What's wrong with development subsidies?

There are many problems with both the concept of development subsidies and the way in which they are typically implemented, monitored, and enforced. Criticism of subsidies and calls for reform come from both the private and public sectors, as well as from both ends of the political spectrum. The major problems with development subsidies include:

1. The process of awarding subsidies lacks transparency and public participation
Most subsidy decisions are made in private meetings, with the public only being let in on the details at the press event announcing the signed deal. The shroud of secrecy and relegation of development decisions to the domain of "experts" by companies and public officials often serves to discourage public participation. When avenues for public participation are available, such as a public hearing, they tend to be poorly publicized and announced too late for community members to organize more than a cursory response to the issues on the agenda.

2. Subsidies often lack binding requirements as to the benefits companies must produce
Many subsidies have few if any requirements companies must meet to qualify for aid. Although some subsidy programs are targeted at the neediest areas, certain types of businesses, or industries that an area hopes to attract, many subsidies are handed out with little thought given to whether the project is the best use of taxpayer money or offers the greatest benefits to communities. The result can be taxpayers paying to promote poverty-wage jobs and sprawl. Subsidy programs that do have requirements often lack the legal teeth (known as *clawback* provisions) to stop payments or demand refunds of subsidies paid in the event that a company fails to live up to its commitments.

3. Company commitments are often poorly monitored and enforced
Requiring companies to meet certain standards to qualify for subsidies does nothing if a company's compliance with the agreement is not monitored and enforced. Many jurisdictions never check up to make sure that development projects create the jobs, pay the wages, or meet the environmental standards or investment requirements they agreed to as a condition of a subsidy. When a company is found to be noncompliant, officials are often reluctant to enforce penalties, fearing that they will be cast as "anti-business."

4. Subsidies come with hidden costs
Tax expenditures -- uncollected income, sales, and property taxes -- are generally the largest subsidies companies receive. Very few jurisdictions figure out how much a subsidy deal is actually worth, or track how much they are spending on subsidies in their budgets. In addition, economic development subsidies can produce *hidden taxpayer costs* when subsidies are giving to companies that pay poverty-level wages. In those cases, taxpayers pay twice: once for the direct subsidy, and again for programs such as Medicaid, food stamps, and housing assistance that are funded through taxpayer dollars and are needed by a company's workers need to make ends meet.

5. The costs vs. benefits of subsidies to taxpayers are rarely analyzed
Public officials rarely evaluate the actual outcomes of projects against their projected impact on an area's development. In addition to getting hard figures on the costs of subsidies and better monitoring of compliance as discussed above, development officials need to assess whether the larger expectations of the project -- such as the creation of multiplier effect jobs or the attraction of other new firms to the area -- pan out. Even with that information, however, it can be hard to say what new development, including the subsidized project itself, would not have happened "but for" the subsidy, and which would have gone ahead regardless.

6. Subsidies often go to companies that would have built there anyway
Subsidies are increasingly treated as entitlements rather than enticements, both by companies shopping for the best deal and by governments trained to reach for their checkbooks at the rumor of a corporate relocation. Companies such as Boeing, Marriott, and Sears all spurred bidding frenzies by putting out relocation feelers, and then collected millions in tax breaks for staying put. In reality, location decisions rarely hinge on subsidies. Business basics -- proximity to markets, availability of labor, quality of infrastructure, quality of life, etc. -- determine where companies move. It is *public goods* that benefit all employers that are the key to a good business climate, although a company is never going to turn down free money. Spending for economic development is best directed to education, skills, and infrastructure, not expensive, company-specific subsidy giveaways.

7. Subsidies divert money from public goods
Money not collected through tax breaks would otherwise go to fund roads, schools, fire departments, and other public services that benefit all citizens and businesses. New development in an area increases the demand for such services. When large corporations avoid paying their fair share, the burden gets shifted onto working families and small businesses. The rest of us pay more, or the quality of our public services declines, or usually some of both.

8. Subsidies put local businesses at a disadvantage
Subsidies are disproportionately handed out to large companies moving into an area from out of state, giving them advantages that long-standing, existing businesses don't get. Fiscal conservatives, free-traders, and libertarians often oppose subsidies on the grounds that they interfere with the market, giving government-aided preference to one group over another. Small business owners bear the brunt of the impact of this unfair competition. These companies may have long histories as community members and taxpayers, but it is the big corporations new to the area that get special breaks. The situation gets even uglier when governments subsidize large retailers such as Wal-Mart. In those cases, multi-national big-box giants receive taxpayer aid to open stores that compete directly with local merchants.

9. Subsidies promote an economic "war among the states"
Subsidies also fuel competition among state and local governments looking to attract large companies to their regions. Companies are experts at playing jurisdictions off one another, often with the help of professional site location consultants, who work to create bidding wars that up the size of subsidy offers (and the size of the commission the consultants receive). The result is a race to the bottom that benefits no one but the companies. Many public officials realize this and want to stop offering subsidies altogether, but fear that they will be left at a competitive disadvantage.

10. Some subsidies may be illegal
Currently, a court case is challenging the legality of certain subsidies with regards to interstate competition. In *Cuno v. DaimlerChrysler*, the Sixth Circuit court struck down Ohio's investment tax credit, which gives companies a break on their state corporate income taxes on the condition that they purchase and install machinery in a Ohio production facility. The court ruled that the subsidy violates the commerce clause of the Constitution by discriminating against interstate commerce. The case is being appealed to the Supreme Court, but meanwhile, politicians eager to save their beloved subsidy programs are drafting legislation that would preempt the court's ruling. For more information about this case, see Michael Mazerov, *Should Congress Authorize States to Continue Giving Tax Breaks to Businesses?*, published by the Center on Budget and Policy Priorities.