Office of the City Attorney

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TO: **Mayor Jordan**
City Council

CC: **Don Marr**, Chief of Staff
Paul Becker, Finance Director
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FROM: **Kit Williams**, City Attorney

DATE: **March 9, 2016**

RE: **Using Public Funds for Private Economic Development**

Currently the *Arkansas Constitution* has several provisions blocking cities' power to give tax payer money to private corporations for "economic development." For example, *Article 12 § 5* **Political subdivision not to become stockholders in or lend credit to private corporations**.

> "No county, city, town or other municipal corporation, shall become a stockholder in any company, association, or corporation; or obtain or appropriate money for, or loan its credit to, any corporation, association, institution or individual."

This section was part of the 1876 *Arkansas Constitution* enacted by the people to prevent a repeat of the financial problems that Arkansas cities had created for themselves by using tax dollars for economic development and other "schemes", many of which went bust and left taxpayers "holding the bag." These economic development schemes continue to be a problem on the state level. Please see attached an excellent column entitled "Taking a gamble – Use of public funds risky business" published in Monday's *Northwest Arkansas Democrat Gazette*.

Another similar prohibition against a city "lending its credit" is found in *Article 16 § 1* "Neither the State nor any city, county, town or other municipality in this State shall ever lend its credit for any purpose whatever; nor shall any county, city or town or municipality ever issue any interest bearing evidences of indebtedness…." This section has been changed by Amendment 62 to allow the issuance of bonds with voter approval and Amendment 65 authorizing revenue bonds which do not require voter approval unless proposed for economic development purposes. However, the general prohibition of a city using taxpayer revenue other than for governmental purposes such as building streets, water and sewer mains, paying city employees, buying city equipment, etc. currently remains in force. These limitations have protected cities' treasuries for almost a century and a half from the problems that occurred prior to 1876.

Another important Constitutional provision is found in *Article 6 § 11* **Levy and appropriation of taxes.**

> "No tax shall be levied except in pursuance of law, and every law imposing a tax shall state distinctly the object of the same; and no moneys arising from a tax levied for any purpose shall be used for any other purpose."

I used this Constitutional provision to successfully challenge and overturn the County Assessor's improper allocation of mills needed to support the TIF district bonds. A synopsis of this argument is printed in the Case Notes section following *Article 16 § 11.*

> "In a City's challenge to the County Assessor's allocation of millage rates, the Assessor was incorrect to allocate more mills to a school district for purposes of the tax-increment financing formula than were passed by the voters because to do so would have violated *Ark. Const. art. XVI, § 11. City of Fayetteville v. Wash. County*, 369 Ark. 455, 255 S.W.3d 844 (2007)."

The Legislature has proposed a new Constitutional Amendment for the General Election ballot this November which would eviscerate and remove these long standing constitutional protections for city taxpayers. With strong backing from the State Chamber of Commerce and industrial developers, this proposal is likely to pass under the banner of "creating jobs." If so, Arkansas cities will likely be invited into bidding wars with each other for new "economic development" that we currently enjoy without opening the city's treasury and forcing our taxpayers to subsidize new development.

If this new constitutional provision passes, please remember Research Associate Jacob Bundrick's caution that the use of public funds for economic development is a "risky business." He ends his column:

> "When government officials use taxpayer money to bet on economic development projects, it is the taxpayers who carry the risk. Burdening Arkansas taxpayers with undue risk is poor public policy."

If the proposed constitutional amendment passes, next year's City Council will be faced with professionally designed economic development proposals with both promises of "clean energy," "good paying jobs," "increased tax revenue," etc. and threats to go elsewhere if taxpayer money is not handed over as an incentive to locate in Fayetteville. It will take a stiff backbone by our City Council members not to gamble taxpayer money on such economic development schemes that could (or could not) perform as advertised.

Taking a gamble

Use of public funds risky business

March 7, 2016

JACOB BUNDRICK
SPECIAL TO THE DEMOCRAT-GAZETTE

Guest writer

Funding economic-development projects with taxpayer money is a risk to Arkansans. Yet, politicians frequently do it.

Most recently, government officials committed to providing tax dollars to Energy Security Partners (ESP). The Economic Development Corporation of Jefferson County devoted more than $3.9 million to ESP. The company is also negotiating with the Arkansas Economic Development Commission for state incentives. With the public's money in hand, ESP plans to build a $3.7 billion industrial gas-to-liquids processing plant in Jefferson County. In return for their tax money, taxpayers can expect ESP to create 225 jobs that will pay an average wage of $40 per hour.

While projections may be enticing, using tax dollars to fund economic-development projects like ESP is no more than a gamble with public money.

In a recent *Talk Business & Politics* article, Mark Agee, vice president of business development at Emerging Fuels Technology, said there has been talk of gas-to-liquids projects in recent years, but large capital costs and volatile oil prices have halted them. Because the project makes more economic sense when natural gas is cheap and oil is expensive, fluctuating oil prices have made financing hard to come by.

Edward Osterwald, a partner at Competition Economists Group in London, added that building such a plant today is essentially "placing a bet" that natural gas will remain cheap while the price of oil will rise. But is gambling with taxpayer money really the best public policy?

The state of Arkansas has gambled and lost taxpayer money before. Government officials previously bet that the federal government would extend wind-energy tax credits and subsequently funded businesses in the wind industry. Nordex, a wind turbine manufacturer in Jonesboro, received more than $3.9 million in subsidies from the Governor's Quick Action Closing Fund. Beckmann Volmer, a steel company supplying turbine main frames to Nordex, received $1.5 million.

But less than three years after opening, Nordex ceased production in its Jonesboro plant, citing "the wind industry's global overcapacity and the continued uncertainty and instability of the U.S. market." Shortly after Nordex shut down operations, supplier Beckmann Volmer entered bankruptcy. Public officials lost their bet, but taxpayers lost their money.

Betting on economic-development projects with tax dollars equates to moral hazard. Moral hazard occurs when people engage in risky activities that they otherwise would not because they share the risk with others. Put more simply, people tend to take more risk when using someone else's money instead of their own.

Government officials are willing to place corporate-welfare bets on projects like Energy Security Partners because they are using taxpayer money rather than their own paychecks. If the bet fails, politicians do not lose, taxpayers do. Politicians are able to raise more "economic development" money through taxation, but taxpayers never see their lost tax dollars again.

Rather than taxing Arkansans to gamble with public money, the state should let the market decide which economic development projects are viable. If private investment is willing to finance an economic-development project, the state should let the market run its course. There is no need to spend tax dollars on corporate welfare when private money is willing to fund a business.

Furthermore, if private money is unwilling to finance a company, state and local governments should not either. The fact that private money will not fund a business should signal to government officials that the project is not a good investment. Ignoring this signal puts Arkansas taxpayers at risk.

Projections surrounding economic-development projects like Energy Security Partners are often alluring. But if these projects are good investments, private money will fund them without the help of corporate welfare.

When government officials use taxpayer money to bet on economic-development projects, it is the taxpayers who carry the risk. Burdening Arkansas taxpayers with undue risk is poor public policy.

Jacob Bundrick is a research associate with the Arkansas Center for Research in Economics (ACRE) at the University of Central Arkansas.

LETTERS