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FDI incentives pay—politically

by

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Despite broad skepticism about the benefits of globalization, the majority of U.S. states have offered lucrative tax incentives to attract investment.[1] The size of these incentives is generally considered too large to be welfare enhancing, and many economists are skeptical of the effectiveness of these policies. Yet despite the mounting evidence to the contrary, the incentives offered by U.S. states (and foreign countries) continue and have actually increased in their generosity over time.

In the fall of 2009, we sought to solve this puzzle by conducting an internet survey of 2,000 Americans as part of a Cooperative Congressional Election Study (CCES) project. In this survey, we included questions to assess how individuals feel about FDI and the individuals' efforts to hold politicians accountable for its attraction.[2] Our central finding is that politicians can use tax incentives to take credit for investment flowing into their district, or deflect blame for losing the competition for mobile firms. Thus, fiscal incentives, while economically inefficient, may be a useful tool for politicians to win reelection.

Our first question in the survey asked, "In recent years ____ companies have invested in the United States. Do you think these investments are good for the U.S. economy?" One-third of

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[1] The 2008 Pew Global Attitudes Survey found that only 25% of Americans thought foreign investment had a "very good" or "somewhat good" impact on the United States while 67% answered "negative" or "very negative" opinion. http://pewglobal.org/category/data-sets/

[2] Nathan M Jensen, Edmund Malesky, Mariana Medina, and Ugur Ozdemir, "Pass the bucks: investment incentives as political credit-claiming devices. Evidence from a survey experiment," Paper presented at the 2010 Globalization and Governance Conference, Washington University in St. Louis, 2010.

the respondents had the above blank filled in with the word "*foreign*," one-third with "*Japanese*," and one-third with "*Chinese*." When asked about foreign companies, the majority of respondents (55%) indicated that these investments are good for the U.S. economy. A sizable percentage disagreed (22%) or answered "don't know" (23%). Support for investment increased when asked about Japanese investment, where 61% of the respondents answered "yes," and the remainder answered "no" (18%) and "don't know" (21%). This support plummeted to only 35% when asked about Chinese investment, with 45% answering "no" and 20% "don't know."

These survey results reveal mixed support for FDI with sizeable minorities either skeptical or uncertain of its benefits. When asked about Chinese investment, the skeptics outnumber the supporters, likely due the perception of China as our closest foreign competitor. We imagine that a similar survey in the 1980s may have found skepticism toward Japanese investment, when Japan was seen as our closest rival.

A second set of questions[3] asked citizens about their voting intentions for governor. While many factors affect voting for governor, attracting investment (foreign or domestic) has become central to many governors' economic development strategies. We asked respondents to imagine a 1,000-job manufacturing facility either choosing to locate in the respondent's state or in another state, and how this affected voting intentions for the governor.

Our results were striking. The attraction of investment, without knowing the firm-specific reasons for the location decision, led 20.9% more respondents to say they would vote for the incumbent governor than in states that did not receive the investment, after controlling for individual and state determinants. This was especially apparent for independent voters (23.6%), whereas partisan voters (strong Democrats or Republicans) were less swayed by this information.

We also provided information on tax incentives, asking respondents to consider a situation in which the state provided either above-average or below-average incentive packages. Again, our findings were clear. For states that received the investment project, the governor received an additional 5.6 percentage-point vote bonus for offering tax incentives from independents. This bears repeating. Independent voters preferred governors that provided tax incentives to attract investment to governors who received investment without offering generous tax incentives.

When states "lost" our hypothetical investment project, the contrast was even clearer. Governors who did not receive the investment were always worse off than governors from states who attracted the investment, but the "punishment" was much less severe if tax incentives were offered. Put another way, if you are a governor of a state and are certain that a firm is going to locate within your borders, offering a tax incentive gets you an extra 5.6 percentage points of votes from independent voters. Go ahead and take credit for the investment. If you know your state is going to lose the project, the decision is easier still. Offering the tax incentives provides an extra 5.3 percentage points of all votes and 11.2 percentage points of independents. "It's not my fault, we offered them tax incentives!"

The findings from the survey indicate two clear points related to public policy. First, the tax wars among states, and possibly among countries, are strongly driven by domestic politics. Politicians may be trying to take credit for investment that is going to come anyway and/or trying to minimize blame for investment that does not come. Even without any tax competition, politicians may be taking advantage of voters' perceptions (or misperceptions) of competition.

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[3] YouGovPolitmetrix uses a sample matching methodology to account for non-response bias in internet surveys and simultaneously generates a nationally representative sample of respondents. We administered our questions to 2,000 respondents, who matched the national population demographically.The sample matching correction for Polimetrix has been shown to deliver highly representative samples and accurate forecasting predictions in repeated studies of this nature. See Lynn Vavreck and Douglas Rivers, "The 2006 Cooperative Congress Election Study," *Journal of Elections, Public Opinion, and Parties,* 18.4, 355-366 (2008).

Second, despite some popular rhetoric against FDI, and specifically Chinese FDI, we find strong evidence that there are massive political benefits to attracting FDI.[4] Although many voters are skeptical of its benefits nationally, they clearly reward politicians for attracting investment to their state.

Congressional pollsters have noticed a strange pattern over time. While nobody seems to like the institution of Congress or incompetent politicians, survey data (and the 90% reelection rate) suggest that voters like *their* members of Congress. Our findings point to an interesting parallel with the perceptions of Americans on FDI: there is some skepticism of the benefits of FDI, unless it is creating jobs in *their* state.

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The Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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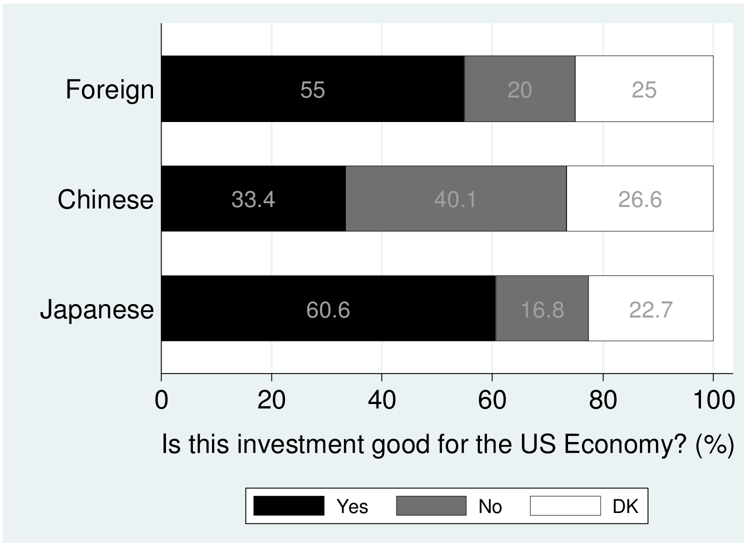
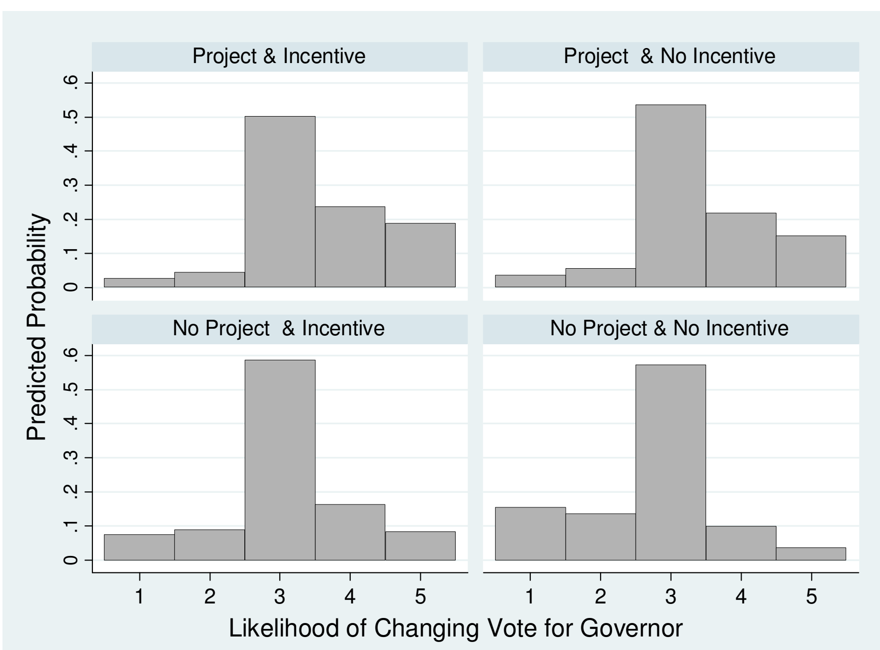
[4] One example is the increasing concern about FDI and national security. See Edward M. Graham and David M. Marchick, *US National Security and Foreign Direct Investment* (Washington D.C.: Peterson Institute for International Economics, 2006).

Figure 1. FDI incentives: is this investment good for the U.S. economy?[a] (Percent)



[a] Results from all voters, sample size 1,944. "In recent years [foreign], [Chinese], [Japanese], companies have invested in the United States. Do you think these investments are good for the U.S. Economy?" (Options randomized into three groups)

Figure 2. FDI incentives: likelihood of changing vote for governor [a]



[a] Results from independent voters, sample size 453. Horizontal Access likelihood of voters changing support for Governor from 1 (very unlikely) to 5 (very likely).