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Considering a "Deal Closing Fund" for Louisiana

INTRODUCTION

Responding to feedback from Louisiana's local, regional and state economic development professionals, Governor Foster has proposed the creation of a $25 million "deal closing fund." Also called the Louisiana Opportunity Fund, it would provide financial incentives in the form of infrastructure grants (e.g., access roads) to attract new companies to Louisiana; to encourage existing companies to expand here; and, potentially, to match competing offers from other states to keep companies here that are considering a move.

State officials contend that other states already have similar funds, which can be used to close deals in highly competitive negotiations for major new business investments (e.g., manufacturing sites) or expansions. These states can act quickly (in weeks or even days) to offer cash and/or infrastructure grants in situations that purportedly require incentives greater than a standard package. Louisiana, conversely, must wait for a legislative session in order to offer additional discretionary incentives–namely infrastructure grants–needed to close a deal in such situations.

Technically, Louisiana already has a deal closing fund in the form of its Economic Development Award Program (EDAP). However, its annual funding of approximately $5 million provides substantially less firepower than state officials desire. The Governor proposes to expand EDAP by adding $20 million of one-time funds out of capital outlay, dedicated to infrastructure grants, to be called the Louisiana Opportunity Fund.

This brief report examines the Governor's deal closing fund proposal, including a review of similar programs in other southern states, a brief look at the past performance of EDAP, and a discussion of problems associated with such programs. The report concludes with design recommendations for the proposed Louisiana Opportunity Fund, assuming the concept could become a perennial economic development instrument.

Deal Closing Funds in Other Southern States

A reasonable starting place for examining the merits of this proposal is to take a look at what other states in the South are doing. A deal closing fund may be defined as a discretionary incentive fund that can quickly commit cash and/or infrastructure grants to attract new business investment or in-state expansion of existing businesses in highly competitive bidding situations. Using this definition, the concept is fairly new in the South, with several states creating such funds in the last several years (e.g., Florida and Georgia). Various names have been used for deal closing funds nationally, for example: Governor's Opportunity Fund (Virginia), Sunny Day Fund (Maryland), and the Quick Action Closing Fund (Florida).

As a practical matter, however, several southern states have had deal closing funds for many years in the form of discretionary

TABLE 1
State-Level Deal Closing Funds in the South

State	Fund(s) Size/Year[1] (In Millions)	Fund(s) Size/Capita	Population[2] (In Millions)
North Carolina	$30.0	$3.7	8.2
LOUISIANA (Expanded EDAP, *Proposed*)[3]	**25.0**	**5.6**	**4.5**
Florida	21.5	1.3	16.4
South Carolina	18.0	4.4	4.1
Virginia	17.8	2.5	7.2
Georgia	13.0	1.6	8.4
Arkansas	6.3	2.3	2.7
LOUISIANA (EDAP)[3]	**5.0**	**1.1**	**4.5**
Mississippi	4.0	1.4	2.9
Tennessee	2.0	0.3	5.7
Alabama	–	–	4.5
Oklahoma	–	–	3.5
Texas[4]	–	–	21.3

1. Includes *estimates* of state deal closing funds and discretionary infrastructure funds used for cash and/or infrastructure grants in competitive bidding situations for new or expanding businesses. SOURCE: representatives of state economic development agencies and, in some cases, state departments of transportation, as well.
2. U.S. Census Bureau estimates, 2001.
3. Includes funding that has been (or might be) used for retention purposes and/or noncompetitive bidding situations.
4. Texas reportedly has several large deal closing funds supported by local economic development agencies.

infrastructure grant funds, sometimes housed in state departments of transportation, that are often employed in competitive bidding situations. Accordingly, Table 1 lists funding estimates of 12 southern states for *both* deal closing funds and discretionary infrastructure grant funds that exhibit deal closing fund characteristics. Most southern states have at least one or two such funds.

Because an expanded EDAP would display characteristics of both deal closing funds and discretionary infrastructure grant funds used in competitive bidding situations, the term "deal closing fund" will refer to both types for the remainder of this report.

Funding for these programs has varied dramatically by state over time. Florida's explicit deal closing fund, the Quick Action Closing Fund, was initially proposed at $50 million, was funded at $4 million, and is currently at $1.5 million. (Florida also has a discretionary infrastructure fund used only in competitive situations, the $20 million Economic Development Transportation Fund.) Conversely, the Virginia Governor's Opportunity Fund began at about $7.5 million in the early 1990s and has since been increased to approximately $15 million annually ($30 million per biennium).

Typically these funds have not been the principal tools used to land huge economic development projects like the Mercedes and Hyundai plants in Alabama or the Nissan plant in Mississippi. Rather the massive grants for these projects–in the hundreds of millions–were secured largely through regular and/or special sessions of each state's respective legislature. Mississippi, for example, authorized a special deal closing fund in 2000–the Ace Fund–but it has never been funded. The $4 million fund amount listed for Mississippi in Table 1 represents the estimated competitive portion of three separate infrastructure grant programs.

Interestingly, Texas, which is typically considered one of Louisiana's principal competitors for economic development projects, has no deal closing fund or discretionary infrastructure fund at the state level. This may be misleading, however, as there are reportedly several large, local deal closing funds in the state. Other states, too, probably have local or regional deal closing funds financed through various means; therefore, examining only state-level funds provides an incomplete picture. For example, North Carolina has seven regional economic development partnerships, quasi-public entities that receive money from the state (as well as from local government and the private sector), some of which is used for incentive funds. Louisiana's tax system, with its relatively high homestead exemption and sales taxes, significantly constricts the ability of local economic development agencies to raise substantial deal closing funds of their own. Nevertheless, at least two parishes in Louisiana have developed modest deal closing funds financed with local dollars.

Deal closing fund structures and funding guidelines vary dramatically from state to state. While it is difficult to draw generalities about their designs, some features are fairly common as illustrated in Table 2.

Some states, such as Georgia and North Carolina, have one or more funds specifically targeted at poor and/or urban communities, whereas other states, such as Mississippi, target specific industry sectors. Most of the southern states do not have restrictions for industry or location with respect to their deal closing funds.

Judging from the range of deal closing funds of these other states, Louisiana currently may have a competitive disadvantage in certain bidding situations. This potential disadvantage is probably less related to the size of available grants from EDAP–most competitive grants are comparable to or smaller than past EDAP grants (see next section)–and more related to the total amount of funding available, which may limit the number of deals for which such funds can be employed.

Not included in this comparison are various funds in other states that have been established to provide *cash* grants for new or expanding companies based on the number of new jobs and/or total investment, but are not explicitly for competitive bidding situations (thus they are not really deal closing funds). Examples of these funds include Virginia's Investment Partnership Grant Fund and Florida's High-Impact Sector Performance Grants. Grants from these funds can be in the millions of dollars so, in some cases, they may minimize the importance of incentives provided by state deal closing funds.

TABLE 2
Common Features of State Deal Closing Funds in the South

Eligibility	• Grants generally restricted to new or expanding businesses in competitive bidding situations • A few states provide retention grants on a limited basis
Incentive Form	• Grant to local government entity for enticing a particular company to locate or expand there • Assets typically remain owned by local government entity
Use of Funds	• Basic infrastructure (e.g., access roads or rail spurs), site preparation, and sometimes buildings and/or machinery and equipment • Cash awards rarely allowed
Award Criteria	• Number of jobs created, average wage level, amount of investment • Matching by local government entity required or strongly encouraged
Grant Amount	• Most grants under $500,000; few over $1 million • Funds have maximum grant amounts per project ($150,000 is most common) and/or per new job, and/or limits derived from projected state and/or local tax impact
Governance	• Most formal decisions made internally by state economic development agency (which may be a quasi-public entity) and/or state department of transportation • Some decision processes involve governor for a tentative commitment and/or final approval
Contract	• Varies widely; some states employ contracts (or at least memorandums of understanding) specifying number of jobs, average wages, and/or investment and timeline • Clawbacks (penalties for nonperformance) implied or specified
Timing	• Application to approval takes less than one month • For highly attractive projects, tentative commitments often made in just a few days (and sometimes hours)

EDAP: Louisiana's Existing Deal Closing Fund

Prior to approving a major increase in funding for EDAP in order to create the Louisiana Opportunity Fund, lawmakers should carefully consider EDAP's past results. First created in 1995, EDAP has gone through a number of administrative and structural changes. For most of its life, grant awards required the approval of the Joint Legislative Committee on the Budget; however, this requirement was removed in the 2001 legislative session to allow decisions to be made more quickly. Fund decisions can now be made in one to two weeks, which is equivalent to or better than the standard process for deal closing funds in most southern states. EDAP is now controlled by the Louisiana Economic Development Corporation (LEDC), a 12-member board that reviews loans, grants, and incentive programs administered by the Department of Economic Development (DED). Its members include the Secretary of the DED and 11 gubernatorial appointees.

In its first five years of funding (FY 1997-2001), EDAP made 52 awards totaling $25 million, averaging $475,000 per grant award. These awards were made in the form of grants (46), loans (2), and legislative line items (4). Awards during this period ranged from $10,000 to $3.25 million, and about 75% of them were between $100,000 and $600,000. Typically, awards have been made for access roads/rail, site acquisition and preparation, construction expenses, buildings, and capital equipment. The largest award, $3.25 million (for the Navy's Information Technology Center at the University of New Orleans), was made by legislative line item appropriation. The largest EDAP *grant* award made using the normal application process was a $1.3 million grant for Patout Equipment, a sugar cane processor located in Iberia Parish.

According to DED records, grant awards during this five-year period contributed to the retention of 6,790 jobs and to the creation of 5,666, which suggests the fund has been used as more of a retention tool than a job creation tool. This is not surprising because at least 60% of the recipient firms were already located in Louisiana when they were awarded EDAP grants. Considering only grant awards (excluding loans and legislative line items), EDAP has awarded an average of about $2,000 per new or retained job, but awards ranged from about $190 to $75,000 per job.

A troubling fact about past EDAP grant awards is that the average wages of the new permanent jobs they helped to create have declined markedly in the last three years. After reaching a high of nearly $32,000 in FY 1999, the average wage level for new jobs associated with each grant award dropped to less than $19,000 in FY 2000 and less than $18,000 in FY 2001. These wage levels compare poorly with Louisiana's 2000 per capita income of $23,041. Of course, a more complete judgement of wage rates would require comparisons on a parish-specific basis. Fortunately, new jobs associated with the first seven EDAP grants made so far in the current fiscal year have improved somewhat to about $21,200 on average; most of these jobs appear to exhibit wages above their associated parish-specific per capita averages.

To some degree, these relatively poor wage levels may reflect the fact that knowledge-intensive firms (e.g., high tech companies) do not select sites based on the lowest cost as do firms primarily employing low-skilled labor (e.g., light manufacturing facilities or call centers). Instead, these firms value the presence of advanced factors such as a critical mass of highly educated talent, specialized university research and development facilities, and access to key customers and suppliers–financial incentives will not attract them if these factors are not available. If this explanation for the low wage levels is correct, it suggests that even an expanded fund will face difficulty securing the kinds of jobs Louisiana would most like to attract.

Problems with Discretionary Incentive Funds

While an expanded deal closing fund for economic development may help the state win certain competitive bidding situations in the future, it also raises several significant concerns:

1. Deal closing funds are somewhat contradictory to the cluster-based strategy adopted by the DED.

A cluster may be defined as a geographic concentration of interrelated competitors, suppliers, customers, related industries, and supporting institutions (e.g., university research centers and trade organizations), each focused in whole or in part on a narrow product category such as software or wine. Examples include medical devices in Boston, semiconductors in Austin, or data storage in San Jose. Research has shown that the long-term success of export-oriented firms (i.e., those serving customers outside of their immediate region or state) is highly correlated with the vibrancy and size of their home base clusters. In response to this growing body of research, DED has adopted a new marketing and business development approach that focuses on cultivating nine industry clusters (e.g., biotechnology and advanced materials). The jury is still out on what constitutes good cluster development policy, but the DED's adoption of a cluster-based approach is a positive development in any case. However, deal closing funds are not among the economic development strategies considered important by those who have thoroughly studied cluster development.

The leading thinker in the development of modern cluster theory, Dr. Michael Porter of Harvard University, suggests that government should not directly intervene in the private sector by subsidizing individual companies on a selective basis (as deal closing funds do). He has written, "Setting policies to benefit individual firms distorts markets and uses government resources inefficiently… Although industrial policy aims to distort competition in favor of a particular location [e.g., a state], cluster theory focuses on removing obstacles, relaxing constraints, and eliminating inefficiencies to productivity and productivity growth." (from "Location, Competition, and Economic Development: Local Clusters in a Global Economy," *Economic Development Quarterly,* February 2000).

Dr. Porter suggests that appropriate state government actions include building high quality K-12 educational systems, creating specialized education and training programs, establishing university research efforts in cluster-related areas (like the Governor's information technology and bioscience initiatives), and organizing government departments around clusters (like the DED's recent reorganization effort). It seems odd that the DED would advocate a proposal seemingly in conflict with the basic tenets supporting its new cluster strategy.

2. A substantial amount of funds would be wasted.

A central bargaining problem associated with any state's deal closing fund is that the state never knows how much, if any, grant assistance is necessary to ensure that a particular firm will choose to locate, expand, or stay in the state. Companies hold all the cards because they can play the states against each other. Third party representatives like site consultants exacerbate this situation by making the bargaining process even easier for companies–and by making it even more difficult for states to determine a company's actual bargaining position.

Proponents of an expanded EDAP argue that this dilemma can be mitigated by conducting careful cost-benefit analyses prior to making each funding decision. Unfortunately, traditional cost-benefit analyses will not be sufficient in these types of bargaining situations: the bigger the state's projected payoff is relative to the cost, the greater the likelihood that the company would have come here even without the grant. As a result, so-called accountability reports that show the state's supposed return on investment (ROI) for incentives can be highly misleading.

Of course, most business recruitment incentive programs entail some degree of waste. The problem here is that the state would be picking winners and losers in the private sector on a discretionary basis, which is generally bad public policy.

3. A larger fund would increase the likelihood that some companies will attempt to manipulate the program.

For many companies, the prospect of obtaining an infrastructure grant of $200,000 or so (through EDAP) is not enough to warrant a company playing games to get the grant in situations where they have already chosen Louisiana. However, once the potential stakes rise into the millions, some companies are bound to seek competitive offers from other states in order to secure large(r) grants from the Louisiana Opportunity Fund, even if they have already chosen to come to (or to stay in) Louisiana.

Just as Louisiana is eager to lure companies here and will rapidly make "bona-fide" offers to attract firms that show significant interest, other states aggressively market themselves, as well. This means that firms that apply for grant funds here can secure competitive offers from other states with relative ease. The state will be in a very poor position to evaluate an appropriate deal in these situations.

Enterprise Florida, the quasi-public entity that administers Florida's Quick Action Closing Fund, does not disclose grant recipients or amounts for this purpose. The DED, as a public body, will not have this option.

4. Louisiana could reinforce its image as the "make a deal state."

One of Louisiana's most challenging problems is its lingering image of corruption. A deal closing fund involving large grants would very likely attract a great deal of attention in the business community, both in Louisiana and elsewhere. Those companies that apply for but do not receive funds will likely complain about the politics involved, irrespective of how funding decisions are made. Even if the fund is managed with the best of intentions, it is likely to generate a certain degree of contention, as did a similar fund in South Carolina.

5. Combining a deal closing fund with a cluster-based approach could generate intense opposition from existing firms.

Much research has shown that dynamic, successful clusters are most often characterized by the presence of direct competitors in near proximity. If the fund provides grants to attract competitors to existing Louisiana businesses, it will generate a substantial degree of controversy (while nevertheless improving the long-term viability of the state's clusters). If the fund does not do so, its value to build clusters will be greatly diminished.

6. Like EDAP, the Louisiana Opportunity Fund would only help at the margin; it would not make up for existing deficiencies of the state.

Unless the fund offers relatively exorbitant grants relative to the size of prospective projects, the state is unlikely to attract the kinds of firms that do not already consider Louisiana. More likely the fund will help the state win competitive bidding situations for the types of companies that currently consider Louisiana.

7. The fund would consume scarce political (and financial) capital that is desperately needed to address the core drivers of successful economic development.

In the long run, Louisiana's prosperity will be highly correlated with its ability to upgrade educational quality and access at all levels. This will require sustained efforts at reform, as well as the injection of substantial new financial resources. Fundamental tax reform is also critical. By pursuing targeted tax incentives and a bigger discretionary incentive fund, policymakers run the risk of creating a false impression: that Louisiana can significantly improve its economy without making tough choices. The few jobs picked up on the margin could be offset by even a modest loss of momentum to address the larger issues.

PAR recognizes that deal closing funds are common in the southern states and that, in tie-breaking situations, they can tip the scales in favor of states offering substantial grants in addition to their standard incentive packages. Nevertheless, PAR generally considers such programs to be bad public policy–they are justifiable only to a limited extent because of the competitive dynamic generated by their relatively widespread use.

Constitutional Concerns

Deal closing funds of any sort raise significant constitutional issues in Louisiana due to the prohibition in Article VII, Section 14, against the loan, pledge, or donation of public funds, credit, or property to any person or corporation, public or private, with certain exceptions. The exceptions include programs of social welfare for the aid and support of the needy. No explicit exception exists for programs to support business recruitment.

Dedicating funds to provide an access road that could also be used by the general public probably would not raise a significant constitutional issue. However, providing funds to construct or purchase buildings or buy capital equipment, to be leased back to the benefiting company at a discount to market rates, could be construed as a violation of the constitution. In the past, economic development practitioners have sought to justify such actions using the "cooperative endeavors" clause in the aforementioned section. This clause simply states that, for a public purpose, the state and its political subdivisions may engage in "cooperative endeavors" with each other, as well as with private corporations. What this means in practice has been a subject of significant debate. Some economic development officials argue that this clause would validate deal closing fund grants because the public benefit, in the form of tax revenue (and, qualitatively, in the form of jobs), would be greater than the amount of the grant. Of course, this argument requires the assumption that the benefiting company would not have come here or expanded here without the grant.

This constitutional issue is not limited to EDAP. There are a number of other state aid and loan programs for economic development that essentially raise similar concerns. Several attempts have been made to amend the constitution to more clearly allow such activities; however, all of the associated referendums failed to pass. The constitutionality of a deal closing fund in Louisiana has never been tested in the courts. Until such a test occurs, the use of such a program will remain under a constitutional cloud.

Design Recommendations

Some would argue that establishing restrictive guidelines for the proposed Louisiana Opportunity Fund is an exercise in futility because it would be funded with one-time money. PAR believes such guidelines are important, however, because a fund of this sort could become a regular part of Louisiana's economic development arsenal. Some other southern states, such as North Carolina, use non-recurring funds for their deal closing funds; nevertheless, they tend to get funded every year.

If Louisiana elects to create an expanded deal closing fund, PAR strongly suggests the following design elements in order to ensure its impact is optimized and that prudent safeguards are enacted:

MINIMUM ELIGIBILITY REQUIREMENTS

1. Highly competitive bidding situations only.

Funds should only be provided for tie-breaker situations where a company is in the final stages of site selection and considers Louisiana to be roughly equivalent in terms of factor advantages to at least one other state.

This restriction would help ensure that the state avoids at least two distinct, unwise actions. First and most obviously, the state should not deliberately aid projects that would happen here even without state funding. Second, the state should avoid projects that would *only* happen with state funding–new sites or plant expansions that *require* a government subsidy to be successful are not the kinds of investments Louisiana should be making, even if they create a few jobs in the short-term. Such bad state "investments" could include companies in weakening industry sectors, as well as certain high tech firms that would face significant disadvantages in locating here under present conditions.

2. Companies in previously defined clusters.

Only companies that would clearly be viewed as important to Louisiana's previously defined clusters should be considered for grants. Scarce resources must be used in a targeted manner. Furthermore, direct competitors to existing Louisiana businesses should *not* be placed at a disadvantage in the selection process.

A source of concern here is that Louisiana's clusters, as presently defined, likely are far too broad. Clusters typically include competitors, suppliers, and related industries within tightly drawn industry segments. However, according to the "DED Reorganization Task Force Report" (March 1, 2001), Louisiana has defined its clusters very broadly: "…Louisiana's clusters are extremely broad-based and cover most high-value industries. Between those industries and all suppliers and providers of service that could serve them, most businesses within the state are covered." With this kind of approach, the state has more of a broad industry sector strategy rather than a cluster strategy. The distinction is important because the positive benefits associated with clusters occur due to direct and indirect interactions between interrelated firms that may span *multiple* industry classifications. Optimal results will be achieved only if the state's clusters are tightly defined.

Each of the DED's new cluster heads should make it a priority to map their respective clusters to better identify the important interconnections between their constituent companies, as well as to identify the particular industry segments in which the state *actually* has critical mass. The state may ultimately define its clusters much differently than it does today.

3. Minimum of 25 new permanent jobs and $5 million capital investment.

While setting thresholds for new jobs and investment is largely arbitrary, it will nevertheless help focus attention on more significant projects. For comparison, Louisiana's existing EDAP program, typically funded at $5 million per year, requires at least 10 new (or retained) permanent jobs for eligibility, with no minimum capital investment.

4. Good jobs with health insurance.

Prospective grant recipients must offer permanent jobs with average salaries at least 10% higher than the respective parish's (or state's) per capita average, and they must provide full health insurance coverage.

Louisiana should not be providing grants to companies that are coming here merely for cost advantages and that do not offer attractive compensation packages. If the fund is truly used to attract firms within the state's previously defined industry clusters, this should not be an unreasonable threshold.

5. Highly restricted retention awards.

One of the most troubling potential uses of these funds is to retain companies that are threatening to leave for another state, with no prospect of creating new jobs (or only just a few). As discussed earlier, companies have little difficulty acquiring "bona-fide" offers from other states to move their sites, so will have significant incentive to manipulate the system if retention awards are allowed. (This will be particularly true as the size of potential grants grows exponentially.) *Therefore, PAR suggests that retention awards should either not be allowed at all or restricted to no more than 20% of available funds in any particular year.*

AWARD CRITERIA

1. Importance to existing clusters.

LEDC should seek input from existing cluster participants about the value prospective recipients would have in strengthening an existing cluster. Priority should be given to prospective grant recipients that would have the greatest potential to strengthen an existing cluster. Perhaps the best example is that of a key supplier type that does not currently exist in near proximity.

As discussed earlier, attracting direct competitors will help build clusters but will generally not be welcomed by the companies with which they will compete. For this reason, companies should not be solicited for input in funding decisions involving potential competitors.

2. Local matching funds.

Although the funding will be from the state, many if not most of the business recruitment activities occur at the local level. In order to ensure that local governments and/or local economic development agencies only request funds when they are critical, LEDC should give preference to grant proposals that would provide local matching funds. However, poor areas with no ability to provide matching funds should not be penalized. *Consideration should be given to developing a sliding scale for matching fund expectations, with the poorest areas expected to do nothing and the wealthiest areas (i.e., those with the least need) expected to match at least dollar for dollar.*

3. Jobs and investment.

All things being equal, prospective grant recipients should be prioritized by the number of good jobs, as well as the capital investment, to which they are willing to commit.

MAXIMUM GRANT AMOUNTS

Two years of direct and indirect state tax impact.

One of the most difficult aspects of implementing deal closing funds is determining whether to offer a grant and, if so, how much to offer. Based on discussions with other states and leading national thinkers on negotiations and economic development incentives, there is no clear solution to this problem. Knowing that a significant percentage of grant funds will go to companies that would have located, expanded, or stayed here anyway, a reasonable approach is to place a limit on the maximum amount of a grant relative to the projected state tax impact. Virginia, which has one of the largest explicit deal closing funds in the South, has an internal ROI target of two years of direct and indirect state tax impact. PAR recommends that this ceiling be adopted for the Louisiana Opportunity Fund, and further that the economic multiplier applied to estimate the indirect state tax impact be limited to a maximum of three in order to minimize unwarranted inflation of economic impact projections. *Any state tax incentives during the two-year period should be deducted from the calculation of state benefit.*

Example: DED's current approach to cost-benefit analyses assumes that new permanent jobs will yield a direct state tax impact of approximately 6% of payroll. Therefore, for a project with new permanent jobs averaging $30,000, the maximum grant per job would be $3,600 to $10,800, depending on the economic multiplier and considering only new permanent jobs. Additional factors would include payroll and sales taxes associated with temporary construction jobs, as well as sales taxes from capital investment, minus any state tax incentives in the two-year period (e.g., Quality Jobs or Enterprise Zone and/or targeted tax incentives).

OTHER PROVISIONS

1. Contractual agreement with clawbacks.

All grant awards should require a contractual agreement to be executed by the DED, the sponsoring local government entity and the benefiting company. (This is already common practice with EDAP grants.) The agreement should include the company's commitments with respect to new permanent jobs, average wage levels and capital investment.

In order to ensure companies are committed to following through with their commitments, pre-defined clawback provisions should be included in the contract. These should specify penalties for nonperformance equal to 10% of the grant amount plus a proportional penalty associated with each of the performance areas as follows: (1) for the number of new permanent jobs or amount of capital investment, the penalty should be proportional to the maximum noncompliance fraction between the two (e.g., a penalty of 15% of the grant award would be levied if the number of jobs created was 10% less than promised and capital investment was 15% less than promised); and (2) for average wage levels, the penalty should be 20% of the grant award for every $1,000 less than the promised average wage (e.g., a penalty of 50% of the grant award would be levied if the average job paid $2,500 less than promised). In all cases, the maximum penalty should be limited to the total grant award plus 10%.

Given these performance requirements, LEDC should advise companies that their applications should be based on conservative forecasts. Similarly, LEDC's review should consider only these conservative projections.

2. Transparency.

Following the signing of each award contract, the DED should make the principal details of the award publicly available. These would include the recipient company, the sponsoring local government entity, the award amount, and any matching grants, as well as the performance requirements (job creation, wage levels, and capital investment).

Clearly some of these suggested design elements would be subjectively applied in practice. PAR recognizes that making such a fund work will require an expectation that the LEDC board will act in good faith and will make every effort to comply with the letter and spirit of the fund guidelines.

Deal Closing Funds in Context

The events of September 11 may have momentarily slowed the march towards globalization, but that march is nevertheless likely to restart in short order. As globalization regains momentum, *all* American states will find it increasingly difficult to compete for low-skilled but relatively high paying jobs when countries like China, for example, exhibit average hourly manufacturing wages of less than 25 cents. In short, a low cost strategy is not likely to be sustainable in the long-term, at least not without a significant decline in the state's relative prosperity. Therefore, Louisiana must move forward with increasing urgency to upgrade its educational and research base in order to maintain–and expand–its stock of quality, high paying jobs.

Every dollar Louisiana spends essentially fighting a price war with similar states could help the state win a few new jobs on the margin but may reduce its ability to fight the broader war of upgrading skills, education systems and research capabilities. The central question posed by the Louisiana Opportunity Fund proposal is whether the state's incremental resources would be best used by creating a bigger deal closing fund to help attract companies that already consider Louisiana, or by investing additional resources in core economic development drivers (e.g., strengthening university research capacity) to improve Louisiana's ability to attract those companies (and employees) that currently do not consider the state at all. Unfortunately, there is no clear answer to this question.

Given the uncertain payoffs and difficult problems associated with deal closing funds, PAR suggests that the $20 million in capital outlay money would be better spent building additional university research capacity (e.g., laboratories and specialized equipment) in academic disciplines considered important to the state's nine industry clusters. Investing the funds in this manner would be much more consistent with the principles of cluster-based economic development.

PAR hopes that state leaders and citizens will not mistakenly view the deal closing fund proposal as one of the more important elements of a serious economic development strategy, which would necessarily focus on educational quality at all levels, as well as fundamental tax reform.

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