



THE POLITICAL ECONOMY OF STATE-PROVIDED TARGETED BENEFITS

State governments are increasingly using targeted benefits, such as tax credits and exemptions from sales taxes, to attract companies to their states. New research published by the Mercatus Center at George Mason University casts doubt on whether these targeted benefits actually achieve their stated goals of promoting employment, innovation, economic growth, and revitalization.

As George Mason University economists [Christopher J. Coyne](#) and [Lotta Moberg](#) show in a new study, policymakers often overlook the unseen and unintended negative consequences of these targeted benefits, including increased lobbying and cronyism, costly misallocation of resources, and a system that is biased against smaller firms. A better policy would be a level playing field, which does not discriminate between businesses.

Below is a brief summary of Coyne and Moberg's paper. To read the paper in its entirety and learn more about the authors, see "[The Political Economy of State-Provided Targeted Benefits](#)."

BACKGROUND

State governments have increased their use of targeted benefits in their efforts to promote employment and economic growth. These benefits include

- business tax credits for investment, property tax abatements, and reductions in the sales tax paid by the recipient business; and
- the establishment of "enterprise zones," granting advantages to companies that hire and invest in these areas.

THE IMPACT OF TARGETED BENEFITS

Targeted benefits often fail to achieve their stated goals and have major negative consequences such as misallocation of resources, an increase in lobbying and other rent-seeking, an increase in cronyism, and a bias toward large firms.

Misallocation of Resources

When policymakers provide targeted benefits, they remove the profit and loss signals that investors would otherwise use to determine the highest-valued uses of a particular resource. The lack of

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market signals also means that policymakers have no way of knowing the value of alternative uses of the resources being redirected as a result of their policies. The result is costly government investments that often fail to yield the benefits expected by policymakers. For example,

- A study of the Michigan Economic Growth Authority Tax Credit Program estimated the program's cost per job to be approximately \$45,000.
- A study of Minnesota's Department of Employment and Economic Development estimated that its Opportunity Building Zones cost approximately \$29,900–\$30,800 per job.
- Louisiana provided \$1.7 billion in incentives to Cheniere Energy with the goal of creating an additional 255 jobs and retaining another 77 jobs, costing the state nearly \$7.5 million for each job.

Encouraging Rent-Seeking

Companies end up expending resources on the political relationships necessary to secure future gains in the form of targeted benefits. These are resources that would otherwise be used for wealth creation. To affect policy, businesses create the impression that they are willing to relocate, and signal to policymakers that they fulfill the criteria of a suitable benefit recipient.

Institutionalizing Cronyism

Just as productive entrepreneurship leads to further wealth-creating activities, rent-seeking can multiply and create further economic woes.

- Companies begin to habitually serve political interests instead of satisfying consumer needs, and political competition replaces market competition. Consequently, cronyism—the established practice of exchanging favors between powerful people in politics and business—may become entrenched in the social fabric of a state.
- Increasing cronyism increases the demand for those who are skilled in lobbying and creating political connections. There is a growing industry of “location consultants,” some of whom demand up to 30 percent of the subsidies they negotiate, who assist companies seeking to relocate based on the best benefits package offered by state and local governments. Cronyism can become institutionalized as politics becomes a key factor for the economic sustainability of private businesses. In the future, the companies that succeed will be the ones that are most efficient at rent-seeking and influencing policy, not the ones offering the best products to consumers.

A Bias toward Larger Firms

When targeted companies hire people and invest, they can create the illusion that the benefits they receive increase a state's well-being. Policymakers therefore have an incentive to make large-scale, observable investments that appear to contribute more to a state's economic development. This creates a bias toward large firms when granting targeted benefits.

- In 1995, 79 percent of the 203 companies with gross revenues over \$300 million were receiving some kind of tax break, and companies such as Alcoa, Boeing, Nike, and Intel received benefits packages worth over \$2 billion each.
- In 2007, Alcoa obtained a then-record \$5.6 billion benefits package from the state of New York. In return, Alcoa agreed to make \$600 million in investments, and promised not to fire more than 165 people.
- In 2013, Boeing set a new record with \$8.7 billion in benefits from the state of Washington, where Boeing agreed to build the wings of its new 777X aircraft.

SUGGESTED SOLUTIONS

Rather than using policies that are *discriminatory* toward particular firms and industries, policy-makers would be better off pursuing policies that level the playing field for all businesses. To attract companies to their states while avoiding market distortions, policymakers should

- allow current targeted benefits to expire, and abolish state programs that grant them on a regular basis;
- make sure that targeted benefits cannot be granted on an ad hoc or informal basis;
- cooperate with other states to form an agreement about dismantling targeted benefits; and
- broadly lower tax rates to encourage company investments and obtain a more efficient allocation of resources.