The dark side of state competition for foreign direct investment: That which is seen and that which is not seen

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Abstract

Bastiat (1995) explained that the difference between good economists and bad ones is that good economists seek out the not-so-obvious costs and benefits of proposals, not just obvious ones. It is easy to recognize the effects of bringing an auto plant into a community, with the resulting higher rates of employment, higher incomes and higher real estate values. The less obvious side of this action involves the special-interest politics that drives collective action. When the gains to those benefiting are highly concentrated and the losses on those paying for the action are diffused, the collective decision can easily result in one where the losses outweigh the gains. There are also deadweight losses from both the special taxes and subsidies involved in attracting the new investment. Rent-seeking losses are also bound to occur as those who stand to gain from the proposition expend real resources in their effort to influence the choice, while those who stand to lose sometimes expend resources to fight the proposal. Competition by states and communities seeking to lure foreign direct investment, especially in the form of auto plants, sometimes results in bids for the plant exceeding some *ex post* value of having a plant locate in a region or state, as those who have the highest estimate of the value of the plant become willing to pay the most, resulting in what is called the "winner's curse." We note that winner's curses do not occur *ex ante*. However, since public sector economic development decision makers do not bear all benefits and costs of their decisions, their decisions are unlikely to be "socially optimal."

In the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects. Of these effects, the first alone is immediate; it appears simultaneously with its cause; it is seen. The other effects emerge only subsequently; they are not seen; we are fortunate if we foresee them.

There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen (Bastiat, 1848, para. 1.1-1.2).

Introduction

Frédéric Bastiat is known for his clever pamphlets, now essays, in support of free trade. The quote above comes from one of his better known essays he titled "That which is seen and that which is not seen."[1] Bastiat chides all of us to recognize not only the most obvious effects of certain actions, but to also search for the potentially hidden effects of those actions, "that which is not seen."

Foreign Direct Investment (FDI), particularly in large manufacturing facilities, is often courted by state and local economic developers in order to increase employment, incomes and the tax base. Since attracting such facilities would have obvious effects on local economic development, other states and communities also find it advantageous to lure those facilities to their communities. The pursuit of such facilities turns into a competitive bidding process.

In the past several decades, many automobile manufacturers around the world have found it easier to market their automobiles in countries where they have facilities, making automobile manufacturing one of the most obvious investments for economic development officials to attract. Such investment is seen as bringing good jobs to a local economy and boosting area wages. With much to gain for a state's economy, state economic development offices have courted auto manufacturers with enthusiasm—often offering land, tax breaks, educational and training subsidies, as well as other inducements. With so much at stake, automobile manufacturers find themselves with many suitors, encouraging the competitive bidding for their hand, just as professional sports teams seek competition among cities for subsidized stadiums and training facilities.

We examine the dark side of the competition for auto manufacturing facilities, especially foreign-owned plants. One aspect of this dark side, "that which is not seen," is the particular tax breaks given to attract such foreign investment that lead to a differential in tax rates between the attracted auto plants and all other businesses.

The result is what economists call deadweight losses. The existence of deadweight losses from taxes and subsidies reduces overall economic well-being, as the economic losses outweigh the gains.

Another aspect of the dark and unseen side of competition to attract foreign auto plants is that special-interest gains are often less than the losses to outsiders. As the gains by some and losses to others are not perceived by a single mind, what might be called "socially rational" action is seldom the result of democratic action. Not only is there a high probability that such a social decision results in greater total losses than gains, but there is also a high probability that resources within a state are wasted in the competitive political process. In this paper, we seek to discuss the competitive bidding process among southern states for auto plants. The bidding process creates certain distortions in development, as newer, sexier facilities are treated more favorably than many existing incumbent businesses. Reductions in taxes on these newer businesses often result in higher taxes for incumbent firms and for other taxpayers, or reduced spending on important areas such as education.

This paper examines the competition for FDI, using Alabama's successful courting of the Mercedes Benz plant now located in Tuscaloosa County as an example. After a brief discussion of the magnitude and potential impact of opening an auto plant in a southern state, we examine some of the competitive inducements offered by Alabama and other states. Then we turn our attention to the dark side of competitive inducements, the deadweight loss from a distorting tax structure that gives inducements to some businesses but not others within the state. Next, we examine the problem of special-interest politics and why democracies often lead to collective action decisions where the gains outweigh the losses. Rent-seeking losses occur in the presence of special-interest politics. We also discuss the potential problem of the "winner's curse," and why winners in these competitive games are often losers. "Auctions" among states for auto plant sites will also be discussed.

The potential impact of opening an auto plant in the South: *That which is seen*

FDI decisions are often heated and highly politicized. States vigorously compete for the opportunity to attract plants which promise greater economic activity for the surrounding regions. Local governments and politicians are tempted by these plants with a vision of greater employment, higher wages, and the attraction of even more business activity, due to the spillover effects observed in

agglomeration economies. However, this praise is not unanimously shared by all. Some opponents feel that the opportunity cost is often too high, and these funds could be better spent elsewhere. For instance, some argue these large subsidies are better spent on education.

In order to help answer this question, Greenstone and Moretti (2004) analyze the economic effects of FDI by comparing similar 'winners' and 'losers' of the plants' decisions. Here, winners are defined as the ultimate plant location chosen. The losers are defined as those locations that survived the selection process but narrowly lost to the plant's ultimate location. The main employment finding is that the wage bill increased by $16.8 million annually for the winning counties, relative to the 'losers.' The implication is that six years later the wage bill in the county of the winner is roughly $100 million higher than that of the loser. However, this is not enough to ascertain whether a subsidy will be worth it for the local government and its citizens; all costs are not taken into account. Therefore, following the work of Roback (1982), Greenstone and Moretti (2004) use property values as proxies for the welfare of the surrounding area because they serve as a measure of the benefit of the subsidy as well as a measure of the cost of the subsidy which is due to from the increase in property taxes or a reduction in local public goods. They report an increasing trend of a magnitude of about 1.1% to 1.7% in annual property values following the announcement of a plant opening. This result implies that local residents experience an increase in their net welfare.

While the Mercedes Benz plant is included in their study, it is not exclusive; it is only one of more than 82 firms analyzed. Therefore, while wages and property taxes seem to have increased on average for the study, there is no guarantee that this is true for every case. The following section focuses on the case study of the Mercedes Benz plant in Vance, Alabama (near Tuscaloosa).

Competing for the Mercedes Benz plant

The Mercedes Benz plant located in Vance, Alabama is a 3.2 million square foot facility, from a $400 million initial investment. Its main responsibilities are to produce the M-Class sports utility, R-Class sports tourer, GL-Class luxury SUV, with future plans to produce the C-Class sedan and coupe. As of 2013, it employs 2,800 with an annual production of 182,000 units, comprising 25% of the value added to the vehicle. The overall annual economic impact is estimated to be over $1.5 billion in production, while exporting to

more than 135 countries. At the time of construction, Daimler AG (Mercedes Benz) projected the plant would employ 1,500 workers directly and about 11,500 indirectly.

In April 1993, Daimler AG announced it would build its first passenger vehicle in the United States. After a six month site-selection process involving over 150 potential locations, Daimler AG chose Vance, Alabama for its $300 million plant. Construction of the plant was completed in July 1996, and production began the following January. Alabama was not the only state that competed for the Mercedes Benz facility. South Carolina, North Carolina, Georgia, Ohio, Tennessee, Nebraska, New Hampshire, and 23 other states all submitted offers to entice the plant to locate in their area.

The Tuscaloosa City Council pledged $30 million towards the purchase of land for Mercedes Benz. In addition, the City Council of Northport unanimously approved a $1 million enticement package. The City of Vance was not able to contribute financially, but they promised to never annex the Mercedes Benz facility into city limits. Furthermore, the Industrial Development Authority (IDA) of Tuscaloosa agreed to purchase the land for the plant and sell it for a total of $100 or $0.10 per acre. The State of Alabama also agreed to reimburse Mercedes for construction expenses, which totaled $42.6 million in 1995 after the plant was developed. A few studies estimate the incentive package to be worth over $253 million for the $300 million plant in Vance (Mitol, 2001; Trogen, 2002; Greenstone and Moretti, 2004), meaning that the FDI provided by Daimler AG could have only amounted to as little as $47 million.

Mebane, North Carolina was another finalist for the Daimler AG plant location. In Mebane, the Governor of North Carolina made a last minute attempt to convince the legislature to finance a $35 million auto technology center as part of a $109 million incentives package from North Carolina (Tuscaloosa News, Oct 1993). A last minute meeting with the Alabama legislature helped finalize negotiations. The legislature approved a 25 year corporate tax break for Daimler AG that included a 5 percent tax break on wages to allow Daimler AG to pay back construction debt. Additionally, North Carolina gained permission from the legislature to entice Daimler AG to come to Mebane by using attractive tax increment financing or economic development financing bonds. These allow property taxes paid by Mercedes to be allocated towards projects that will directly benefit their company, such as road construction (Charlotte Observer 1993). Other businesses in North Carolina chipped in to help persuade Mercedes to locate in Mebane. First

Citizens Bank promised to provide "cut rate" mortgages to 50 executives if they banked with them. Duke Power agreed to purchase or lease 10 Mercedes Benz sports utility vehicles as part of its electrical contract. In addition, the state arranged to purchase 1,000 more vehicles over the span of two years if the plant decided to locate in Mebane. Furthermore, US Air agreed to provide free flights to Mercedes Officials to visit the plant location.

Another top competitor for the plant location was Summerville, South Carolina. Similar to Tuscaloosa and Mebane, Summerville agreed to purchase the land needed for the facility, worth about $25 million, and lease it to Daimler AG for $1 per year. Trait-based behavior, or behaving like those who are very similarly situated, suggests that South Carolina was a viable location, since in the previous year, a comparable BMW plant chose to locate in Spartanburg, South Carolina (McDermott, 2011).

Mercedes Benz pitted South Carolina, North Carolina, and Alabama against each other, with offers from those states added to their requirement list. The final condition may have sealed the deal for Alabama. Mercedes Benz demanded the wages of their workers should be paid by the state for their first few years. The front-runner, North Carolina, balked, and Alabama met their condition graciously, agreeing to also train workers and upgrade the infrastructure. However, not all agreed that wooing Mercedes Benz was a great investment. The Governor, Jim Folsom, was voted out of office before the first vehicle was produced in 1997. Part of the electorate's displeasure was that the State was forced to borrow from its own pension fund at a high bond rate.

"Tax and subsidize" and deadweight loss: *That which is not seen*

In his discussion of the differential welfare effects of income and excise taxes, Friedman (1952) suggests that broad based and equal taxes reduce the welfare losses from taxation, conditional on the relative substitutability of producers and consumers. Nonetheless, a differential tax on investments, taxing a Mercedes plant at a lower rate or even subsidizing it while taxing investments in other types of businesses at a substantially higher rate inevitably leads to deadweight losses.

Consider the case shown in Figure 1, with the supply and demand given in the diagram. Recalling from basic economics, a demand curve shows the marginal benefits to buyers and the supply curve shows the marginal costs of the sellers. The net benefits or gains from trade in the market are maximized where marginal benefits

equal marginal costs. The gain to the buyers, which is seen as the area below demand and above market price (the area of ΔABD), is termed "consumer surplus." The gain to the sellers is graphically represented by the area below the market price but above the supply (the area of ΔDBC), and is called "producer surplus." Producer surplus is the extent to which sales exceed variable costs. Consumer plus producer surplus, or total gains from trade, are represented by the area of ΔABC.

Figure 1: Supply, demand and gains from trade
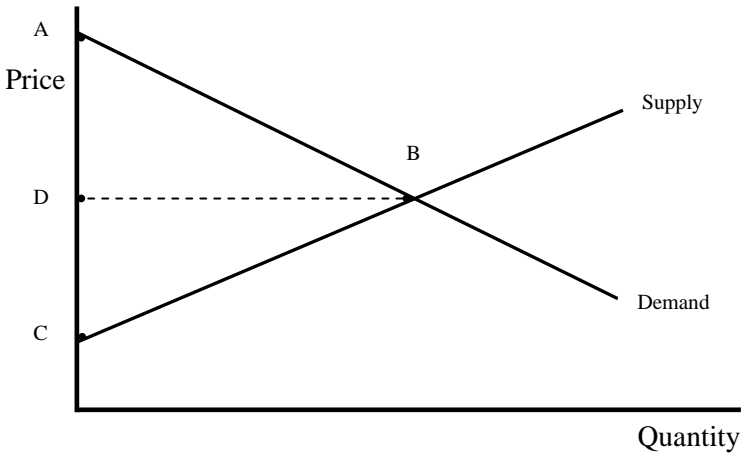
A tax in the market is shown in Figure 2 as pushing up the marginal costs to the sellers by the amount of the tax, JK. We see that a per-unit tax shifts the supply to the left to the curve labeled "Supply with tax." Alternatively this tax raises the marginal cost of the sellers, measured as the height of the supply curve--raising it by the amount of the tax, JK. Consumer surplus is reduced to the area of ΔAEG, while the producer surplus is reduced to the area of ΔHFC. Part of this loss of consumer and producer surplus can be seen as the area of the rectangle GEFH, which amounts to the gross tax revenues of the state. Lost to society is the area of the ΔEBF, the deadweight loss of the tax. This deadweight loss of the tax is due to the existence of infra-marginal units whose benefits exceed their marginal costs, are never realized. Deadweight loss, then, amounts to the gains that fail to materialize because of the tax.

Figure 2: Market with a tax
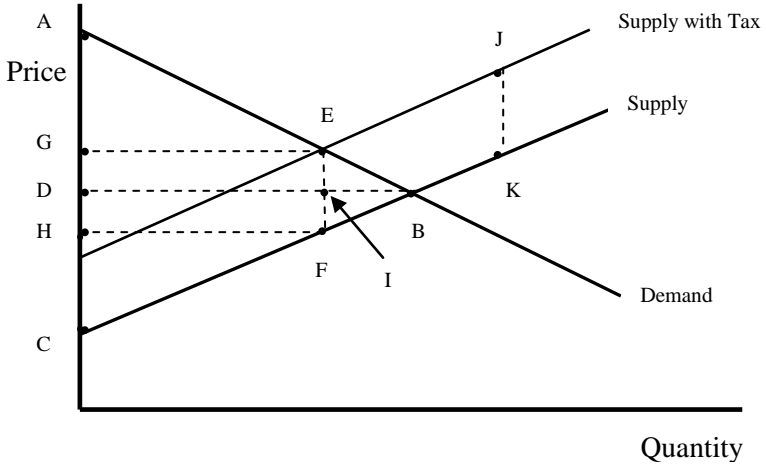
In a market with a subsidy, the marginal costs (or height of the supply curve) to the sellers are reduced instead of increased as we saw in Figure 2. In Figure 3 we view a market with a subsidy, KL. This subsidy is can be measured by the area of the rectangle, DBMN. There is a deadweight loss here as well that is measured by

Figure 3: Market with a subsidy
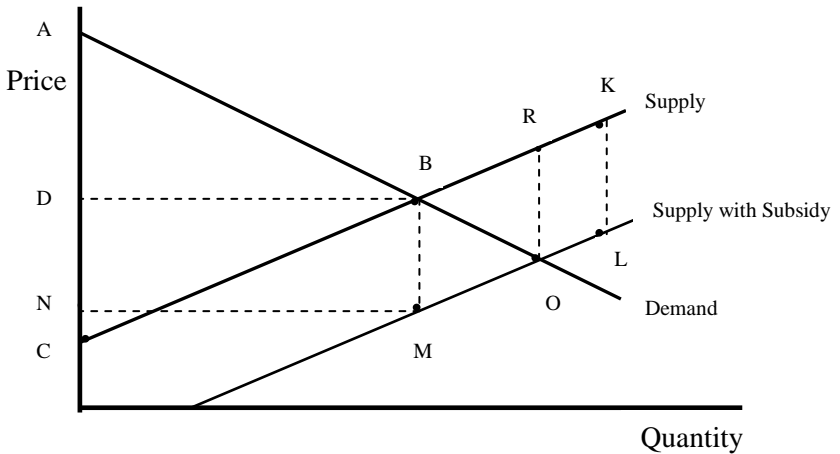
the area of the ΔBOR. The deadweight loss of the subsidy is due to units being produced between B and R where the marginal costs (on Supply) exceed the marginal benefits (on Demand) of those units.

Transferring the taxes raised in one market, GEFH, to subsidize those in another market by the amount DBMN, produces deadweight losses in two areas, one in the taxed market of the area ΔEBF and one in the subsidized market of the area ΔBOR.

The deadweight losses from the taxes associated with the Mercedes subsidy are costly to society because consumer and producer surplus are not maximized; elasticities dictate tax incidence, or the burden of the tax on the buyers and on the sellers. Ramsey (1927) suggests that excise taxes should be placed on goods inversely proportionate to their elasticities of demand in order to minimize the deadweight losses from taxation (termed the "Ramsey Rule"). However, Holcombe (2002) explains that even under the Ramsey Rule there will be undesired consequences, i.e., rent seeking (Tullock, 1967; Krueger,1974). Producers will use the political process to garner favorable tax conditions and exemptions in order to receive preferential treatment over other producers, as we discuss later.

A subsidy to Mercedes for the automobile plant requires higher taxes on other sectors and producers. Because they are unobserved by citizens, politicians can and do support subsidy programs (Bastiat, 1995). To the extent the opportunity cost of the subsidy funds are recognized, some politicians suggest the funds could be better spent alternatively in education or other sectors of the economy. However, it is rarely recognized that taxes are shifted to other goods and other tax classifications. Moreover, eliminating the subsidy is rarely considered as an option, one that would allow producers and consumers to face no additional taxes. Deadweight losses from taxation are rarely considered.

The political process hides the true costs of taxation. A subsidy for the Mercedes automobile plant implies that taxes will increase in other sectors, but it does not indicate on whom the taxes will be placed. In order to assure that taxes will not be recognized in the local economy, taxes are often placed on others on a much wider spatial scale; instead of tax increases in the local economy, taxes are often increased at the state and federal levels of government. The benefit principle of taxation is not upheld considering that citizens in the rest of Alabama and other states will not receive the benefits from the subsidy. In Tuscaloosa County, revenues from property taxes, income taxes, and debt outstanding increased at a much lower rate than the State of Alabama. During the years 1997 through 2002, the total debt increased 39.5% in Tuscaloosa and 56.5% in Alabama. Similarly, property taxes per capita increased 28.4% in Tuscaloosa

and 37.7% in Alabama. While it is certainly difficult to suggest that the Mercedes plant is responsible for these differences in taxes and debt, the finding that taxes and debt increase more at the state level than for the Tuscaloosa region comes as no surprise.

Special-interest politics, collective action and reductions in social welfare: *That which is not seen*

In his 1957 book, *An Economic Theory of Democracy*, Anthony Downs provided the beginnings of a rational theory of collective action, looking particularly at the act of voting. He described rational voting using expected value theory. He proposed that in considering the decision to vote or abstain that the potential voter votes when the value of the vote, V, is positive but abstains when it is negative. He used the equation $V = PB - C$, where P is the probability of altering the outcome with one's vote; B is the increase in value to the potential voter if his candidate or proposition wins instead of losing; and C is the cost of the act of voting.

Since in most elections, the probability of changing the outcome is vanishingly small (see Boudreaux, Coats and Walia, 2011), even a small cost of voting results in abstention. Noting the seeming irrationality of voting in Downs' model in which people would almost certainly abstain, Riker and Ordeshook (1967) reconciled observed voting with the idea of rationality by adding a variable, D, for citizen duty or the cost of non-voting for the citizen. Still, the addition of this "duty" variable does not alter the small impact of the benefits of changing the outcome.

Downs (1967) notes that more important than the "rational abstention" that he brings to light is the issue of "rational ignorance," the idea that since the expected benefits per person are so low in his voter-calculus equation (and Riker and Ordeshook's D does not change this), the value of additional information is quite low, while the marginal cost of information acquisition is relatively high, so people are largely ignorant on public or civic matters, except for those few who have a high citizen duty to stay informed about such issues or do so for entertainment purposes. Largely the information that most citizens obtain is what they learn coincidentally from political advertisements, which is seldom balanced information.

Olson (1965) notes that small, concentrated groups; where the costs of collective action and organization are low (C in Downs's model) and the benefits per person (B in Downs's model) are relatively high attract the attention of politicians through lobbying effort. These groups are able to redistribute wealth from the rest of

society, as the costs of collective action are higher (C per citizen) and the diffuse benefits of stopping the policy (B per citizen) are lower. In such cases, politicians and bureaucrats can gain support for policies that concentrate the benefits of the policy on a special interest group, while the costs of the policy are diffused among everyone else.

In attracting an auto plant or some other FDI, local landowners, workers, and businesses have much to gain and a large incentive to apply political pressure to bring in the plant. At the same time, most citizen-voters see the obvious positive effects of an auto plant in the state but fail to notice the dark side, *that which is not seen*. These unforeseen costs of attracting such a plant are the higher taxes for other taxpayers and lower spending than would be otherwise on important areas, such as health, education, and police and court protection, in addition to the deadweight losses and rent-seeking losses from such competition.

What makes the competitive bidding for sports teams and for auto plants rather similar is that both are done in the name of "economic development." These are not individual decisions by those who both stand to benefit and bear the costs—the benefits and costs are not all weighed out in a single mind. Here, special deals that are not available to others are meted out to attract targeted firms, and, in fact, are paid for by others, rather than equal protection under the law. Some benefit a lot, while many others individually bear a small cost. The small number of individuals who benefit, or expect to benefit, are willing to pay large sums to influence the public decision of attracting large foreign operated automobile plants or NFL franchises.

On the other hand there are many who are likely to bear the costs, either by paying extra taxes or receiving fewer benefits, or who merely continue to pay the same taxes while new firms are subsidized, and their individual shares of these costs are rather small and seldom seen or perceived. These many bearers of the economic development costs have such a small chance of affecting the outcome of the public, "economic development" decision and face only a small individual cost. They have little incentive to oppose the economic development proposal to attract a new plant or a professional sports franchise. This bias of the incentives to participate in influencing the public decision leads to active support, but lethargic opposition, favoring the proposal.

Special interests, particularly where concentrated and easily organized, can usually be counted on to attempt to push for projects

that benefit group members. If it were immediately apparent that a particular program put $1000 into the pockets of each member of the special interests group, while taking $100 from each outsider, those outsiders would quickly say no. But given the low incentives to seek out information about public affairs, due to negligible marginal impact on decisions, programs where the redistributed gains and losses are not obvious, the redistributive program's costs are not easy to perceive. For example, some occupational licensing, such as for floral arrangers, seem innocuous to most people, but these laws usually only serve the purpose of keeping out new suppliers, raising the prices of their services. A policy that attracts a major employer into one area of the state is recognized and lauded by all, even though some in other parts of the state end up with higher taxes and fewer businesses than would have located there otherwise.

The "winner's curse" and competitive bidding: *That which is not seen*

Winners of a bidding contest for FDI in the form of an auto plant as Greenstone and Moretti (2004) describe, may not be winners at all. Kagel and Levin (1986) discuss the problem of the winner's curse, in the context of a common value auction. In a common value auction the value of the item being auctioned is supposedly the same for various bidders, but the information sets of the bidders vary, particularly the information about the item's value. Common-value auctions are distinguished from private value auctions, auctions where the value of the auctioned item is completely private and subjective. Auctions of coins, treasury bills, cattle, and oil and gas leases are examples of common-value auctions. While we would argue that all values are private and subjective, perhaps a better way to distinguish between common- and private-value auctions is that in common-value auctions, the item is being purchased for its investment value, for possible resale or in order to produce another good. While some information may be common or public, expectations and the opinions shaping expectations vary across bidders.

Expectations of this common value, being shaped by information and opinion will be distributed over a range with some mean, as well as some maximum value. More often than not, the value turns out to be closer to mean of expectations than to the maximum value of the expectations. In a common-value auction, the winner of the auction, the one bidding the highest, is the bidder with the maximum

subjective expectation for the item's value. The highest bidder could, then, win the auction, but because of the strong chance that the bid exceeds the *ex post* value of the item, sustain a loss as a result—the "winner's curse."

Brätland (2011) criticizes the notion of a winner's curse in capital goods, noting that different bidders have different plans for the capital good, rejecting the notion of a true common value of the item up for bid, just as Austrian economists have consistently rejected the notion of some true or objective value of a good. Still, given that the bids we discuss here are made by politicians using other people's money, the idea that there might be errors in judgment should be taken seriously.

Kagel and Levin (1986) point out, however, that the problem of the "winner's curse" increases in likelihood as the number of bidders grows, as bidding becomes much more aggressive. Boone and Mulherin (2008) examine the winner's curse problem in the market for corporate takeovers, but find no evidence of such a curse. Blair (2012, 294-300), in his sports economics textbook, discusses the problem of the winner's curse in the competition among cities for professional sports teams. While sports teams and auto plants seem very different, they are similar in many aspects. The following section describes how local governments treat both sports franchises and auto plants in the interest of economic development.

Rent-seeking losses: *That which is not seen*

If a redistributive special interest policy merely took $10 from each of 1000 people to give $1000 to each of 10 members of a special interest group, there would be neither a net gain nor net loss across the society, though we might still worry about fairness. However, those gaining the $1000 in this case would pay up to $1000 to make that gain. In other words, they would put real resources of up to $1000 in place if it would secure a $1000 gain. While losing bids in an auction do not get collected and some of the losing bids by state governments in attracting FDI similarly do not get paid, as these bids are conditional upon favorable site selection, some of the attempts to persuade a company to locate in a state or community are sunk and are expended regardless of the site selection. For example, studies done to persuade a company to select a site or to persuade state or community government officials to back a plan cannot be undone. Political supporters of some policy that redistributes wealth in their favor place bids--bids that often then become sunk bids--to advance their plans, while local opponents and distant competitors make

competing sunk bids. These sunk bids to bring a manufacturer or any other business into a community represent a cost of the special-interest redistribution process.

Tullock (1967) first brought this special loss from redistributive competition to light, noting that such a loss is much greater than the deadweight loss involved, such as those from tax distortions as described above. Later, Anne Krueger (1974) pointed out the significance of Tullock's discovery of these special costs of redistribution, costs that serve as a drag on economic growth, and naming these special losses "rent seeking" losses and this name has stuck. In economics a rent is both a payment to land and a return that does not vary with output or supply, but rather varies only with demand. Redistribution does not produce any output, but the gains to some from redistribution have a cost because those who seek the gain, the prize, expend resources attempting to win the prize and so do their competitors. Competition increases the waste from seeking a prize derived from redistribution.

Was it worth it? A look at some of the costs of competing for an auto plant: *That which is seen and that which is not seen*

In order to "win" the Mercedes Benz plant, Alabama agreed to a $253 million incentive package, and the business community came up with an additional $11 million. In comparison, South Carolina agreed to a $130 million incentive package for its BMW plant in the prior year (McDermott, 2011). Many felt that the package cost too much. When calculating the costs per worker, the Mercedes Benz plant in Vance was estimated to cost $150,000 per worker. This estimate was more than double the nearest BMW plant in South Carolina estimated at $72,000 per worker. Kebede and Ngandu (1999) estimate the payback period to recoup the incentives package for the Mercedes Benz plant to be anywhere from 4 to 7 years. This would place the recoupment between the years 2002 and 2005.

Opponents of these incentive packages have suggested that the deal has not paid off for Alabama, citing Alabama's drop in per capita income ranking from 41st to 42nd from 1993 to 1999 (BLS, Local Area Unemployment Statistics). As of 2007, Alabama's per capita income remained ranked 42nd in the United States. Critics suggest that the benefits of local economic development were not realized after the Mercedes Benz plant was developed. But in contrast, the state unemployment rate did decline.

In 1993, Alabama's state unemployment rate was 7.5%, ranking 40th in the United States. In 1999 and 2007, the unemployment rate

decreased to 4.8% and 3.5% corresponding to the 37th and 11th ranking, respectively (BLS, Local Area Unemployment Statistics). While the decrease in the unemployment rate from 1993 to 1999 may be attributed to the Mercedes Benz plant in Vance, the decrease in 2007 could be attributed to other plants, such as the subsequent construction of the Honda and Hyundai plants. Opponents of FDI suggest that the money from incentives packages would be better spent on investments in human capital at all levels. (Sun Herald, 2001)

Higher education spending might increase regional earnings (Goldstein and Drucker, 2006). This may suggest that some of the funds used to subsidize the Mercedes Benz plant could have been used towards education funding at the University of Alabama, for instance, which could have resulted in an increase in regional earnings. Obviously, the Mercedes Benz plant increased the local regional income in the Tuscaloosa area more than the entire State of Alabama. Per capita income for the State of Alabama in 1997 was $20,930. Three years after the Mercedes Benz plant, the per capita income increased to only $22,222 in 2000 after adjusting for inflation. This represents a modest 6% increase in real per capita income over 3 years. In contrast, Tuscaloosa observed an increase of per capita income during the same period of 9% from $21,022 to $22,886 (Bureau of Labor Statistics; Consumer Price Index).

Another metric to measure the impact of the Mercedes Benz plant on the local economy is the average property values in the region. Property values increased 5.25%, 4.15%, 0.75%, and 3.63% annually for each of the years between 1997 and 2000. However, Oates (1969) finds that there is also a positive relationship between expenditures per pupil and average property values. One may conclude that these property values may have increased by spending the funds alternatively on education.

Conclusion

We do not conclude here that the Mercedes-Benz plant in Vance, Alabama was a mistake for the people of Tuscaloosa County or even for the state as a whole. However, the decision to bid and ultimately induce Daimler AG to locate there was a decision that did not fully weigh the benefits and the costs of the bid. There are several problems with states bidding to influence plant location decisions-- the dark side of economic development bidding on FDI. While high wage employment of a new auto plant is easy to understand and later to observe, the costs are more difficult to see and to foresee. Bidders

seldom see that those in communities far from the proposed auto plant continue to pay higher taxes that pay for subsidies promised to the auto manufacturer. Bidders especially do not see the deadweight losses incurred—the deadweight losses from taxing some to subsidize others. Subsidies also come at the cost of worthwhile public or shared goods, such as police protection, courts, highways, or schools. Since winners and losers in the state are from different groups, those in the winning group disregard losses by others and bids outweigh gains. Sometimes, economic development bids to attract FDI exceed the value to the community because winners are often those who estimate the value of the gain more than the rest of the bidders. We also seldom see the rent-seeking costs incurred in fighting for the plant, such as the use of state and community-paid economic development staffs. The unseen side of the competition for FDI should be brought to light and considered along with the gain seen.

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[1] Bastiat wrote his pamphlets or essays in French and this essay is known by different titles, depending on the translation. The essay is also known as "What is seen and what is unseen," which is the title from our source based on Cain's translation as we cite in our references.