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ECONOMIC DEVELOPMENT INCENTIVES AND THE LEGAL AND ECONOMIC ISSUES OF OPEN VERSUS SEALED BIDS

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INTRODUCTION

This paper takes as given that the goal of economic development incentives (EDIs) is to improve the economic welfare of the citizens of a particular geographic area. This paper does not attempt to answer the question of whether EDIs, in their many forms, have in fact succeeded in improving economic welfare, either in absolute terms or above where economic welfare would have been in the absence of the EDI. This paper takes the current state of EDI policy and implementation as given, and focuses the analysis instead on the economic and legal issues associated with open versus sealed bids. This paper reviews the different approaches taken by various jurisdictions regarding the openness of the bidding process and explores the sometimes counterintuitive impact of making the bidding process more open and transparent on the creation of economic wealth. The specific experiences of the Boeing, Dell, Google and Caterpillar EDIs are used to illustrate the analysis.

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I. OVERVIEW OF STATE JOB CREATION TAX INCENTIVES

State and local leaders across the country have continued to face strong pressure from constituents and pundits to create jobs during the prolonged job decline, which has affected a broad array of industries. Many states are faced with the loss of traditional manufacturing jobs. Facing these losses, states have turned to economic development incentives to spur job growth.

North Carolina and South Carolina have emerged as national competitors to bring new companies to their respective states using a mix of state and local EDIs.¹ North Carolina has long battled the loss of its traditional manufacturing jobs in the textile and furniture industries. Recently, state leaders in North Carolina have focused much of the state's large EDI packages towards technology companies—seen as a shift away from manufacturing. South Carolina, while also targeting technology companies, has landed several high-profile manufacturers with EDIs, including BMW Manufacturing Company² and The Boeing Company.³ North Carolina has shown a willingness to compete for large manufacturers with their neighbor to the south. In 2010, both North Carolina and South Carolina submitted bids to heavy manufacturer Caterpillar, Inc., which ultimately chose Forsyth County, North Carolina over a site in South Carolina.⁴

Both states combine county or municipal incentives with state-level incentives to create bids that often climb into the hundreds of millions of dollars.⁵ Local incentives take many forms, including tax

¹ See generally Sherry L. Jarrell, Gary Shoesmith & J. Neal Robbins, *Law and Economics of Regulating Local Economic Development Incentives*, 41 Wake Forest L. Rev. 805 (2006).

² Jack Lyne, *New South Carolina Incentives Spur BMW's \$400M, 400-Job Expansion*, SITE SELECTION, Sept. 28, 2009, <http://www.siteselection.com/ssinsider/incentive/ti0210.htm>.

³ David Slade & Katy Stech, *Boeing's Whopping Incentives*, POST & COURIER, Jan. 17, 2010, <http://www.postandcourier.com/news/2010/jan/17/boeings-whopping-incentives/>.

⁴ Richard Craver, *Caterpillar to Expand Its Operations in Sanford*, WINSTON-SALEM J., Aug. 6, 2010, <http://www2.journalnow.com/business/2010/aug/06/caterpillar-to-expand-its-operations-in-sanford-ar-393666/>.

⁵ Slade & Stech, *supra* note 3.

rate reductions, refunds, grants, and property improvements.⁶ State EDIs in North Carolina and South Carolina arise from similar statutory mandates and delegated authorities. In North Carolina and South Carolina, like many other states, the state-level EDIs can be grouped into two predominant categories: job-based EDI and infrastructure EDI.

Both North Carolina and South Carolina governments operate in a traditional, three-prong system consisting of a supreme court, governor, and bi-cameral legislature.⁷ Both states have adopted freedom of information legislation (FOIA).⁸ The question presented here is whether the general notion that "transparency in government is good" is truly beneficial in an EDI bidding process. The first step is to examine the available incentives in each state and the information that is made public during the bidding process.

A. NORTH CAROLINA

North Carolina has two primary EDI programs. The first, "Tax Credits for Growing Businesses" (TCGB), contains incentives for job creation and for property investment.⁹ The N.C. General Assembly created this program in 2006.¹⁰ The purpose of this legislation was to replace the William S. Lee Quality Jobs and Business Expansion Act with more narrowly-tailored credits that would create jobs and increase

⁶ See, e.g., Irwin Speizer, *The China Trade: The State Lands the Headquarters of a Company from a Country Many Tar Heel Manufacturers Love to Hate*, BUS. N.C., May 2006, at 36 (discussing North Carolina's use of direct grants, state tax credits, training assistance, and direct incentives from county governments to lure Lenovo to the Research Triangle area).

⁷ For North Carolina, the structure of the state government is described in the N.C. Constitution, NORTH CAROLINA STATE CONSTITUTION, N.C. GEN. ASSEMB., <http://www.ncga.state.nc.us/legislation/constitution/nconstitution.html> (last visited June 28, 2011). For South Carolina's structure of state government, see the S.C. Constitution, SOUTH CAROLINA CONSTITUTION, S.C. LEG. ONLINE, <http://www.scstatehouse.gov/scconstitution/scconst.htm> (last visited June 28, 2011).

⁸ Public Records Law, N.C. GEN. STAT. § 132 (2010); Freedom of Information Act, S.C. CODE ANN. § 30-4-10 (2010).

⁹ Tax Credits for Growing Businesses, N.C. GEN. STAT. § 105-129.80 (2010).

¹⁰ The governor signed this bill into law on August 17, 2006. H. B. 2170, 2005-2006 Sess. (N.C. 2006).

business investment in the state.¹¹ Before the TCGB program, the William S. Lee Act regulated a tiered incentive system in North Carolina, which favored rural areas over more developed counties. From a jobs perspective, a tier-1 county (wealthiest type of county) would receive \$500 in incentives per job created, while a tier-5 county (poorest type of county) would receive \$12,500 in incentives for the same job.¹²

The second program is the One North Carolina Fund ("One NC"), formerly the Governor's Industrial Recruitment Competitiveness Fund.¹³ The One NC program promotes the installation and purchase of equipment, structural repairs, and construction of new improvements.¹⁴

B. SOUTH CAROLINA

Like North Carolina, South Carolina has job-creation and infrastructure incentives. There are three jobs incentives: the traditional annual job tax credit and exemptions,¹⁵ the annual small business job tax credit,¹⁶ and the accelerated small business job tax credit.¹⁷

South Carolina also promotes infrastructure and physical plant investment with targeted credits.¹⁸ The state uses a fairly complex system of fees-in-lieu of property taxes; it also provides credits in the form of sales tax exemptions, grants, and loans for land acquisition. South Carolina has also offered credits for worker training and relocation, water and sewer infrastructure, site preparation, and road or rail improvement.

¹¹ *Id.*

¹² WILLIAM SCHWEKE & FRANK DI SILVESTRO, CORP. FOR ENTER. DEV., BUSINESS INCENTIVES AND NORTH CAROLINA'S TIER 1 COUNTIES: HAVE THEY WORKED? (Dec. 2008), [http://cfed.org/assets/pdfs/BusinessIncentives_Tier1Counties\[1\].pdf](http://cfed.org/assets/pdfs/BusinessIncentives_Tier1Counties[1].pdf).

¹³ One North Carolina Fund, N.C. GEN. STAT. § 143B-437.70 (2010).

¹⁴ ONE NORTH CAROLINA FUND, N.C. DEP'T COMMERCE, <http://www.nccommerce.com/en/BusinessServices/LocateYourBusiness/WhyNC/Incentives/OneNorthCarolinaFund/> (last visited June 28, 2011).

¹⁵ S.C. CODE ANN. § 12-6-3360(C)(1) (2010).

¹⁶ § 12-6-3360(C)(2).

¹⁷ § 12-6-3362.

¹⁸ *See, e.g.*, S.C. CODE ANN. § 12-14-60 (2010) (This investment tax credit is calculated as a percentage of the total aggregate basis for the particular property.).

C. SEALED VERSUS OPEN BIDDING

Both North Carolina and South Carolina have adopted specific exemptions from their respective freedom of information and public records legislation. In North Carolina, no disclosure is required under a public records request until an EDI is awarded or rejected.¹⁹ To the contrary, in South Carolina, "confidential proprietary information provided to a public body for economic development or contract negotiations purposes is not required to be disclosed" under FOIA even after an EDI has been awarded or rejected.²⁰ Such a distinction means that North Carolina is considered more "open" in its bidding process than South Carolina.²¹ It is also important to note that cost-benefit data relating to EDI packages are not exempt from disclosure under FOIA in either North Carolina²² or South Carolina.²³ Nevertheless, the quality of cost-benefit analyses is not regulated and varies greatly.

II. RECENT EDI ACTIVITY IN NORTH CAROLINA AND SOUTH CAROLINA

It is of interest to compare the bidding activity in open versus closed states, particularly when they bid against each other for the same company. North Carolina and South Carolina have bid against each other with numerous EDI packages over the past decade. While North Carolina's policy requires that incentive offers for companies be made publicly available, policymakers in South Carolina, including (former) Gov. Mark Sanford and House Speaker Bobby Harrell, have advocated

¹⁹ N.C. GEN STAT. § 132-6(d) (2010).

²⁰ S.C. CODE ANN. § 30-4-40(a)(5)(c) (2010).

²¹ In a December 2010 survey grading states on how well they disclose their EDIs online, *Good Jobs First*, a nonprofit nonpartisan research center in Washington, DC, gave South Carolina a score of zero, the lowest possible score. In comparison, North Carolina scored 69. Philip Mattera, et al., *Show Us the Subsidies*, GOOD JOBS FIRST (Dec. 2010), <http://www.goodjobsfirst.org/showusthesubsidies>.

²² N.C. GEN STAT. § 132-1.11 (2010).

²³ S.C. CODE ANN. § 30-4-55 (2010). It is worth noting, however, that this section only requires disclosure either after the offered incentive is accepted or when the project is publicly announced, whichever occurs later.

to keep the bidding process sealed in an effort to attract major employers by keeping their business plans private.²⁴

South Carolina alone has allocated roughly \$2.5 billion in incentive packages from fiscal year 1999 to 2008, resulting in 11% annual growth in gross state product (GSP) compared to a national average of almost 15% growth.²⁵ In response, at least in part, to this lack of growth, some South Carolina legislators have called for revisions to the current regulations on incentive offerings. Senator Tom Davis drafted legislation—S. 206, The Economic Incentive Transparency Act—which would radically transform the EDI process in South Carolina. According to Senator Davis, “There’s really no formal due diligence on these incentives to objectively analyze their public costs and benefits . . . all we do is mouth the words ‘it creates jobs’ and the analysis doesn’t really go beyond that.”²⁶

For the purpose of the analysis in this paper, North Carolina’s EDI bidding process is considered more open than South Carolina’s. Note that, in this context, this does not signify a policy of complete transparency, but rather a policy that requires relatively more information to be disclosed during the bidding process. Four cases, in particular, highlight the nature of the controversy over whether “openness” helps or hurts a state’s efforts to bring a target company home. The level of economic wealth in these cases ranged from \$50 million to upwards of \$1 billion, demonstrating just how much taxpayer funds are at stake and how essential is further analysis on the effects of transparency within EDI bidding processes.

A. TOM DAVIS, S. 206, HIGHLIGHTS OF BILL

Senator Davis’ proposed bill calls for not only significant changes in the nature and timeliness of disclosure of EDIs during the

²⁴ Ben Szobody, *Sweet Incentives Can Leave Sour Taste*, N.C. INST. FOR CONSTITUTIONAL LAW (Aug. 1, 2010), <http://www.ncicl.org/article/363> (last visited June 28, 2011). S.C. House Speaker Bobby Harrell called North Carolina’s unilateral disclosure of incentive details “not real bright” and postulated that such disclosures enable other states to make better offers.

²⁵ Simon Wong & Jameson Taylor, *A Review of Total State Spending, Part II: An Effective Spending Cap for South Carolina*, S.C. POL’Y COUNCIL (Dec. 20, 2010), <http://www.scpolicycouncil.com/pdf/1215budgetpartii.pdf>.

²⁶ Eric K. Ward, *Bill Proposes Transparency in Incentives*, NERVE (Dec. 22, 2010), reprinted in BEFORE IT’S NEWS (Jan. 24, 2011, 08:44), http://beforeitsnews.com/story/373/283/Bill_Proposes_Transparency_in_Incentives.html.

bidding process, but also for radical changes in the way economic value is assigned.²⁷ Some of the highlights of the bill include new requirements such as a cost-benefit analysis by an independent economist for incentives that exceed \$100,000 over a five-year period, a clawback provision should the company not meet expectations, and a cap on subsidies where the cost per job created exceeds the average per capita income within the state (approximately \$31,800 in 2009).²⁸ The proposed bill requires public notice and a hearing for all incentive packages valued at over \$100,000.²⁹ The bill also requires that a cost-benefit analysis be communicated to the general public through the Department of Commerce's website, as well as to the general media through email.³⁰ The bill also describes in detail a process by which information concerning the transaction could be made accessible to the public without also revealing the target firm's trade secrets and personal data. The South Carolina Senate referred this bill to the Committee on Finance in January 2011, where no further action has been taken yet.³¹

B. ARGUMENTS FOR/AGAINST TRANSPARENCY

A major issue for all officials associated with the EDI bidding process is whether taxpayer funds are being utilized in the most appropriate manner. Historically, South Carolina officials have advocated a more closed process, citing the advantages to potential target firms. In North Carolina, a commentator has also recognized the potential disadvantages of a transparent process:

State officials always have insisted that they have to do economic development deals in secret, lest they scare off would-be investors and hurt our chances against other states. . . . Unlike South Carolina and Alabama, North Carolina has a law that requires incentive offers to be made public, in real time.³²

²⁷ S. 206, 2011-2012 Leg., 119th Sess. (S.C. 2011)

²⁸ *Id.* at §§ 12-66-120 to -130 (2011).

²⁹ *Id.* at § 12-66-140 (2011).

³⁰ *Id.*

³¹ S. JOURNAL, 2011-2012 Leg., 119th Sess. 1-206 (2011).

³² Op-Ed., *Secrecy Drives Up Cost of Economic Development*, N.C. INST. FOR CONSTITUTIONAL LAW (Aug. 17, 2010) [hereinafter *Secrecy Drives Up Cost*], <http://www.ncicl.org/article/369>.

North Carolina's historic corporate income tax structure consists of a flat 6.9% rate in comparison to South Carolina's 5% rate.³³ However, the governor's new budget will reduce North Carolina's corporate income tax rate to 4.9%, the lowest in the Southeast and third lowest in the nation.³⁴ This variable has influenced the bidding process in terms of competitive interstate bids in order to entice companies to receive the most beneficial packages possible. There is a possibility that the change in the economic climate within North Carolina, with such a significant adjustment to its income tax structure, will change how the state chooses to offer EDIs.

A recent study of 338 deals in North Carolina involving business incentives offered between 2001 and 2008 showed that the median value of incentive packages was at least \$200,000; yet the average value of North Carolina incentive packages was \$2 million, skewed by a few outliers valued at over \$10 million.³⁵ Schweke and Taylor highlighted the effects of a handful of very large, local incentive packages and warned that interstate bidding wars may destroy value through over-paying in the terms of the deal.³⁶ In three of the following cases, it appears that North Carolina provided considerably larger packages than other states involved in competitive bidding.

While there has been research in the academic literature concerning the impact of EDIs, there is a lack of research regarding the effects of a transparent bidding process on these deals. The following four cases were selected based on size, publicity, and abundant competition among states and localities for investment and jobs. Both pundits and vocal state representatives have acknowledged that North Carolina is relatively more transparent than South Carolina in their disclosures on EDI.³⁷ Both states have advocates and opponents for their current strategies, and these four particular cases have served as fodder for each line of reasoning.

Dell, Google, Caterpillar, and Boeing are major corporations that

³³ *State Corporate Income Tax Rates, 2000-2011*, TAX FOUND. (Mar. 1, 2011), <http://www.taxfoundation.org/taxdata/show/230.html>.

³⁴ Matt Young, *Governor Presents Surprise Tax Relief for North Carolina Businesses*, CARY CITIZEN, Feb. 20, 2011, <http://carycitizen.com/2011/02/20/governor-presents-surprise-tax-relief-for-north-carolina-businesses/>.

³⁵ WILLIAM SCHWEKE & BRIAN TAYLOR, CORP. FOR ENTER. DEV., LOCAL ECONOMIC DEVELOPMENT INCENTIVES IN NORTH CAROLINA (Dec. 16, 2008), [http://cfed.org/assets/pdfs/LocalIncentives_12-16-08\[1\].pdf](http://cfed.org/assets/pdfs/LocalIncentives_12-16-08[1].pdf).

³⁶ *Id.*

³⁷ *Secrecy Drives Up Cost*, *supra* note 32.

have sought to relocate in the Southeast and, thus, have stirred up competition for their investment. In all four cases, states and counties with different disclosure policies offered major EDIs in order to convince these companies to select their locations, and thus may offer some insight into the interaction between EDI policy and the economic outcomes. According to the 2011 rankings of Fortune 500 companies, each corporation is ranked within the top one hundred firms within the U.S.³⁸ At the time of this publication, these four firms employ over 390,000 people and had revenue of \$204.06 billion in the past twelve months.³⁹ Each of these deals was highly publicized, not only for the implication of the job growth or the value of their EDI packages but also because a major corporation with powerful name brand recognition would now be part of the local economy. Google and Dell are important case studies from the high-tech industry because each company eventually accepted EDI packages in North Carolina, and their bidding processes complement each other. Additionally, Caterpillar and Boeing offer rich examples from the manufacturing sector of the need for research on the effects of transparency.

1. DELL

Dell was the recipient of a highly-publicized EDI for a computer manufacturing plant in Winston-Salem in 2004.⁴⁰ The deal was highly sought after and involved tax breaks worth up to \$277 million in exchange for Dell's promise to provide 1,500 jobs that paid \$14 an hour. This suggests that the state was willing to pay \$185,000 per job as part of the incentive package at a time when the per-capita income in

³⁸ *FORTUNE* 500, CNNMONEY (May 23, 2011), http://money.cnn.com/magazines/fortune/fortune500/2011/full_list/.

³⁹ *Google Inc. (GOOG): Profile*, YAHOO! FIN., <http://finance.yahoo.com/q/pr?s=GOOG+Profile> (follow "Key Statistics" hyperlink) (last visited June 28, 2011); *Caterpillar Inc. (CAT): Profile*, YAHOO! FIN., <http://finance.yahoo.com/q/pr?s=CAT+Profile> (follow "Key Statistics" hyperlink) (last visited June 28, 2011); *Boeing Co. (BA): Profile*, YAHOO! FIN., <http://finance.yahoo.com/q/pr?s=BA+Profile> (follow "Key Statistics" hyperlink) (last visited June 28, 2011); *Dell Inc. (DELL): Profile*, YAHOO! FIN., <http://finance.yahoo.com/q/pr?s=DELL+Profile> (follow "Key Statistics" hyperlink) (last visited June 28, 2011) (summing the "Full Time Employees" and "Revenue" for the trailing twelve months as of April 29, 2011 for all four companies).

⁴⁰ See Jarrell, Shoesmith & Robbins, *supra* note 1.

North Carolina was only \$29,246.⁴¹ Instead, only four years after the plant's grand opening, 905 workers lost their jobs when Dell announced its intentions to close the plant.⁴² The plant never fulfilled its promise to employ 1,500 workers.⁴³

North Carolina was engaged in a bidding war with the state of Virginia for the Dell factory from the onset of the location selection process. Virginia privately offered only \$30-\$37 million; nevertheless, Forsyth County, North Carolina offered Dell an EDI package worth \$240 million and \$37 million in state and local taxes, respectively.⁴⁴ N.C. Representative Paul Luebke expressed frustration when Virginia's bid was finally revealed and worried that "North Carolina was bargaining against itself" in reference to the interstate bidding that went on. Mike Randle, publisher of *Southern Business & Development*, argued that "North Carolina had to overpay for Dell because it had missed out on every 'signature deal' for the last 10 years."⁴⁵ While Dell was able to pay back the majority of the incentives, the \$18 million in public money spent to help Dell prepare for the opening of the plant in 2004 appears not to have been repaid.⁴⁶

2. GOOGLE

In 2007, North Carolina offered a controversial EDI package to bring the Google data center to Caldwell County.⁴⁷ The package was valued at \$212 million in tax cuts, infrastructure improvements, and

⁴¹ See David G. Lenze & Kathy Albetski, *News Release: State Personal Income*, BUREAU OF ECON. ANALYSIS, U.S. DEP'T OF COMMERCE (Mar. 28, 2005), <http://www.bea.gov/newsreleases/regional/spi/2005/spi0305.htm>.

⁴² See Emery P. Dalesio, *Millions Spent Luring Dell to NC Can't Be Recouped*, STREET (Oct. 9, 2009), <http://www.thestreet.com/story/10609805/millions-spent-luring-dell-to-nc-cant-be-recouped.html>.

⁴³ See *id.*

⁴⁴ See Paul Chesser, *Magazine: NC Overpaid for Dell*, CAROLINA J. ONLINE (Jan. 14, 2005), http://www.carolinajournal.com/exclusives/display_exclusive.html?id=2107.

⁴⁵ Paul Chesser, *Did NC Overpay for Dell Plant?*, CAROLINA J., Apr. 2005, at 5, available at http://www.johnlocke.org/acrobat/cjPrintEdition/carolina_journal.2005.04.pdf.

⁴⁶ Dalesio, *supra* note 42.

⁴⁷ See Cullen Browder, *Google Incentives Fuel Debate About the Tactic*, WRAL.COM (Feb. 9, 2007), <http://www.wral.com/news/local/story/1197713>.

other incentives over thirty years in an effort to bring 210 jobs to a community that had lost over 2,100 jobs in just three years.⁴⁸

Transparency was a major issue from the onset of the transaction. Google conducted a bidding process by dispatching an employee to gauge interest among different states and counties without informing state officials which company he was representing. Rhett Weiss, one of Google's site negotiators, required that each county sign a strict confidentiality agreement and did not inform participants in the highly-competitive bidding of Google's identity until months into the process.⁴⁹

The local Caldwell County portion of the \$212 million Google deal was estimated to be as high as \$165 million.⁵⁰ Part of the rationale behind the Caldwell County deal was a desperate effort to outbid South Carolina. "Some news reports portrayed a direct, one-on-one competition between North Carolina and South Carolina, which implied one of the states would lose out. In reality, according to Google officials, 12 locations in seven states [were] under consideration"⁵¹ In return for "a 100 percent waiver on business property taxes and an 80 percent waiver of real estate property taxes for the next 30 years," Google planned to bring 210 jobs paying approximately \$48,000 a year to Caldwell County at a cost of over \$1 million per job.⁵² Many critics of the deal felt that Google executives took advantage of Lenoir and Caldwell County officials through intense secrecy throughout the bidding process.⁵³

⁴⁸ Nanette Byrnes & Coleman Cowan, *The High Cost of Wooing Google*, BLOOMBERG BUSINESSWEEK (July 23, 2007), http://www.businessweek.com/magazine/content/07_30/b4043066.htm.

⁴⁹ *Id.*

⁵⁰ Jonathan Q. Morgan, *Using Economic Development Incentives: For Better or Worse*, POPULAR GOV'T, Winter 2009, at 16, http://www.sog.unc.edu/sites/www.sog.unc.edu/files/article3_13.pdf.

⁵¹ Paul Chesser, *Did SC Get a Better Google Deal?*, CAROLINA J. ONLINE (Apr. 6, 2007), http://www.carolinajournal.com/exclusives/display_exclusive.html?id=3993.

⁵² See John Dayberry, *Based on Google Experience, Caldwell Officials Say Apple Will Be Sweet Deal*, HICKORY DAILY REC., July 12, 2009, <http://www2.hickoryrecord.com/news/2009/jul/12/based-google-experience-caldwell-officials-say-app-ar-90040/>.

⁵³ Bob Orr, a former North Carolina Supreme Court justice who was running for governor, spoke publicly against Google's negotiation tactics. "It's simply unconscionable from an ethics standpoint for this company to go in

Debate continued when Google announced that it planned to build an additional \$600 million data center in Berkeley County, near Charleston, S.C. Berkeley County appeared to get a much better deal than Caldwell County; a Google spokesman said the company planned to “pay \$58.8 million over the 30 years (\$1.96 million per year) in real and personal property taxes through South Carolina’s FILOT program.”⁵⁴

It was recently announced that Caldwell County and the City of Lenoir would receive \$2 million in tax revenue because Google delayed its request for tax rebates due to its failure to provide the minimum number of jobs listed in its contract.⁵⁵ One Google official stated that the company would not have considered relocating to North Carolina or South Carolina without the lure of large incentive packages. He said that without EDIs “the whole part of our economic analysis doesn’t come out right [making relocation economically unfeasible].”⁵⁶

3. CATERPILLAR

Caterpillar recently announced that it elected to build a new equipment plant in Winston-Salem, North Carolina. The decision was a result of aggressive bidding between Winston-Salem; Spartanburg, South Carolina; and Montgomery, Alabama. After an intense bidding process where South Carolina and Alabama were privy to North Carolina’s public offers in advance of the official bid, Caterpillar elected to accept the incentive offer of up to \$40 million in Winston-Salem.⁵⁷

from this very unfair bargaining position . . . These are business decisions by the smartest businesspeople in the world, and it's just exploiting a desperate town.” Byrnes and Cowan, *supra* note 48.

⁵⁴ Chesser, *supra* note 51. South Carolina’s FILOT (fee-in-lieu of property taxes) program enables counties to offer reduced property tax rates to companies that promise significant capital investment and job creation. These reductions can be substantial, 10.5% to 6% or even lower, which can translate to massive long-term savings for a company.

⁵⁵ See Paul Teague, *Google Gives Up 2008 Incentives*, NEWS-TOPIC (Lenoir, N.C.), May 1, 2008, <http://www2.nccommerce.com/eclipsfiles/18921.pdf>.

⁵⁶ Chesser, *supra* note 51.

⁵⁷ Szobody, *supra* note 24.

As part of the transaction, Caterpillar was projected to employ 392 full-time and 118 contract workers in the new \$426 million plant.⁵⁸ The facility is 850,000 square feet and is expected to pay an average salary of \$40,482 a year.⁵⁹ Considering the \$40 million in incentives (\$17 million to be provided by the state and the remaining \$23 million to be provided by Forsyth County), North Carolina effectively paid roughly \$78,431 per job. Bob Orr, a former N.C. Supreme Court justice and the executive director of the N.C. Institute for Constitutional Law, voiced his frustration on the matter: “If the whole process was on eBay, we’d save the states millions of dollars.”⁶⁰ He further explained that he felt as if North Carolina was being taken advantage of on a continuing basis.⁶¹ “If you look at the budget holes state and local governments are facing, it simply makes no sense to be giving this kind of money away.”⁶²

Orr is not the only state official who feels that way. Bobby Harrell, the South Carolina House Speaker, expressed that North Carolina’s decision to be transparent and reveal parts of their incentive offerings provides other states with an unfair advantage.⁶³ South Carolina and Alabama had the opportunity to analyze North Carolina’s bid and assess their own offerings without reciprocating any information. The simple act of having multiple entities in a competitive bidding process with different policies over transparency creates a situation where states have the potential to overpay in order to increase the likelihood that their bid is selected.

This process seems to destroy value for taxpayers by including other states just for the sake of competition. The Mayor of Montgomery, Alabama, Todd Strange, told The Montgomery

⁵⁸ Richard Craver, *Caterpillar Era Underway in Winston-Salem*, WINSTON-SALEM J., Nov. 12, 2010, <http://www2.journalnow.com/business/2010/nov/12/caterpillar-era-under-way-winston-salem-ground-bro-ar-531889/>.

⁵⁹ *Caterpillar Officially Announces Winston-Salem Project*, NEWS & RECORD (Greensboro, N.C.), July 30, 2010, http://www.news-record.com/content/2010/07/30/article/reports_caterpillar_chooses_winston_sal_em.

⁶⁰ Szobody, *supra* note 24.

⁶¹ David Bracken, *Winston-Salem Lands Caterpillar*, CHARLOTTE OBSERVER, July 31, 2010, <http://www.charlotteobserver.com/2010/07/31/1592590/winston-salem-lands-caterpillar.html>.

⁶² *Id.*

⁶³ Szobody, *supra* note 24.

Advertiser in the weeks leading up to the final decision that he did not expect that Montgomery could match Winston-Salem's offer.⁶⁴ It is unclear whether Montgomery or Spartanburg, South Carolina ever intended to enter bids even near the \$40 million package offered by Winston-Salem, demonstrating the potential inefficiencies that arise when transparency can act as an advantage or disadvantage. Orr commented, "That is all part of the game—using the competition to maximize an incentive offer."⁶⁵

4. BOEING

In late 2009, South Carolina announced that Boeing would be constructing a 787 Dreamliner assembly line in North Charleston and creating 3,800 jobs in the process.⁶⁶ South Carolina officials and its then-Governor, Mark Sanford, desperately sought to land the Boeing project, as the state felt that it had missed an opportunity with the company during a competitive bidding process in 2003. Many reporters eagerly compared Boeing to other "crown jewel" companies of the state, such as BMW, located in Greer, South Carolina.⁶⁷

The recent Boeing plant was yet another opportunity for North Carolina and South Carolina to compete in the same bidding process. Back in 2003, the two states bid against each other for the first assembly line for the 787 airplane, but Boeing decided to build its plant in Everett, Washington.⁶⁸ While North Carolina never officially released any information on the 2009 bid, it was widely rumored at the time that South Carolina would be bidding against North Carolina. This environment marked a stark contrast from previous bidding wars

⁶⁴ Craver, *supra* note 58.

⁶⁵ Szobody, *supra* note 24.

⁶⁶ Mike Randle, *Our Take on Boeing's South Carolina Deal*, S. BUS. & DEV., <http://www.sbd.com/Features/OurTakeonBoeingsSouthCarolinaDeal/tabid/308/Default.aspx> (last visited June 28, 2011).

⁶⁷ Dominique Cantelme, *South Carolina, Already Home to More than 100 Aerospace-related Companies, Lands a Crown Jewel: Boeing's Second 787 Dreamliner Plant*, BUS. FACILITIES, Jan. 1, 2010, <http://www.businessfacilities.com/articles/2009-economic-development-deal-of-the-year-awards.php>. *Business Facilities Magazine* gave South Carolina and the Boeing project its 2009 Economic Deal of the Year Gold Award.

⁶⁸ Alan M. Wolf, *N.C. Officials Remain Quiet on Boeing as Washington Wooing Intensifies*, NEWSOBSERVER.COM (Oct. 14, 2009), <http://blogs.newsobserver.com/business/nc-officials-remain-quiet-on-boeing-as-washington-woosing-intensifies>.

between these two states. Historically, South Carolina was privy to EDI information that North Carolina disclosed prior to the company choosing its final location. However, the high stakes of the Boeing project reversed the roles of each state during the bidding process. The rumor of competition with North Carolina may have drastically impacted the monetary value of South Carolina's bid in its effort to ensure that the assembly line was built in North Charleston.

A significant amount of controversy has arisen over the Boeing process, specifically there have been complaints regarding the lack of disclosure of financial analysis in the months following the announcement. The sheer size of the incentives made the offering one of the largest EDI packages that the state had ever offered, at a value of \$450 million for the company to create 3,800 jobs and invest over \$750 million in a seven-year period.⁶⁹ The package was a result of a hard-fought bidding war with Everett, Washington for the second time in less than a decade, providing additional motivation for South Carolina to make a successful bid.

After the initial announcement, many citizens and policymakers within the state were excited at the prospect of having such a large corporation within the aerospace industry that could provide the state with several thousand jobs. Yet, within months of the opening announcement, one local newspaper reported that the incentive package may be worth as much as \$900 million, twice what was originally broadcasted when Boeing accepted the EDIs.⁷⁰ The *Post and Courier* performed its own cost-benefit analysis of the EDIs, which had been valued at approximately \$450 million. The newspaper determined that the lower valuation did not factor in property and sales tax breaks that Boeing would not have had to pay if it had not chosen North Charleston as its location. By almost any measure, the EDIs alone will be sufficient to fully reimburse Boeing for the company's \$750 million investment required to build the plant in North Charleston. A cost-benefit analysis, which was performed in preparing the package, estimated that for every \$1 spent in taxpayer funds, the state and community of North Charleston would receive \$14.⁷¹ Many of the officials involved with the deal attempted to deny claims that the \$450

⁶⁹ John McDermott & Yvonne Wenger, *Boeing Lands in North Charleston*, POST & COURIER (Charleston, S.C.), Oct. 28, 2009, <http://www.postandcourier.com/news/2009/oct/28/boeing-picks-charleston/>.

⁷⁰ Slade & Stech, *supra* note 3.

⁷¹ *Id.*

million figure was ever released and argued that the benefits of Boeing far outweighed the costs of bringing the corporation into the state.⁷²

According to these figures, it appears that South Carolina was willing to spend approximately \$200,000 or more in taxpayer funds per Boeing job. This large sum and the subsequent attempts by officials to quell criticism over the deal was part of the motivation for Senator Davis's proposed S. 206 bill. The South Carolina Department of Commerce believed that this EDI represented an investment that would create the proposed 3,800 jobs at the Boeing factory, along with 5,971 jobs indirectly associated with the construction of the infrastructure and suppliers, which could result in a \$5.2 billion economic gain over a 15-year period.⁷³

With the lack of disclosure through FOIA concerning the true value of the EDI package, it is difficult to ascertain whether the \$900 million is an accurate value for the offering. Still, the discrepancies in value, lack of prompt disclosure, and perceived secrecy all highlight issues that may arise for taxpayers in states with closed policies.

III. THE ECONOMICS OF OPEN VERSUS SEALED BIDDING

There is a rich and growing literature on the impact of state and local EDIs on various measures of economic wealth, including job creation, salary levels, and tax revenues. The findings are mixed, however, in large part because of the empirical and research design challenges associated with isolating the impact of EDIs on a community.⁷⁴

While much of the existing literature concludes that EDIs destroy economic wealth, a growing minority of more recent studies argue that if used judiciously the EDI process can isolate the most beneficial offers.⁷⁵ Edmiston, for example, finds that because business follows labor, the most effective EDIs may entice people, not firms, to

⁷² *Id.*

⁷³ *Id.*

⁷⁴ Jarrell, Shoesmith & Robbins, *supra* note 1.

⁷⁵ Timothy J. Bartik, *Solving the Problem of Economic Development Incentives*, 36 GROWTH & CHANGE 139 (2005); Michael Greenstone & Enrico Moretti, *Bidding for Industrial Plants: Does Winning a 'Million Dollar Plant' Increase Welfare?* (NBER Working Paper No. 9844, 2003), available at <http://www.econ.berkeley.edu/~moretti/milliondollarplant.pdf> (arguing that EDIs create value).

relocate.⁷⁶ Greenbaum and Bondinio explore differences in the types of funding mechanisms used in EDIs.⁷⁷ They find that governments that focus more on attracting businesses rather than job creation tend to use loans rather than grants to fund EDIs, while those that face more significant financing barriers, surprisingly, favor grants over loans, even though grants typically are not repaid. Future research into the impact of EDIs on wealth creation will need to control for the types of financing mechanisms used.

Although the question of whether EDIs can create wealth rages on, there seems to be no debate about the desirability of transparency in the EDI bidding process. The near-universal opinion in both the popular press and the academic literature is that an open bidding process is preferable; state and local governments should disclose the details of EDI bids to the public during the bidding process and hold hearings to allow the public to discuss, debate, and presumably even alter or veto the bid.⁷⁸ An open and transparent bidding process is distinguishable from the broader issue of accountability, where recipient firms may make regular reports to the state on the status of any performance pre-conditions of the EDI (for example, on number of jobs created or retained) over the duration of the funding.

A columnist in the *Knoxville News Sentinel* recently lamented, “Nobody, you see, is ever supposed to know anything about allocating state money to corporations that are considering opening or expanding an enterprise within Tennessee. Not until the deal is done. Well, maybe unless you’re a sworn-to-secrecy insider, privileged to know that which cannot be entrusted to common folk.”⁷⁹ Texas State Controller Susan Combs identified a perceived flaw in the allocation of Texas Enterprise and Emerging Technology funds following a wide-ranging review of the state’s job incentives programs. The review was prompted after questions arose over links between contributors to

⁷⁶ Kelly D. Edmiston, *Attracting the Power Cohort to the Tenth District*, 94 ECON. REV.: FED. RES. BANK OF KAN. CITY 69 (2009).

⁷⁷ Robert Greenbaum & Daniele Bondonio, *Incentivizing Economic Development: An Empirical Examination of the Use of Grants and Loans*, 7 S.C. J. INT’L L. & BUS. (forthcoming Oct. 2011).

⁷⁸ Bartik, *supra* note 75, at 140 (“Local decisions about incentives will be improved by a more democratic process with full information . . .”).

⁷⁹ Tom Humphrey, *Humphrey: Shhh! Bredesen’s \$51 Million Secret*, KNOXVILLE NEWS SENTINEL, May 16, 2010, <http://www.knoxnews.com/news/2010/may/16/shhh-bredesens-51-million-secret/>.

Governor Perry's campaign and companies that had been awarded job-creation grants under the programs. "Due to the flexibility of the decision-making process, the program appears less transparent at times, causing a perception of outside influence [in the awarding of EDI funds]" she wrote.⁸⁰

The 2003 incentive package that brought the Scripps Research Institute to Florida is facing some buyer's remorse as well. "Nobody asked what \$569 million could do for Florida if such a mega-subsidy was directed to other needy purposes Nobody asked because nobody knew. To some who think government should be more publicly accountable with taxpayer dollars used to lure new business, the secrecy of the Scripps deal barely passes the sniff test."⁸¹

Most proponents of increased disclosure base their arguments on philosophical grounds of equity and fairness. They contend that because the state is spending the public's money, the public has a right to know how its money is being spent. Sealed bids, those known only to the involved parties, encourage secrecy and corruption, neither of which has a place in the EDI bidding process. Under this view, state and local government officials have an obligation to fully disclose the details of the proposed EDI bid to the public, and to hold hearings to allow for public commentary and debate about the nature of the bid.⁸²

A. THE ECONOMIC ARGUMENT FOR DISCLOSURE

This paper argues that if the goal of EDIs is to create economic wealth, then the issue of whether the bidding process should be open or closed should be determined, or at least informed, by its impact on

⁸⁰ *Comptroller Urges More Openness of Job Incentive Programs*, CBS DALL. / FORT WORTH, Dec. 23, 2010, <http://dfw.cbslocal.com/2010/12/23/comptroller-urges-more-openness-of-job-incentive-programs/>.

⁸¹ Robert Trigaux, *Who Really Benefits From the Subsidy Game?* ST. PETERSBURG TIMES, June 13, 2005, http://www.sptimes.com/2005/06/13/Columns/Who_really_benefits_f.shtml.

⁸² See Bartik, *supra* note 75; see also Peter D. Enrich, *Business Tax Incentives: A Status Report*, 34 URB. LAW. 415 (2002); John Howe and Ingrid Landau, *Do Investment Attraction Incentives Create Decent Jobs? A Study of Labour Conditions in Industry Assistant Contracts*, 19 LABOR AND INDUSTRY 97 (2009).

wealth creation.⁸³ Timothy J. Bartik, senior economist at the W.E. Upjohn Institute for Employment Research and widely regarded expert on EDIs, calls for greater transparency of incentives and incentive offers, yet he does not provide thorough economic analysis to support this demand. Bartik's reasons for greater transparency include the following: (1) disclosure will improve the bargaining position of economic developers; (2) it will promote broader public debate; (3) it will allow better research on incentives; and (4) it is essential for any incentive regulation by the federal government or supranational organization.⁸⁴

An example may help illustrate the implications of Bartik's reasoning. Assume that if Company X relocates in South Carolina, \$100 of additional economic wealth is created for society, where society consists of consumers, businesses, and government. Further, assume that all parties concur with this figure.⁸⁵ If South Carolina offered Company X an EDI package of \$100 in tax rebates and other measures, and Company X accepted the offer, the net economic impact of the relocation to society would be \$0 (ignoring the waste and loss of value associated with the mechanisms for collecting and distributing the tax revenues). If South Carolina reduced its offer to \$80 and Company X accepted, South Carolina and its citizens would be better off by \$20. Lastly, if South Carolina paid \$120 to entice Company X, \$20 of social economic wealth would be destroyed.

This example enables a closer examination of Bartik's first reason for transparency. Bartik theorizes that "disclosure may . . . give economic developers a more accurate knowledge of what alternatives are open to business locations decision makers, which should improve the bargaining position of economic developers. Businesses already know what they have been offered by different local areas, but

⁸³ The authors are not aware of any academic study on the impact of transparency of EDI bids on economic wealth. The studies which approach the issue of transparency in EDI bidding either ignore the issue of openness or simply conclude, without analysis and apparently on some unspoken philosophical grounds, that the bidding process in EDIs should be more transparent. Bob Orr plainly laid out the options when he told the *Greenville News* that while transparency has the potential to drive up the price of EDI bids, secrecy makes it a sure thing. See *Secrecy Drives Up Cost*, *supra* note 32.

⁸⁴ Bartik, *supra* note 75.

⁸⁵ Notice that if this same company were to relocate to some other state, instead, the impact on social value would likely be different.

economic developers do not.”⁸⁶ Bartik is suggesting one of two things: either that the value of Company X to South Carolina is a function of its value to other states and that South Carolina needs to know those bids in order to assign value to the relocation, or that South Carolina knows the value of this company’s relocation but wants to pay as little as possible in a winning EDI bid.

The first interpretation is not plausible for two reasons. First, the value of a company to a state depends on the specific economic conditions in that state, not on the company’s performance in some other state. Second, if every state needed to see what another state was offering in order to assess value, no state would be able to unilaterally assign value to the deal. Specifically, if Bartik is assuming that officials need information on competing offers in order to determine value, he must explain how competing offers from other states are economically valid in the first place while offers from the state in question are not. Finally, under this interpretation of Bartik’s first reason for transparency, the competing states’ offers must be interpreted as accurate disclosures of the value of the company to those states. There is an important distinction between the actual economic value of the relocation to a state, and the (winning) EDI bid by that state. It is the difference between the two that determines the value of EDIs to society.

The second, more valid interpretation of Bartik’s first reason is that knowledge of other offers helps the state fashion a bid that is high enough to win, but not so high as to “overpay” for the EDI, where overpayment is determined by the relationship between the actual value of the relocation to the state and this state’s bid. The impact of transparency on the bidding process, however, remains an open question under Bartik’s formulation.

Bartik’s second reason for calling for national transparency in the EDI bidding process is that it will promote broader public debate. As economic value is clearly not determined by democratic vote, Bartik must be referring to public debate about the veracity of the state’s bid. The mechanism by which public debate may “improve” the EDI bid is unclear. Unless public debate generates higher quality information about the relocation or supplants state officials’ deliberation with a superior analysis of the data, the call for public debate on the EDI bidding process holds little promise for improving the economic impact of EDIs. If Bartik is referring to the disciplinary impact of public

⁸⁶ Bartik, *supra* note 75, page 149.

debate against overpaying, then the relationship between transparency and the bidding process remains unresolved.

Bartik's third justification for transparency in EDIs is that it "allows better research on incentives." This seems more directed toward improving the impact of the incentives on economic well-being and wealth than on deliberately increasing transparency of the bidding process.⁸⁷ Bartik implicitly assumes that incentives can in fact be improved, which remains an open and fairly complex empirical question, and that independent researchers are in a better position than the state to assess the impact of the EDIs on wealth.

The last of the four reasons Bartik offers in support of EDI transparency is that "it is essential for any incentive regulation by the federal government or supranational organization." It appears that, in this instance, Bartik is referring to the transparency of the details of the state or local EDI programs to the federal organization, which simply requires direct reporting by the state to the federal body, not public hearings and debate. While it is likely that the states will not voluntarily agree to a uniform EDI policy, this begs the question of whether local EDIs will be found to be unconstitutional under the Commerce Clause.⁸⁸ If unconstitutional, the issue of whether public disclosure at the time of the bid adds value becomes moot. However, in the foreseeable future, the use of local and state EDIs is very likely to remain widespread.

Although Bartik's reasons may seem compelling and intuitive, he does not provide an economic analysis to support his demand for transparency. Since the goal of EDIs is to create economic wealth, then only if open bids support wealth creation should the EDI bidding process be open. The economics literature may provide insight into the potential impact on the level and distribution of wealth creation of sealed versus open EDI bidding processes. Two lines of research in the

⁸⁷ See Enrich, *supra* note 82. Enrich points out that better data on costs and benefits could enable better analysis of the economic impact of a program. However, publicizing the data does not necessarily improve either the quality or the analysis of the data. In fact, Enrich goes one step further, suggesting that toothless disclosure measures could provide political cover for continued escalation of the interstate subsidy competition.

⁸⁸ See Jarrell, Shoemith & Robbins, *supra* note 1; Enrich, *supra* note 82. Enrich observes that most of the tax breaks offered to influence business location decisions appear to violate well-established Commerce Clause norms, and litigation challenging their constitutionality may offer the best hope of reversing the continuing proliferation of tax incentives.

economics literature are relevant: economics of search and auctions.

B. ECONOMICS OF SEARCH

In the seminal work in this field, George J. Stigler, winner of the 1982 Nobel Prize in Economic Sciences, explains that searching for the best price on a product or service creates economic wealth.⁸⁹ A “search” is the process by which “[a] buyer (or seller) who wishes to ascertain the most favorable price . . . canvass[es] various sellers (or buyers)”⁹⁰ If there was perfect information where buyers and sellers have full knowledge of each other and of the products or services being bought and sold, or if all products or services were identical, then search creates zero additional value. However, if there is imperfect information about the parties, product, or service, or if the product or service varies either in its features, quality, or terms of sale, then search creates benefits.⁹¹ The benefits of search are the added value or revenues from a better match between supplier and consumer. The benefit can be as simple as finding the same good at a lower price. The larger the price dispersion, the greater the potential benefits of search,⁹² since with search one is likely to find a lower price. Price dispersion, however, is a biased measure of ignorance (or “asymmetric information”) in the market. Price dispersion is also due to heterogeneity of the buyers or sellers in the market.⁹³

Nonetheless, search costs money. The costs of search are essentially the time, man-hours, and the possibility that by continuing to search and delaying purchase, the better deal will slip away. The optimal amount of search is given by the point where the additional benefits of search equal its additional costs.⁹⁴

⁸⁹ George S. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ Research applying the economics of search to the labor market was awarded the 2010 Nobel Prize in Economics. THE PRIZE IN ECONOMIC SCIENCES 2010: MARKETS WITH SEARCH COSTS, ROYAL SWEDISH ACADEMY OF SCIENCES, http://nobelprize.org/nobel_prizes/economics/laureates/2010/info.pdf. For a survey of the literature applying search costs to the labor market, see Richard Rogerson, Robert Shimer & Randall Wright, *Search-Theoretic Models of the Labor Market: A Survey*, 43 J. ECON. LIT. 959 (2005).

The costs and benefits of search may be illustrated with an example from the labor market.⁹⁵ An unemployed person benefits from searching for the best job, one that best matches their skills and preferences to employers' needs. A good match results in an efficient, sustainable outcome, which creates the maximum value for society. The optimal search is the one that equates the additional benefits of search (finding a job for which the person is best suited, in a geographic region they prefer, that gives them the opportunity to advance, and other factors) to the additional costs of continuing to search (explicit costs of the job search such as gas, printing resumes, and conducting on-line searches, as well as the implicit costs of search such as foregone income and the psychological costs of being unemployed). If the costs of search were so high that a person took the first job offer, there is a higher probability that the person would be a poor match for that job and would leave that job for a different one sooner. Social welfare would decline as a result of this poor match.

The same holds for other types of economic transactions. In the case of EDIs, the buyer can be modeled as the firm and the sellers as the various states and counties trying to entice the firm to either relocate to or expand in their region. Each state is "selling" a bundled good which consists of a particular labor force, infrastructure, capital base, climate, tax policy, and EDI offer. These goods vary considerably across states and through time. The more varied the goods, the higher the potential gain to the firm from search for the best "price," or lowest cost.⁹⁶

The state with the most attractive package—the one that maximizes the revenues and minimizes the costs to the firm—will win the deal. Part of the price the buyer pays to obtain the best deal is search cost. The state has every incentive to minimize this cost to the firm by quickly and clearly identifying itself as a potential supplier of the good, and communicating the details of the EDI offer to the firm. Disclosing the bid to the public, however, would improve neither the

⁹⁵ Research applying the economics of search to the labor market was awarded the 2010 Nobel Prize in Economics. THE PRIZE IN ECONOMIC SCIENCES 2010: MARKETS WITH SEARCH COSTS, ROYAL SWEDISH ACADEMY OF SCIENCES, http://nobelprize.org/nobel_prizes/economics/laureates/2010/info.pdf. For a survey of the literature applying search costs to the labor market, see Richard Rogerson, Robert Shimer & Randall Wright, *Search-Theoretic Models of the Labor Market: A Survey*, 43 J. ECON. LIT. 959 (2005).

⁹⁶ See Enrich, *supra* note 82 (discussing conditions under which incentives might serve the end of matching firms with their most productive jurisdiction).

quantity nor the quality⁹⁷ of the information exchanged between the state and the firm. On the contrary, it may raise the cost to the company of relocating to or expanding in that state. Companies often require that their relocation or expansion plans be kept confidential to protect trade secrets and confidential taxpayer information, and to avoid excessive real estate speculation that might drive up the costs of land acquisition.⁹⁸ The financial economics literature has generated some evidence that may predict the impact of regulations requiring hearings and similar public disclosure of trade secrets and other innovative business plans.

For example, in 1968, the William's Act was amended to require a 20-day waiting period in tender offers and disclosure of specific information about how the company planned to create value.⁹⁹ These amendments are analogous to requiring public hearings and open bidding in EDIs. As a result of the Williams Act, bidder competition and the level of bids significantly increased which reduced the returns to the winning bidder and their incentive to invest in tender offers. As expected, the overall amount of economic wealth generated by tender offers fell, and more of that wealth was captured by the target.

The implications of the impact of the Williams Amendment for EDI policy are clear. Opening the bidding process and requiring more transparency about the details of EDI bids will likely result in increased interstate and intrastate competition for the target firm. When there are more potential locations in play and public hearings delay agreements and the implementation of innovative business plans, a company may be able to elicit larger EDI bids from hopeful candidates eager to outbid one another and "win" business. This chain reaction may ultimately transfer more wealth (in the form of EDIs) from the chosen state to the target firm, thus reducing the social benefits of the incentives program.

⁹⁷ See ASWATH DAMODARAN, *INVESTMENT VALUATION: TOOLS AND TECHNIQUES FOR DETERMINING THE VALUE OF ANY ASSET*, 577 (Wiley ed., 2d ed. 2002).

⁹⁸ See Morgan, *supra* note 50; Zach Patton, *Why Are Tax-Incentive Deals Almost Always Negotiated in Private?* GOVERNING, July 31, 2008, <http://www.governing.com/topics/economic-dev/Hush-Money.html>. (In Lenoir, landowners who sold to Google via third-party transactions later complained that they would have held out for more money had they realized that they had such a deep-pocketed buyer.)

⁹⁹ Gregg A. Jarrell & Michael Bradley, *The Economic Effects Of Federal And State Regulations Of Cash Tender Offers*, 23 J.L. & ECON. 371-407 (1980).

C. THE AUCTION LITERATURE

An auction is a public sale where goods or services are sold to the highest bidder. In economic theory, an auction refers to any set of trading rules for exchange. The basic components of an auction model consist of a set of potential buyers (states, in the case of EDIs), the joint distribution of valuations for these potential buyers (how much value could be created by the firm in each of these states), and a reserve price rule (the minimum EDI package) used by the seller.¹⁰⁰

In the context of EDIs, an auction takes place when two or more states bid to attract a company to its jurisdiction using tax abatements or similar incentives as payment.¹⁰¹ If bidders are risk-neutral, homogeneous, have the same information set, and bid competitively (rather than engage in collusion, for example), then both open and sealed bidding processes yield the same revenue to the firm, the same bidder participation, and the same winner. This is the “revenue equivalence theorem.”¹⁰² In practice, however, these assumptions fail to hold, and the impact of requiring openness in the EDI bidding process depends on the degree to which these assumptions fail.¹⁰³ For example, some research finds that open bidding, by enabling bidders to inspect one another’s valuations,¹⁰⁴ encourages collusion between bidders to reduce offer prices. Other studies find that when bidders or states are asymmetric (have different costs of implementing EDI packages, for example), the expected revenue generated to the firm and the expected value of the EDI program to the state may be higher or lower under open bidding versus closed bidding, depending on the nature of the asymmetry.¹⁰⁵ Others find that the nature of the relevant information, whether common or private, determines whether open or

¹⁰⁰ Kenneth Hendricks & Harry J. Paarsch, *A Survey of Recent Empirical Work Concerning Auctions*, 28 CANADIAN J. ECON. 403 (1995).

¹⁰¹ See Rachel Weber, *Do Better Contracts Make Better Economic Development Incentives?* 68 J. AM. PLAN. ASS’N 43 (2002).

¹⁰² William Vickrey, *Counterspeculation, Auctions, and Competitive Sealed Tenders*, 16 J. FIN. 8 (1961), available at <http://walrandpc.eecs.berkeley.edu/228aF04/Vickrey61.pdf>.

¹⁰³ See Eric Maskin & John Riley, *Asymmetric Auctions*, 67 REV. ECON. STUDIES 413 (2000).

¹⁰⁴ See Daniel A. Graham & Robert C. Marshall, *Collusive Bidder Behavior at Single-Object Second-Price and English Auctions*, 95 J. POL. ECON. 1217 (1987).

¹⁰⁵ See Maskin & Riley, *supra* note 103.

closed bidding dominates.¹⁰⁶ However, no distinct patterns emerge. In addition, much of this literature presumes a profit motive on the part of the participants, which is questionable in the case of state-administered EDI programs.

Some evidence in the auction and game theory literature suggests that open bidding increases the incidence of both the “winner’s curse” and “adverse selection.” By sharing information about the nature and specifics of the EDI bid with the public and thus with other potential bidders, open bidding may result in less wealth creation by the winning state.¹⁰⁷

D. WINNER’S CURSE AND ADVERSE SELECTION

The winner's curse occurs in common-value auctions with incomplete information. In a common-value auction, the information about the auctioned item is spread among the bidders; hence, a bidder would modify the value of winning if the once-private information of opponents was made available through, for example, an open bidding process. In a private-value auction, a bidder’s estimate of the value of winning is independent of the value placed on winning by others.

The winner of an auction is, of course, the bidder who submits the highest bid. Since the auctioned item is worth roughly the same to all bidders in a common-value auction, they are distinguished only by their respective estimates. The winner, then, is the bidder making the

¹⁰⁶ See Angel Hernando-Veciana, *Information Acquisition in Auctions: Sealed Bids vs. Open Bids*, 65 GAMES & ECON. BEHAV. 372 (2009) (open auctions induce more private information acquisition and are associated with improved efficiency); see also Olivier Compte & Philippe Jehiel, *On the Value of Competition in Procurement Auctions*, 70 ECONOMETRICA 343 (2002) (the optimal bidding format is a function of the type of information and the number of bidders); Eric Rasmusen, *Getting Carried Away in Auctions as Imperfect Value Discovery* (Indiana University, Working Paper, 2007), available at <http://www.rasmusen.org/papers/backburner/carried-rasmusen.pdf> (suggesting that overbidding may not be overbidding at all, but a reassessed higher value stimulated by observing other player’s bids, even in private value scenarios, thus favoring open bidding).

¹⁰⁷ See P. R. Milgrom & R. J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 ECONOMETRICA 1089 (1982) (showing that if state valuations are correlated, bids are higher with open bidding); Charles R. Plott, *Laboratory Experiments in Economics: The Implications of Posted-Price Institutions*, 232 SCI. 732 (1986) (showing that bids are higher and efficiency—value creation—is lower with posted or open prices).

highest estimate. If we assume that the average bid is accurate, then the highest bidder overestimates the item's value. Thus, the auction's winner is likely to overpay.

Bidders may try to avoid the winner's curse by bid shading, or placing a bid that is below their estimation of the value of the item for sale. This increases the likelihood that they may lose out to a competing bidder; consequently, this may be a negative outcome if the bidder lacks alternative options. The bidder has expended resources to woo investment, but has nothing to show for it.

The severity of the winner's curse increases with the number of bidders.¹⁰⁸ This is because the more bidders there are, the more likely it is that some of them have overestimated the firm's value to the state. To the extent that open bidding encourages more competition and/or higher bids, the winner's curse problem is intensified. "Winning the auction is bad news to the extent that it reveals the winning bidder's signal was more optimistic than that of the other bidders, and the greater the level of competition the worse the news associated with winning."¹⁰⁹ Looking at EDIs, a winning bid amid robust competition may suggest that the winner has overpaid, thus destroying social wealth. The winner's curse problem is also more severe in cases where the estimator has limited liability for valuation mistakes, as is the case with EDIs, as government officials are not held personally liable for overpayment.¹¹⁰ Ironically, some argue that open bidding and similar accountability provisions may actually protect state officials from accusations of misevaluation.¹¹¹

For auctions with private values, when the value of the firm to the state is independent of its value to other states, the winner's curse is less likely to arise. Any bidding mechanism that encourages states to

¹⁰⁸ See Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447 (1997-1998) (challenging the contention that the winner's curse causes state officials to systematically overestimate the benefits generated by the attracted firm).

¹⁰⁹ See Kenneth Hendricks, Joris Pinske, & Robert H. Porter, *Empirical Implications of Equilibrium Bidding in First-Price, Symmetric, Common Value Auctions*, 70 REV. ECON. STUDIES 115, 115 (2003).

¹¹⁰ *Id.*

¹¹¹ See Enrich, *supra* note 82 (accountability measures can be used by politicians to manipulate voters' perceptions of whether they are doing their jobs well); see also Milgrom & Weber, *supra* 107 (the returns to EDIs may be more symbolic in that accountability measures offer protection from accusations that cities give away too much or too little).

perform a careful cost-benefit analysis of the value of attracting or retaining a specific firm to that state, regardless of the value other states may assign to that transaction, results in fair valuations and efficient outcomes. Sealed bids reduce the incidence of the winner's curse and its associated costs by circumventing the incentive to outbid actual or potential competitors.

E. EMPIRICAL EVIDENCE: OPTIMAL BIDDING PROCESS

Auctions are of specific interest to economists because they are explicit mechanisms, which demonstrate the way that prices are formed and values are assigned.¹¹² There is much theoretical work on auctions that has been done; however, empirical work is much more limited, as are the conclusions on optimal bidding processes and design of markets.¹¹³

Recent empirical research into the optimal auction process has had two main goals.¹¹⁴ One is to test the behavioral theories about how potential buyers actually bid. If the valuations of the buyers and the probability law governing these valuations are known to the researcher, then this question is easily addressed by comparing the submitted bids with those predicted by the optimal open or closed bidding strategy.¹¹⁵ Experimental or laboratory studies suffer from the problem that the behavior of subjects in the lab may differ from agents in the real world. Thus, while informative and cost-effective, experimental studies are no substitute for careful field work. Field data, on the other hand, are drawn from diverse buyers with unknown valuations and little choice in the types of bidding mechanisms they use.¹¹⁶

The second goal of empirical research on auctions is to identify the probability distributions governing the valuations of potential buyers so that their observed bids from a cross-section of auctions can be used to infer whether open or closed bidding was optimal. Auction theory states that if the revenue generation is the same between open and closed bidding processes, participants will be indifferent between

¹¹² Hendricks & Paarsch, *supra* note 100.

¹¹³ Philip A. Haile, Han Hong, & Matthew Shum, *Nonparametric Tests for Common Values in First-Price Sealed-Bid Auctions* (Yale Univ. Cowles Found. for Research in Econ., Paper No. 1444, 2003), *available at* <http://cowles.econ.yale.edu/P/cd/d14a/d1445.pdf>.

¹¹⁴ Hendricks & Paarsch, *supra* note 100.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

regimes and will randomly switch between bidding mechanisms.¹¹⁷ Yet, there are almost no instances of this type of switching in private industry. The problem may be, however, that there are very few markets in which buyers can choose which bidding format they will use. Only two relatively robust markets allow buyers to influence bidding format, and both involve public transactions. One is the auction of U.S. treasury bills, and the other is timber auctions by the U.S. Forest Service.¹¹⁸

The U.S. Forest Service timber program provides a useful test case as it uses both open and sealed bidding, at times even randomizing the choice. This market also involves heterogeneous bidders, with sophisticated mills bidding directly against small loggers for tracts of land and timber.

Susan Athey and Jonathan Levin, professors of economics at Harvard & Stanford respectively, have found that with heterogeneous bidders, sealed bidding promotes entry by weak bidders, which, in their study of timber auctions, were small logging firms that lacked manufacturing capacity.¹¹⁹ In a sealed-bid auction, the bidders with the highest value—in this case, larger mills with manufacturing capability—have an incentive to shade their bids a bit below their true valuations in order to increase profits; therefore, weaker bidders can win despite not having the highest valuation. This window of opportunity gives weaker bidders an incentive to enter sealed-bid auctions and may be akin to the adverse selection issue discussed earlier. These results must be applied to EDIs with caution, however, because the bidders studied by Athey and Levin are firms with profit motives. Other research on unobserved auction heterogeneity—when a researcher does not have access to all common information, such as the bidders' cost structures—adds texture to Athey & Levin's findings.¹²⁰ These studies show that differences in bidders have a significant effect on the auction outcome, including profits and efficiency. Bidder costs and the reservation price set by the seller are higher than previously estimated using one-dimensional models of bidder private

¹¹⁷ See Maskin & Riley, *supra* note 103, at 413.

¹¹⁸ See *id.*

¹¹⁹ Susan Athey, Jonathan Levin, & Enrique Seira, *Comparing Open and Sealed Bid Auctions: Evidence from Timber Auctions*, 126 Q. J. ECON. 207 (2011).

¹²⁰ Elena Krasnokutskaya, *Identification and Estimation of Auction Model with Two-Dimensional Unobserved Heterogeneity*, 78 REV ECON. STUD. 293 (2011).

information.¹²¹ Small differences in modeling or inferences create significant differences in empirical results. Empirical research on the impact of open versus closed bidding mechanisms is in its infancy, and the results are unclear.¹²²

IV. CONCLUSION

Philosophically, it is easy to support an open EDI bidding process because taxpayers expect their public officials to be accountable for decision-making concerning government spending and subsidies. But because the goal of EDIs is to maximize economic wealth—whether measured in terms of the number or quality of jobs created, land value, or tax revenues—one must look to the economic consequences of open versus closed bidding before concluding that open bidding mechanisms are better.

The economics literature suggests that with diverse bidders and imperfect information, the EDI prices paid by states with open bidding are significantly higher than those with sealed bids. As a result, less wealth is created for states with open bidding, and more of that wealth is retained by the target firms, exemplifying the winner's curse as in the Dell example.

The economic costs and benefits of disclosure are especially complex with EDIs because such activities have one foot in private industry and the other in the public domain. They involve supra-market transactions and negotiations where the usual economic incentives to minimize costs and maximize value may be superseded by political motives, such as serving the public good and retaining political office. It may very well be that if all states were open, overbidding would not occur, and efficient outcomes would prevail. Such a result, however, would require federal intervention, likely through the Commerce Clause of the United States Constitution.

¹²¹ *Id.*

¹²² Hendricks & Paarsch, *supra* note 100.