Testimony of Stephen Herzenberg, Keystone Research Center, on House Bill 2340 and Senate Bill 1279 "The Economic Development and Fiscal Accountability Act"

Joint Hearing of the Senate Community, Economic, and Recreational Development Committee and the House Finance Committee

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My name is Stephen Herzenberg. I hold a PhD in economics from the Massachusetts Institute of Technology. I am also the Executive Director of the Keystone Research Center, the mission of which is to promote a more prosperous and equitable Pennsylvania.

I appreciate the opportunity to testify this morning before this joint hearing of the Senate Community, Economic, and Recreational Development Committee and the House Finance Committee.

Let me begin by thanking Senator Pat Browne, Representative David Levdansky, and Senator Jane Earll for their leadership on the issues of economic development transparency and accountability.

My testimony divides into three parts. The first part underscores the objective need to strengthen economic development accountability and transparency. The second presents evidence that Pennsylvania has an opportunity to build on a strong position, relative to other states, when it comes to disclosure and also when it comes to smart targeting of business subsidies to places that make sense. The third part of this testimony addresses some of the differences that remain regarding accountability legislation. Given the level of consensus that exists on the substantive issues at the heart of the two bills under discussion today, the Pennsylvania legislature has an opportunity to enact reforms that would make Pennsylvania a national model in the area of economic development and accountability.

The Need to Strengthen Economic Development Accountability.
Accountability needs to be strengthened because it is not currently adequate. To establish this, Keystone Research Center reviewed the current state of accountability in a report released in March (*Good Jobs, Strong Industries, a Better Pennsylvania: Towards a 21st Century State Economic Development Strategy*, online at http://keystoneresearch.org/sites/keystoneresearch.org/files/KRC2010report_0.pdf).

For nine major Pennsylvania business subsidy programs, pages 31 to 33 of *Good Jobs, Stronger Industries* consider three dimensions of accountability: (1) transparency and disclosure, (2) post-grant monitoring, and (3) "recapture" provisions. (Recapture—or "clawback"—provisions require companies to repay all or part of a subsidy if they fail to deliver on up-front job creation and wage commitments.)

Improved disclosure is essential because it makes it possible for citizens and researchers to see how public subsidies are being used and to analyze whether this distribution makes sense. The current state of disclosure makes it impossible to tell whether Pennsylvania's subsidies are targeted sensibly based on place, job quality, and industry. That is, we cannot determine whether subsidies

- go to locations that use existing infrastructure and are accessible to high unemployment communities where people most need jobs;
- result in creation of decent-paying jobs; or
- are awarded to businesses in industries that make sense—i.e., to industries within which regions have a realistic possibility to enhance competitive strength and increase self-sustaining job growth without further subsidies.

With regard to post-grant monitoring (e.g., do companies actually create promised jobs?) and to the adequacy of recapture provisions, our review relies on recent reports by the Legislative Budget and Finance Committee and the Auditor General. These reports documented a need for better monitoring and increased recapture.

To its credit, the Department of Community and Economic Development has demonstrated an internal commitment to improving post-grant monitoring and, in the case of the one program for which data exist (the Opportunity Grant program), has increased recapture of money from companies that fail to create promised jobs. (Whether recapture from other programs has also increased we do not know because of a lack of information.)

Pennsylvania Can Build on Strength to Become a National Leader in Economic Development Accountability and Smart Targeting of Subsidies. While Pennsylvania needs to strengthen accountability, it is important to note that the starting point for greater accountability is significantly better than average. Both the Ridge and the Rendell Administrations deserve credit for this.

Good Jobs First, the national nonprofit clearinghouse on subsidy accountability, ranks Pennsylvania 12th in the nation for online business subsidy disclosure. (The specific criteria used by Good Jobs First to evaluate public information online were searchability, level of detail, and thoroughness.) Pennsylvania does well compared to other states because of the online "Investment Tracker" database, established during the Ridge Administration and maintained by the Rendell Administration. The Investment Tracker reports all state subsidies, the name of the applicant for assistance, the county, jobs existing, jobs pledged, and award amounts. To upgrade the Investment Tracker and make it a "best in class" disclosure tool the state needs to add information on the address of the business site, the industry of the company, whether companies actually created jobs, and job quality (wages and whether the company provides health benefits). It is also important that DCED upload the enhanced information in a way that can be easily downloaded into a data set by researchers.

In discussions with current and past DCED officials, it has been suggested that most of the additional information needed already exists in DCED's internal data bases. If so, that is great news. It has also been suggested that the key information could be captured through modest modifications to the single application for economic development assistance created by DCED in the mid-1990s. If an online single application could be kept live for companies awarded subsidies, the same form could be used to provide information on jobs created and wages one year, two years, and three years following distribution of funds. (A variant of the same online tool could help localities comply with improved disclosure requirements.) The gist of these conversations is that DCED is already within shouting distance of being able to provide national model disclosure and transparency for its economic development programs.

Pennsylvania is also poised to become a national leader in smart targeting of economic development subsidies. Last week, Keystone Research Center released a report that documented increasingly smart targeting of business subsidies from three major Pennsylvania business subsidy programs.[1] Based on extensive interviews, we attribute the greater focusing of subsidies on older Pennsylvania towns (including boroughs), inner suburbs, and cities to both local economic developers and to state government's 2005 adoption of the Keystone Principles (see p. 17 of *Making Smarter Investments*).

The accountability bills would provide transparency and data that reinforce the well-established movement to smart targeting of subsidies within the Pennsylvania economic development community. Greater disclosure makes it easier for economic developers to push back on subsidies that don't fit with their regional economic strategies and with land-use plans—disclosure makes it easier to say "no" because all the "yeses" will be subject to more systematic scrutiny.

Reconcilable Differences. We think that today's hearings will further demonstrate broad support for greater economic development accountability across partisan and stakeholder lines. For example, written testimony in support of accountability today is being provided by conservative (the Allegheny Institute) and progressive think tanks (KRC), environmental and smart growth groups, labor and, I believe, the planning community.

Furthermore, support for the *goals of* greater transparency and disclosure is nearly universal.

We are aware of three concerns about the accountability bills entering today's hearings. First, I believe there are some misconceptions that the bills contain "prevailing wage" provisions. They don't. The bills contain wage standards that aim to ensure that subsidies not go to companies that pay poorly by the standards of their industry in the place where they locate. Most companies don't get subsidies. Why would we want to distribute subsidies to companies in the lower end of the wage distribution? (Although I don't have time to elaborate the point, these companies are the least likely to contribute to innovation and self-sustaining industry growth.)

[1] See Maria Cristina Herrera, Stephen Herzenberg, and Michael Wood (2010), *Marking Smarter State Investments: The Geographic Distribution of Business Subsidies in Pennsylvania*, Harrisburg, PA: Keystone Research Center, online at http://keystoneresearch.org/sites/keystoneresearch.org/files/MakingSmarterStateInvestments.pdf).

Second, I believe there are some concerns about disclosing company-specific information based on the idea that this would negatively impact companies' competitiveness. I don't yet understand this argument. Moreover, this information is only being disclosed for companies that receive public subsidies. That said, the policy issue that drives the need for wage data relates to the desire to find out whether go to companies that pay poorly by the standards of their industry. Compromises might be explored on this whereby DCED has to collect the information and make it available in response to right-to-know requests but where what is publicly disclosed in data online is not company-specific.

Third, I understand DCED has concerns about the cost of implementing the accountability bills. Clearly, every opportunity should be pursued to implement better disclosure and reporting as efficiently as possible. Since better disclosure mostly requires refining the existing single application and Investment Tracker, the cost after initial implementation should be very low. Bottom line, before recent cuts, Pennsylvania spent an estimated $300 million per year on subsidies for individual businesses. We need to spend a fraction of one percent of that money to ensure adequate disclosure and accountability.