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RESEARCH SUMMARY

A Federal Bailout for States Could Stop Wasteful Subsidies: How Congress Can End the Interstate Economic Development Arms Race

Congress is debating the size and scope of its assistance to state and local governments facing a pandemic-caused $975 billion budget gap for fiscal years 2020–2022. In "Federal Pandemic Relief Could End the Interstate Economic Development Arms Race," Michael D. Farren and John Mozena propose a response from Congress that many federal, state, and local leaders would support: any further aid should come with a condition banning state and local economic development subsidies.

BANNING SUBSIDIES WOULD HELP STATE BUDGETS

There is good evidence that granting subsidies harms the fiscal health of state and local governments. The approximately $95 billion spent annually on subsidies is equivalent to each of the following:

- 4.5 percent of all state expenditures
- Double the total 2019 bond expenditures of the states
- The combined annual expenditures of 11 states

BANNING SUBSIDIES WOULD HELP THE FEDERAL BUDGET

Congress provided $750 billion in grants to state and local governments in 2019. To the extent that these grants are fungible, the federal government has likely been partially bankrolling every competitor in this mutually destructive subsidy arms race.

Decreasing future grants by the $95 billion spent on subsidies could pay for all federal food assistance programs ($68 billion) and build two new aircraft carriers ($25 billion) every year.

BANNING SUBSIDIES WOULD IMPROVE ECONOMIC GROWTH

Economic development subsidies generally don't lead to economic growth. They obviously benefit the favored corporations, but the costs of subsidies are often forgotten or ignored.

- Other businesses and workers pay higher taxes, reducing their contribution to economic growth.
- Public services, such as education, public safety, and infrastructure, are cut to help pay for subsidies. This reduces current and future economic development.
- Subsidies add to the advantages large corporations have over smaller competitors, discouraging entrepreneurship and artificially increasing economic inequity.

- Subsidies reduce innovation, which makes American companies more inefficient—and therefore less competitive—in the global economy.

STATES STRUGGLE TO SOLVE THE PROBLEM THEMSELVES

- Local voters face greater difficulty in organizing to resist subsidy-granting than large, politically influential corporations do to lobby for it. This dynamic creates an imbalance of political influence that perpetuates the problem.
- Many policymakers know it would be better to work together and avoid subsidies, but they lack an easy means to cooperate. Congress can help by mandating cooperation.

SUPPORT FOR ENDING SUBSIDIES IS BIPARTISAN AND WIDESPREAD

- Taxpayers, businesses, and voters from across the political spectrum grow increasingly frustrated at local governments giving corporate handouts while their own taxes rise and public services decline.
- Many policymakers are tired of the endless treadmill of subsidies and prefer to concentrate on more effective governance.
- Economic development officials often say that they want to focus their efforts on broadly based economic development policies, rather than act as middlemen for corporate handouts.
- Teachers, firefighters, and other public employees know that each dollar lost to subsidies is a dollar that cannot be spent on their equipment, training, or salaries.

Today's subsidy arms race is a legacy of ill-informed recovery efforts from the Great Depression. Past experience suggests that the wasteful spending will again accelerate as state and city officials grow desperate to show voters that they are trying to stimulate economic growth. Congress has the opportunity to solve the subsidy arms race in one fell swoop, before it harms America's nascent economic recovery.