

RESEARCH SUMMARY

## Interstate Compacts against Economic Development Subsidies: How to Stop the Economic Race to the Bottom

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State and local policymakers use targeted economic development subsidies in an attempt to attract new businesses to their jurisdictions or to encourage already-established companies to expand or maintain their current operations. Unfortunately for policymakers and taxpayers, these subsidies are more likely to undermine economic development than to enhance it.

In “[An Interstate Compact to End the Economic Development Subsidy Arms Race](#),” Michael D. Farren and Matthew D. Mitchell examine subsidies such as cash handouts, income tax credits, and any government-granted privilege that creates exclusive economic benefits for the recipients. They explain why subsidies don’t work and describe the economic problems they cause. The authors also explain why policymakers continue to offer subsidies. An interstate compact—an agreement not to offer subsidies—can stop this counterproductive economic race to the bottom.

### WHY SUBSIDIES DON’T WORK

- It is estimated that only one out of every eight subsidies influences a company’s decision about where to locate, whether to expand, or whether to stay put. That means that most of the estimated \$95 billion states and cities spend on subsidies every year is wasted.
- Subsidies must be funded by taxes—and higher taxes tend to discourage economic activity.
- Subsidies are also paid for by a reduction in spending on public services such as education, public safety, and infrastructure.
- Subsidies can also protect the subsidized company from competition. The company may not have to work quite as hard to create value for its customers or control costs as it would have without the subsidy.

### WHY POLICYMAKERS KEEP OFFERING THEM

- Many of the costs of subsidies (such as those listed above) are generally not considered, or are undercounted, before investment decisions are made.
- Taxpayers face greater difficulty in organizing to oppose subsidies than companies face in campaigning to maintain them.
- Politicians believe it is politically advantageous to offer subsidies, especially when politicians in other localities are doing so. A recent survey found that 84 percent of mayors believe it is beneficial to offer subsidies.

## **INTERSTATE COMPACTS CAN MAKE THEM STOP**

- States and cities can enter into agreements with each other to refrain from offering subsidies that seek to poach companies from one another.
- Such agreements, outlined in a clause in the US Constitution, are known as interstate compacts and carry the weight of law.
- During the past several years there have already been multiple attempts to develop an interstate compact to address the problems of economic development subsidies.
- Interstate compacts allow the states to work together to solve common policy problems without intervention by the federal government.

## **AN INTERSTATE COMPACT WOULD DO MORE TO ENCOURAGE ECONOMIC GROWTH THAN ALL THE SUBSIDIES COMBINED**

The money currently wasted on subsidies could be used to improve critical public services and provide tax reductions for all households and business. This change would do more to improve economic growth than the trillions of dollars that politicians have wasted on subsidies, trying to convince voters that they are doing something to improve the economy.