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RESEARCH SUMMARY

Is There a Tradeoff between Economic Development Incentives and Economic Freedom? Evidence from the US States

By using targeted incentives such as tax exemptions, abatements, regulatory relief, and taxpayer assistance, state and local governments across the United States aggressively recruit and retain businesses to help sustain and grow their local economies. Research has found that local economies with higher levels of economic freedom also have higher levels of income and faster economic growth. Because higher taxes and stricter regulations reduce economic freedom, do these targeted incentives increase it?

In "Is There a Tradeoff between Economic Development Incentives and Economic Freedom? Evidence from the US States," John A. Dove and Daniel Sutter explore the relationship between these incentive packages offered to businesses and the level of economic freedom in states.

FINDINGS

Using the Good Jobs First Subsidy Tracker 3.0, which offers a comprehensive look at incentive deals across the United States, and the Fraser Institute's Economic Freedom of North America Index (EFNA), which looks at levels of government spending, taxation, and labor market freedom, Dove and Sutter find the following:

- States that spend more on targeted development incentives as a percentage of gross state product have less overall economic freedom.
- To illustrate the magnitude of this effect, Alabama, which is ranked 26th in the EFNA index, has an average overall economic freedom score of 6.9297. A 10 percent increase in incentive expenditures would be associated with lowering its score to a range between 6.5347 and 6.1667, dropping Alabama to a ranking anywhere between 38th and 45th.
- Of the three areas within the EFNA index, labor market freedom is most affected by targeted development incentives.

TARGETED INCENTIVES MAY STUNT ECONOMIC DEVELOPMENT

As states continue to compete for businesses by improving the business climate or the level of economic freedom, this paper offers evidence about how development incentives and freedom of local economies relate. Though targeted incentives may, in fact, increase economic freedom if the tax incentives slowly diffuse across industries and ultimately become broad based rather than selective and targeted, Dove and Sutter do not find that happening in their analysis. Rather, states that use targeted incentives most intensely have lower levels of economic freedom. This could be because state governments that use more subsidies or tax breaks to attract businesses spend more or raise tax rates for everyone else, reducing overall economic freedom.