MERCATUS CENTER
George Mason University

RESEARCH SUMMARY

States, Businesses, and the Art of the Megadeal: Discredited Economic Incentives versus Sound Economic Policy

State and local governments often seek to attract firms with targeted economic incentives, such as loan guarantees and tax abatements. This practice continues despite the fact that such policies do little, if anything, to promote economic growth or employment. So why do they do it? And what kinds of states are more likely to offer these targeted economic incentives?

As Peter T. Calcagno and Frank L. Hefner explain in "Targeted Economic Incentives: An Analysis of State Fiscal Policy and Regulatory Conditions," they do it because the political benefits of incentive packages can outweigh the economic realities. Those most likely to offer megadeals (tax incentives of $75 million or more) are states with high unemployment rates, high income tax rates, and government spending in excess of state revenues.

The authors make the following points in their analysis of targeted economic incentives:

- *What deters businesses:* High tax burdens, complex regulations, and poorly trained labor increase the cost of doing business.
- *What improves the economic climate:* Reforming fiscal and regulatory policies could make conditions more attractive to investment, without state or local governments picking winners and losers.
- *Why reform rarely happens:* Policy reform can be politically costly and does not have the immediate political benefits of "creating jobs."
- *What many policymakers prefer:* They opt for the status quo and offer firms targeted incentives instead of reforming fiscal and regulatory policies.
- *What policymakers believe incentive packages will do:* They will offset the otherwise negative economic conditions within the state.
- *Where competition occurs within states:* Local governments also offer megadeals to attract firms and increase employment.

The "jobs created" at a new plant are easily visible to voters in the state and local community. Less visible to them are the jobs lost elsewhere in the economy because of the higher tax burdens on businesses and consumers. Voters are also less likely to see cronyism and "rent-seeking" as firms lobby for tax breaks and other subsidies, which can result in a bidding war between state and local governments.

In the end, a firm that bases its location decisions on the generosity of available incentives and subsidies is a firm that will relocate when it gets a better offer. Rather than relying on megadeals, policymakers can improve tax, regulation, and labor market conditions, which will benefit all firms, targeted or otherwise. Such reforms will not only help attract businesses but persuade them to stay, resulting in long-term benefits to the community.