

Economic Development

The same prudence which in private life would forbid our paying our own money for unexplained projects, forbids it in the dispensation of the public monies.

– Thomas Jefferson

Governor John Hoeven has made economic development the hallmark of his administration. He has greatly increased the size and scope of the Department of Commerce since he founded it.

His aggressive economic development plans have given grants, tax breaks, loan interest buy-downs, and other benefits to certain industries. As with most programs, the government's involvement hinders true economic growth. No number of bureaucrats, legislators or other public officials is fit to decide which businesses can survive in the North Dakota marketplace and which ones cannot. The government is neither qualified nor smart enough to pick winners and losers in the private sector; therefore it should stop trying to do so.

The North Dakota Constitution is explicitly clear about not giving direct support to private businesses. Article X, Section 18 of the North Dakota Constitution states,

*The State, any county or city may make internal improvements and may engage in industry, enterprises or business, not prohibited by article XX of the constitution, but neither the state nor any political subdivision thereof shall otherwise loan or give its credit or make donations to or in aid of any individual, association or corporation except for reasonable support of the poor, nor subscribe to or become the owner of capital stock in any association or corporation.*⁹

Governments, however, have found ways to get around the literal meaning of the North Dakota Constitution. Rather than giving money directly to private corporations, the cities and counties have formed local non-profit corporations. These economic development corporations use state and local tax dollars to lure (or bribe) businesses into those communities. The current system of economic development socializes the risk while concentrating the benefits on a few.

As Chapter 3 explained, creating long-lasting economic development requires that start-up businesses have access to capital. The state can do much to ensure that businesses have access to capital without assuming the risk of lending it or giving money away. By reducing regulations and taxes, capital is freed to invest in higher wages, more jobs, or new businesses. Some businesses will fail, but that is the nature of the marketplace.

No small group of people is qualified to plan the entire economy.

Think about it. Millions of producers and consumers are connected to the North Dakota economy and operate within a network of interests that is organized to satisfy both producers and consumers in the most efficient way possible. Any small group of people who thinks it is able to guide or plan what consumers will or should buy or what producers will or should produce now and in the future is

Recommendation: Government is not qualified to pick business winners and losers; therefore, it should stop trying to plan the economy.

WEBSMART

In 1999–2000, the owners of WebSmart, a telemarketing company headquartered in Minot, sought and received loans totaling \$1 million from the Bank of North Dakota and Minot’s MAGIC Fund.

Lee Peterson, head of North Dakota Commerce Department and MAGIC Fund executive, gave WebSmart another \$300,000 subsidy.¹⁰

It was a pretty good situation for everyone. The state was able to tout WebSmart as an economic development success to further its agenda, and the owners of WebSmart were able to get taxpayer subsidies because of their connections to public officials.

In 2002, WebSmart closed. An investigation by the *Fargo Forum* revealed that the MAGIC Fund provided capital for WebSmart with questionable accountability measures.¹¹

In 2003, Attorney General Wayne Stenehjem noted that WebSmart could not pay former employees the \$300,000 it owed in back wages. The city inquired as to whether it could pay the wages, but it legally could not. The city also sued WebSmart for the \$230,000 loan it had provided to WebSmart.¹² In 2003, the state also filed a lawsuit against WebSmart to recover the lost wages.¹³ WebSmart’s building and land went to First Western Bank and Trust.¹⁴

In Grand Forks, the city’s Growth Fund wrote off a \$447,000 loan it had given to WebSmart. The fund was public money.¹⁵ It is impossible to tell how much of the loans were repaid because of confidentiality laws.

MARVIN WINDOWS

In 1997, Marvin Windows was lured (or bribed) to Grafton. In exchange for their move, Marvin Windows received a twenty-year property tax exemption and \$1,000 per employee per year up to 500 employees.

What is wrong with subsidizing companies like this? First, by subsidizing the labor of one company, Grafton is putting other companies at a competitive disadvantage. Why shouldn't all companies be treated equally? Second, by subsidizing Marvin Windows, Grafton has inflated property taxes for everyone else. In 2007, the City of Grafton paid Marvin Windows \$470,000 and collected \$560,491 in property tax revenue. If Grafton had not made payments to Marvin Windows, a resident owning a \$100,000 home would have saved \$424.71. Isn't that the relief that citizens want?¹⁶

harmful to economic and individual liberty. Why? Governments that provide tax credits, tax exemptions, or grants to any particular industry and not others are attempting to predict what future consumers and producers want. In those cases, governments are picking winners and losers.

North Dakota's state government has a poor recent history of investing in bad businesses. Who loses? Taxpayers. Consider the story of WebSmart.

Failures of the ethanol industry

Another economic development boondoggle is the state's investment in ethanol plants. The oldest ethanol plant in North Dakota is the Alchem plant in Grafton. Since 1989, the Alchem plant has received \$14,585,841 in direct subsidies.¹⁷

North Dakota's second oldest ethanol plant is owned by Archer Daniels Midland (ADM). Since 1989, the ADM plant has received \$8,262,104 in state subsidies.¹⁸ If providing more than \$8 million in public money to a private company is not enough, consider the size of ADM.

For the first quarter in 2007, ADM posted earnings of \$441 million.¹⁹ If ADM needs additional capital to run an existing plant, it should be able to find it. North Dakota taxpayers do not need to contribute to ADM's profits.

It is argued that "investing" in ethanol production is a legitimate option because the "infant" industry needs time and resources to grow. Alchem has existed for 25 years, with

the ADM plant nearly the same age. At what point do infants grow up?

Once again, the state has shown itself to be unable to efficiently and carefully spend taxpayer dollars. Even with state investments of nearly \$15 million, the Alchem plant is apparently still unable to remain profitable. In October 2007, the Alchem plant was temporarily shut down leaving 30 employees without jobs. The reason for the shutdown was low ethanol prices combined with high corn prices.²⁰ Even with record high gasoline prices, some ethanol plants were unable to stay open.

Last year, Bank of America economist Eric Brown and a University of Missouri report concluded that with already thin margins for ethanol plants, their unprofitability will continue to get worse.²¹

In June 2008, VeraSun announced that it was delaying the opening of a new ethanol plant in Hankinson until the “outlook for ethanol selling prices and overall margins improve.”²² Ethanol simply cannot survive in the marketplace. Why should taxpayers be forced to invest in it?

As gasoline prices have skyrocketed over the past couple years, the ethanol industry has been making several arguments in its case for government subsidies: “It’s good for rural North Dakota.” “It will reduce America’s dependence on foreign oil.” “It will stop global warming.”

The fact is that all good-paying jobs in rural North Dakota will help rural North Dakota. Those jobs can be created without subsidizing the industry. The evidence is mounting to suggest that any benefits of ethanol are much smaller than what was initially expected.

According to economist and Iowa State University professor David Swenson, ethanol helps rural economies, but not nearly as much as is commonly perceived. He cautioned lawmakers to understand the entire economic impact of ethanol before diverting public funding to the industry. He said, “The gap between the rhetoric of promotion and the analysis of state economists is often immense. If excess public funds are diverted to the promotion of ethanol industries based on highly inflated jobs values, the state runs the very real risk of shortchanging other worthy public spending categories.”²³

QUALITY ONE WIRELESS

Just recently, Quality One Wireless (Q1W), a cell-phone refurbishing company, went out of business in Devils Lake. When Q1W moved into Devils Lake just more than a year ago, it promised up to 80 jobs. To lure (or bribe) the company to come to Devils Lake, the city agreed to buy and then lease \$220,000 worth of equipment.²⁴ The city lost approximately \$110,000 on the one-year experiment.

For those who believe that global warming is a problem, a study released by researchers affiliated with Princeton University concluded that “the widespread use of ethanol from corn could result in nearly twice the greenhouse gas emissions as the gasoline it would replace because of expected land-use changes.”²⁵ It is also widely known that there are not nearly enough acres in the country to grow enough corn to replace a significant number of barrels of oil imported by the United States.

All of this evidence points to the fact that ethanol is not doing what officials promised it would do. If ethanol were currently a viable industry, government wouldn’t need to support it.

Greater Fargo-Moorhead Economic Development Corporation

Fargo-Moorhead’s case also illustrates the problems with government-funded economic development. The Greater Fargo-Moorhead Economic Development Corporation (GFMEDC) put a ½ cent sales tax on the June 2008 ballot. The tax would have raised about \$9.5 million per year. The biggest problem with the tax was that it would have been levied by a corporation of appointed people, rather than by elected officials.

The GFMEDC “is funded privately and publicly... the Cass and Clay County Commissions provide funding.” According to its communications director, in 2007 the GFMEDC received \$375,000 from Cass County and \$175,000 from Clay County (Minnesota).²⁶

In May 2008, the *Fargo Forum* reported that the corporation’s president Brian Walters could not give anyone a detailed budget regarding how the money would be spent.²⁷ It is a case of “just give us the money and then we’ll tell you how we’re going to spend it.”

Attracting high-paying jobs to Fargo is a good idea. It can be done in many ways. But, there were two fundamental problems with the economic development plan created by the GFMEDC.

First, it is entirely un-American and undemocratic to have unelected board members spend taxpayer money. “No taxation without representation” was a rallying cry for the American Revolution. Yet Fargo citizens were being asked to surrender their tax dollars to an appointed, non-elected board. Money should be spent by those directly accountable to the people at the ballot box. If the GFMEDC’s Board makes a poor investment with taxpayer money, there is no mechanism for the people to make sure those members do not get any more money or that the member is removed from the Board.

Second, it is a fallacy that government can buy jobs. Providing for good infrastructure is one of government’s legitimate functions, but when taxpayer money is funneled to private companies under the guise of “economic development” or “infrastructure improvements,” there is no accountability, and the line between the common good and private interests is severely blurred. This is socialism, the exact opposite of economic and individual liberty.

Fargo taxpayers understood this message and voted down the tax increase. Without publicly-funded economic development projects, people ask how economic development would occur. Elected leaders must put faith in the people. Nobel Prize-winning economist Milton Friedman said, “What most people really object to when they object to a free market is that it is so hard for them to shape it to their will.”

Centers of Excellence

Another economic development program that has received millions of dollars of support is the Centers of Excellence program. In 2003, the state launched the concept of Centers of Excellence to maintain “momentum” in areas of economic development. They are called a “cornerstone of our economic development agenda.”²⁸ In 2005, the state announced the first round of funding. Hoeven said, “We’re off to a strong start, with very promising projects that hold real potential for creating new business opportunities and higher paying jobs for our citizens.” According to the state, Centers of Excellence are hubs of “research and development on one of the campuses of the North Dakota University System around which related businesses expand and dynamic new businesses cluster.”²⁹

These Centers of Excellence are designed to bring the public and private sectors together to bring investment into university research programs, which in turn create future employees for the private sector partners. The 2007 functional review of Bismarck State College’s National Energy Center of Excellence clearly demonstrates that these projects have not yet had the desired effects.

BSC was selected for Centers of Excellence funding in 2005. On October 7, 2007, a *Bismarck Tribune* op-ed stated that “with a couple of years of existence, it’s time for those who are funding the grants – the North Dakota taxpayers – to start to see some hard numbers of jobs actually created.”³⁰

It is fundamentally incorrect to say that the state government, through the Centers of Excellence, can create jobs. After all, it is the private companies who do the hiring. Furthermore, the energy industry is booming, especially in western North Dakota. To think that an energy Center of Excellence is needed to get companies to start hiring more people in the energy field is absurd.

A study commissioned by the North Dakota Petroleum Council, the North Dakota Workforce Development Council, the North Dakota Department of Commerce, Job Service ND, Career and Technical Education, and Williston State College concluded that North Dakota’s oil and gas industry will need “1,700 to 1,800 new employees by 2010.” The jobs range from “equipment operators and truck drivers” to “engineers and geologists.” Oil and gas industry jobs paid an average yearly wage of more than \$60,000, in 2005.³¹ The oil and gas industry is only one sector of the energy industry in the state. The jobs are already here. Government money is not needed to create jobs in the energy field.

Proponents argue that research and training need to be occurring, so companies can take advantage of technology to produce more energy and reduce their costs. With current oil profits at all-time records, do the companies need \$3 million in grants? Can’t these companies in the industry fund their own research?

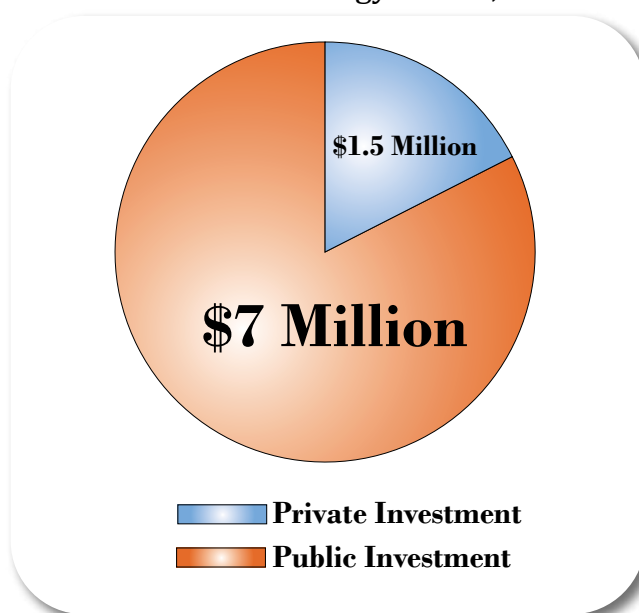
When the state made the announcement that BSC would be awarded a grant, it was projected that matching funds would amount to more than \$13 million. Through 2007, only \$1.5 million of private-sector cash had been invested in the new energy building, while public-sector money has accounted for more than \$5.8 million. In other words, 79 percent of the funding for the Center of Excellence has been taxpayer dollars (state, local, and federal). Taxpayers also donated land appraised at more than \$1.2 million, which pushes taxpayer investment up to 82 percent. Furthermore, the report states, “we are still short of funds and continue to seek support to meet construction costs.”³² Graph 4.1 compares public investment in the Center of Excellence to private investment.

Proponents of the program state that “time is needed to see if such programs work. Furthermore, their full effects cannot be felt for years after the Centers are started.” If such is the case, then after the first round of Centers of Excellence funding, why were there three more rounds of Centers of Excellence funding with tens of millions of dollars approved? The government should have had evidence that the programs are accountable for what they have spent before drastically expanding them. It is politics, plain and simple.

An ever expanding government that refuses to lower taxes, even with projected surpluses and overflowing “rainy day” funds, that wastes millions of dollars of taxpayer money on projects that are failing or have not yielded any type of results cannot be trusted to protect individual and economic freedom. Any company that needs public resources to stay in business is a business that does not deserve private investment, much less public investment. Business people understand that; politicians do not.

The only way to ensure a strong, growing state economy is to make sure that elected officials understand the proper role of gov-

Graph 4.1
BSC National Energy Center, 2007



ernment. The business of government is not business... the business of business people is business. It is important to keep it that way.

Proponents of government-funded economic development have seemed to find ways to circumvent Article X, Section 18 of the North Dakota Constitution. Too often, politicians find ways to get around the Constitution, when they should let the Constitution guide them. One of the main tenants of socialism is the merging of government and business. Clearly, heading that direction is not the way for North Dakota to move forward.