

ASSESSING LARGE STATE ECONOMIC DEVELOPMENT EXPENDITURES

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ABSTRACT

Many states in the U.S. provide substantial incentives to entice large businesses to locate in their state. The economic literature has mostly concluded that firm-specific incentives are not effective at bringing in new businesses. Yet, these incentives remain popular, and state economic development expenditures are increasing. This paper takes a fresh look at the evidence of the effectiveness of economic development spending with a focus on episodes of large increases in expenditures by state governments. We find that large expenditure increases on economic development are not correlated with lower prime-age employment rates in a state the year after the expansion of funds. We also find no statistical relationship between GDP per capita and large increases in economic development spending. In addition, we provide a simulation to estimate the impact of an alternative use of the economic development funds: income tax cuts. In a case study with Arkansas data, we find that economic development spending increases employment at twice the cost of an equivalent income tax cut.

Keywords: Economic development, State government, Development incentives, employment

INTRODUCTION

State governments have been increasing their spending on economic development in both nominal and real terms. According to data from the Council for Community and Economic Research (C2ER), state governments annually spent an average of \$207,057,990 per state on economic development between 2007 to 2023. In 2023, state governments spent an average of \$426 million on economic development. On a per-capita basis, the level of state economic spending more than doubled recently from 2017 (\$41) to 2023 (\$96).

In addition to these large increases in spending over the years, some states drastically increase their economic development spending over a one-year span. In the C2ER data from 2007 to 2023, we found 95 episodes of increases of \$75 million or more on economic development from the previous year. Large expenditures on economic development, such as “Megadeals,” are typically justified by two objectives: 1) increased employment, or 2) higher-paying jobs. We investigate whether these large expenditures have been effective in achieving those goals.

Some megadeals for specific firms are very large, such as Boeing’s \$8.7 billion package in Washington in 2013 or Micron Technology’s \$6.36 billion package for Micron Technology in 2022 (Good Jobs First Subsidy Tracker). Those packages catch the eye, but most states have dozens of economic development programs, such as tax credits, loans, grants, workforce development, and infrastructure funding, which can add up to a significant amount of money for a firm, but do not always make the news. It’s essentially impossible to study the effectiveness of one

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economic development program, since many programs simultaneously try to achieve the same or similar outcome of increasing jobs or productivity. Our study instead focuses on large increases in state economic development spending overall over the years. The overall spending focus allows us to evaluate the success of economic development programs in general.

From a standard economics textbook, government subsidies create a deadweight loss unless the government is funding a market or firm with positive externalities. Even before the standard textbook, Adam Smith argued against the government favoring a firm:

The statesman who should attempt to direct private people in what manner they ought to employ their capitals would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it. (Smith, 1789 ed. *Wealth of Nations*, Book IV, Ch. II)

A more sophisticated argument in favor of a state government subsidy would be the “but for” argument. This argument is that the government is not really losing government tax money with the incentive package, since the firm would not have located in the state “but for” the economic development assistance. In other words, the government may subsidize the firm to locate in the state, but the firm will more than pay back the subsidy by coming to the state, paying taxes, and generating positive spillovers. This argument rests on the marginal case - one where the business is torn between locating in two places that would yield a very similar profit, and the incentive package is the tipping point. Such a case seems very unlikely, as economic incentives are not a top priority for business location decisions. A survey by Jolley, Lancaster, and Gao (2015) in North Carolina found that incentivized firms ranked the economic incentives as the 15th priority among business climate factors. More important factors were skilled labor, the regulatory environment, and general tax rates.

Under certain parameters, such as externalities or marginal business decisions, state spending on government economic development could in theory achieve its objectives. Therefore, we need an empirical investigation. In the next section, we examine the current literature on government economic development spending. In Sections III and IV, we will add our contribution to the literature by providing a fresh look at the empirical relationship between large economic development spending and employment and economic growth. We will not find such evidence. In addition, even if economic development spending is bringing in jobs, we use the literature to estimate the per-job costs of such spending. In Section V, we find the cost per job to be excessive with government spending compared to an alternative: lowering the income tax rate. We find that the private sector creates jobs at a lower cost than government spending. Section VI concludes.

LITERATURE ON ECONOMIC DEVELOPMENT INCENTIVES

The literature on economic development incentives is large and fairly consistent. A study by Bartik (2018) reviewed 30 papers that examined economic development incentives. He concluded that the literature estimates that 2 to 25 percent of incentivized firms made their decision location based on the incentive. This finding means that 75-98% of the incentivized firms would have made their ultimate location decision regardless of the incentive package. In addition, Bartik found that the 2-

25% may be a generous number, as many studies are biased toward overestimating the “but-for-the-incentive” percentage.

Not only is the evidence weak regarding the effectiveness of economic development incentives, but there could also be other unseen adverse effects of such spending. Firms and individuals may put time and effort trying to acquire economic development funding. The evidence shows that the politically-connected firms are the ones most likely to receive incentives (Aobdia, Koester, & Petacchi, 2024). Slattery & Zidar (2020) also find that subsidies increase during an election year with an incumbent governor. All sorts of lobbying and other rent-seeking behavior means fewer resources are being employed in productive work. Special deals by state governments via economic development programs encourage unproductive work (Calcagno & Hefner, 2018; Baumol, 1990).

Are Megadeals more successful than standard economic development incentives? Consistent with the literature (Mattera, Tarczyska, & LeRoy, 2013; Calcagno & Hefner, 2018), we define a megadeal as \$75 million. In short, the evidence does not support megadeals, though there are not many studies that examine big expenditures overall. Lincicome, Joffe, and Chanwong (2024) used the Good Jobs First Subsidy total data as a percentage of GDP and did not find a positive relationship between economic growth and subsidy size. In fact, they found a negative relationship. They also point to several megadeals that are not working out as promised, such as Ford Motor in Michigan, Rivian Automotive in Georgia, and VinFast in North Carolina.

Calcagno and Hefner (2018) examined multiple megadeals and found they ultimately did not achieve their goal of increasing employment. Slattery and Zidar (2020) found high cost-per-job promises, such as the basic chemical manufacturing subsidies costing more than \$900,000 per job. They also did not find any strong evidence that firm-specific tax incentives increased economic growth at the state level, nor at the local level. Mitchell, Farren, Horpedahl, and Gonzalez (2019) examined Wisconsin’s megadeal with Foxconn and estimated that it would lower economic activity with deadweight losses by billions of dollars over 15 years.

Even if economic development spending is found to have positive relationships with employment or economic activity, we must consider it in relation to alternative policies. Public spending is fungible. Wang (2016) found that economic development “expenditures are associated with decreases in expenditures on productive public goods such as education and highways as well as corrections, police, and fire protection and sanitation.” McDonald, Decker, and Johnson (2020) found that economic development incentives negatively affect the fiscal health of the state.

We add to the literature in two important ways. First, we examine large increases in economic development spending overall and with updated data on prime-age employment and GDP per capita. The previous literature mostly tried to identify subsidy deals or used a simulation to estimate the expenditures on economic development. We take the total economic development spending outlays as summarized by the Council for Community and Economic Research. We also examine the changes in prime-age employment rates as opposed to the overall employment rate, which allows us to narrow in on the group most likely affected by employment opportunities. Second, we take advantage of data in Arkansas and use the literature to simulate the cost per job

with economic development spending versus a reduction of taxes. To our knowledge, we are the first to use this technique and data in estimating the cost per job.

DATA

To examine the effectiveness of state spending on economic development, we look at the typical two main goals of the spending: 1) employment and 2) economic growth. The usual arguments for increased expenditure on economic development are to increase the number of jobs or to create better jobs. In other words, a successful economic development expenditure would either show up in the employment rate or in per-capita output.

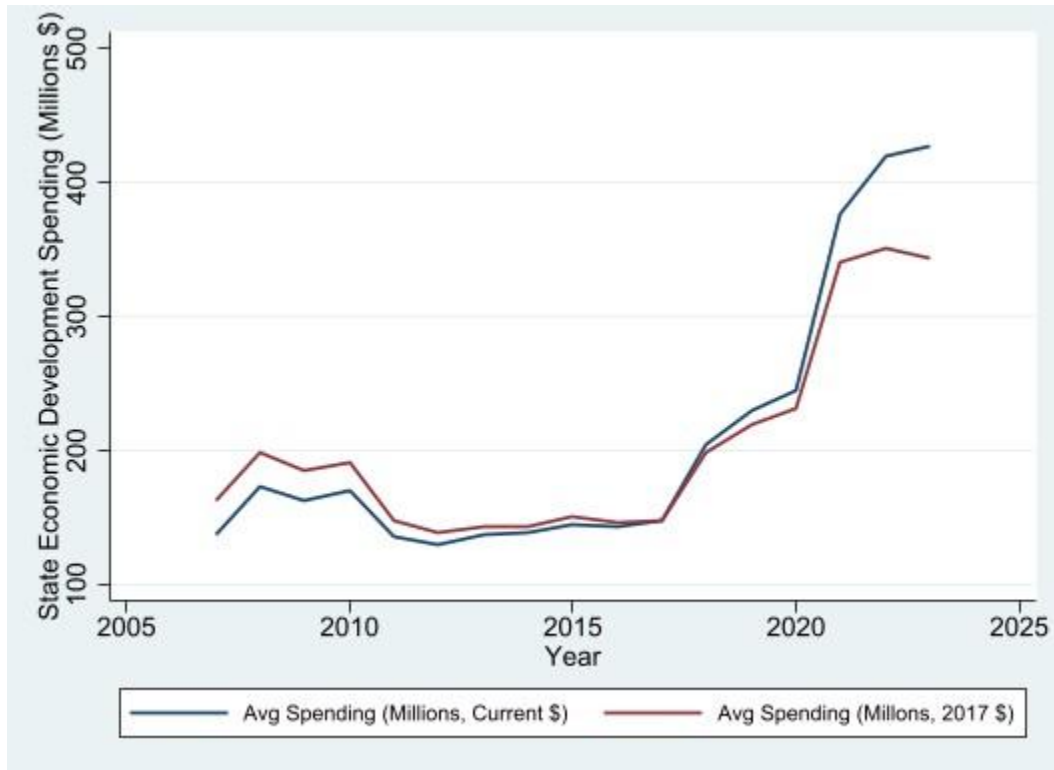
To measure employment, we focus on the state-level prime-age employment rate, which is the percentage of 25-54 year-olds in the state who are employed. The prime-age employment rate has advantages over the typical unemployment measure, including 1) avoiding demographic trends that have nothing to do with economic health, and 2) avoiding the labor force participation bias that may occur if discouraged people leave the labor force. To measure economic output, we use state real GDP per capita (2017 chained dollars).

As a measurement of state economic development spending, we use annual total state economic development spending from the Council for Community and Economic Research (C2ER). Our paper is focused on large increases in expenditures, equivalent to “Mega” deals. Here, we use \$75 million to designate a large expenditure, consistent with the Good Jobs First definition. Sometimes the purpose of large spending increases is to lure a firm to locate in a state. We use a dummy variable that is equal to “1” if state economic development expenditures increased by at least \$75 million from the previous year or 0 if it did not. We lag the variable by one year, to give the expenditures time to work and to avoid reverse-causality issues. Using further lags could eliminate important years of observation, but it’s not unforeseeable that projects need more time. Jobs may also happen sooner, as building plants could increase employment. We settled on a one-year lag compromise, but we did run alternative lags which did not overturn any insights. We observed 95 episodes of mega spending, which is to say about 11% of the years for a state will result in a large increase in economic development expenditure.

From a quick scan of the data, we can easily observe that state-level economic development spending has increased in recent years in nominal and real terms. Figure 1 graphs the average annual state government expenditure on economic development in millions of dollars. Spending was relatively flat for about 10 years, but then it increased rapidly, outpacing general inflation. We seek to see if these large increases were effective.

The available data for government expenditures is 2007 to 2023, therefore, that is the year of our state-level panel data for most of our regressions. For our control variables, we include educational attainment (% of population age 25+ with a bachelor’s degree), population level, and state-level economic freedom (overall subnational score), where a larger number (0 to 10) represents more economic freedom. The economic freedom variable incorporates government spending, taxes, and labor market regulation (including state minimum wage).

Figure 1. Average Annual State Government Spending on Economic Development (Millions \$)



We also use GDP per capita as a control in employment rate regressions. As an additional consideration, we include the per-capita spending on economic development in one of the models. This variable can allow us to isolate the impact of a large expenditure change for a given change in the level of spending per capita. Table 1 describes and summarizes the data.

Table 1. Summary Stats and Key for State-Level Data 2007-2023

Variables	Description	Obs	Mean	Std. Dev.	Min	Max
Employment Rate	Data is at the state level and provides the yearly prime age (25-54 y/o) employment rate. Data obtained from the U.S. Bureau of Labor Statistics: https://www.bls.gov/lau/ex14tables.htm	850	78.67	4.11	67.4	88.1
Mega (lag)	1 of Economic Development Spending grew by \$75 Million or more from previous year (then lagged). Data is from the Council for Community and Economic Research (C2ER). https://www.c2er.org/	750	0.12	0.33	0	1

Variables	Description	Obs	Mean	Std. Dev.	Min	Max
Educational Attainment	The % of adults (age 25+) at the state level with a bachelor's degree or higher. The 2008-09 data was obtained from the Federal Reserve Bank of St. Louis (FRED) and the Census Bureau.	850	30.23	5.69	17.1	47.8
Population (log)	The natural log of the yearly state level population. Data from the U.S. Census Bureau.	850	15.18	1.01	13.19	17.49
GDP per Capita (log)	Natural log of state real GDP per capita (2017 chained dollars). Bureau of Economic Analysis	850	10.92	0.19	10.48	11.42
Per-Capita Economic Development Spending (lag)	Per-Capita total economic development spending. Data from the Council for Community and Economic Research (C2ER).	800	51.23	69.19	2.14	775.32
Economic Freedom	Economic Freedom overall score - Subnational. 0-10. 10 is highest economic freedom. Scores from Economic Freedom of North America. 2007-2022. https://www.fraserinstitute.org/studies/economic-freedom-north-america-2024	800	6.17	0.944	3.78	8.12

MODEL AND RESULTS

To estimate the effectiveness of large economic development expenditures, we run a two-way fixed effects model for state-level data, 2007-2023, controlling for year effects. This time period is chosen as this is the available data for economic development expenditures. Table 2 displays the estimates for four models where the dependent variable is the state prime-age employment rate.

In the first model, we include mega spending as the only independent variable. This variable is equal to 1 if the previous year the state increased spending on economic development by \$75 million when compared to the year before. The coefficient is negative, but not statistically different from zero.

In the second model, we control for educational attainment and population. We do not find any of the coefficients, including mega spending, statistically different from zero.

In the third model, we add GDP per capita. We find that variable to be positively correlated with the employment rate, as expected. Still, we do not find any statistical significance from lagged mega spending.

In the fourth model, we attempt to control for state-level institutions, including taxes and labor market regulations. To do so, we include the economic freedom variable from the Fraser Institute. This is an overall measure (subnational measure, ignoring federal government institutions), 0 to 10, where a higher number means lower taxes, less government spending, and/or a less restrictive labor market. In addition, the fourth model includes lagged per-capita economic development spending. This means that the coefficient on a mega expenditure (\$75 Mil +) on the employment rate, will take into consideration the changes in per-capita economic development expenditure.

Table 2. Mega Spending and Prime-Age Employment Rate: Two-Way Fixed Effects. State-Level Data, 2007-2023

Variable	Prime-Age Employment Rate (1)	Prime-Age Employment Rate (2)	Prime-Age Employment Rate (3)	Prime-Age Employment Rate (4)
Mega Spending (lag)	-0.12	-0.11	-0.14	-0.22**
	<i>0.11</i>	<i>0.11</i>	<i>0.10</i>	<i>0.11</i>
Educational Attainment		0.17	0.05	0.070
		<i>0.17</i>	<i>0.16</i>	<i>0.16</i>
Population (log)		0.23	-3.50	-4.70
		<i>5.06</i>	<i>4.80</i>	<i>5.44</i>
GDP Per Capita (log)			7.53**	7.03**
			<i>3.01</i>	<i>3.24</i>
Economic Freedom				0.56
				0.38
Per-Capita Economic Development Spending (lag)				0.00
				<i>0.00</i>
Constant	77.09***	69.03***	47.11	67.00***
	0.19	74.52	77.13	87.44
N	750	750	750	700
Year Effects?	Yes	Yes	Yes	Yes
rho	0.90	0.89	0.91	0.94
Notes: Robust standard errors in italics. *, **, *** represent p-values < .10, .05, and .01 respectively.				

One reason for doing this is that we can isolate the effect of big changes from the small and medium changes in economic development spending. With these control variables, lagged mega spending has a negative and statistically significant relationship with the prime-age employment rate. If a state increased its economic development spending by over \$75 million, its prime-age employment, on average, decreased the following year by 0.225% points, controlling for other relevant factors. This result does not provide supportive evidence for large increases in economic development spending.

A possible explanation for the negative relationship between the lagged mega spending and employment is the crowding out effect. The government could be competing against and replacing productive enterprises with government-subsidized ones. If government subsidization leads to higher taxes, we also have the classic deadweight loss – loss of production (and employment) from higher taxes.

In Table 3, we examine the relationship between economic development spending and economic output, as measured by real GDP per capita. This is a similar two-way fixed effects model, but with real state GDP per capita as the dependent variable. In none of the three models do we find a statistically-significant relationship between mega spending and real GDP per capita. Educational attainment, Population, and the Prime-Age Employment Rate were all positively related to GDP per capita and statistically significant at the 5% level. The per-capita economic development spending had a marginally significant relationship with real GDP per capita when controlling for mega spending. A possible interpretation of this is that maintaining development programs with incremental increases is more effective than large increases in spending.

Table 3. Mega Spending and GDP per Capita (log): Two-Way Fixed Effects. State-Level Data, 2007-2023

Variable	Log GDP Per Capita (1)	Log GDP Per Capita (2)	Log GDP Per Capita (3)
Mega Spending (lag)	0.002	0.004	0.002
	<i>0.006</i>	<i>0.005</i>	<i>0.005</i>
Educational Attainment		0.016***	0.015***
		<i>0.0054</i>	<i>0.005</i>
Population (log)		0.5***	0.49***
		<i>0.15</i>	<i>0.16</i>
Employment Rate			0.006**
			<i>0.002</i>
Per-Capita Economic Development Spending (lag)			0.00006*
			<i>0.00003</i>
Economic Freedom			0.01

Variable	Log GDP Per Capita (1)	Log GDP Per Capita (2)	Log GDP Per Capita (3)
			<i>0.01</i>
Constant	10.84***	2.91	2.44
	<i>0.0085</i>	<i>2.21</i>	<i>2.37</i>
N	750	750	700
Year Effects?	Yes	Yes	Yes
rho	0.96	0.995	0.996
Notes: Robust standard errors in italics. *, **, *** represent p-values < .10, .05, and .01 respectively.			

ARKANSAS CASE STUDY: THE OPPORTUNITY COSTS OF ECONOMIC DEVELOPMENT SPENDING

Despite the lack of evidence for the effectiveness of economic development spending, it is still popular and growing in the U.S. This spending does come with opportunity costs. For this section, we take a look at Arkansas, where we have available data on economic development spending and “job creation.” One example of an Arkansas program designed to affect business location is the Quick Action Closing Fund (QACF). It is a program for which published information regarding (promised) employment creation and job retention is available. The QACF is for Arkansas to “compete with other states to attract new business and economic development to the state or to retain existing business in the state” (Arkansas General Assembly, 2007).

During the 2007 to 2022 period, the Arkansas Economic Development Commission (AEDC) estimated that the QACF created 33,992 jobs on a budget of \$358,263,198.08 (AEDC FY 23 Annual Report). It is difficult to know whether such a claim is true, as there is no way to know if those jobs would have existed without the spending. Our panel analysis suggests that the program likely did not produce those jobs. We generously assume those jobs were at least created. However, we look at other research to get an estimate of how many of these jobs were created because of the economic development spending, as opposed to being created regardless of the spending.

Suppose we consider Bartik’s (2018) range of effectiveness: 2% to 25% of incentivized firms made their move based on the incentive. On average, this would imply that only 2% to 25% of the jobs created by Quick Action Closing Fund were actually created by the program. At these success rates, the cost per job can be demonstrated below by taking the total spending and dividing it by the number of jobs created or retained, discounting the jobs number with estimates from the literature:

- (1) At 2% success: $\$358,263,198.08 / (33,992 * 0.02) = \$526,981.60$
At 25% success: $\$358,263,198.08 / (33,992 * 0.25) = \$42,158.53$
At 13.5% success: $\$358,263,198.08 / (33,992 * 0.135) = \$78,071.35$

Note that the QACF may be the tip of the iceberg in terms of costs. These programs are often combined with other funding in the form of interest-deferred or preferential-rate capital loans, property and sales tax credits, and other forms of subsidies. Given the literature on economic development incentives, we estimate that the cost per job created ranges between \$42k and \$527k. If we used the mid-point of the literature, the cost of job created is \$78k. All of these calculations are likely low-end estimate of the cost-per-job figure, given other costs associated with implementing the subsidies.

An Alternative: Reducing the Individual Income Tax Rates

To understand the effectiveness of a government program, we must consider alternatives. When we are examining the success of subsidizing job creation, we must do so considering other ways to create jobs. According to C2ER data, Arkansas spent \$2,803,809,502 on economic development between FY2007 and FY2022. This is equivalent to \$175,238,094 per year. Suppose Arkansas, for example, were given full autonomy to spend those economic development funds to increase employment. One alternative to government spending is reducing taxes and letting the private sector spend the money as it sees fit. We look at the literature to find an estimate of employment effects from changes in taxes.

Economist Owen Zidar (2019) found that a tax cut for the bottom 90% of earners equivalent to 1% of the Gross State Product would increase employment by 3.42 percentage points within two years of the rate reduction. We seek to simulate this estimation for the state of Arkansas using tax data from fiscal year 2022. Drawing from C2ER data, we calculated that Arkansas spent \$479,348,063 in 2022 on economic development. The employment effects of using that money for tax cuts on the bottom 90% were estimated utilizing the methodology from Zidar and FY 2022 IRS Statistics of Income (SOI) Tax State data.

First, we divided total economic development spending in FY 2022 by 1% of the Arkansas 2022 Gross Domestic Product (Bureau of Economic Analysis):

$$(2) \quad (\$479,348,063/\$1,659,893,000) = 0.2888$$

We do this so that it gives us the fraction of the 1% of GDP that is available for a tax cut, which allows us to use Zidar's 3.42 coefficient. In other words, we can't reduce taxes by 1% of GDP by eliminating economic development funding, but we can reduce it by 0.2888 of the 1% of GDP. Therefore, instead of increasing employment of the bottom 90% by 3.42%, we can increase it by:

$$(3) \quad 0.28 * 3.42\% = 0.9576\%$$

This means that a reduction of taxes on the bottom 90% equivalent to the annual economic development spending is predicted to increase employment of the bottom 90% of earners by 0.9576%. To see how much more employment this means for the bottom 90%, we first took 90% of the number of individual income and employment tax filers (IRS 2022) in Arkansas, which was 1,686,053. This 90% is calculated as follows:

$$(4) \quad 0.90 * 1,686,053 = 1,517,448.$$

Next, we took 0.9576% of those individuals to get the following:

$$(5) \quad 0.009576 * 1,517,448 = 14,531 \text{ jobs}$$

This calculation says 14,531 more Arkansans would have been employed in 2022 if the economic development spending had been devoted to tax relief for the bottom 90%.

To get the cost per job if the economic development spending was devoted to tax cuts for the bottom 90%, we do a simple division of the total money spent on economic development by the number of jobs created if the money was given back to taxpayers:

$$(6) \quad \$479,348,063 / 14,531 = \$32,988$$

The \$32,988 is less than even the most generous (lowest) cost estimates we have for cost-per-job-created from the Quick Action Closing fund. Allowing people to spend their own money creates jobs at a lower cost than when the government subsidizes job creation.

Using national figures of the cost of federal tax rate reductions and national labor force participation rates, Zidar (2019) found that the average cost per job created from such a tax cut was \$31,500. Notably, our simulations of cost per job using Arkansas data show that the cost per job in Arkansas in 2022 was similar to the estimate computed by Zidar.

CONCLUSION AND POLICY IMPLICATIONS

Economic development spending typically aims to increase employment and increase wages; however, the empirical evidence suggests it does neither. We analyzed the effect of large expenditure increases on economic development. Our study finds no change or a negative change in prime-age employment rates the year after a large expenditure of \$75 million or more on economic development. Lastly, we found no statistically significant relationship between large economic development spending and GDP per capita. These findings are consistent with previous literature and should encourage policymakers to consider alternative courses of action in their goals of increasing employment, attracting or retaining businesses, and spurring economic growth. Expenditures on ineffective economic development spending could be spent in areas that are typical public goods, such as infrastructure and education.

Alternatively, the money spent on economic development could be returned to the taxpayers. With Arkansas data, we estimate the private sector can create jobs at half the cost when compared to the public sector, even when generously taking the job creation numbers published by the government agency. Overall, the empirics do not support government subsidization of job creation.

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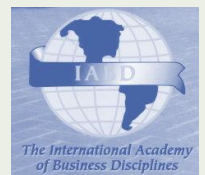
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