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POLICY BRIEF

Setting Community Development Priorities in Maine

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States receive federal grants in many forms. One of the most flexible is Community Development Block Grants (CDBGs), which states divvy up among localities too small to be entitled to direct funding from the Department of Housing and Urban Development (HUD).[1] This grant-making power gives state governments a valuable tool: the state determines its funding priorities and sifts through applications from localities. Maine has prioritized direct payouts to favored local businesses, an approach to community development that is ineffective and open to cronyism. Maine can benefit from redirecting that money to alternatives that are better aligned with the state's broader priorities for public investment.

SETTING PRIORITIES

CDBG funds arrive outside of normal budgets; that is, localities cannot count on receiving a grant in any given year. For localities, CDBG funds can be the cherry on top after all normal expenses are paid or can—at least temporarily—fill gaps left by shrinking budgets. States, however, not localities, decide which types of activities to fund each year.

As table 1 shows, states have distinct priorities. West Virginia has a clear top priority, putting 96 percent of its CDBG allocation into water and sewer systems. That was a popular choice; public improvements (including to water and sewer systems) accounted for 63 percent of CDBG use (in fiscal year 2016) in the 18 states analyzed here.[2] Most states prioritize infrastructure, especially water and sewer systems.

Housing was a top priority only in Vermont, which put 58 percent of its CDBG grant into construction, rehab, land acquisition, and other housing-related activities.

Table 1. Spending Priorities for 2016 CDBGs in Maine and Peer States

STATE	PUBLIC FACILITIES & IMPROVEMENTS	ECONOMIC DEVELOPMENT	HOUSING	ADMINISTRATION & PLANNING	ACQUISITION	PUBLIC SERVICES	OTHER
Maine	27%	34%	24%	5%		7%	3%
Alaska	97%			3%			
Arkansas	55%	39%		5%			<1%
Idaho	84%	5%		10%			1%
Iowa	55%	19%	18%	6%	1%	<1%	1%
Kansas	87%	1%	5%	7%	1%		
Kentucky	52%	7%	17%	9%	3%	11%	
Mississippi	62%	28%		11%			
Montana	45%	20%	1%	19%		15%	
Nebraska	53%	13%	18%	13%	1%	<1%	2%
Nevada	65%	3%	4%	14%	11%	4%	1%
New Hampshire	40%	26%	21%	6%	7%	<1%	<1%
New Mexico	95%			4%			1%
North Dakota	64%	5%	14%	8%	8%		1%
South Dakota	89%			6%		4%	1%
Vermont	15%	2%	58%	5%	17%	2%	1%
West Virginia	96%			3%			1%
Wyoming	51%	<1%		18%	28%	2%	
Average	63%	11%	10%	8%	4%	3%	1%

Source: US Department of Housing and Urban Development, "CDBG Activity Expenditure Reports," accessed March 12, 2020, https://www.hudexchange.info/programs/cdbg/cdbg-expenditure-reports/.

Maine was the only state where economic development, which consists almost entirely of grants to for-profit companies or "micro-enterprises," was the top priority, at 34 percent. (Arkansas put more into economic development but spent an even larger percentage on public improvements.) Newer program data for Maine are available, showing that the state has decreased grants for housing (down to a single million-dollar grant in 2019) and increased grants for public improvements. Economic development activities were 35 percent of 2019 CDBG expenditures.[3]

Economic development grants are prone to cronyism and usually ineffective. It is time for Maine to reevaluate its budgetary choices and prioritize CDBG uses that are fairer and deliver better results for residents.

THE GELATO FIASCO

In 2015, Gelato Fiasco, Inc., received a $350,000 state CDBG grant.[4] In addition to dishing out delicacies in Brunswick and Portland, Gelato Fiasco was shipping to 2,000 grocery stores by April 2015 and had already received a $200,000 investment from the Maine Venture Fund.[5] The state's support raises questions of fairness and invites suspicion of cronyism. Gelato Fiasco competes with other Maine businesses for prime retail space, employees, supplies, and private investments, and it has the government on its side.

Many other companies have found their way onto the list of favorites: $50,000 for Todd's Custom Contracting; $690,000 for Central Maine Meats; $240,000 for Modernist Pantry; and $60,000 for Bob's Neighborhood Store in Madawaska.[6] The list of unsupported businesses is, of course, much longer. Some well-known food exporters, not so different from Gelato Fiasco, are absent from the 1982–2019 recipient list: Wyman's, Raye's Mustard, Stonewall Kitchen, the Maine Beer Company, and Steve's Snacks.

Local governments, which petition the state on behalf of local companies, are not disinterested parties. After Crowe Rope (which had received a large grant in 1996) went bankrupt in 2002, the town of Winslow repossessed the premises. The town ended up leasing Crowe's old building to Orion Ropeworks and Johnny's Selected Seeds.[7] Winslow thus has a direct interest in its tenants' ability to make rent. Since then, Orion Ropeworks has received three CDBGs as a result of Winslow's intervention in 2005, 2011, and 2012.[8] These disbursements represent 79 percent of Winslow's grants since 2000. Whether self-serving or not, direct grants to for-profit businesses open up towns and the state to charges of cronyism.

ECONOMIC DEVELOPMENT SUBSIDIES DON'T WORK

Research consistently finds that targeted government aid does not help the broader economy, even though its nationwide cost amounts to 38 percent of state corporate tax revenues.[9] The jobs created by the favored business are offset by job losses among competitors and lower startup rates.

A study by the Mercatus Center at George Mason University explores development incentives using theoretical frameworks from industrial organization, game theory, public-choice economics, and institutional economics. The authors find that development incentives are likely to be counterproductive because, among other reasons, they are likely to lead to production that is not cost-effective and to wasteful lobbying on the part of firms.[10]

Presenting new research in *Economic Development Quarterly*, four authors find that "in contrast to their intended purpose, incentives crowd out new firms, and the crowding out effect is so large that it offsets any effect incentives might have in attracting new firms."[11] Another group of authors studying a wide range of policies finds that "targeted tax incentives and financial assistance—as currently practised—are more likely to harm growth and [increase] income inequality."[12]

Three political scientists from North Carolina State University find that states that used more fiscal incentives from 1990 to 2015 ended up in worse fiscal health, controlling for other characteristics.[13]

Consultants frequently produce optimistic projections for economic development policies. However, those projections are rarely rigorous. As political scientist Terry Buss opined after reviewing "dozens of studies and strategies," industry targeting "is based on poor data, unsound social science methods, and faulty economic reasoning and is largely a political activity."[14]

In other contexts, state governments and scholars bemoan the race to the bottom of localities competing against each other to attract big-box stores and other large employers. Law scholar Michael Walker has suggested that the state of Maine should put stricter limits on the use of tax increment–financing deals for development.[15] But instead of curtailing this behavior, Maine's use of CDBG funding promotes it.

A RELIABLE ALTERNATIVE: REPAIR AND REPLACE INFRASTRUCTURE

Infrastructure repair and replacement are more promising and fairer uses of CDBG funds: localities are routinely unprepared for the long-term costs of replacing infrastructure,[16] and lump-sum replacement costs align with the lump-sum nature of CDBGs. The coronavirus crisis of 2020 has likely led to larger-than-usual infrastructure backlogs that will take years to work through.

Funding infrastructure repair and replacement through CDBGs relieves towns of the burden of imposing higher taxes or issuing bonds.

Funding new infrastructure, by contrast, is riskier. New infrastructure creates a permanent maintenance liability; if the new costs are not matched by economic growth, the result is a greater permanent burden on the recipient. Grant funding for new infrastructure projects creates a well-known "ribbon cutting" effect, where local elected officials bask in the immediate excitement and are long retired when the added maintenance costs come due.[17]

There is little scholarship on the economic effects of basic infrastructure in the contemporary United States—in no small part because road access, clean water, and electricity are nearly universal. The primary benefits of infrastructure repair and replacement are in local budgets and quality of life. Roads do eventually get repaved, and water mains are eventually replaced—but perhaps not until a crisis forces the issue. CDBGs should not be the only source of funding for staying ahead of these inevitable costs, but they can be part of the solution.

AN URBANIST ALTERNATIVE: FUND NEW OR EXPANDED SEWER SYSTEMS IN TOWN CENTERS

Maine's town centers are not only iconic tourist attractions; in many cases, they also provide walkable, highly valued residential neighborhoods with access to a small cluster of jobs, schools, and amenities.[18] Clustered development is more cost-effective for local governments and schools and has less environmental impact than scattered development.

But the growth of many small town centers is sharply limited by the lack of sewerage.[19] Although demand may exist for town lots, they cannot be built—or even platted—without a sewer in place. And constructing a sewer speculatively is a major risk for a small town.

To promote the growth of these key centers, Maine could program a portion of its CDBG funds to create or expand sewer systems in locations that conditionally allow walkable lot sizes and subdivision of existing lots.[20] Such an investment would not be without risks, so the state would have the burden of evaluating whether demand for town lots would be sufficient to cover ongoing maintenance and eventual replacement costs for any grant-funded sewer.

Maine already distributes other water and wastewater loans and grants, including the Clean Water State Revolving Loan Fund. And Maine voters have indicated that wastewater treatment is a priority, approving a $30 million bond issue to fund a State Municipal Construction Grant Program.[21] Maine should enhance the effectiveness of existing programs by giving priority to places where local zoning allows wastewater infrastructure to be most efficient.

If successful, newly growing town centers could address a conundrum facing many small Maine towns: a housing stock that is at the same time too large and too dilapidated, and for which new development seems to come at the expense of older neighborhoods. The Milo Comprehensive Plan could describe most Maine towns: "Although Milo does have an oversupply in their housing market, the available houses do not currently match the housing demand. Many of the unoccupied or available housing units are lower quality while the current demand is for higher-end housing."[22]

CONCLUSION

State and local policymakers should take a critical and long-term view of grant-funded spending priorities and avoid funding private businesses, which inevitably leads to the perception of favoritism. The principles outlined in this brief apply to grant programs other than the CDBG program and to states other than Maine. This brief presents the case that repair and replacement of infrastructure are reliable and low-risk uses of flexible federal grants and that judiciously located sewer systems could allow attractive, walkable development in small town centers; rigorous internal analysis may find an even more worthy spending target. Regardless, states and towns should always be prepared to alter their spending priorities to better serve their citizens.

ABOUT THE AUTHOR

Salim Furth is a senior research fellow at the Mercatus Center at George Mason University. He studies regional, urban, and macroeconomic trends and policies and has testified before the US Senate and House of Representatives. Previously, he worked at the Heritage Foundation and Amherst College. His writing has been featured in *National Affairs*, *American Affairs*, *The City*, and *Public Discourse*, and he wrote regularly for the *Wall Street Journal's Think Tank* blog. He earned his PhD in economics from the University of Rochester in 2011.

NOTES

1. Principal cities of metropolitan areas, cities with populations of at least 50,000, and urban counties with populations of at least 200,000 are entitled by statute to direct annual Community Development Block Grants, bypassing the state government. In fiscal year 2018, Auburn, Bangor, Biddeford, Lewiston, and Portland and Cumberland County received entitlement grants.
2. The 17 peer states were selected as relatively comparable to Maine, which has a large rural population share and low population growth, among other traits.
3. Maine Department of Economic and Community Development, "CDBG Funded Projects 1982-2019" (dataset), accessed March 12, 2020, https://www.maine.gov/decd/community-development/cdbg-program.
4. Maine Department of Economic and Community Development, "CDBG Funded Projects 1982-2019" (dataset).
5. "Our History," Gelato Fiasco, accessed March 12, 2020, https://www.gelatofiasco.com/our-story/timeline/; Maine Venture Fund, *2015 Periodic Report*, December 15, 2015, http://lldc.mainelegislature.org/Open/Rpts/hg4057_m2m3_2015.pdf.
6. Maine Department of Economic and Community Development, "CDBG Funded Projects 1982-2019" (dataset).
7. Meg Robbins, "Johnny's Selected Seeds Buys Part of Winslow Building from Town for $1.65M," *Central Maine Morning Sentinel*, November 24, 2019.
8. Maine Department of Economic and Community Development, "CDBG Funded Projects 1982-2019" (dataset).
9. Cailin Slattery and Owen Zidar, "Evaluating State and Local Business Incentives," *Journal of Economic Perspectives* 34, no. 2 (2020): 90–118.
10. Matthew D. Mitchell et al., *The Economics of a Targeted Economic Development Subsidy* (Arlington, VA: Mercatus Center at George Mason University, 2019).
11. Mark Partridge et al., "The Effects of State and Local Economic Incentives on Business Start-Ups in the United States: County-Level Evidence," *Economic Development Quarterly* 34, no. 2 (2020): 183.
12. Stephan J. Goetz et al., "Sharing the Gains of Local Economic Growth: Race-to-the-Top versus Race-to-the-Bottom Economic Development," *Environment and Planning C: Government and Policy* 29, no. 3 (2011): 428.
13. Bruce D. McDonald III, J. W. Decker, and Brad A. M. Johnson, "You Don't Always Get What You Want: The Effect of Financial Incentives on State Fiscal Health," *Public Administration Review* 9999, no. 9999, published ahead of print (2020): 1–10.
14. Terry F. Buss, "The Case against Targeted Industry Strategies," *Economic Development Quarterly* 13, no. 4 (1999): 339.
15. Michael Walker, "Tax Increment Financing in Maine," *Maine Law Review* 70, no. 1 (2018): 115.
16. Charles Marohn, "What Should My City Do about Our Infrastructure Backlog?," *Strong Towns*, January 13, 2020.
17. Stephen Lee Davis, "America's Infrastructure Priorities Need Repair," *Strong Towns*, May 14, 2019.

18. A report focused on similar town centers in Vermont shows how zoning can be reformed to promote town centers' best features. Congress for the New Urbanism and Vermont Agency of Commerce and Community Development, *Enabling Better Places: A Zoning Guide for Vermont Neighborhoods*, 2020.

19. Maine's minimum-lot-size law requires, inter alia, 20,000 square feet (slightly less than a half acre) for single-family lots with on-site, subsurface solid waste disposal. ME. REV. STAT. ANN. tit. 12, § 4807 (2020). Most towns go further and require an acre or more.

20. Rumford and Skowhegan offer a model of this policy, both maintaining 10,000-square-foot minimum lot sizes for new sewer-served lots and 40,000 square feet for lots without municipal sewerage. However, towns promoting walkability would do better to set the minimum at 5,000 square feet or fewer to allow a mix of walkable lot sizes. RUMFORD, ME., A REV. CODE OF ORDINANCES, ch. 31, art. 3, § 301 (2020); SKOWHEGAN, ME., SUBDIVISION REVIEW ORDINANCE § 6.10.2.1 (2012).

21. Maine Department of Environmental Protection, "January 2020 O&M Newsletter," January 2, 2020, https://content.govdelivery.com/accounts/MEDEP/bulletins/27224c2.

22. Town of Milo, *Comprehensive Plan 2005*, August 11, 2006, K-1.