, and submit quarterly financial and performance reports to the TWC. Additionally, the grant recipient must maintain data on the expenditure of grant funds for at least three years after the contract has ended. Finally, payment of the full contract amount is contingent upon the TWC's determination that the project has met the requirements of the contract.

Smart Jobs Fund

According to a leading economist, the Smart Jobs Fund did not fail, it was never tried as the program was originally envisioned.[11] This is troubling commentary on what was once the state's largest employer-driven customized job training program and the cornerstone of Texas' workforce development policy. The now expired Smart Jobs Program was created by the Legislature in 1993 and administered by the Texas Department of Economic Development (TxED). The program was designed to respond to the growing demand for highly skill workers in emerging occupations of the technology sector and to retrain workers displaced by downsizing in the defense industry. Grants were awarded directly to Texas businesses on a quarterly basis to provide customized training for their employees. Funding for the program came from the unemployment insurance assessment of 1/10th of 1% of wages paid by employers. Smart Job grants could not exceed more than $1.5 million to a single employer and were restricted to creating or retraining jobs that met certain wage criteria.

Through the years, the Legislature substantively amended its purpose and tenuously expanded the scope of the Smart Jobs program to a more generalized, broad reaching training program serving businesses of diverse types and sizes throughout the state. Further, it served businesses' training needs so long as the jobs paid workers at or greater than the county average wage. The program's scope increased tremendously and no longer focused solely on training highly skilled workers for selective industry but, also, any industry paying the requisite wages. Many believe the expansion of the program lead to TxED's inability properly administer it which caused its demise. The Legislature has an opportunity to benefit from the events of the past.

Analysis of Other States' Job Training Programs

Job training programs in the U.S. vary tremendously. One of the most comprehensive analysis of these programs is a study performed by the National Governor's Association with a grant from the U.S. Department of Labor and provides detailed information on programs in forty-seven states.[12] The survey found that 40 percent of job training dollars nationwide were targeted to firms already located in the state in which they were seeking to expand. Only 29 percent of funds were used to train employees of companies new to the state or for new employees of existing companies. Over half of the funds were spent to train workers already employed by their companies.

California

The California program is considered an example for the nation to emulate. Strong emphasis is placed on performance-based accountability after training has been provided. For example, trainees must stay employed for at least 90 days after training before an employer is reimbursed. The program is also divided to address four types of job training: retraining, new-hire training, special employment training, and the welfare to work program. The tiered system addresses several employment goals such as the needs of high-demand industries and those of the unemployed. The results of the California program are positive, trainees change jobs less often and receive wage increases.[13]

Georgia

The Georgia Quick Start Program is part of a broader training and skills system that goes back 35 years and targeted for companies new to the state. Instead of providing funding for training, the Quick Start program involves the actual provision of training or sets it up through a technical institute. An interesting example is the Certified Manufacturing Specialist program that provides a generalized 150 hours of basic manufacturing training and produces specialists for the industry.[14]

Iowa

Iowa funds its Industrial New Jobs Training Program, an employer-focused job program, through the issuance of debt certificates. These certificates are based on the number of persons trained and are issued and sold by the community college involved in training. The money is then repaid by using a portion of the income tax withholding for employees receiving the training. This innovative program is aimed at firms new to the state or the expansion of existing firms.[15]

Michigan

Michigan, a leader among corporate site selectors, formed the Economic Development Job Training Grant Program that awards funds competitively to community colleges who provide training. The program works with local workforce development boards which control services but do not provide the training. One important factor used to award grants is whether the grantee is a business in a high economic impact sector that produces goods or services exported out of the state. Comprehensive monitoring of the program is a reason for its success.[16]

New Jersey

New Jersey's financial support for its Customized Training Program ranks that state as the leader in per-capita spending for incumbent worker training programs. An economic development tool, the program often serves as a financing vehicle to encourage firms to relocate or expand in the state. The New Jersey Department of Labor estimates that the largest proportion of dollars spent, approximately 65 percent, is used to fund training for firms already located within the state that are creating new jobs through expansion. Customized training grants may be awarded to individual employers, employer organizations, labor organizations, or a consortium of employers and one or more education institutions. Employers are encouraged to use the community colleges, four-year schools or universities, or county vocation school for external training assistance to complement internal training activities. Customized training programs are designed to meet the predominant needs of the employers and they may select from a variety of training programs available, ranging from basic adult education to company specific skills training.[17]

North Carolina

North Carolina's employer focused job training programs are inexpensive and accessible to every firm in the state through the state community college system, which consists of forty-eight colleges. Community colleges are the sole providers of the state's customized job training programs, which makes the state programs unique from those in other states. The goals of North Carolina's customized training programs have evolved since they originated in the late 1950s from primarily focusing on attracting new companies to the state to including the goal of enhancing the competitiveness of existing firms.[18]

SELECTED PUBLIC HEARING FINDINGS

The committee received a significant amount of testimony on the importance of developing and maintaining a highly skilled workforce for the future of the Texas economy. Both large and small companies testified on the need for continued and increased job training funding.

Sandy Johnson of Barrious Technology, Inc. in Houston stated, as it is small technical companies are already at a disadvantage competing with large companies for contracts without the added difficulty of recruiting trained personnel. She said small companies greatly benefit from the Skills Development Fund which allows her to recruit people who do not have a four-year college degree and train them on site. Johnson stressed they gain a valuable skills in a short amount of time and become loyal to the company. She also believes it is important for companies to collaborate with high education institutions. Her collaboration with the San Jacinto Community College District has been integral in her success with the Fund and the training of her employees.

Tim Kropp of MRI Technologies in Houston agreed with Johnson on her testimony. He stated that his employees are young and most are not college graduates. This is due to competition from large companies for college graduates. He said through the Skills Development Fund his company is able to hire people without degrees and train them with the skills they need to do the work of someone who has earned a degree. Kropp stated as more industries move into the Houston area there are increased contracting opportunities for large and small companies but securing personnel will be the greatest challenge. He recommends expanding the Skills Development Fund to train talented people who did not pursue a higher education yet have the ability to work in a rewarding technical field. Finally, Kropp also recommends creating more outreach programs that expose children to technology at an early age and ensuring the high school students get counseling on the possibilities of pursuing a college degree in a scientific or technical field.

Jeff Worley of the Boeing Company stated the company employs over 8000 people in Texas and is needing to hire 800 in Houston as it transitions its work on the human space flight program from California to Houston. He said Texas must produce a highly skilled workforce for its economic future. Boeing is a global company that makes decisions of where to locate based on the global competitive advantage to the company. Their challenge today is to fill those 800 jobs with skilled personnel. He believes Texas needs to retain skilled employees for it to be attractive to other aerospace companies. Approximately 300 to 400 of the 800 employees they are looking to hire must go through worker training such as the Skills Development Fund Program. He believes that more training is needed throughout Texas for it to remain competitive and would certainly endorse increased funding for the program. Furthermore, he stressed the need for more outreach programs in high school to get kids excited about the future of aerospace and technology careers. Worley stated that he can attest to the success of Boeing's outreach and internship programs at the college level.

CONCLUSION

Research showed that economic development professionals and corporate executives have a favorable perception of Texas. While its prominence in the nation has noticeably slipped in recent years there are economic development efforts and investments which Texas can make now which will have a significant impact on the overall business development strength of the state. Undoubtably, one of those efforts is a continued commitment to workforce development and job training. In order to assist the state regain national prominence and thrive as a global competitor, Texas must first work to improve its workforce development and job training efforts. The Texas labor pool is young and increasing in population. Taking action now by concentrating its focus on targeted training programs and strengthening its educational funding at all levels will lay the ground work for the Texas economy to grow and prosper for years to come. Furthermore, as our nation continues to undergo a profound structural transformation towards a knowledge and idea based economy, it must be prepared to meet the workforce demands of the future. After all, economic development is about people. While other factors such as access to global markets, transportation systems, metro locations, and tax incentives influence corporate decisions, access to a skilled workforce remains the top priority of corporate site seekers behind site location decisions.

RECOMMENDATIONS TO THE 78TH TEXAS LEGISLATURE*

1. The Legislature should consider increasing its investment in the Skills Development Fund. TWC's 2003-2004 based budget request of $12.5 million per year of the biennium should be supported. Their first exceptional item requesting an additional $12.5 million per year for the biennium should also be given serious consideration. TWC estimates these additional funds could provide training for 9,450 trainees per year.

2. The Legislature should enact another state funded workforce training program similar to the former Smart Jobs Fund to complement the Skills Development to be competitive with other states or it should increase the funding of the Skills Development and develop it into the state's premier job training program to market throughout the state. The availability of skilled workers and effective job training opportunities are the most critical factors in a corporation choosing a location in which to operate its business.

3. The Legislature should consider authorizing a Smart Jobs-type training assessment in the

Unemployment Insurance Tax Fund Program, once the fund is solvent. The assessment rate under the previous Smart Jobs Program was 1/10th of 1% of the UI tax rate paid by employers . While the solvency status of the UI system is uncertain, this assessment proved to be an effective source of workforce training funds in the past and the Legislature should investigate this option.

4. The Legislature should consider creating a "high impact fund" designated for job training and contingent on available funding. It would target large, unique projects that would have a significant impact on the Texas economy.

5. The Legislature should strengthen the partnerships with economic development organizations, community and technical colleges and local workforce development boards which establish training priorities for high skill, high wage jobs in each of the 28 respective board regions.

6. In order to ensure a growing technology workforce, the Legislature should continue to support and promote programs such as the Technology Workforce Development Act (Education Code, Chapter 51) administered by the Texas Higher Education Coordinating Board and aimed at increasing the number of baccalaureate degrees in computer science, electrical engineering and other high tech fields.

7. The Legislature should create an interim advisory committee composed of the House Committees on Economic Development, Higher Education and Public Education to collaborate on state workforce development and education policy to prepare for the growing knowledge and idea based economy.

** According to the state comptroller's estimate, the 78th Legislature will face at least a $5 billion budget shortfall for fiscal 2004-2005 representing the difference between available revenues and the amount needed to continue to pay for existing programs. The committee makes the following recommendations on the basis of their perceived contribution to the state's economic development policy and mindful of the upcoming budget deliberations.*

CHARGE TWO

REVIEW THE DEVELOPMENT CORPORATION ACT OF 1979, INCLUDING THE 4A AND 4B ECONOMIC DEVELOPMENT TAX. CONDUCT A THOROUGH ANALYSIS OF THE HISTORICAL USE OF THIS TAX AND DETERMINE SUCCESS AND FAILURE IN PROMOTING JOB CREATION AND BUSINESS DEVELOPMENT.

COMMITTEE WORK

The House Committee on Economic Development held two hearings to discuss Interim Charge #2. These included Austin on February 5, 2002 and Austin on August 27, 2002.

BACKGROUND

The Legislature adopted the Development Corporation Act of 1979 to promote economic development. The Act was created to allow cities to create local economic development corporations to attract businesses and create jobs. It was amended in 1989, allowing voters in many Texas cities to have the option of imposing a local sales and use tax to help finance their communities' economic development efforts. Voters must approve the additional sales tax and the city must create a development corporation to monitor the projects. In 1997, the Legislature required each economic development corporation to submit an annual report to the Texas Comptroller of Public Accounts. The Comptroller is charged with compiling information from each corporation and preparing a biennial report to the Legislature.

The Comptroller reports that cities which adopted the economic development sales tax raised revenues in excess of $285 million in FY 2000 and $324 million in FY 2001. These figures indicate that the tax is a significant local revenue source for economic development. The strength of the tax is in allowing local communities who have authorized it to use it to target and meet local economic development needs. The primary objective of most economic development corporations has been job creation and retention. The next preferred activity was infrastructure projects.

Cities may adopt an economic development sales tax under Section 4A or Section 4B of the Development Corporations Act of 1979. The Section 4A sales tax is eligible to cities in a county with a population of less than 500,000 if the new combined local sales tax rate would not exceed 2 percent and th city is not part of a rapid transit authority. A city that is eligible to adopt a sales tax under Section 4A may hold an election to adopt the tax under Section 4B if the new combined local sales tax would not exceed 2 percent. A city located in county with a population of 750,000 or more is also eligible, but there is an additional eligibility requirement: the current combined sales tax rate cannot be 7.25 percent at the time of the election. A city with a population of 400,000 or more that is located in more than one county and has a combined sales tax rate that does not exceed 8.25 percent may also enact the Section 4B sales tax.

By the end of FY 2001, 199 cities had adopted the Section 4A economic development sales tax. Section 4A tax proceeds may be used to fund any of thirteen types of expenditures under the Development Corporation Act. Two of the categories are pursuant to authorization under Section 4A of the Act. Under Section 4A, the act specifically allows industrial development corporations to undertake projects, the primary purpose of which is to provide business airports and port-related facilities. The remaining eleven categories for expenditures of Section 4A tax proceeds are: manufacturing and industrial facilities, recycling facilities, distribution centers, small warehouse facilities, closed or realigned military bases, related facilities, facilities to promote new and expanded business development, facilities to promote job creation and retention, job training facilities, educational facilities, and targeted infrastructure.

At the end of FY 2001, 325 cities had created Section 4B economic development corporations. The Development Corporation Act provides a wide variety of purposes for which Section 4B tax proceeds may be expended. Section 4B proceeds may be spent on land, buildings, equipment, facilities an improvements for items that it under the definition of "project" under Section 2(11)(A) of the Act. The Attorney General has concluded that the term "project" encompasses the land, buildings, equipment, facilities, and improvements that are suitable for any of the following: promotion of manufacturing an industrial facilities, recycling facilities, distribution centers, small warehouse and storage facilities, air or water pollution control facilities, development of redevelopment of closed military bases and facilities related to these projects, facilities to promote new and expanded business development, facilities to promote job creation and retention, job training facilities, education facilities and facilities for use by institutions of higher education, targeted infrastructure, athletic facilities, parks and related public space improvements, tourism and entertainment facilities, commercial facilities, certain public facility improvements, transportation improvements, infrastructure improvements, other business-related improvements.

In 2001, the Legislature authorized the Texas Department of Economic Development (TxED), in conjunction with the Attorney General and the Comptroller of Public Accounts, to develop a training seminar to ensure that the officers of a development corporation created by a municipality or county and the officials of the municipality or county that created a development corporation under the Development Corporation Act of 1979 properly and legally operate the development corporation and administer the tax imposed for the benefit of the development corporation. TxED is to issue a certificate of completion to each person who completes the seminar. The seminars are to be held in different regions of the state for the convenience of persons required to complete the seminar. The city attorney, the city administrator, or the city clerk of a city that created a Section 4A or Section 4B development corporation, the county clerk or the county attorney of a county that created a Section 4A or Section 4B development corporation, and the executive director of a Section 4A or Section 4B development corporation or other person who is responsible for the daily administration of a 4A or 4B development corporation to attend a seminar at least once in each 24-month period. TxEd has contracted with the Texas Economic Development Council (TEDC), a major state association of economic development corporations, cities, and economic development professionals, to administer the training seminars. The seminars began during the summer of 2002 and eleven seminars have been scheduled through 2003 in different locations throughout the state. TEDC reports the seminars are generating much interest, even those public officials who are not required to complete the training are attending to gain a better understanding of the economic development law.

Differences Between Section 4A and 4B Tax Uses

The Development Corporation Act of 1979 empowers local communities to pursue various economic development projects adding to the economic viability and business attractiveness of the area. There are significant differences and similarities among the sections.

Section 4A: The tax is primarily intended for manufacturing and industrial development, and cities must use the tax revenues to focus on these areas.

Section 4B: The tax provides cities with a wider range of uses for the tax revenues because it is intended to give communities an opportunity to undertake a project for quality of life improvements, including economic development.

Section 4A

Cities may use the money raised by this sales tax to acquire land, buildings, equipment, facilities, and improvements for purposes related to:

- manufacturing and industrial facilities, recycling facilities, distribution centers, small warehouse facilities;
- commercial development and expansion in blighted or economically depressed areas and development areas;
- a general aviation business service airport that is an integral part of an industrial park;
- port-related facilities to support waterborne commerce; and
- maintenance and operating costs associated with projects.

Section 4B

Cities may use the money raised by this sales tax for a wide variety of projects including land, buildings, equipment, facilities, and improvements related to projects defined in Section 4A or found by the board of directors to be required or suitable for use for:

- professional and amateur sports (including children's sports) and athletic facilities; tourism; and entertainment facilities; convention and public park purposes and events, (including stadiums, ballparks, auditoriums, amphitheaters, concert halls, learning centers, parks and open space improvements, municipal buildings, museums, exhibition facilities;
- related store, restaurant, concession, parking, and transportation facilities;
- related street, water and sewer facilities; and
- affordable housing.

To promote and develop new and expanded business enterprise, a city may provide:

- public safety facilities;
- recycling facilities;
- streets and roads;
- drainage and related improvements;
- demolition of existing structures;
- general municipally owned improvements;
- maintenance and operating costs associated with projects; and
- any other project that the board determines will contribute to the promotion or development of new or expanded business enterprise.

Section 4A and 4B

In 1997, the Legislature added "job creation and retention, job training, and educational facilities" to the definition of project for all Section 4A and 4B development corporations.

SELECTED PUBLIC HEARING FINDINGS

Overall economic development corporations and professionals are very satisfied with the current operation of the economic development sales tax law. The sales tax gives local communities the ability to control their economic development and lure new business to the area and assist in the expansion of existing ones. However, there were several concerns voiced during the public hearings process regarding use of the tax for retail projects and the potential of cities pursuing the means of rolling the economic development sales tax dollars into the cities' general fund. The following is the most relevant testimony received by the committee on the economic development sales tax.

Julie Crouch, City Manager of Rockwall and Treasurer of the Texas Economic Development Sales Tax Association (TEDSTA), testified on the positive impact of the Section 4A and 4B tax has had throughout the state. It is a key component of economic development in Texas. She stated that in FY 98-99 most of the money statewide was target for job creation and retention efforts.

Infrastructure projects were a close second. Crouch stressed that an important aspect of the tax is that it assists communities retain jobs that could have been lost to other states and helps them keep and grow companies in their area. An important fact is that a significant amount of the tax money is used in blighted and economic depressed areas. The tax not only benefits a community by generating business and job creation but also by revitalizing blighted areas. In Rockwall a majority of the money is spent on businesses located in enterprise zones. She stressed a vast majority of the 490 cities are using the tax like the voters and Legislature envisioned.

Crouch warned the Legislature must also ensure that the Section 4A and 4B taxes are always separate and dedicated economic development funds. As a city official and an economic development professional, she has heard of proposals of rolling those funds into the general operating account of cities. She warned that Texas would lose a vital economic development tool which would hamper economic development efforts if that ever happened.

Allison Thompson, Economic Development Director for the City of White Settlement, supports using Section 4A and 4B dollars for retail development projects. She said that using the tax incentives for retail projects is essential for and a major component of the economic development of many communities. In her opinion retail establishments mean jobs to many smaller communities that do not have the ability to attract major manufacturing facilities. Smaller communities view all jobs to the area as new and expanding job opportunities. She used the departure of Kmart from White Settlement as an example. When they left she went to the neighboring Walmart and asked them what they wanted to see in the now vacant structure. They supported bringing in another retail facility that would compete with them so that the area continued to be a retail destination. Thompson added that although direct tax incentives are awarded to retail establishments, most of the tax dollars used for retail are targeted at funding for infrastructure such as roads and sewer projects to lure developers to establish retail facilities such as malls.

Michael Bourn, Executive Director of the Amarillo Economic Development Corporation, testified that Section 4A and 4B proceeds should not be used as direct retail incentives. He stated that retail facilities locate where they do due to economic factors such as the financial growth of the area. When incentive monies are used to attract retail the only side benefitting is the retailer since they would not be located in the area if they did not think they would make a profit. He stressed that retail does not bring in new money to the area but instead lives off the money that is already there. A previous legislative change in the Section 4A law created confusion and some communities viewed it as a means to use the tax to provide retail incentives when that was never the intent. The question now is do we allow it to continue to happen or do we tighten up the law to clarify that the tax can be used to fund infrastructure to attract retail establishments and not as a direct retail incentive? He said there is a diversity of opinion and its usually between small and large communities. Bourn added that a direct incentive should be limited to primary and basic employers that create jobs and grow the economy. Retail establishments will come if the market is there for them to succeed. He recommended that if a corporation wanted to give a retail incentive they should perform a competitive analysis to ensure that existing retail operators are not harmed and then have a referendum. This would leave the decision at the local level.

Danny Booth, President of the Terrell Chamber of Commerce and Chair of the Texas Economic Development Council (TEDC), stated TEDC does not support the use of Section 4A and 4B taxes to support incentives that are awarded directly to retail establishments. However, they do support the use of the taxes for infrastructure that compliments a major retail development project. For example, a Tanger Outlet Mall moved into Terrell after considering other Texas cities. Terrell did not give them a direct incentive but did fund infrastructure that was necessary for the mall project to locate in the city. By doing so, Terrell was able to open up more properties to further development in the vicinity of the mall. He said last year the mall took in $40 million which benefitted the sales tax coffers of the city and state. Furthermore, the mall brings in people from outside that state since 30% of their revenues are from Louisiana shoppers.

The committee also received written testimony suggesting that a percentage of the tax collected be set aside to assist existing or new small businesses in the local community. The argument was that some communities hold on to the tax dollars to lure large companies when there are existing businesses in the community that could grow and expand with some assistance.

CONCLUSION

The Development Corporation Act of 1979, with the enactment of the Section 4A and 4B economic development tax, has been the primary local revenue source for economic development. Cities value the ability to raise local economic development tax dollars to fund projects that attract businesses and create jobs. It is an important source of revenue that encourages economic development throughout Texas. This has lead to successive increases in the number economic development corporations established to pursue local development projects. In FY 2000 there were 490 corporations and that number increased by 34 in FY 2001 to 524. Sales tax revenues in FY 2000 totaled $285 million and rose to $324 million in FY 2001.[19]

The strength of the Section 4A and 4B economic development sales tax rests in the fact that revenues are controlled locally and projects are funded through local determination. It has proven to be a local economic development driving force that is supported by cities and economic development professionals. However, it has certain limitations for smaller communities that are not able to raise significant amounts of sales tax revenues to engage in projects of substantial scope. This has lead to the debate whether the use of funds for direct retail incentives, used by small communities, are within the spirit of the law. Certain small cities have determined that retail establishments mean jobs and a sales tax source to them and have used their economic development tax dollars for retail incentives. Most economic development professionals believe, when retail projects are considered, the law should be limited to luring or assisting in the development of a retail project through infrastructure improvements instead. Unless the law is clarified to clearly state that funds cannot be used for direct retail incentives, certain cities will no doubt continue to use it for those purposes.

To date the any changes to the Development Corporation Act of 1979 have generated much interest and concern. The last significant changes came about when the economic sales tax law was amended to add sports facilities and job training as qualified projects. The economic development sales tax is an important source of revenue for cities, successfully assisting them to encourage business development in their communities. It has been a vital economic development tool and any modifications to the law should be approached with the aim at promoting its strengths and ensuring continued local control.

RECOMMENDATIONS TO THE 78TH TEXAS LEGISLATURE

1. The Legislature should work to protect the current status of the Development Corporation Act of 1979 and oppose efforts to modify the law in a way that would reduce local control of tax dollars. However, the Legislature should continue to investigate the use of tax dollars for direct retail incentives to ensure the use of the tax is not detrimental to existing businesses in a community.

2. The Legislature should continue to monitor the progression of the economic development sales tax seminars which are held throughout the state for municipalities and counties that have created economic development corporations and evaluate their effectiveness in providing information on the tax and its administration.

CHARGE THREE

ACTIVELY MONITOR THE STATUS OF THE UNEMPLOYMENT COMPENSATION TRUST FUND. STUDY THE MECHANISMS IN CURRENT LAW DESIGNED TO

KEEP THE FUND BALANCE IN THE DESIRED RANGE. REVIEW PRACTICES IN OTHER STATES TO ASSESS WHETHER THE EFFECTIVENESS AND FAIRNESS OF THE SYSTEM MIGHT BE IMPROVED.

COMMITTEE WORK

The House Committee on Economic Development held two hearings to discuss Interim Charge #3. These included Austin on February 5, 2002 and Austin on August 27, 2002.

BACKGROUND

The Unemployment Insurance (UI) program is a federally funded program created under the Social Security Act. The UI program is administered through revenues collected in accordance with the Federal Unemployment Tax Act (FUTA) which are federal unemployment taxes paid annually by employers to the Internal Revenue Service. The FUTA tax paid by employers is set at 6.2% of the first $7,000 in wages paid to each employee. If employers pay their taxes on time, FUTA provides for a credit of 5.8% against the federal unemployment tax they paid, leaving a FUTA tax of 0.8% of taxable wages. So long as the state remains in conformity with FUTA mandates as determined by the U.S. Department of Labor (DOL), Texas employers would continue to receive the full offset credit. However, if DOL deems the state to be not in conformity, the credit can be withdrawn, causing employers to pay the full 6.2% tax rate. Proper maintenance of the UI Trust Fund and its solvency are critical factors for conformity.

The Texas Workforce Commission (TWC) assesses and collects a payroll tax from employers which is then deposited in the Unemployment Insurance Trust Fund, the fund from which unemployment benefits are paid to unemployed workers who have lost their jobs through no fault of their own. The general tax rate paid by each employer is experienced based with the tax rate determined significantly by the amount of UI benefits paid to former employees. The other factors determining the UI tax are the Replenishment Tax and, possibly at certain times the Deficit Tax. The UI Trust Fund balance must be above the defined floor or minimum allowable balance on October 1 of each year. Should the UI Trust Fund balance fall below the floor, the Deficit Tax is triggered and imposed on employers the following year.

General Tax

In order to avoid dramatic shifts in benefits paid by employers, the experience used to determine benefits involves the prior three years of taxable wages and benefits paid to former employees. This is an important part of the General Tax Rate. Employers who have their accounts charged due to a history of paying unemployment insurance claims are accessed a General Tax Rate (GTR).[20] It is computed on October 1 of each year to be assessed during the next calendar year. The rate is arrived at by multiplying the Benefit Ratio by the Replenishment Ratio. The benefit ratio is determined by take a three year history of chargebacks to an employers account and dividing it by the last three years of taxable wages paid to employees. If the employer has no history of chargebacks in the last three years, the general tax is zero. For 2002, the minimum tax rate is 0.30% and the maximum tax rate is 6.54%, while the average tax rate is 0.85%.

$$\textit{GTR} = \textit{Benefit Ratio} \times \textit{Replenishment Ratio}$$

$$\textit{Benefit Ratio} = \frac{\textit{last three years of chargebacks}}{\textit{last three years of taxable wages}}$$

$$\textit{Replenishment Ratio} = \textit{1/2 of benefits paid but not charged to any employer}$$

Replenishment Tax

The Replenishment Tax Rate (RTR) is a flat tax imposed on all experience employers which is used to replenish the UI Trust Fund for half of all the benefits paid to unemployed workers that are not charged to a specific employer. The RTR was created in order to ensure that UI funds were recouped when no employer was linked to the benefits paid out . The responsibility is spread out among all employers with established UI history.[21]

$$\textit{RTR} = \frac{\textit{One-half benefits but not charged to any employer}}{\textit{One Year's Total Taxable Wages}}$$

Deficit Tax

The third possible component of an employer's tax rate is the Deficit Tax Rate (DTR). Employers will pay this additional tax in 2003 due to the UI Trust Fund level falling below the statutorily established floor of $785.6 million. The last time employers paid a Deficit Tax was in 1995. The purpose of the Deficit Tax is to bring the UI Trust Fund balance back to the minimum reserve level or floor and goes into effect when the trust fund balance is below the floor on October of the previous year. The Deficit Tax Rate is calculated by taking the deficit ratio multiplied by an employer's UI tax rate from the previous year. The Deficit Ratio is determined by taking the UI Trust Fund deficit on October 1 and dividing it by the revenue from the general and replenishment tax from the previous year.[22] TWC's 2003 estimated UI Deficit Ratio is 0.55. However, the TUCA provides that the maximum Deficit Tax rate is capped at 2.00%. Any employer with a Prior Year Rate (PYR) of 3.63% or higher in 2002 would have to pay the maximum Deficit Tax in 2003. An employer paying the minimum General Tax Rate of 0.30% would pay an additional 0.17% as a Deficit Tax Rate. The average Deficit Tax Rate is 0.47%.

$$DTR = DR \times \text{Employer's Prior Year Rate}$$

$$DR = \frac{\text{UI Trust Fund deficit on October 1}}{\text{\$ from General and Replenishment Tax from the Previous Year}}$$

Initial Tax

Employers new to the Unemployment Compensation Trust Fund pay an initial tax rate of 2.7% on the first $9000 paid to each employee usually for18 months. This initial rate is assigned to new employers to the point they become eligible for the General Tax Rate which happens as soon as a claim is made against an employer's account through one year.

Solvency of the UI Trust Fund

The UI Trust Fund's solvency is determined each year on October 1. The UI Trust Fund floor is equal to the greater of $400 million or 1% of the total taxable wages for four calendar quarters ending the preceding June 30. As of June 30, 2002, the Trust Fund floor was set at $785.6 million. The UI Trust Fund Ceiling is equal to 2% of the total taxable wages for the four calendar years ending the preceding June 30. Due to the narrow range between the ceiling and floor, Texas ranks 53rd among all states and territories in adequacy of trust fund reserves as determined by reserves relative to taxable wages.[23]

In previous years, TWC was also charged with collecting the Smart Jobs Assessment of 0.1% or 1/10th of 1% of taxes paid by employers and deposited into the Smart Jobs Fund, the fund from which the Smart Jobs training program was operated. The Smart Job Assessment is no longer collected as it was due to expire on December 31, 2001 and was not continued by the Legislature. TWC estimates removing the 0.1% assessment returned $75 to $80 million to the UI Trust Fund.[24]

The unique partnership between states and the federal government was initiated in 1935. It was designed to be "counter-cyclical," to accumulate and hold significant funds during good economic times and pay out benefits when businesses laid off workers in bad economic times and simultaneously stimulate a lagging economy.[25] The national UI program serves a dual purpose, stabilizing the economy during economic recessions and serving as a "safety net" of income for employees who lose their jobs. However, layoffs are straining state UI funds nationally and testing this safety net for the first time since welfare reform policies were implemented.[26] Governing Magazine reports that Texas' reserves are the lowest than any other state in the county.[27] While some states such as New Mexico and Vermont reported reserves of two or more years in early 2002, Texas, New York and Illinois had less than six months remaining. The policy in Texas is to intentionally keep their unemployment reserves low during good years and cope with shortfalls in the UI Trust Fund when they occur. The accepted economic philosophy is its better to have money circulating in the economy working for businesses than to have it accumulating in the Trust Fund. This policy is readily endorsed by the business sector. However, experience with the current UI fund balance and economic downturn may prove that keeping the trust fund balance so low may also be detrimental to a stagnant economy.

Texas has a history of working to keep the fund solvent. In 1983, the UI tax structure was changed by raising the floor and ceiling, and creating a temporary solvency tax and a permanent deficit tax to move the fund back to the floor. When the fund balance goes beyond the ceiling a surplus tax credit is given to employers. Using the Deficit Tax and the surplus tax credit, a range for the floor was established. It can be adjusted if the fund is beyond the floor or the ceiling. In 1987, the taxable wage base was raised to its current level of up to $9000 paid to each employee and, since then, no major changes have been made to the method taxes or benefits are determined.

However, the Deficit Tax has been implemented before and used in good economic times while a tax credit has been returned to employers when times were bad. This is due to the narrow range between the ceiling and floor. In 1994 and 1995 when the economy was strong, a Deficit Tax was implemented. Conversely, in 1991 and 1992 when the economy was sluggish, approximately $300 million was returned to employers. In fact, a surplus credit or Deficit Tax was trigger ten times between the twelve year period of 1984 to 1995.

Current UI Trust Fund Status

The status of the UI Trust Fund reached a tenuous point in 2002. On October 1, the UI Trust Fund fell below the floor by approximately $539.9 million. As previously explained, this means that Texas experienced employers will pay a Deficit Tax not to exceed 2.0% for 2003. During the House Committee on Economic Development hearing on August 27, 2002, Cassie Carlson Reed, Executive Director of the Texas Workforce Commission, provided testimony projecting what the state is currently experiencing. The following is her testimony on the status of the UI Trust Fund and explanation of the Deficit Tax Rate for 2003.[28]

TWC performed a floor test on the UI Trust Fund in August 2002 and determined by October 1, the fund would have $225.7 million in reserves placing the it $539.9 million below the floor of $765.6 million. The floor is determined by the total of 1% of taxable wages paid by employers for four quarters ending June 2002. A balance amount below the floor value on October 1 automatically triggers a Deficit Tax for 2003.

Reed testified the UI Trust Fund would be much lower below the floor, possibly double the current amount, if Texas would not have gotten a federal transfer of $596 million in March 2002 under the Reed Act. This redistribution to the states happens when the federal UI Trust Fund reaches its cap. A total of $8 billion was redistributed nationally, with Texas receiving $596 million. The March allotment passed by Congress was part of the President's economic stimulus package.

Texas is paying $44 million of benefits each week and $200 million per month. It was estimated that at that rate the trust fund balance would be zero in November or early December. Once that happens Texas would be required to borrow from the U.S. Treasury to pay benefits. Reed projected the need to borrow through April 2003, after which the tax receipts would come in from employers in the 2nd quarter, making the UI Trust Fund solvent again. The Deficit Tax would be indicated in employers' tax statements which are mailed in December. She added that TWC Chairman Diane Rath would request loan from the Department of Labor.

Reed explained the loan works as a line of credit which allows Texas to borrow what is required to pay employee benefits for that day. When TWC receives tax receipts in April during the 2nd quarter, she stressed Texas will repay the U.S. Treasury everything that is owed. However, she warned that Texas may have to borrow again in late 2003 and the cycle may repeat itself.

She reiterated that because the UI Trust Fund will be below the floor a Deficit Tax will be triggered in 2003. The average Deficit Tax Rate is a minimum of 0.17% to a maximum of 2.0% with the average rate of 0.47%. Any employer with a Prior Year Rate of 3.63% or higher will have to pay a maximum tax of rate of 2.0%.

The projected 2003 yearly cost of the Deficit Tax per employee will average $42.30. The minimum cost of the tax, applicable to those with no layoffs, is projected at $15.30 per employee. An estimated $180 per employee is the cost for those employees with a Prior Year Rate of 3.63% or above. The deficit ratio for 2003 is set at .055 which is the amount which the trust fund is below floor divided by the UI general and replenishment tax revenues.

Legislation from the 77th Legislature: HB 2086

An attempt was made during the 77th Legislative Session to increase revenues into the UI Trust Fund and improve its solvency by gradually increasing the taxable wage base $1000 per year from $9000 to $12,000 by 2004. The taxable wage base is a key component of an employer's tax payment and was set at $9000 by the Legislature in 1987. An employer's tax rate is applied to the first $9000 of an employee's wages. In 2001, the House Committee on Economic Development passed House Bill 2086 by Rep. Ken Yarbrough to deal with the issue of solvency. The measure was sent to the full House where it failed to pass to engrossment by a vote of 63 yeas, 75 nays and 2 present not voting.

An increase in the taxable wage base was considered to provide for a safer UI system and help protect the UI Trust Fund. It was argued that a gradual increase of the wage base over a three-year period would help to gradually introduce a tax increase to employers. The goal was to insure that the UI Trust Fund had enough funds to cover unemployment compensation payments and to prevent a deficit tax from being imposed on all experience-rates Texas employers. Since 1988, the average UI payroll tax on employers has fallen significantly, form 1.39 percent of total wages to only 0.37 percent in

1999, costing the trust fund hundreds of millions of dollars. Rep. Yarbrough stressed that raising the taxable wage base then, before the economy entered a recession would be more prudent economic policy than forcing employers to pay a Deficit Tax while the economy was week. Moreover, if the fund was ever insufficient to cover unemployment compensation payments, the state would have to borrow the funds to cover its needs from the federal government with interest. If the taxable wage base was gradually raised to $12,000 by 2004, Texas would be up to the national average in UI Trust Fund solvency. Also, it would have generated more than $182 million for the trust fund in FY 2002-03 and ensured that Texas would not have to impose a deficit tax on employers or borrow money.

Opponents to HB 2086 argued that the bill would have increased taxes by one-third on Texas employers to cover a deficit that might not occur. They stressed that the Deficit Tax, which was designed specifically to replenish the fund which it fall below the floor, is the better mechanism for generating money for the fund and would be easier for business to bear than a permanent tax increase.

CONCLUSION

The UI tax system is a significant component of Texas economic policy. Affecting employers, employees and the economy as a whole, its proper operation and balance status are indicative of the state's business and social policy climate. The UI Trust Fund is the funding source to pay unemployment benefits to unemployed, eligible workers who lose their jobs through no fault of their own. The House Committee on Economic Development has been charged with monitoring the status of the unemployment insurance compensation fund for the past three legislative interims. Comprehensive analyses have been performed on the UI Trust Fund by the committee in its Interim Reports to the 76th and 77th Legislatures, detailing the complexities of the system and mechanisms that are used to formulate tax rates and benefit payments.[29] However, unlike the previous two Legislatures, the 78th Legislature will encounter a UI System in a precarious situation, one that has fallen below its statutory floor and operating with a Deficit Tax on employers.

The major policy issue confronting the UI Trust Fund system and the Legislature is solvency. The 78th Legislature will consider whether statutory changes need to be implemented to ensure greater solvency in the UI Trust Fund or whether the Deficit Tax, as a correctiive mechanism, is the favored tool in order to ensure the UI Trust Fund is raised above the statutory floor when reserves have dipped below it.

Solvency varies from state to state and it is a policy issue which Texas grapples with. Currently, Texas ranks 53rd in among states and territories for fund solvency. The UI Trust Fund system is designed to keep the amount of reserves fluctuating. After all, the policy in Texas has been to keep the UI general tax rate low to allow money to work in the economy instead of taking it from employers and having it sitting in the UI Trust Fund reserves.

The realistic options available are to decrease outflow from the fund or to increase revenue to the fund. There are vocal proponents on either side. Changes could be made to decrease payments from the fund by requiring those unemployed to find work more expeditiously, increase the investigation of ineligible claimants, and step up collection of claim overpayments. Other changes can increase revenues to the fund such as raising tax rates, increasing the taxable wage base, and increasing the collections from delinquent tax payers.

RECOMMENDATIONS TO THE 78TH TEXAS LEGISLATURE

The Legislature should continue to monitor the status of the Unemployment Compensation Trust Fund.

CHARGE FOUR

ACTIVELY MONITOR THE AGENCIES UNDER THE COMMITTEE'S JURISDICTION.

COMMITTEE WORK

The House Committee on Economic Development held two hearings to discuss Interim Charge #4. These included Austin on February 5, 2002 and Austin on August 27, 2002.

BACKGROUND

Throughout the 77th Legislative interim, the committee monitored Texas Department of Economic Development, Texas Workforce Commission, Texas Council on Workforce and Economic Competitiveness, and Texas Aerospace Commission.

RECOMMENDATIONS

The committee does not have any recommendations at this time regarding the agencies under its jurisdiction since they are currently going through the Sunset review process.

ENDNOTES

ENDNOTES

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