Wooing Foreign Investment Comes At A High Price For Some States

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March 5, 2008

EDITORS AND REPORTERS: Bruce Elmslie is available for interviews at 603-862-3347 or bte@hopper.unh.edu. A high-resolution photo of Elmslie is available for download at http://unh.edu/news/img/UNH_BruceElmslie.jpg. The article Foreign Direct Investment, Economic Growth, and the Human Capital Threshold: Evidence from U.S. States, is available at http://www.unh.edu/news/docs/RIEelmslie2008.pdf.

DURHAM, N.H. - New research from the University of New Hampshire shows that the states spending the most to woo foreign companies to their communities - millions of dollars - do not have the educated or skilled workforce that would allow them to fully capitalize on the investment made by foreign companies.

It is only those states with a more educated and skilled workforce -- a minimum human capital threshold -- that benefit the most from spending so much money to attract foreign companies. In these communities, the money spent to attract foreign direct investment (FDI) has a greater impact on per capita growth than would spending the money on domestic programs, according to Bruce Elmslie, UNH professor of economics, and his co-authors Timothy Ford at Southern Arkansas University and Jonathan Rork at George State University.

The research is presented in the journal article "Foreign Direct Investment, Economic Growth, and the Human Capital Threshold: Evidence from U.S. States." It appears in the February 2008 issue of the *Review of International Economics*.

Between 1978 and 1997, the presence of foreign firms in the United States increased dramatically, with employment by foreign firms in the nation tripling. Gross Domestic Product attributed to these firms increased nine times, and total assets of foreign firms increased 20 times. By 1997, 6.3 percent of U.S. output - $384.9 billion - was produced by foreign companies.

Given this increase in foreign direct investment, the researchers sought to determine whether states that were spending millions in incentives to bring foreign investors and companies to their communities would benefit more if they had instead invested that money in domestic programs, such as public education.

"When a state is at the educational threshold where foreign and domestic employment have the same differential effect, education contributes five times more to productivity growth than does increased employment. Such a finding puts yet another exclamation point on the benefits of a well-educated workforce," according to the authors.

The researchers determined that a 1 percent change in employment increases the growth rate in the economy by .02 percent a year. In contrast, 1 percent change in the percentage of residents with a college degree increases the economy's growth rate by .1 percent a year.

The impact of a well-skilled workforce is illustrated by Alabama's decision to spend $253 million in incentives to lure Mercedes-Benz to its state in 1993. Achieving a 1 percent increase in employment would have required 21,741 new jobs; the Mercedes-Benz deal generated only 1,500 new jobs - a .039 percent increase in employment.

On the other hand, Alabama was just .2 percent below the educational threshold - the point at which the impact of foreign and domestic employment is the same, and at which education contributes much more to productivity than increased employment. To reach that threshold, Alabama needed 8,385 more residents with a college degree. If Alabama would have spent $253 million on educating its workforce instead of on wooing Mercedes-Benz, it could have spent more than $30,000 on educating those residents.

"Given the results of this paper, only the states positioned solidly above the threshold should consider paying more to attract a foreign firm relative to a domestic firm. Only states with a comparatively well-trained workforce have the capacity to take advantage of the presence of foreign technology," according to the researchers.

-30-