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The Effects of Foreign Direct Investment on Local Communities*

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Little evidence exists on the effects of foreign direct investment (FDI) on local communities in the United States, despite evidence that U.S. communities actively bid against each other for FDI. We use detailed county-level panel data from South Carolina across 5-year intervals from 1980 through 1995 to investigate the effect of foreign manufacturing plants on local labor markets and on the level and distribution of local government budgets. We find that foreign investment raises local real wages much more than does domestic investment, but lowers per capita county-government expenditures and redistributes monies away from public school expenditures.

Key Words: foreign direct investment; local public finance; labor markets.

1. INTRODUCTION

The competition for new firm investment by state and local governments in the United States seems to be ever increasing. The amount and variety of state and local incentives to attract firms have progressed to include local property tax relief, free land, job tax credits, "enterprise zones" which give firms greater benefits for locating in economically depressed areas,

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and major infrastructure improvements. Beyond these now "standard" incentives, competing states also spend significant resources tailoring specialized incentive packages for potentially large investments.

This competition has led both policymakers and economists to question whether the competitive bidding for investment by local communities is actually harmful. The main concern is that various localities may end up in a bidding war that results in a "prisoner's dilemma" that benefits the firm at the expense of the winning community and the welfare of the entire country. In fact, to the extent that communities have a common valuation of the plant located in their area, even the local community that receives the investment may suffer a "winner's curse," because it bid too much.

The most notable recent incident may be the incentives offered by the State of Alabama to attract Mercedes-Benz AG in the early 1990s. As detailed by a November 24, 1993 article in the *Wall Street Journal*, Alabama ended up promising over $300 million in incentives to Mercedes, including free land, employee salaries the first year of operation, property tax relief, payroll tax credits, state spending on Mercedes automobiles, etc. This led many to believe Alabama may have paid too high a price, as expressed by George Autry [28], head of an economic development group based in North Carolina: "They're [Alabama] losing money to invest in their people, their roads, their state in general. For a state like Alabama, which needs money for education, that's a problem." As this example shows, even some policymakers understand that these competitions involve significant trade-offs.

The large wave of foreign direct investment (FDI) flows into the United States in the past two decades adds another dimension to the competition for investment.[1] Beyond the potential adverse welfare effects described above from state and local competition, foreign firms' gains from the incentives accrue to capital owners that likely reside primarily outside the United States. In addition, foreign plants may be less involved in the local community (e.g., through charitable giving) than domestic ones, which could lessen local benefits from the investment.[2] These issues, along with

[1] Research on FDI into the United States has mainly examined the possible reasons for the large inflow in the late 1980s and early 1990s and location decisions, including agglomeration issues addressed in Head, Ries, and Swenson [18]. Graham and Krugman [17] provides a survey of possible explanations for the wave of inward FDI in the U.S., and related literature. Much less has been done to examine the impacts of the foreign firms and plants on the United States, particularly at a local level. There are some exceptions, besides the papers we discuss below, that examine nationwide and industry wage effects of foreign investment. These include Graham and Krugman [17] and Blomström [3], which discuss economy-wide impacts of FDI for the United States, Caves [5] which examines productivity effects of FDI, and Blonigen and Figlio [4] which finds local FDI affects legislators' decisions on trade policy.

[2] In this paper, the terms "foreign" and "domestic" plants refers to *ownership* location, not geographic location of the plant.