The Case for Abolishing the Economic Development Administration

A Great Society Relic that Robs Peter to Pay Paul

By David Bier

September 2012

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Executive Summary

Recent federal stimulus packages to revitalize America's troubled economy share a common heritage with the four decade-old Economic Development Administration (EDA)—they both are based on the belief that America's international competitiveness and economic growth depend on government investments. This approach is fundamentally flawed. Not only do such grants not create economic growth, they are actively harmful to it.

- EDA investments do little more than shift resources from one area of the country or the economy to another. Because government has no resources of its own and relies on taxation for revenue, it can only rearrange resources rather than create them. This was vividly illustrated in 2011 by an EDA grant to Visalia, California, which promptly incentivized the relocation of a factory from Brisbane, California. Such redistribution from one town to another is not economic development—it is economically wasteful.

- EDA's measures of success are flawed. They value projects according to how many jobs they create rather than to how much value they bring to the community. This directs EDA grants toward projects with large numbers of jobs, like stadiums, convention centers, or other public works rather than to projects that private investors would consider productive. In 2011, for example, EDA gave Cedar Rapids, Iowa, its largest grant ever, $35 million, for a convention center slated to lose $1.3 million by its fifth year. Profitability, not job creation, should be the test for a successful project.

- EDA's second measure of success—how much private or public investment a project receives—leads the agency to actively harm local communities by encouraging them to raise "development taxes" to qualify for a matching grant. It actually gave an Economic Adjustment Strategies award to Pueblo, Colorado, for raising taxes by $88 million. In Cedar Rapids, taxes went up when EDA offered its grant, even after voters rejected the tax increases.

In the four decades since its creation, EDA has funded professional football practice facilities, model pyramids, wine tasting rooms, and other clearly wasteful projects. But the more significant problem is that it funds projects at all, directing money politically to the benefit of incumbent politicians. EDA's funding should be immediately revoked, allowing private entrepreneurs to direct capital to the best projects.

Introduction

On a site near Las Vegas' McCarran airport sits a sign that reads, "UNLV Harry Reid Research and Technology Park." Behind it stands … not much. In 2008, Senate Majority Leader Harry Reid (D-Nev.) attended the ribbon-cutting ceremony for the $2 million project, which got a boost from grants from the federal Economic Development Administration (EDA). By 2009, no businesses had relocated to the park, and the project was out of money.[1] Today, the Park has no buildings whatsoever and one road—Solutions Parkway—that leads to nowhere.[2]

How did taxpayers get stuck paying for this boondoggle? The answer to that question lies in the relatively obscure federal agency that provided the seed funding. Born at the height of President Lyndon Johnson's "Great Society," the Department of Commerce's Economic Development Administration has been shoveling out grants to similar projects, ostensibly to promote economic growth, since the mid-1960s. EDA claims its programs have proven successful, but a critical look reveals a different picture. EDA's basic premise—like that of the recent stimulus packages—is that economies suffer from a lack of government support.

This paternalistic approach to economic development is evident in EDA's mission statement: "to promote innovation and competitiveness, preparing American regions for growth and success in the worldwide economy."[3] But American industry is not a child that must be raised by government. Competition provides all the incentive U.S. businesses need to innovate, compete, and succeed in the global economy.

EDA has not outlived its usefulness; it was never useful at all. In October, 2011, Rep. Mike Pompeo (R-Kan.) introduced a bill to do just that, the EDA Elimination Act of 2011 (H.R. 3090).[4] It is long past time the EDA was abolished.

Giving with One Hand, Taking with the Other

Many commentators in recent years have argued that "the U.S. is broke,"[5] but that is not quite accurate. The government has not *gone* bankrupt, the government *is* bankrupt—perpetually. Without next year's revenues flowing in, the U.S. Treasury would empty each year. Government has no money of its own. It must take resources from elsewhere in the economy in order to pay for its spending.

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Public expenditures are not like those in the private sphere. When a farmer purchases a tractor for his farm, he pays for the purchase with profits from the crops produced by his labor. By contrast, when the government decides to grant $100 to farmers, it pays for it with the labors of everyone else in society. Thus, when EDA attempts to promote economic growth in one

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region of the United States or one sector of the economy, it does so at the expense of other regions or sectors. A 2003 Congressional Research Service study on EDA found that, "By and large the growth is likely to have been at the expense of growth in some other areas—quite likely, ones that are also poor and underdeveloped, and ones that are in near proximity."[6]

Consider the recent case of EDA's $2 million grant in 2011 to Visalia, California, in the San Joaquin Valley. EDA promoted the project as a way to help the city "expand a key section of Plaza Drive that will provide better access to the Visalia Industrial District and attract new businesses to the region. The project is expected to create 250 jobs and generate $10 million in private investment."[7]

A couple of months after the project's completion, Visalia had attracted new business. That summer, VWR International, a medical supplies manufacturer, built a 500,000 square-foot warehouse in the new expanded industrial zone. However, that was at the expense of a distribution warehouse 200 miles away in Brisbane, California, in the San Francisco Bay Area, which the company closed to take advantage of the subsidies offered in Visalia. The closing will result in the loss of 331 jobs in Brisbane—183 at the warehouse plus 148 jobs at companies that depend on VWR for business—more jobs than the entire Visalia project was supposed to create.[8] Jobs were not created, but merely shifted from one place to another.

EDA handed VWR International its development grant—or more accurately, its relocation grant—despite the fact that not even two years earlier, it was caught using stimulus money to help relocate Multinational NCR from Dayton, Ohio, to Atlanta, Georgia. Georgia officials attracted the company from Ohio with their "Mega Jobs Tax Credit." Local officials asked for and were initially granted $5 million in Recovery Act money,[9] but EDA rescinded the offer after Rep. Pat Tiberi (R-OH) and others protested the move.[10]

EDA grants are not simply transfers from one group to another. Government spending contains significant transaction costs, which include the cost of private sector resource reallocations (like VWR's move), tax collection, and agency salaries and general expenses ($100 million for the EDA).[11] The Government Accountability Office has found that up to 60 percent of some EDA program budgets are used to cover "administrative costs."[12] No business could survive with such high administrative costs. All this spending is inefficient waste. As they do in the absence of government spending, consumers ought to freely decide what companies receive their money if only because it efficiently permits transfers from consumers to producers.

Flawed Measures of Success

After he retired, former EDA Director Orson Swindle admitted that the agency's structure is inherently flawed. "The minute politics enters the equation, rational financial management and economic decision making goes out the window," he said.[13] A project may seem perfectly good to an EDA bureaucrat, but that bureaucrat has no means of judging between multiple projects that seem equally good on paper. In the market, prices, profits, and losses guide people to direct resources to projects that create wealth and away from ones that do not. This most important market process assures that resources are not wasted and used most productively.

Governments depend on taxes rather than free exchange, so they must attempt to replace profits and losses with bureaucratic targets and goals. Consider EDA's primary goal: job creation. This standard not only fails to measure economic development, it completely inverts it. If increasing the number of jobs were the only thing that mattered, a hotel that needed 1,000 workers to build would be twice as valuable as the same hotel built with only 500 workers. In the market, the opposite is true. When technology reduces the labor required to travel, make a meal, or build a hotel, that is progress. But by EDA's criteria, such savings in labor are an ill to be tamed.

Only profits and losses provide incentives that make sense of economic activity. Losses ensure that poor investments do not receive the funds good investments deserve. They indicate that consumers value the good or service less than the resources required for their production, signaling to the producer that these resources (workers, raw materials, machinery) are demanded by consumers elsewhere in the economy. When producers are shielded from losses and ignore the demands of consumers, value-destroying activities are rewarded at the expense of value-creating ones.

EDA misses all these signals. It continues to fund losing projects regardless of their costs. Consider their recent $35 million grant to Cedar Rapids, Iowa, for a new convention center. For decades, politicians, bureaucrats, and city planners have used big projects like convention centers and stadiums as arguments for huge public expenditures to "revitalize the community." The Cedar Rapids case is particularly illustrative because the warning signs were there so early, and EDA completely ignored them.

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Project costs were originally estimated at $67 million, but in less than a year, they increased by $8.6 million. In order to save face, EDA kept funneling taxpayer dollars into the project, which only further incentivized city-level funding. A year after the original

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$35 million grant, EDA responded to the increased costs with $2.9 million in development loans to the city.[14] EDA approved the original grant despite the fact that the city's own projections show the center losing almost $1.3 million by its fifth year.[15]

EDA simply turned a blind eye to the evidence in this case. University of Texas, San Antonio professor Heywood Sanders studied publicly financed convention center projects for several decades and found that "[N]ew centers and expansions are delivering remarkably little in terms of attendance and activity. What is even more striking, in city after city, is that the new private investment and development that these centers were supposed to spur—and the associated thousands of new visitors—has simply not occurred."[16] EDA, however, will no doubt continue to fund projects similar to Cedar Rapids in the future.

Convention centers and business parks are not the only problems. EDA also funds commercial district development plans, tourist attractions, and other real estate ventures. It even awarded $500,000 to a college in South Carolina to build a football training stadium for the Carolina Panthers.[17] It once even awarded $500,000 to build replicas of the Pyramids and Great Wall of China.[18] Convention centers, stadiums, business parks, and tourist attractions should all be built on their own merits due to consumer demand, not flimsy arguments about fringe economic benefits.

As a government bureaucracy, EDA has an inherent incentive to use job creation as its key measure. More beneficiaries mean more people to defend the agency's spending, so it makes sense to maximize the number people who benefit from a project.

This explains EDA's second measure of success, the investment EDA projects attract. More investment, like more jobs, means more defenders of public spending. In order to qualify for a grant, EDA requires recipients to match it, which can inflate investment numbers. This incentivizes local and state planners to raise taxes and funnel public dollars into projects selected by EDA's jobs criterion.

Consider the agency's recent $2 million grant to build a wine tasting room, gift shop, and banquet hall at the Walter Clore Wine and Culinary Center in Richland, Washington. The Center asked Washington's state government to supply the matching funds EDA requires.[19] The state supplied the center with $1.5 million. Still short $500,000, the Center now demands $100,000 more from Benton County, where it is located.[20] By EDA's reckoning this whole exercise yielded $3.6 million of value in new "investment," when in fact it is a huge misallocation of resources.

Without profits as a guide, EDA's proxy measures lead to absurd conclusions.

EDA officials testified to the House Subcommittee on Economic Development that, “EDA pays for itself—and then some.”[21] The same fallacy is found in the agency’s annual report, which claims a “return on investment of $6.90 for every federal dollar invested.”[22] Unsurprisingly, that is not the case.

EDA’s “return on investment” bears no relation to the similar private sector concept. What it actually means is that for each dollar EDA grants it directs almost $6.90 into those projects. But all this means is that EDA has managed to politicize more than $2 billion worth of resources while wielding a $300 million budget. The agency grants and loans money to projects likely to be completed, thus adding to its job creation figures. These are generally state and local government projects. In a 2004 review of one EDA program, for example, the Government Accountability Office found that only 17 percent of its projects received any private investment at all.[23]

Bureaucratic efforts to replace profit and loss with other measures have always proven futile—and always will. Profit is the only way to measure value creation. It demonstrates that consumers—that is, everyone in society—values the final product more highly than the resources required to make it. Conversely, loss demonstrates the project’s resources are needed elsewhere in society. Bureaucratic pseudo-measures miss these crucial points and direct resources towards projects society values less.

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Ignoring Market Signals

Government agencies not only miss market signals, they sometimes intentionally work at odds with them. EDA has two programs that most explicitly do this, Trade Adjustment Assistance for Firms (TAAF) and Revolving Loan Funds (RLFs). According to EDA’s 2010 Annual Report, Revolving Loan Funds “make loans at interest rates that are at or below market rate to small businesses or to businesses that cannot otherwise borrow capital.”[24] In other words, even when the agency does know the market signal—the price for loans to certain businesses—EDA ignores it.

Government-subsidized loans are not unique to EDA. In the early 1990s, the Department of Housing and Urban Development (HUD), another economic development agency, imposed regulations on the two government-sponsored enterprises, Fannie Mae and Freddie Mac, forcing them to grant more than half of their mortgages to households with incomes below the national median.[25] Predictably, housing prices soared as the demand for new homes expanded.

The higher prices for houses signaled to investors and contractors to direct their labor and capital into the mortgage

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market. However, house prices had been so distorted that they did not accurately reflect the risk associated with the loans. As the riskier loans began to default in 2007, the price for housing fell dramatically. Many people who held mortgages that were worth far more than their homes simply walked away. The housing bubble and the recession that followed were caused by resources being directed politically rather than by consumers in the market.

EDA has no sense of history. RLFs are just as flawed as HUD's subsidized mortgages. Credit in an economy is limited, and so EDA loans divert capital away from more productive uses. One study of EDA loans, conducted by the agency itself, found that the mean default/write off rate was 8.6 percent or "about 5.6 percentage points higher than the default rate of standard commercial mortgages (3 percent)."[26] Another EDA study found it was even higher, that 13 percent of all EDA loans defaulted or 7.5 percent higher than the market rate.[27]

EDA's Trade Adjustment Assistance for Firms and Community Trade Adjustment Assistance (TAA) programs ignore the profit and loss mechanism itself. These programs provide "project grants to communities that have experienced, or are threatened by, job loss resulting from international trade impacts" and "technical assistance provided to firms that have lost domestic sales and employment due to increased imports of similar or competitive goods."[28] In order to qualify, firms must show a decline in sales over the preceding twelve months, supposedly due to "trade impacts"—a hopelessly fuzzy concept.

In other words, EDA is determined to undermine the will of the people—consumers in the market—who choose other products over those sold by these firms. EDA wants to reverse this process in order to prevent "out-migration in distressed regions." But as a Congressional Research Service paper has noted, "there are usually reasons why businesses do not choose to locate in particular places. Normally, one would think that location choices are the result of a reasonably efficient market allocation. To interfere with this allocation, it may be argued, is to obtain a suboptimal allocation of resources."[29]

The fact is that EDA subsidizes inefficient firms at the expense of efficient ones. EDA acknowledges in its 2010 annual report that, within two years, "[TAAF] participating firms' sales decreased by 14 percent, employment decreased by 16 percent, and productivity increased by 3 percent. During the same period, the Bureau of Labor Statistics reported that nationwide employment decreased by 12 percent and productivity increased by 9 percent. In other words, U.S. companies as a whole fared better than companies that used the TAAF program."[30]

Even if the program could prevent these firms' decline, that would not be an argument for perpetuating it. Certainly the government can help companies in the short term—as the federal bailouts of General Motors and Chrysler in 2009 demonstrated—but protectionist subsidies do not benefit the economy as a whole. American car consumers are forced through taxes to pay to build cars they do not want to buy, which means they have fewer dollars to invest and to buy other products.

Subsidies for failing firms prevent businesses, workers, and capital from sifting to other industries (or from creating new industries) where they could better serve consumers. This is a natural process that results simply from consumer choice and competition. Governments can only undermine it and prevent the transfer of capital goods to their most beneficial use.

Since EDA's TAAF applies only to manufacturers, it is worth considering manufacturing jobs as an example of why EDA should not protect industry. The number of manufacturing jobs in the United States has decreased from almost 20 million in 1979 to about 11 million in 2010.[31] Nonetheless, manufacturing *output* has increased, which means that less labor is creating more wealth. The workers who lost their manufacturing jobs relocated to other industries where their work was put to better use. As Federal Reserve Chairman Ben Bernanke points out, "During the 1990s, average earnings in manufacturing industries that showed net declines in employment… were $10.63 per hour. [Meanwhile], wages in expanding service-providing industries… were $11.26 per hour, about 6 percent higher."[32] This wage differential indicates that the new service jobs were more highly valuable to society than the old manufacturing ones.

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Infrastructure: A Special Case?

According to its own annual report, "EDA's Public Works and Economic Development investments help distressed communities revitalize, expand, and upgrade their physical infrastructure."[33] While infrastructure is necessary for economic development, infrastructure development should respond to current demand that results from a vibrant economy, not hope to create growth *ex nihilo* with increased spending. In any case, state and local governments should supply their own infrastructure or even better rely on the private sector, not depend on federal grants to subsidize oversized budgets.

To the extent that repairs are needed, they are the result of governmental failures. State budgets are enormous, and the fact that the most critical projects like bridges and roads do not receive budgetary priority is the result of politics, not lack of funds.

The Economic Development Administration's infrastructure projects are often just disguised corporate welfare projects.

Minnesota's infamous 2010 bridge collapse came only a few years after the state gave Minnesota Twins billionaire owner Carl Pohland $392 million for the new ballpark—75 percent of its cost—paid for by a sales tax forced on one county, the same county as the bridge.[34]

This story could be repeated in nearly every state. New York's Tappan Zee Bridge is another famous example of state neglect. The city and state have known it has needed rebuilding for decades, but have moved slowly, prioritizing other more politically expedient projects. Consider the fact that New York's state budget hit $93 million—$43 million for schools, Medicaid, and public employee benefits. Infrastructure grabs a mere $2.8 billion of the remaining $50 billion.[35]

A major reason for the slow-up is the federal money the state wants, which comes with strings attached. The National Environmental Protection Act (NEPA) requires a lengthy environmental assessment process for projects receiving federal dollars. As Nicole Gelinas of the Manhattan Institute reported in *City Journal* last year:

> [A] state's department of transportation must announce its plan to draw up such a statement; consider alternatives to meeting its goal (including doing nothing); hold public hearings; draw up a draft statement; hold more public hearings; draw up a final statement; secure the approval of various federal agencies; and only then start its project. New York is only at the "draft" stage of this long process…. "There's no question that the NEPA process slows things down," says Jeffrey Zupan, who has studied the Tappan Zee project for the Regional Plan Association.[36]

Federal subsidies hurt state infrastructure not only with regulatory strings, but also because they let state legislatures off the hook, permitting them to indulge other more political beneficial priorities. Maryland, for example, massively cut infrastructure spending after it received $771 million in federal infrastructure subsidies from the American Recovery and Reinvestment Act, so much so that they actually spent $90 million less than before the stimulus.[37] In other words, Maryland Governor Martin O'Malley (D) seized the opportunity to raid the Transportation Trust Fund to prevent spending cuts elsewhere.

The Economic Development Administration's infrastructure projects are often just disguised corporate welfare projects. In 2011, for example, EDA gave Lee County, North Carolina $800,000 for infrastructure improvements, but all the improvements went

to earth-moving equipment giant Caterpillar. A $500,000 state industrial development grant helped the county match the funds from EDA. Local planners sank another $900,000 million of their county's own money into the project as well.[38] All told, more than $2.2 million went to pave Caterpillar an access road.

Infrastructure development should be driven by economic growth rather than vice-versa. Since the Tappan Zee has been built, Gelinas notes:

> [C]ompanies—Volkswagen, Xerox, the Geigy Chemical Corporation, and other major firms—took advantage of a much larger pool of potential commuters and created solid office and industrial jobs in the county…. New York has simply outgrown the Tappan Zee, something you can't blame on the bridge's original planners. Today, with Rockland's population reaching 300,000 people, four times as many people cross the span daily as the state had originally projected.[39]

The proposed bridge is planned in response to this economic growth, not with the expectation that the bridge in and of itself will cause economic growth.

But in yet another instance, EDA actually operates in complete opposition to the economically prudent position. Rather than invest in communities that need infrastructure in response to increases in population or economic growth, agency grants "help distressed communities revitalize."[40] In other words, they invest in projects that lack demand in communities that are in decline, just the opposite of what private sector investors would consider worthy projects.

Ideally, government should play only a very limited role in infrastructure. Major corporations like Caterpillar can afford to cover the costs of roads they need to access their properties. Local infrastructure should be built with local taxes based on local demand, and state highways and bridges should be built and maintained on the premise that their users will pay for their costs. For instance, the Dulles Greenway, a privately constructed highway in Northern Virginia, is entirely funded by tolls, and the police who patrol it are reimbursed by the owners.[41]

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Negative Effects on Localities

EDA claims that its approach "prevents a 'race to the bottom' in which cities, counties, and states, undercut each other in order to attract short-term growth."[42] Except this is exactly what EDA's grants often accomplish. After subsidies to Visalia, California, incentivized VWR to move there, the city VWR left, Brisbane, immediately proposed subsidies of its own to

As former EDA director Orson Swindle once said of his agency, EDA is a "congressional cookie jar."

convince the company to stay.[43] This is a true "race to the bottom," where each government further harms its own citizens to protect certain big businesses. Real competition, on the other hand, promotes efficiency, productivity, and innovation by incentivizing businesses to improve.

The agency claims it is "guided by the basic principle that communities must be empowered to develop and implement their own economic development and revitalization strategies."[44] But its grants and interventions undermine this goal. The largest single grant ever given by EDA, for example, went to build the convention center in Cedar Rapids, Iowa.[45] The mayor took the money and then used eminent domain authority to seize a private hotel.[46] The hotel owner gave the city its property for EDA's events center complex at a nearly $2 million loss after the threat.

When convention center expert Heywood Sanders warned the town about the project, public officials' ambivalence to the project's failure was typical. "It will lose money. He's absolutely right," said the city's project manager. "We know that. The city knows that. The question is how do you minimize the loss?"[47] Such reactions are normal when local officials receive tens of millions of dollars from the federal government. The money provides too strong of an incentive to push forward projects that make little sense.

Furthermore, one side effect of EDA's investment measurement is that it requires matching funds from the town to increase its investment numbers. The agency often encourages municipalities to create special "development taxes" to qualify for EDA matching grants. Pueblo, Colorado, for instance, was granted an Economic Adjustment Strategies award for raising $88 million to meet an EDA matching grant.[48] In the Cedar Rapids case, a sales-tax increase to pay for the center was rejected by voters, but city planners went ahead with the project—and the tax—after EDA intervened.[49] In other words, EDA grants often do not even help the communities they target.

Conclusion

EDA does not, as it claims, "promote innovation, competitiveness, or prepare American regions for growth and success." However, its grants do provide great photo-ops for politicians. As former EDA director Orson Swindle once said of his agency, EDA is a "congressional cookie jar."[50] Iowa Rep. Dave Loebsack (D-IA) certainly did not miss the opportunity for press after EDA granted millions to his district in Cedar Rapids.[51] UNLV rewarded Sen. Harry Reid by naming their Research and Technology Park after him.

A study on EDA two decades after its opening in the *American Journal of Political Science* found that, "[A]gency grant announcements during election campaigns were subject to considerable political manipulation, but that these projects for the most part would have been announced anyway. Thus agencies depoliticize grant processing by allowing the politicization of the timing of the decision."[52] In other words, EDA has allowed their grants to be used to help incumbents win elections.

EDA exists because it gives politicians big stages on which to demonstrate their usefulness to their constituents, not because it confers benefits on the average American. Congress should immediately abolish EDA and turn its attention to finding ways to allow for real economic growth.

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