

Ms. Debbie Davenport  
Auditor General  
Office of the Auditor General  
2910 N. 44<sup>th</sup> St., #410  
Phoenix, Arizona 85018

Dear Ms. Davenport:

I respectfully submit this response to the Auditor General's performance audit and sunset review of the Arizona Department of Commerce.

I am pleased that the audit staff found no evidence of malfeasance, incompetence or mismanagement in the agency. I also appreciate the acknowledgment that Commerce has done much to address deficiencies in its enabling statutes, helping to improve program administration and service to constituents. The report points out that this Department needs to hone its numerous performance measures, and that the legislature should consider improving the reporting and evaluation processes associated with economic development incentive programs. I agree with those conclusions.

However, this review failed to measure the actual *performance* of the Department. This document contains little information regarding legislative intent, program performance, accomplishments and constituent value/satisfaction. In fact, this report, as evidenced by the conversation in our meeting of April 2, 2003, focused from the outset on significantly reducing agency size or *eliminating* Commerce entirely. Department officials made repeated efforts to shift the review premise from "what can be eliminated" to whether this agency is fulfilling its legislative mandates—to no avail. Furthermore, the report suffers by the fact that auditors chose to rely on sometimes outdated, conflicting or non-comparable literature instead of contact with constituents to assess the value of the Department activity.

Since my appointment as Director in January 2003, I have focused the agency to strengthen its ability to deliver value added integrated economic development assistance—particularly to rural areas--and to improve support to constituents statewide. From generating, gathering and analyzing data for use in decision-making at all levels of government, through foundational work at the community level in preparation for business expansion and attraction to the establishment of industry-driven workforce development, the Arizona Department of Commerce is solidly positioned to produce and implement the mandated 10-year state-wide, economic development plan. *The findings make implementation of a 10-year statewide economic plan or any focused economic development effort impossible.* This is foolhardy at a time when our economic base industries continue to erode.

We are disappointed that the audit team focused on eliminating or downsizing the agency rather than looking for opportunities to improve efficiency and constituent value.

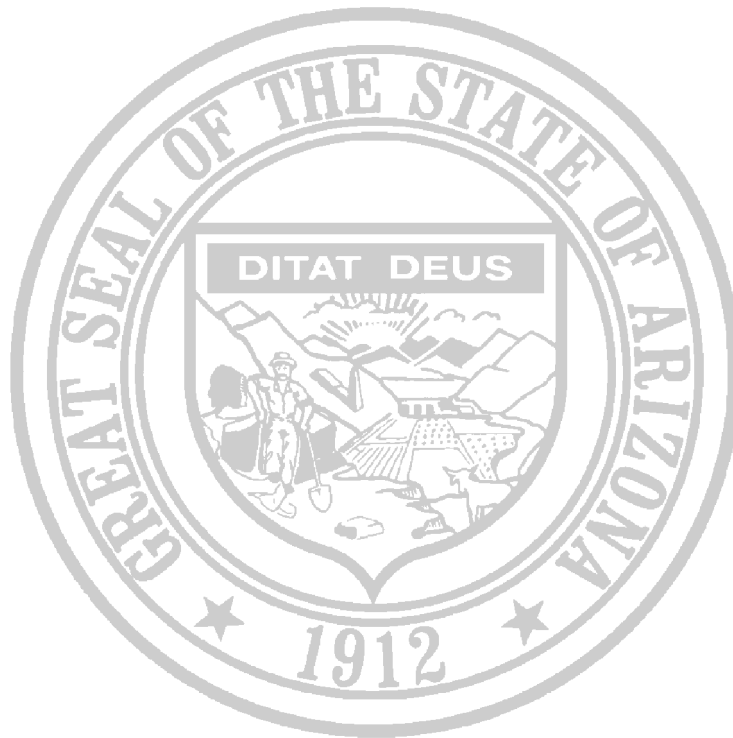
Respectfully,

Gilbert Jimenez  
Director

**ARIZONA DEPARTMENT OF COMMERCE  
RESPONSE TO THE AUDITOR GENERAL**

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## **ARIZONA DEPARTMENT OF COMMERCE RESPONSE TO THE AUDITOR GENERAL**

The Arizona Department of Commerce respectfully submits that this performance report fails to recognize the fundamental purpose of the Department or the application of its multiple programs to develop useful economic information and promote economic, community and workforce development in Arizona.

Economic development is a team sport in which Arizona faces significant challenges: fierce competition from other states and countries; vast disparities in opportunities and resources between urban and rural communities; and a dearth of quality economic, community and workforce development information for decision makers at all levels. Consequently, local and regional economic development organizations depend on the Department to provide statewide leadership, coordination and both technical and financial resources. Recognizing this need, every state in the Nation has an organization similar to the Department.

Investment by the state and effective collaboration with local entities results in:

- Increasing per capita income. (Arizona per capita income is at 85% of the national average.)
- Increasing industry diversity. (Arizona ranks 40<sup>th</sup> among states in economic diversity and last among states considered competitors for the attraction and development of technology industries.)
- Increasing the tax base, which increases government resources to fund critical public services.

For maximum effectiveness in statewide economic development, the Department organizes its programs and efforts into four core areas:

### **PLANNING, RESEARCH & POLICY**

#### **Data + Analysis = Information**

- Supplying state and local decision-makers with good information to support good decisions, the Department compiles, analyzes and reviews economic data from more than 125 federal, state, local and private sources.
- The Department's broad stakeholder base enables cost sharing among government, university and civic groups, as well as businesses. For the 2002 Statewide Economic Study, the Department leveraged more than \$100,000 of in-kind services to the state.
- The Department spearheads many of the state's most targeted and comprehensive research projects including:
  - ✓ Arizona's Economic Future
  - ✓ Positioning Arizona and Its Research Universities
  - ✓ Arizona's Economic Infrastructure
  - ✓ Arizona's Special Economic Sectors
  - ✓ Preliminary Examination of Arizona's Governmental Revenue Structure
  - ✓ Impact of Arizona's State Parks
  - ✓ Number of Small Businesses in Arizona
  - ✓ Community Economic Analysis (forthcoming)
  - ✓ Impact of Technology Sectors in Arizona's Economy (forthcoming)
  - ✓ Impact of Enterprise Zones (forthcoming)
  - ✓ High Technology Activities in Arizona (forthcoming)

### **COMMUNITY DEVELOPMENT**

#### **Smart Growth is the Foundation for Economic and Community Prosperity**

- Rural areas face high employment, little economic diversity and inadequate infrastructure. The Department provides technical and financial resources to these communities with such efforts as the Rural Economic Development Initiative, Arizona Film Commission, the Main Street program and Growing Smarter planning assistance.

- Military Airports Regional Compatibility Project. The Department coordinates the effort to resolve land use issues and preserve Arizona's military bases, impacting 83,000 jobs and generating \$5.7 billion annually. The Department secured a \$440,000 federal grant that effectively doubles the budget to continue to work at other bases.
- Through the Greater Arizona Development Authority, the Department has leveraged a \$1.1 million investment into \$45 million in low-interest loans. Recent issues include:
  - ✓ Coolidge issued \$3.795 million in revenue bonds for a police/fire building project – and saved \$197,396
  - ✓ Guadalupe issued \$3.445 million in revenue bonds for capital projects and debt refinancing – and saved \$193,680
  - ✓ Clarkdale issued \$400K in revenue bonds for public office space renovations – and saved \$37,655
- The Department works with communities, schools and small businesses to promote energy conservation. In FY03, the Department pulled down \$5 million in grants at no cost to the GF.

## **GLOBAL BUSINESS DEVELOPMENT**

### **Companies Seek a Central Point of Contact**

- More than 80% of companies looking to locate and expand facilities make initial contact with the Department for information such as business climate, workforce and various regions of the state.
- The Department provides more than 30% of metropolitan locate leads and nearly 100% of rural leads.
- The Department leads efforts to grow the economic base, convening cities, universities and private resources to land the International Genomics Consortium and launch the Translational Genomics Research Institute – initiatives that benefit all regions of Arizona.
- Over the next three years, 70,000 new direct and induced jobs from companies assisted by the Department between 1999 and 2002 will result in nearly \$400 million in additional state tax revenue, per noted economist Elliott D. Pollack.
- In FY03, the Department helped 54 companies locate or expand, 14 in rural, 40 in metropolitan areas, together resulting in 14,126 NEW jobs.
- In the past two years, the Department provided export promotion assistance to over 600 small and medium-sized companies. Actual and projected export sales attributed to this assistance conservatively total over \$1.45 Billion.

## **WORKFORCE DEVELOPMENT**

### **Skilled Workers Are Business' Most Important Resource.**

- Today's economy is driven by accelerated product development requiring continued training and increased productivity. Business' top issue is the need for skilled, flexible employees.
- In 2003, the Department leveraged \$12 million in job training tax funds into more than \$25 million of training. Over the next three years, more than 20,000 employees statewide will be trained with these funds.
- The Department combines on-the-job training and related classroom instruction through the state's Registered Apprenticeship program, providing employees the experience needed to succeed in a skilled occupation.
- The Department is improving the coordination of more than \$200 million in federal and state workforce development dollars through Arizona Workforce Connection – a streamlined system aimed at cutting red tape and providing valuable training services to Arizona companies.
- During the Rodeo/Chediski fire, the Department pulled down \$2.3 million in federal funds to retrain workers dislocated by the disaster.

## RECOMMENDATION AND RESPONSE SUMMARY--FINDING 1

Recommendation #1: The Legislature should consider eliminating the following Department of Commerce functions, since, to some extent, they duplicate programs operated by other entities:

- Small Business Services
- Apprenticeship Services
- Economic Information and Research, and
- Growing Smarter Functions

**Department Response #1:** The finding of the Auditor General is not agreed to and the recommendation will not be implemented. (*See Attachment 1-4*)

**Small Business Services:** The assertion that this function is duplicative of other small business entities and state agencies such as SBDCs is false. Additionally, the report does not adequately address the Department's work with Minority and Women-Owned businesses and misunderstands the Department's small business advocacy role.

**Apprenticeship Services:** The assertion that this function is duplicative of services that could be provided by the Department of Labor (DOL) fails to reflect the fact that the recommendation would result in lower service levels, reduced accountability, and the inability for the State to ensure the efforts alignment with the needs of Arizona businesses. Also, after January 1, 2004, any federal assistance would be managed remotely from an office in Nevada, providing only minimal service.

**Economic Information and Research:** This function is fundamental and absolutely critical to the effective operation of all agency programs. The assertion that this function is duplicative of programs operated by other entities is false and misunderstands the development of economic information/policy in several ways. In addition, without additional funding, no other entity has the capacity or desire to fulfill this role.

**Growing Smarter Functions:** This function is the State's only central point of expertise regarding technical components of the Growing Smarter Act. Eliminating it would severely impede statewide efforts to promote planned community growth, particularly in rural areas. Also, this activity is inextricably linked with the Department's work regarding military base preservation.

Recommendation #2: If the Apprenticeship Services function is eliminated, the Legislature should consider transferring the Pre-Apprenticeship services to the Arizona Department of Transportation.

**Department Response #2:** The finding of the Auditor General is not agreed to and the recommendation will not be implemented. Fragmenting this function from the Department's Apprenticeship Services function and the business-led workforce system will impede the state's ability to develop statewide training strategies for in-demand skills.

Recommendation #3: The Legislature should consider options for addressing the following functions:

- International Trade and Investment Office – The Legislature could eliminate funding for this function, retain it, or, similar to a federal program, charge business for these services to help recover a portion of the costs.
- Business Attraction and Office of Innovation – The Legislature could eliminate this function, or retain some or all functions within this function.
- Rural Development – The Legislature could eliminate or retain this function.
- Arizona Film Commission – The Legislature could eliminate this function, or transfer it to the Arizona Office of Tourism.

**Department Response #3:** The Department submits that these functions should be retained and the following elements of the recommendation will be considered for implementation. (*See Attachment 5-8*)

**International Trade and Investment Office:** Unlike federal operations, the Department provides assistance focused on connecting Arizona companies with trade opportunities, by providing export counseling, generating trade leads and organizing trade events. Going forward, the Department will develop a fee structure, currently authorized by A.R.S. 41-1504.01, to charge businesses for export promotion services, helping to recover a portion of associated costs.

**Business Attraction and Office of Innovation:** Because it is the only statewide economic development entity, local and regional organizations depend on the Department to generate new business prospects, coordinate various location projects, and assist with local business retention and expansion efforts. Minimizing State assistance will substantially hamstring local economic development initiatives, particularly in rural areas. Moving forward, to more specifically measure the relative value of assistance, the Department will score locates based on the level of service provided and more accurately survey client companies.

**Rural Development:** This function provides critical state level assistance, helping small and rural communities organize and create the necessary public infrastructure to broaden their economic foundation, attract new businesses, expand the tax base and improve per capita income. This work is foundational, in that it provides local communities with technical expertise and modest grant monies to organize and implement locally driven economic development efforts. The Auditor General’s review found “the communities that Rural Development assists view the function as valuable.”

**Arizona Film Commission:** Attracting a film production company to Arizona injects money into the local economy, particularly important in rural areas. Local film offices depend on the Arizona Film Commission. No other organization serves as the central point of contact for production executives who are comparing production opportunities among competing states. When these executives contact the Department they are not thinking of a particular community, they are thinking of a particular “look.” The Department helps them match that “look” with a location in Arizona, presenting various locations and connecting them with local communities. Every state has a film commission because the film community desires a state-level, knowledgeable point of contact to meet their unique and complex needs. Transferring the function saves no funding and only disconnects the Commission from other economic development efforts.

Recommendation #4: The Legislature should consider eliminating General Fund support for the Arizona Job Training Program. The Auditor General recommends funding administration of the program from the fund, which is created by a dedicated tax and yields an estimated \$14 million annually.

**Department Response #4:** The finding of the Auditor General is agreed to and the Department will seek legislative approval to implement the recommendation.

Recommendation #5: While the Legislature could elect to retain the eight programs above, should it eliminate or transfer these functions it could also elect to sunset Commerce. If Commerce were sunset, the following five functions should be retained and could be transferred to other state agencies:

- Transfer the Arizona Job Training Program’s administration to the Department of Economic Security
- Transfer staff support for the Governor’s Workforce Development Council to the Department of Economic Security
- Transfer the Energy Office to the Arizona Department of Housing
- Transfer administration of tax-exempt private activity bonds to the Commerce and Economic Development Commission

- Transfer responsibility for the Arizona Military Airports Regional Compatibility Project and its federal Department of Defense Grant to another executive branch agency.

**Department Response #5:** The finding of the Auditor General that these programs be retained is agreed; however, the recommendation to transfer the programs is not agreed to and will not be implemented.

The report confirms that these functions should be retained because they provide valuable services to Arizona businesses, workers, cities, or counties, and do not require state appropriations.

**Arizona Job Training Program:** The Job Training Program is funded by a dedicated payroll tax and serves as one of only two state-level business attraction and retention tools. Only the Department has the stakeholder base and expertise to strategically administer this program. Transfer of a business-focused program to a welfare agency diminishes the efficacy of the program.

**Governor's Workforce Development Council:** The Department of Labor has consistently asserted that each state's workforce development strategies be focused on the workforce system's primary client – the business community. The Department is the State's link to the business community and, as such, is in the best position to administer this function within the greater context of statewide economic development strategies.

**Energy Office:** The report's assertion ignores the critical policy role of this function. As the recent gas situation demonstrated, reliable infrastructure is an absolute necessity for business retention and job creation. The Department informs growth and planning decision-making statewide and has the State's unique expertise regarding energy policy issues and trends that directly impact business' ability to locate and remain in the state.

**Tax-exempt Private Activity Bonds:** This function is outside the mission and competency of the Commerce and Economic Development Commission. Current status enables alignment with other key Department resources and statewide economic development strategies.

**Arizona Military Airports Regional Compatibility Project and Department of Defense Grant:** The Department is the only State agency with the planning expertise to ensure effective monitoring and implementation of the project, and to promote integration of this effort with Growing Smarter implementation.

Recommendation #6: If the Legislature elects to terminate Commerce, it should also eliminate Commerce's administrative functions.

**Department Response #6:** The finding of the Auditor General is not agreed to but the recommendation would be implemented if the Legislature chooses to eliminate the Department.

If the Department is eliminated, Arizona would become the only state in the nation without an effective statewide economic development agency, relegating the state to third-tier business environment status, generating much negative publicity and costing much more in future dollars to rebuild.

Additionally, Arizona would be unable to address two of its most pressing economic challenges – low per capita income and a lack of industrial diversity (40<sup>th</sup> among states). Arizona's per capita income is 85% of the U.S. average and dropping. Improving opportunity for Arizona's citizens requires attracting and growing new, high paying jobs in diverse industries.

Rural communities, which look to the Agency more than the metropolitan areas for infrastructure development and business relocation opportunities, will be especially impacted.

## RECOMMENDATION AND RESPONSE SUMMARY--FINDING 2

Recommendation #1: The Legislature should consider modifying the Department of Revenue's statutes to allow more complete reporting of the income tax credit program's fiscal impact on the State.

**Department Response #1**: The finding of the Auditor General is agreed to and the Department will advise the Legislature as it considers the recommendation.

At a minimum, the Department should be permitted to compare its data with DOR's to check accuracy. Currently, the Department receives some confidential information from the taxpayer but has no way to validate this information independently.

Recommendation #2: The Legislature should consider mandating in statute that a cost effectiveness analysis be conducted before:

- Commerce reviews each Enterprise Zone
- The Governor and/or Legislature renew each Military Reuse Zone; and
- The Legislature renews or revises any Commerce-administered tax incentive program.

**Department Response #2**: The finding of the Auditor General is agreed to and the Department will advise the Legislature as it considers the recommendation.

Unlike many other states, no resources are allocated to the Department to conduct cost/benefit evaluations of economic development incentives. Local zone administrating entities may not have resources for this purpose. The Department recommends that the legislature allocate sufficient resources for program evaluation.

In general, the Department agrees that the program is difficult to measure but does not agree with the Auditor General's impression that the costs exceed the benefits, and that incentives do not significantly impact job creation or business location and expansion decisions. First, the literature review was not specific to Arizona - Arizona's program is somewhat unique. Second, a June 2003 study entitled: "Cost-Benefit Analysis of California's Enterprise Zone Program" refutes some of the major sources of the Auditor's report. The study casts serious doubt on the methodology used by earlier researchers and suggests that if properly and conservatively evaluated, the California program clearly generates more revenues than it costs the state. ([See attached Auditor General Reply](#))

More importantly, the impression that the EZ program does not create jobs is erroneous. For example, if it is claimed that jobs are not created, there is no incentive provided by law. Moreover, if a company fires an employee that was among the new hires promised, the incentive can no longer be taken. Also, if a company closes or leaves the zone location, the credits stop and the company is prohibited from using carry forward credits.

Recommendation #3: The Legislature should consider mandating in statute that any Enterprise Zones and Military Reuse Zones that are found not to be cost-effective are terminated.

**Department Response #3**: The finding of the Auditor General is agreed to and the Department will advise the Legislature as it considers the recommendation.

It is important to note that eliminating a designation may create issues regarding vested rights. Firms make business decisions based on the understanding that the enterprise or military zone benefits will be available to them. A claim might be made against the State if a current operational zone is terminated.



As a result, the Department recommends that evaluation and potential termination occur only at the program level and when the program is subject to a normal five-year sunset review.

Recommendation #4: The Legislature should consider requiring a cost-benefit analysis of any new tax incentive programs prior to adopting them.

The Legislature should consider requiring a cost-benefit analysis of any new tax incentive programs prior to adopting them. The finding of the Auditor General is agreed to and the audit recommendation will be implemented should the Legislature incorporate this administrative discretion upon adopting new tax incentive programs.

Although it is true that an incentive or tax policy may not be as important as other factors in making location or expansion decisions, states do become finalists only when these more important factors are satisfied, such as adequate infrastructure and a well-trained workforce. Incentives often tip the scale in favor of one state over the next.

Finally, it is very misleading to suggest that Arizona has a liberal incentive policy or has made a habit of providing incentives similar to the examples the Auditor General used in referencing Tennessee, Kentucky, or Alabama when attracting firms to the state. In fact, Arizona has been very conservative with its incentive programs and it is not accurate to compare activities in those states with Arizona. .

## ATTACHMENT

**1) Small Business Services is the only statewide, one-stop resource for business. This service helps cut government red tape and reduces barriers to small business development by efficiently directing potential and existing entrepreneurs to available public/private resources and regulatory entities – without the run around.**

The Legislature created the Department's small business function to address the following issues:

- Small businesses face significant challenges navigating federal, state and local regulations, acquiring licenses and permits, and accessing public/private resources. In State government alone, over 57 offices impact business to some degree.
- Minority and women-owned businesses often face a unique set of challenges and historically have been under-represented in obtaining state procurement opportunities.
- Small business needs a conduit for entrepreneurs to connect with the Governor, Legislature and State agencies in order to address government barriers to business creation, essentially an ombudsperson.

By creating a centrally located information resource, the State improved service to Arizonans, providing a statewide connection of the multiple federal and local public/private small business organizations, cutting red tape and removing barriers to small business development. By utilizing on-line technology and targeted community outreach, the Department has been able to trim staff from 10.5FTE to 3.5FTE, while maintaining quality service. The Department's services are accessed through the Arizona Business Connection an average of 9,000 times a month. Staff participates in minority and women-owned business outreach an average of 6 times per month and conducts quarterly procurement opportunity informational functions targeted to minority and women-owned service providers.

Federal and local small business organizations rely on the Department's function. The Auditor argues that the network of Small Business Development Centers (SBDC's) could provide the same services. The Department works closely with these centers to ensure no duplication takes place. In fact, the SBDC's connect customers with the Department to address questions regarding basic licensing and regulatory issues.

- According to the State Director of the Arizona SBDC Network, "the SBDC does not provide the important informational and coordinative services that the Department of Commerce provides to small businesses and small business services provider organizations."<sup>1</sup>

The Department collaborates with the State Procurement Office and reaches out to the minority community to improve access to procurement opportunities. The Auditor argues that the "... SBA operates two women's business centers located in Phoenix and Tucson that provide information to women business owners such as how to apply for federal contracts ...." The fact is that the Department's function has statewide responsibility and is most appropriately suited to facilitating improved minority access to state contracts. This function connects with various entities, local, regional and federal, to improve overall opportunities for minority businesses.

Finally, the Auditor General misunderstands the Department's small business advocacy role. Certainly, membership driven business organizations advocate on behalf of dues paying members, and they serve their clients well. The Department's function is one of equal access to state government for all Arizona small business owners.

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<sup>1</sup> Mike York, State Director of Arizona SBDC network, wrote in a letter to Director Jimenez.

- Currently, this function is evaluating opportunities to streamline the state business permitting process, something no membership organization can effectively undertake; developing a stakeholder advisory council; identifying methods to better measure minority access to procurement opportunities; and helping to improve small business outreach among all Department programs.

**2) Apprenticeship and Pre-Apprenticeship Services Program helps businesses address their top priority – access to a qualified workforce.**

The Department assists Arizona employers with designing and implementing apprenticeship training programs, helping develop a supply of skilled labor. The Auditor contends that the federal government is obligated to provide these services if the state does not do so. However, the report fails to reflect the fact that the recommendation would result in lower service levels, reduced accountability, and the inability for the State to ensure the effort's strategic alignment with the needs of Arizona business. The Department has implemented 125 apprenticeship programs in Arizona.

- The federal Department of Labor (DOL) would be obligated to provide only minimal staffing.<sup>2</sup> The Auditor notes that 23 States rely solely on Federal support for this function, however, the report reveals no discussion of service or stakeholder satisfaction levels in those states. Recently, the Department was notified that DOL will eliminate its Arizona based FTE regardless of this recommendation beginning January 1, 2004. Any future Federal assistance will be provided out of DOL's Nevada-based office. Service levels would inevitably decrease to mere updates of new federal guidelines and new apprenticeable occupations. Presence in Arizona would be limited to possible participation at quarterly meetings to address questions or concerns about federal issues.
- Commerce maximizes program efficiency and customer service to Arizona businesses by working with various local, state, or federal programs/initiatives. Most importantly, it aligns apprenticeship training opportunities with the workforce needs of businesses statewide. The federal government would not support apprenticeship operations sufficiently to pursue these objectives.

**3) The Economic Information and Research function analyzes data, develops information, and conducts research that is fundamental and critical to all agency programs. The function also provides quality information to state and local decision-makers regarding economic, community, and workforce development.**

The Auditor states that “The information Commerce maintains is already available from other sources, and some of these sources have additional economic information and research and analysis that is unavailable from Commerce.” This criticism discounts the legislative mandate and demonstrates a fundamental misunderstanding of the development of economic information/policy. First, it isn't just about the availability/access to data, information and research. The primary function of EIR is to integrate multiple, disaggregated data sources, reports and other information, analyze the results and implications from an economic, community and workforce perspective, and conduct appropriate peer/public review. Only at the end of this process do these separate elements become useful for legislators, state and local officials and others in making well-informed public policy decisions. One data set or a single report does not a good decision make.

The Auditor states “...Commerce's role is generally not to perform its own research, but rather to coordinate research conducted by other entities, such as business, government, university, and civic groups.” EIR performs research in the most efficient and effective way – EIR identifies the research need, defines the scope of work, contracts with appropriate consultants/economists, approves and oversees research methodology, and approves the final results as credible and reliable. Throughout the research process, EIR involves a wide variety of agency constituents. EIR created the Economic Research Advisory Committee, a volunteer group that brings together the collective knowledge and wisdom of more than 15 seasoned economists on important economic

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<sup>2</sup>Ronald M. Johnson, Region 6 Director, DOL Employment and Training Administration, in a letter, January 6, 2003.

issues. With all three universities and several state agencies involved, the collaborative effort creates synergy and less duplication of research, saves the state money, and ensures objective and accurate results.

- Department led research projects include: Arizona Economic Base Study, Arizona's Economic Future, Positioning Arizona and its Research Universities, Arizona's Economic Infrastructure, Arizona's Special Economic Sectors, Economic Impact of Arizona's State Parks, Number of Small Businesses in Arizona. Forthcoming reports include: Community Economic Analysis, Impact of Technology Sectors in Arizona, High Technology Activities in Arizona. Department information has been used and referenced in numerous policy-making areas, most recently the Governor's Essential Services Task Force and the Governor's Council on Workforce Policy.

Also, EIR centralizes data and information and ensures its consistency across the Department's varied program responsibilities, ranging from local infrastructure development to business assistance. Data and information on the topics of economic, community, and workforce development are generated by more than 125 individual local, state, national and international sources. EIR ensures Department programs have accurate information.

As the legislatively mandated central clearinghouse for economic, community and workforce development research, EIR serves the public interest by assisting companies. If companies looking to relocate have to visit multiple agency, university and local government web sites to judge the suitability of Arizona, the state will lose out to competing states every time. The Department's EIR clearinghouse database, community profiles, research/studies, and other economic information tools provide the only centralized capacity to facilitate favorable consideration of Arizona communities. Local communities, particularly those in rural areas of the state, rely on EIR's centralized data for their own economic development efforts. No other statewide public or private source has the incentive to provide this perspective and service without additional funding.

**4) The Growing Smarter function is Arizona's only central point of expertise regarding technical components of the Growing Smarter Act, local planning, and military base preservation. This function is critical to statewide efforts – particularly in rural areas – to promote sensible, planned development.**

The Department believes implementation of the Auditors recommendation will have the following impacts:

- Diminish state leadership to promote sensible, planned growth statewide. Growth issues are consistently among the top agenda items of state, local and civic leaders. As the only state entity with expertise in planning, zoning, and Growing Smarter statutes, the Department is absolutely critical to state leadership in this area. No other state agency is monitoring compliance and implementation of the Growing Smarter statutes. For this reason, the Growing Smarter Oversight Council, the panel charged with monitoring the implementation of the Act, relies heavily on Department staffing and expertise.
- Adversely impact the ability of local communities to implement quality growth plans and to comply with the mandates of Growing Smarter. Growing Smarter is an unfunded mandate. 79% of Arizona's rural communities have neither in-house planning expertise nor the capital funds to hire consultants. To provide help, State statute mandates the Department provide technical and financial assistance to communities and counties.<sup>3</sup> These constituents consistently report that this assistance is valuable to local efforts. Over 40 communities and counties have been awarded grant assistance since 1998. Nearly 45% of Arizona's jurisdictions are still the process of updating general plans in compliance with the Growing Smarter legislation.

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<sup>3</sup> Have received Department assistance: Apache Junction, Avondale, Benson, Buckeye, Camp Verde, Carefree, Casa Grande, Cave Creek, Chandler, Clarkdale, Clifton, Colorado City, Coolidge, Cottonwood, Douglas, Eager, El Mirage, Eloy, Fountain Hills, Florence, Gilbert, Glendale, Globe, Holbrook, Huachuca City, Kearny, Quartzsite, Lake Havasu City, Litchfield Park, Oro Valley, Paradise Valley, Payson, Peoria, Phoenix, Pinetop-Lakeside, Prescott Valley, Quartzsite, Queen Creek, Sahuarita, San Luis, Scottsdale, Sedona, Snowflake, Somerton, St. Johns, Superior, Tempe, Williams, Winslow, Youngtown, and Cochise, Coconino, Gila Graham, Greenlee, La Paz, Pima, Pinal, Santa Cruz Counties.

- Growing Smarter functions are inextricably linked with the Department’s work to protect Arizona’s military bases (Military Airports Regional Compatibility Project). Growing Smarter statutes include military planning and zoning mandates related to land use compatibility around active military airports. The mandate for communities and counties to provide plan reviews and amendments to the Department maintains the link between state efforts to preserve Arizona’s military assets and the integration of state guidance into local growth governing documents.

**5) International Trade and Investment Office, utilizing its foreign trade offices in Europe, Mexico, Japan and Taiwan, provides tailored assistance focused on connecting Arizona companies with trade opportunities – export promotion counseling, trade leads, Arizona-specific trade events, etc.**

When Arizona’s businesses export goods and services, they import dollars to the local economy, creating substantial economic impact here in Arizona. Jobs connected with international exporting pay an average of 5-20% higher wages<sup>4</sup>. However, accessing these markets is difficult for small and medium-sized companies. In FY03, the Department conducted 817 technical assistance sessions with 356 companies and business organizations, and organized 5 targeted trade missions. 95% of survey respondents rated the service as important to the businesses’ ability to explore international markets<sup>5</sup>.

- An ASU College of Business study concluded: “Efforts to organize trade shows and trade missions, to develop leads for trade and investment, and to generally promote the Arizona economy are for the benefit of Arizona firms and workers. **Since the benefits are specific to the state, the activities should be carried out at the state level.**”
- The Department’s staff and foreign offices provide customized services that generate opportunities specifically targeted for Arizona companies, thus providing the companies with a competitive edge and more timely information and opportunities. The federal Export Assistance Centers and the foreign-located representatives of the US Commercial Service do not provide such specialized services. According to director of the Arizona Export Assistance Centers for the US Department of Commerce, “Eliminating [state department] assistance to us and our small business sector would result in lost exports, lost jobs, and lost revenue for the state of Arizona. Funding the Arizona Department of Commerce is an investment in our state’s future.”<sup>6</sup>
- Though federal centers work with Arizona companies, when a company requires information or services that are to be sourced/performed outside of the U.S., federal resources overseas handle the inquiries. These foreign-based offices do not work solely for Arizona companies – they work for companies in all 50 states. As a consequence, Arizona companies are lumped into mass, non-customized efforts. For this reason, most states maintain international export organizations to serve local companies. A survey of states’ international business development programs found that of 42 states responding, 37 maintain foreign offices. The average is 6.5 (Pennsylvania has 19; South Dakota has 1).<sup>7</sup> State contacts indicate that a key reason they maintain foreign offices is to provide local companies with targeted leads and services.

**6) The Business Attraction function markets the state to attract new businesses and provides state assistance to existing businesses seeking to expand.**

A Department-commissioned report concludes that Arizona ranks 40<sup>th</sup> among states in industry diversity, last among competing states in development or attraction of technology based industries, and has per capita income

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<sup>4</sup> Howard Lewis III and J. David Richardson, “Why Global Commitment Really Matters.”

<sup>5</sup> Annual survey conducted by the Department of customers that have received extensive support from International Trade and Investment Office.

<sup>6</sup> Frank Woods, Director, Arizona Export Assistance Centers, in a letter to the Department, May, 2003.

<sup>7</sup> Source: The State International Development Organizations and Council of State Governments, December 2002.

at 85% of the national average.<sup>8</sup> Also, recent budget shortfalls demonstrate the importance of expanding the tax base via business development. Though these facts are a function of many factors, targeted economic development efforts can attract businesses from diverse industry sectors that pay salaries above per capita and make substantial capital investment. The Department's work to this end provides critical assistance to local and regional economic development efforts statewide.

The Department generates the majority of business prospects for local and regional business attraction. Companies seek a central point of contact when considering locating in a given state. A national survey concluded that 80% of site selectors first contact the state economic development entity, seeking information such as business climate, workforce data and opportunities throughout the state.<sup>9</sup> A separate survey reports that a top priority of site selection consultants is a single contact at the state level that can handle or expedite their requirements for location.<sup>10</sup> Confirming this, the Auditor accurately states "... economic development officials contacted during the audit reported that businesses prefer to work with a neutral, state-wide contact that can provide impartial information about potential sites and answer questions about a state's business climate."

While there are many local economic development entities, the Department of Commerce is the only statewide organization. Local groups look to the Department for varying degrees of assistance. Rural areas depend almost exclusively on Department-generated qualified business prospects (metropolitan Phoenix about 50% and Tucson about 75%). The Department tailors its outreach to the needs of its stakeholder communities or organizations. All constituents depend on the Department for state-level coordination of some projects and assistance regarding state programs, resources and regulations. Rural areas rely on Commerce for a full range of assistance, including providing detailed information regarding state incentives, operating and tax environment, site selection services, industry expertise, workforce development resources, supply chain contacts, available and appropriate land and real estate, and governmental resources provided by the Department's local, state and federal partners. Recently in a survey of companies served by the Department, all respondents ranked this function's services as important to the decision to locate.

- In FY03, the Department provided location or expansion assistance to 54 companies (21 outside of Maricopa County). Expected 3-year job creation over 14,000 new jobs, with an average salary over \$40,420 (above Arizona per capita), and making capital investment of over \$568.6 million. The Department coordinated 187 prospect visits (159 non-Arizona companies; 28 Arizona companies seeking to expand)
- The Department played the lead role in establishing the Translational Genomics Research Institute (Tgen) and landing the International Genomics Consortium.
- Over the next three years, 70,000 new direct and induced jobs created by companies assisted by the Department between 1999 and 2002 will result in nearly \$400 million in state tax revenue.<sup>11</sup> The Auditor correctly points out that many factors played a role in company decisions to create these jobs. Department assistance benefits companies to varying degrees. The fact remains, however, that all companies in the study sought state assistance. The Department only lists companies where assistance provided meets a value-added threshold. Moving forward, to more specifically measure the relative value of assistance, the Department plans to score locates based on the level of service provided and to more accurately survey client companies.
- The Department launched an online supply chain development portal. AzBusinessLINC.com increases buyer awareness of products and services available throughout the state and identifies sales opportunities for Arizona companies encouraging transactions in and out of state. Successes to date from the test pilot in Southern Arizona: a \$50 million contract of the Department of Defense in Sierra

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<sup>8</sup> Economy.com "Arizona's Economic Future"

<sup>9</sup> The Marketing Center, "Factors in Site Selection", February 1999.

<sup>10</sup> O'Neil and Associates, 1999.

<sup>11</sup> Elliot D. Pollack & Co. Economic Impact Study

Vista; \$1.2 million in international contracts; nearly \$400,000 IT service contract award by a public sector entity in Tucson and several hundred thousand dollars of expected sales by a wire cabling company in Nogales.

- Targeted marketing efforts concentrate on face-to-face meetings as well as participation in trade shows including ComDef and Bio 2004 where existing industries such as Aerospace/Defense and achievements such as the attraction of TGen can be leveraged to attract new locates. A regional initiative marketing clusters of Arizona communities where a critical mass of industry, workforce, and infrastructure exist has also been launched to leverage local resources.

Finally, the Department must address a point by the Auditor that may mislead the legislature: “Research suggests that state-operated economic development efforts have a limited impact. Specifically, one report noted that locally based economic development and employment generation is more likely to be successful if initiated at the community and local level rather than elsewhere.” The cited text is *Planning Local Economic Development: Theory and Practice*. According to the co-author of the third edition of this text, Dr. Ted K. Bradshaw, “[The Department of Commerce] approach seems more in line with what we advocate in which states support local development initiatives and doing things more effectively done by the state than individual communities. In the quote [above], it appears that the auditors misinterpreted the findings.”

[\(See attached Auditor General Reply\)](#)

#### **7) Rural Development functions provide technical and financial assistance important to local initiatives in resource constrained rural communities.**

Arizona’s rural communities face significant economic challenges – high unemployment, low paying jobs and poor industry diversity – and they lack the local resources with which to address these issues. The Department’s Rural Development function provides critical state level assistance, helping small and rural communities organize and create the necessary public infrastructure to broaden their economic foundation, attract new businesses, expand the tax base and improve per capita income. This foundational work provides local communities the technical expertise and modest grant monies to organize and implement locally driven economic development efforts. The Auditor General’s review found “... the communities that Rural Development assists view the function as valuable.”

The two key programs in this effort are the Rural Economic Development Initiative (REDI) and Main Street program. REDI provides technical and financial assistance to more than 30 accredited rural communities. This assistance is typically the only help available and is critical to the ability of many rural communities to pursue economic development strategies. In FY02/03, the Department leveraged approximately \$140,000 in state resources into more than \$748,500 in local economic development projects (examples include rural business development marketing campaigns, site selection materials, labor force studies, etc.).<sup>12</sup> Lack of adequate telecommunications infrastructure is a premier barrier to rural business attraction efforts. The Department is supporting multiple community telecommunications assessments to map existing assets and identify gaps to be addressed by local decision makers.

The Main Street Program organizes and assists rural efforts to revitalize downtown business districts, critical to the economic sustainability of many small communities. This revitalization prevents economic leakage by providing local residents access to retail establishments, helping capture tourist spending that imports new dollars into the community and supports local government services. Since 1986, Arizona Main Street efforts have facilitated 8,186 new jobs, 1,529 new business, 3,774 building projects and \$1.4 billion in local reinvestment. To be sure, the Department does not claim the full magnitude of the impact; however, the results are a testimony to the organized state, federal and local collaboration led by the Department.

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<sup>12</sup> REDI participating communities include Benson, Casa Grande, Coolidge, Cottonwood, Eagar, Eloy, Flagstaff, Globe, Hayden, Kingman, Lake Havasu City, Miami, Nogales/Santa Cruz County, Payson, Pima, Pinetop/Lakeside, Prescott, Prescott Valley, Safford, St. Johns, San Luis, Show Low, Sierra Vista, Snowflake, Somerton, Springerville, Taylor, Thatcher, Wellton, Winkelman, Yavapai-Apache Nation, Yuma.

The Department disagrees with the Auditor General’s suggestion that the Rural Development function could be eliminated. The Auditor argues that a) “Funding and technical support is available to rural communities from other sources,” principally the State Historic Preservation Office (SHPO); and b) “... private fund-raising efforts have created funding for some rural development projects, although these efforts would need to increase if Commerce Main Street program were eliminated.” First, SHPO focuses on preservation planning, but provides no assistance regarding commercial district development or business retention, the critical element in many economic development strategies. Second, the Department encourages private sector contribution by requiring matching funds to public financial assistance. And third, the recommendation does not address the fact that no other entity is positioned to provide assistance delivered by the Department’s REDI program, leaving many communities with little or no opportunity to develop and implement business attraction and expansion strategies. Absent the Department’s Rural Development function, resource-limited rural communities will face increased barriers to economic development.

**8) The Arizona Film Commission attracts film production companies to Arizona, particularly rural areas, injecting substantial economic resources to the local economy.**

Attracting a film production company to Arizona injects money into the local economy, particularly important in rural areas. Local film offices depend on the Arizona Film Commission. No other organization serves as the central point of contact for production executives who are comparing production opportunities among competing states. When these executives contact the Department they are not thinking of a particular community, they are thinking of a particular “look.” The Department helps them match that “look” with a location in Arizona, presenting various locations and connecting them with local communities.

- Local communities depend heavily on the Department’s statewide coordination.
- Production companies rely on the Department to assist with permits dealing with state land, state highways, and federal property.
- Every state has a film commission because the film community desires a state-level, knowledgeable point of contact to meet their unique and complex needs.

According to the president of the Arizona Production Association, a volunteer organization and member association, “The AFC [Arizona Film Commission] is one of the key points of contact for businesses considering bringing in millions of dollars for production.” In addition, he states, “We need clean, high-tech, reusable industries and having the AFC promote Arizona Production as part of the Commerce Department is a great example of that kind of forward thinking.”<sup>13</sup>

The report’s statement that the Arizona Office of Tourism (AOT) helps organize tours of potential film locations is incorrect. This function is primarily managed by the Department – the role of AOT is limited to travel media tours. The recommendation to move this function to AOT does not take into account the need for expertise and experience to facilitate film production, connect with state, local, federal and tribal liaisons, secure production permits and conduct statewide locations scouts—services currently delivered by the Department. Also, transferring the function saves no funding and only disconnects the Commission from other economic development efforts.

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<sup>13</sup> Donald Woodard, President, Arizona Production Association, in a letter.



# AUDITOR GENERAL REPLY TO AGENCY RESPONSE

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The following auditor comments are provided to address certain statements made by the Arizona Department of Commerce:

- In response to the Arizona Department of Commerce's comments related to Finding 2, Recommendation 2 (see page 6 of their response), the Auditor General has determined that a central assumption of a June 2003 study Commerce cites (*Cost Benefit Analysis of California's Enterprise Zone Program*) results in an overstatement of the revenue generated by enterprise zones. Auditors spoke with the study's author, who concurred that the assumption he used warrants further investigation.
- The Auditor General disagrees with the Arizona Department of Commerce's statement (see page 13 of their response) that the Auditor General misinterpreted the passage from *Planning Local Economic Development: Theory and Practice*. In the audit report, the quote is used to support the limited impact of the state in attracting businesses. Auditors contacted both Professors Edward J. Blakely and Ted Bradshaw, who coauthored the third edition of this book. Both authors agree that state efforts in business attraction, specifically "smokestack chasing," are less effective than the overall business climate and other types of efforts, such as providing information and technical assistance, or guaranteed loans. Therefore, the Auditor General concludes that our statement does not misinterpret the intent of either author.