PROTECTIONISM AMONG THE STATES
How Preference Policies Undermine Competition

In the bidding process for state government contracts, states often give significant preference to in-state firms even when the costs of doing so are higher than they would be if the contracts were awarded to out-of-state firms. Such preference policies unnecessarily decrease competition and increase expenditures funded by taxpayers, who end up paying higher taxes in consequence.

A new study for the Mercatus Center at George Mason University is the first to look at broad-based government bidding preferences. It finds that in-state preference policies are associated with a $148 increase per capita in state construction costs and a $158 increase per capita in capital expenditures, which translates to an increase of more than $600 million for the median state in each type of cost.

To read the study in its entirety and learn more about its authors, economics professor Adam J. Hoffer and entrepreneurship scholar Russell S. Sobel, see "Protectionism among the States: How Preference Policies Undermine Competition."

PREFERENCE POLICIES ARE POLITICALLY ATTRACTIVE BUT ECONOMICALLY HARMFUL

Preference policies fit a model of political decision-making, which shows that there is an incentive to support inefficient policies when benefits accrue to firms within a politician's political district. Contrary to economic theory and traditional cost-benefit analysis, politicians often view certain types of costs—such as labor and wages, capital expenditures, and resources purchased from local firms—as benefits to their specific district.

- Policies that give preference to local firms may be politically attractive, but they cause governments to overlook lower-cost bidders.
- In-state firms often have resources within the state to lobby the government, while out-of-state firms may not. Politicians may be more receptive to local firms because these firms donate to their campaigns and have greater power to influence voters.

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- The extent to which preference policies increase costs depends on how broadly the policies are enforced. For example, some states have rather narrow preference policies that only target certain types of businesses or industries, such as small businesses.

DATA AND RESULTS: BROAD PREFERENCE POLICIES INCREASE COSTS AND TAXES

Using data from the National Association of State Procurement Officials and state procurement offices, the study categorizes the states into three buckets: (1) No Policy; (2) Selective/Weak Preference Policy; and (3) Broad/Strict Preference Policy. The data yield the following observations:

- **Capital expenditures** in states with broad preference policies are $158 higher per capita on capital projects than in states without any preference policy. The average household in a state with a broad policy will pay $408 more per year for government services than a similar household in a state with no policy. Overall, this translates to $664 million more in capital expenditures for the median state.

- **Construction costs** in states with broad preference policies are $148 higher per person in the state, or $382 higher per household. Overall, this translates to $622 million in additional construction costs for the median state.

- Broad preference policies damage the economy by raising the costs of government services. These costs are passed on to citizens through higher taxes.

CONCLUSION

States that implement preference policies spend more on construction and capital expenditures per capita than states that do not have such policies. As a result, the average American in a state with a preference policy pays more in taxes for the same type of work. State legislatures should work toward removing preference policies because they harm taxpayers and economic growth.