March 14, 2012

Warren Meyer in Forbes has a great post listing the ten reasons legislation goes bad. It is kind of a road map of unintended consequences. The last two are pure Frederic Bastiat.

Every year I get to teach a day of a high school economics class. Just as the school's resident radical progressive does a day on Marx, I get to come in as the token libertarian. While I am always tempted to go off on a long rant about individual liberty and the role of coercion in both the Republican and Democratic platforms, seeing that it is an economics class I have tried instead to introduce some interesting bits from an array of libertarian favorites, from public choice theory to Austrian economics to Bastiat. What I have decided to do this year is to discuss why bad things happen to well-intentioned legislation. Specifically, I offer these 10 economics traps that legislators frequently fall into:

1. Ignoring incentives *In evaluating how the public will respond to a piece of legislation, one needs entirely to forget the stated purpose or intentions of the law, and look instead at how individuals are likely to respond to the taxes, payments, mandates and rules embodied in the legislation. Tax a behavior, or make it more time-consuming to pursue via regulation, and you will get less of it. Make something cheaper or easier, and you will get a lot more of it.*

Sometimes this is the whole point of the legislation. For example, large taxes on cigarettes are meant to deter consumption. Mortgage interest tax breaks are meant to increase the number of people who own rather than rent their homes.

However, at other times, in the rush to achieve some well-intentioned goal, or even just out of sheer neglect, the incentives built into legislation create significant unintended consequences. Consider two examples

- *In GAAP accounting, interest on debt is treated as an expense, whereas dividends are treated as a return of capital to shareholders. When the corporate income tax system was put in place, it relied on these existing accounting definitions to define taxable income — all perfectly logical. But the net effect was to make the cost of debt tax deductible, while the cost of equity is not. Over time, as corporate tax rates have risen, this has induced a substantial bias towards debt over equity financing, arguably making corporate finance more risky.*
- *When AFDC (welfare) was passed, it was a well-intentioned effort to help poor families, particularly single mothers. Unfortunately, as structured, it created incentives for mothers to remain unmarried, to avoid getting a job, and to even have more children than they might have. Over the following decades, the number of unemployed single women exploded.*

2. Public Choice Theory *Speaking of incentives, it turns out that they are important for legislators and government officials as well. ...*

Walter Russell Mead posts on the looming Detroit bankruptcy.

... Leftie intellectuals spend a lot of time analyzing the "false consciousness" that keeps American workers voting for Republicans who (in the view of the intellectuals) support anti-worker policies. We don't hear nearly as much from these incisive social thinkers about the false urban consciousness that keeps voters supporting policies and politicians that have ruined the cities, but there you are. Many of the policies that are dearest to the hearts of powerful Democratic politicians are responsible for wrecking the lives of many of their most loyal supporters, but the loyal supporters turn out year after year.

When American cities embraced the high cost, high regulation statist model two generations or so ago, they were often the richest and most dynamic places in the country. Increasingly "progressive" policies, with higher wages for unionized teachers, bigger bureaucracies enforcing tighter regulations, more "planning" by qualified technocrats and more government services and benefits to improve the quality of residents' lives were supposed to take the American city into a new golden age.

It's hard to think of many social experiments that have more disastrously failed. Now many of these once flourishing cities are hollowed out shells, while around them suburbs and increasingly exurbs flourish away from the deadening influence of urbanist politics. ...

Also in Forbes, **Joel Kotkin** writes on the continuing foreign investment in our country's economy.

Declinism may be all the rage in intellectual salons from Beijing to Barcelona and Boston, but decisions being made in corporate boardrooms suggest that the United States is emerging the world's biggest winner. Long the world leader as a destination for overseas investment, the U.S. is extending its lead as the favored land of overseas capital.

Since 2008, foreign direct investment to Germany, France, Japan and South Korea has stagnated; in 2009, overall investment in the E.U. dropped 36%. In contrast, in 2010 foreign investment in the U.S. rose 49%, mostly coming from Canada, Europe and Japan. The total was $194 billion, the fourth highest amount on record.

Foreign investment is already reshaping the American economic landscape, shifting wealth and income from differing regions. The transformative role is nothing new. After all, the country started as a colony of England, and for much of the 19th century remained dependent on European investors for everything from building canals to railroads. Without European capital, the settlement of the West and the rise of cities such as New York would have been far slower.

Today this pattern is re-asserting itself as foreign countries rediscover America's intrinsic advantages: a huge landmass, vast natural resources, a large, expanding consumer market and a relatively predictable legal system. Our relatively vibrant demographics demographics — at least before the Great Recession depressed birthrates and immigration — marks a strong contrast with such key countries as Japan, South Korea and Germany, all of which are aging far more rapidly than the United States. China's authoritarian political system leaves many investors reluctant to expose themselves too much to the regime's often less than tender mercies.

The investment boom is concentrated not so much in the most celebrated sectors, such as tech or trophy real estate, but in the more basic industries that are best suited to our large, resource-rich country. Investment in the burgeoning energy sector more than tripled to $20 billion between 2009 and 2010. Some of this investment has come into the renewable industry, where Europe and China also have heavily subsidized companies, but the vast bulk has been devoted to the country's expanding production of oil and gas. ...

Forbes

[When Bad Things Happen to (Supposedly) Good Legislation]()

by Warren Meyer

Every year I get to teach a day of a high school economics class. Just as the school's resident radical progressive does a day on Marx, I get to come in as the token libertarian. While I am always tempted to go off on a long rant about individual liberty and the role of coercion in both the Republican and Democratic platforms, seeing that it is an economics class I have tried instead to introduce some interesting bits from an array of libertarian favorites, from public choice theory to Austrian economics to Bastiat. What I have decided to do this year is to discuss why bad things happen to well-intentioned legislation. Specifically, I offer these 10 economics traps that legislators frequently fall into:

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might have. Over the following decades, the number of unemployed single women exploded.

2. Public Choice Theory   Speaking of incentives, it turns out that they are important for legislators and government officials as well. Many laws and government programs rely on the assumption that these programs are operated by idealized public officials who are solely motivated by the public good. Even excepting the fact that the very concept of the public good is often meaningless (given 300 million separate sets of individual preferences), it is grossly unrealistic to assume that government officials are motivated by anything different than is the average person. Increased pay and benefits, job security, future jobs in the private sector, and promotion are all goals of government employees that may trump the public's interests. Private companies spend inordinate amounts of effort, with only mixed success, aligning these individual goals with the goals of the company through compensation systems, work processes, culture, evaluations, and a myriad of other tools. Congress and government agencies seldom spare a thought for these issues.

Over the last several years, American citizens have often been left scratching their heads over companies that received millions of dollars of stimulus money but created only a handful of jobs. Even using numbers from the supporters of these projects, these projects seem like patently bad investments. Public choice theory tells us that these investments may make perfectly good sense, but we are looking at them with the wrong accounting when we compare the cost to the taxpayers vs. the benefits to the taxpayers.   To understand why these projects were undertaken, we need to look at the cost and benefits to the politicians who supported the programs. In this accounting, on the plus side, we would see things like a really good photo-op (remember those pictures of Obama at Solyndra), a news-cycle of good press, a talking point at election time, and a reputation for being caring, proactive and action-oriented. On the cost side is… nothing. It wasn't the politician's money. It wasn't even his or her campaign money. In effect, the taxpayers paid for some positive PR, and from the politician's viewpoint, this is a good deal. Too cynical to be true? You be the judge.

3. Overriding Price Signals   The importance of prices is frequently underestimated. Prices are the primary means by which literally billions of people (most of whom will never meet or even know of each others' existence) coordinate their actions, without any top-down planning. With rising oil prices, for example, consumers around the world are telling oil companies: "Go find more!"

For a business person, prices (of raw materials, labor, their products, and competitive products) are his or her primary navigation system, like the compass of an explorer or the GPS of a ship. And just as disaster could well result from corrupting the readings of the explorer's compass while he is trekking across the Amazon, so too economic damage can result from government overriding price signals in the market.   Messing with the pricing mechanisms of markets turns the economy into a hall of mirrors that is almost impossible to navigate. For example:

- In the best case, corrupting market prices tends to result in gluts or shortages of individual products. For example, price floors on labor (minimum wages) have created a huge glut of young and unskilled workers unable to find work. On the other side, in the 1970s, caps on oil prices resulted in huge shortages in the US and those famous lines at gas stations. These shortages and gas lines were repeated several times in the 1970′s, but never have returned since the price caps were phased out.

- In the worst case, overriding market price mechanisms can create enormous problems for the entire economy. For example, it is quite likely that the artificially low interest rates promoted by the Federal Reserve over the last decade and higher housing prices driven by a myriad of US laws, organizations, and tax subsidies helped to drive the recent housing and financial bubble and subsequent crash. Many will counter that it was the exuberance of private bankers that drove the bubble, but many bankers were like ship captains who drove their ships onto the rocks because their GPS signal had been altered.

4. Underestimating the Role of Information   A recurring and important theme of the American progressive movement over the last century has been the notion that a few very smart, public-spirited people at the top can plan and manage the economy far better than the chaotic self-organization of individuals operating in free markets. Before they were repelled by the murder and warmongering, progressives were very intrigued by the economic models of communism and fascism. For example, FDR's National Industrial Recovery Act (mercifully gutted by the Supreme Court) was modeled directly on Italian fascism.

But such top-down planning efforts have all failed spectacularly, usually in direct proportion to how comprehensive they attempted to be. Russia under communism and China under the Great Leap Forward are two well-accepted examples, but it can certainly be argued that the failed planning efforts of Japan's MITI in the 1980′s led to gross misallocation of resources that resulted in their economic lost decade. The appeal of such top-down planning efforts never seems to die, however, as many American progressives not only advocated for MITI-style industrial policy for the US in the 1980s but are now arguing that we emulate Chinese state economic command and control.

The reasons these planning efforts fail are too myriad to discuss briefly here, but two important reasons are incentives and information.

- Incentives, because planners can never share, or even know, the unique preferences of all three hundred million people in this country, preferences that drive both individuals' happiness and economic activity. As a result, government plans tend to reflect the planners' preferences, and we get one-size-fits-all solutions.
- Information, because every person in the market is essentially an individual computer — evaluating purchases, assessing investments, and making decisions. Just to take one example, at any one time individuals in this country are evaluating millions of different possibilities for investing their time and money. No planner has the information, the industry knowledge, the experience, or the computing power to out-think this distributed computing system.

There is a story I like to tell about the 1972 oil crisis that many folks don't know. After the Arab oil embargo, and given that government price controls kept markets from balancing supply and demand through higher prices, gasoline supply and demand in this country was in disarray. So the government stepped in, with their top-down central planning hubris, to micromanage gasoline allocation. But even that narrow task was simply too complicated to perform in real time. The planners made distribution decisions by geography based on the prior year's use patterns, but the fact of the gas crisis had substantially changed these patterns (for example, after the embargo, few people were travelling cross-country and more were staying home in the cities). As are result, while many cities had horrible shortages and unbelievable lines, other areas were awash in gas.

5. The Modelling Trap Related to the failure of planning is the reliance on computer models of incredibly complex systems to make policy decisions. The problem is that accurately modelling the US economy is simply impossible. How do I know? Because the potential financial returns from coming up with such a model are astronomical, giving a strong incentive to the smartest people in the world to try it. And so far, they have all failed.

The problem with macroeconomic models is that to build a good one, we need to be able to take each of the millions of potential variables and test them in turn to determine how they alter economic activity while all the other variables are held constant. Unfortunately, the world does not offer us many opportunities to conduct controlled experiments of this type in macroeconomics. So our models are no better than hypotheses, largely untested. Unfortunately, the computer tends to trick us into a false sense of certainty — the models are so complicated and spit out results in such pleasing detail, we start to forget that they represent a mountain of unproven assumptions.

A great example of this was the recent Stimulus program. At the Obama Administration's behest, the Congress spent nearly a trillion dollars on government stimulus programs, all based on the output of a Keynesian economic model that said for $X of stimulus spending, Y jobs would be created. A couple of years later, the CBO came out with a report that said the stimulus had created as many as 2.4 million jobs. The media treated this as an independent data point proving the initial assumptions correct. But it turned out that what the CBO did was run the original model used to justify the stimulus, modifying only the actual amount spent. Later runs of the model was being used to prove that earlier runs of the same model were correct. In fact, no independent confirmation of the true incremental effect of the stimulus was even possible, as millions of other variables were moving and changing simultaneous to government spending increases — it was, and is, impossible to attribute economic changes to just one variable.

6. The Power of Failure — Public vs. Private Accountability Systems As a libertarian who believes in the power of markets and free enterprise, I often get asked how I can trust large corporations so much. To some extent, these questioners are getting confused between being pro-business and being pro-markets. What I tell folks is that I don't trust the executives of large corporations any more than I trust government officials. What I do trust, though, is the accountability processes that exist in a well-functioning market much more than I trust the accountability systems that apply to government.

A lot of attention is lavished on the large rewards that are possible for those who are successful in a capitalist economy, but perhaps even more important is role of failure. Businesses that are inefficient, or make products that no one wants, will fail. And with failure, the capital and skilled workers invested in that enterprise will either be shifted to new, more productive management, or will be shifted into an entirely different business.

In this way Enron's failure, for example, was a triumph. A company that apparently spent too much time working on creative accounting and not enough time making its investments work was eventually starved of capital by the private markets and shut down. In a similar way, the government bailout of GM can be seen as a tragedy, as billions in taxpayer money was spent to keep valuable assets and talented people under the same failed management and strategy.

In contrast, programs and departments in the government that have failed are seldom allowed to die. The managers of Enron and GM were no more happy to see their organizations die than, say, the leaders of Amtrak or the Postal Service. The difference is that eventually, Enron and GM ran out of private bankers willing to finance their continued failure. The US government, whose accounting is far more corrupt than anything attempted at Enron, has one critical advantage Enron didn't have — whenever it needs more money for a failing program, it can simply take more from taxpayers. And whenever it meets an accountability measure it does not like, it can have it eliminated.

One might think the desire for re-election would provide some sort of accountability (forgetting for a minute that most of the government bureaucracy are not elected). But a look at the Solyndra scandal tells us just the opposite. The Obama Administration lost over a half billion dollars of taxpayer money investing in a solar company that private investors would not touch. When the company went bankrupt and most all the taxpayer money was lost, rather than re-thinking the investment strategy (as would any private investor), the Administration chose to accelerate the program — it was more important to give the public the impression that the program made sense than it was to admit failure and conserve taxpayer resources.

7. Rent-Seeking As Congress and the Administration gain more power over markets and the economy, the potential returns to private companies seeking to harness that power for themselves have grown immense. For the right price, Congress or an Agency can be convinced to pass licensing laws that restrict new competition or mandates that citizens must buy one's product, not to mention bailouts, low-interest loans and outright subsidies.

The party in power is irrelevant – if anything, such corporate cronyism has actually accelerated in the transition from Conservative George Bush to Progressive Barack Obama. For example, his green jobs program, perhaps initially well-intentioned, has become a trough at which many a politically connected venture capitalist and corporation has been able to feed. From GM and GE to Solyndra and Fiskar, the game today seems to be to craft business strategies that can attract Federal patronage, rather than private investment.

It is instructive to study the examples used by opponents of capitalism, such as Occupy Wall Street or Michael Moore in his movie *Capitalism: A Love Story*. Nine out of ten times (at least), the real fault in these examples can be traced not to the free operations of markets, but to government cronyism. Bankers escaped accountability in the recent financial crisis not because of some flaw of capitalism but because the government chose to bail them out. Free markets were ready and able to bankrupt them all and redistribute the assets they controlled to new parties.

8. Concentrated Benefits, Dispersed Costs Many government programs take tax money from the majority of taxpayers and spend it for the interest of a few. Some of these are outright rent-seeking arrangements, while others began as well-intentioned programs. Consider ethanol for example. Originally begun as a renewable fuel program, its environmental value has been largely disproved.

However, the ethanol program is extraordinarily hard to end, despite the fact that it is opposed by Republicans and Democrats alike. One reason programs like this are hard to kill is the relationship of benefits and costs. On the benefits side, a very small number of ethanol processors and corn farmers reap enormous gains from the combination of government subsidies and mandates for ethanol. On the cost side, costs are spread across tens of millions of taxpayers and consumers. With billions of dollars each at stake, ethanol refiners are willing to make enormous investments in the political process to retain the program. But since the program may only cost each individual taxpayer or consumer a few dollars, none of them has the resources or incentive to invest a lot in opposition.

9. The Seen and Unseen In Bastiat's classic essay, he argues the difference between a good economist and a bad one is that good economists consider both the seen and unseen. He offers as an example of trade protectionism. Let's assume there is a proposal to raise the price of steel imports to help the US steel industry. The most obvious "seen" effect is that the US steel industry would likely be better off. Increases in the prices of their foreign competition will likely cause customers to buy more US steel and would lead to more employment of US steel workers.

Many often stop at this point and argue that therefore trade protectionism is a net benefit. But Bastiat argues that this is bad economics because it ignores the "unseen." In this case, the unseen is the effect of higher steel prices on steel consuming industries and individual consumers of steel products. Money these consumers might have spent at other businesses must go to paying higher prices for steel and products made of steel. Just because these lost revenues and jobs in other industries are harder to see and count than the job gains in steel does not mean they don't exist. In fact, a careful accounting will show that the country is worse off with the tariffs than without.

I would argue the exact same logic applies to the 2009 Stimulus. Sure, a trillion dollars is likely to create some jobs and economic activity, and because we know where the money was spent, it is easy to spot the jobs it created. But what can't be seen is what the money would have been used for otherwise. The trillion dollars had to be taken out of private hands, either through taxation or through borrowing. Had it not been taken and spent by the government, it would have been employed privately in some way. Unless one argues the government invested the money more productively than would have private parties (a heroic assumption indeed), it's hard to credit much incremental economic activity from the stimulus.

10. Broken Window Fallacy Bastiat's most famous example of the seen and unseen is the broken window fallacy. Imagine that the mayor of a town who wishes to spur economic activity breaks Mr. Smith's front window. Certainly the town glazier is happy, as he now will be paid $100 by Mr. Smith to replace his window. So the town's GDP just increased by $100, right?

Well, the glazier is wealthier by $100, but presumably Mr. Smith, had his window not been broken, would have spent the money on something else, say a new pair of shoes. In this case the unseen tragedy is that the shoemaker is $100 poorer than he might have been. Now, this may seem to make the whole mess a wash — the glazier gains $100 but the shoemaker loses $100. But this ignores the plight of poor Mr. Smith., In a world with no broken window, he would have spent $100 but would have had both a good window and a new pair of shoes. Once the mayor conducted his ill-considered stimulus program, Mr. Smith is still out the $100 but ended up with only a window, and no shoes. The town as a whole, therefore, is poorer.

The broken windows fallacy is a staple of modern politicians. For example, over the last several days, we have seen a number of disastrous tornadoes. As sure as winter follows Autumn, somebody is going to stand up in the media and talk about the silver lining of these storms is the likely economic stimulus from rebuilding, In fact, most of the government "green jobs" programs are the broken windows fallacy writ large. Take just one idea, that the replacement of coal power plants with new solar plants will stimulate the economy. Leave aside the environmental and health effects of such a change. From a standpoint of pure economics, such a change does not create jobs, it destroys them. Obsoleting functional coal power plants is the exact same as throwing a rock through a window. We are spending billions to replace capacity that was perfectly functional, billions that could have been spent otherwise on a myriad of other growth or productivity projects. Think of it this way – we spend billions of dollars and all we have to show for it is the exact same amount of electricity we have today.

The world of political discourse is full of irony. Debates about evolution often pit those who see beauty and wonder in the self-organization and evolution of life against those who believe that such order could have only been imposed top-down by a creator. The irony is that in economic debates, these same folks are often on exactly the opposite sides, with those arguing against interfering with the emergent and evolved order of nature arguing for top-down management of the economy. And it is amazing how often folks who wear "pro-science" on their sleeve will ignore and reject even the most fundamental tenants of economics (e.g. demand curves slope downwards). Hopefully, Left or Right, this has helped a bit in making you a better, perhaps more skeptical, evaluator of legislation.

American Interest

Detroit Nears Bankruptcy

by Walter Russell Mead

For decades, Detroit has been the poster child for urban decline in America. Now things have reached an even newer low: The city is projected to run out of money by next month and seems to have no credible plans to make up this shortfall.

Interestingly, despite statements by Michigan Governor Rick Snyder that the state would appoint an emergency manager to run the city in lieu of the elected government, the *Wall Street Journal* reports that Snyder and Detroit Mayor David Bing have agreed to forgo this process as well, leaving the city in the hands of many of the people who brought it to this point in the first place. The turnaround should begin any minute.

Unemployment in the city of Detroit is estimated at about 20 percent; two thirds of the city's children live in poverty. The two largest employers in the city: the dysfunctional public school system and the crippled city government. Decades of incompetence and corruption by elected officials in tandem with the decline of the once flourishing American automobile industry and (entirely understandable) flight by the better educated and the better off have thoroughly blighted what was once one of America's most flourishing cities.

Leftie intellectuals spend a lot of time analyzing the "false consciousness" that keeps American workers voting for Republicans who (in the view of the intellectuals) support anti-worker policies. We don't hear nearly as much from these incisive social thinkers about the false urban consciousness that keeps voters supporting policies and politicians that have ruined the cities, but there you are. Many of the policies that are dearest to the hearts of powerful Democratic politicians are responsible for wrecking the lives of many of their most loyal supporters, but the loyal supporters turn out year after year.

When American cities embraced the high cost, high regulation statist model two generations or so ago, they were often the richest and most dynamic places in the country. Increasingly "progressive" policies, with higher wages for unionized teachers, bigger bureaucracies enforcing tighter regulations, more "planning" by qualified technocrats and more government services and benefits to improve the quality of residents' lives were supposed to take the American city into a new golden age.

It's hard to think of many social experiments that have more disastrously failed. Now many of these once flourishing cities are hollowed out shells, while around them suburbs and increasingly exurbs flourish away from the deadening influence of urbanist politics. None of this affects the hold of progressive and urbanist ideology on true believers; if anything, they believe even more passionately in the cause. Obviously the problem is that we haven't spent enough on enough tenured teachers, haven't written enough new regulations and established enough new bureaus to enforce them, haven't published enough white papers by enough credentialed planners, haven't extracted enough taxes and provided enough services. If we could just tax the suburbs and exurbs more heavily and spend more of the money in the cities, all would be well.

Via Meadia thinks everyone is entitled to their own beliefs, but we wonder: if you can't learn from Detroit, what *can* you learn from?

Forbes

Foreign Industrial Investment Is Reshaping America

by Joel Kotkin

A worker at a U.S. Honda plant.

Declinism may be all the rage in intellectual salons from Beijing to Barcelona and Boston, but decisions being made in corporate boardrooms suggest that the United States is emerging the world's biggest winner. Long the world leader as a destination for overseas investment, the U.S. is extending its lead as the favored land of overseas capital.

Since 2008, foreign direct investment to Germany, France, Japan and South Korea has stagnated; in 2009, overall investment in the E.U. dropped 36%. In contrast, in 2010 foreign investment in the U.S. rose 49%, mostly coming from Canada, Europe and Japan. The total was $194 billion, the fourth highest amount on record.

Foreign investment is already reshaping the American economic landscape, shifting wealth and income from differing regions. The transformative role is nothing new. After all, the country started as a colony of England, and for much of the 19th century remained dependent on European investors for everything from building canals to railroads. Without European capital, the settlement of the West and the rise of cities such as New York would have been far slower.

Today this pattern is re-asserting itself as foreign countries rediscover America's intrinsic advantages: a huge landmass, vast natural resources, a large, expanding consumer market and a relatively predictable legal system. Our relatively vibrant demographics demographics — at least before the Great Recession depressed birthrates and immigration — marks a strong contrast with such key countries as Japan, South Korea and Germany, all of which are aging far more rapidly than the United States. China's authoritarian political system leaves many investors reluctant to expose themselves too much to the regime's often less than tender mercies.

The investment boom is concentrated not so much in the most celebrated sectors, such as tech or trophy real estate, but in the more basic industries that are best suited to our large, resource-rich country. Investment in the burgeoning energy sector more than tripled to $20 billion between 2009 and 2010. Some of this investment has come into the renewable industry, where Europe and China also have heavily subsidized companies, but the vast bulk has been devoted to the country's expanding production of oil and gas.

The shale revolution in particular has attracted foreign interest. Energy firms from China, France and Spain have all placed major investments in the shale fields of Ohio, Colorado and Michigan. French giant Total recently paid $2.3 billion for minority stakes in the vast oil and gas holdings of Chesapeake Energy.

Perhaps even more important has been a surge in industrial investment, which rose $30 billion just between 2009 and 2010. Much of this growth is concentrated in the chemical industry as well as automobile, steel and other transportation sectors. It is also heavily focused on the southeastern states and Texas — the very places that most surveys reveal have the most hospitable business climates. According to a recent study by *Site Selection* magazine, the five states with the best business climates and 10 of the top 12 are from the old Confederacy.

Foreigners, particularly from large global corporations, are not stupid. They also are not burdened as much as domestic firms with legacy costs or romantic attachments to traditional industrial bailiwicks. "At the end of the day, a company looks at a whole nation and looks at the factors that matter most, like ease of doing business," notes Bill Taylor, who for 17 years headed up Mercedes' U.S. operations. "The Southeast has that and has a workforce willing to be engaged. They have found the area to be very fertile ground."

This has certainly been true for companies such as Mercedes, whose largest U.S. plant is in Tuscaloosa, Ala. Last year the company invested $350 million in the facility.

Nor is Mercedes alone. Arch competitor Volkswagen last year announced it will build a new assembly plant in Chattanooga, Tenn. Nissan, Toyota and Kia have all announced major new plant openings or expansions over the past three years throughout the region.

These are not inconsequential investments. With the average cost of building these facilities at over $1 billion, and the higher-paying manufacturing jobs they represent, such plants represent major employment generators. They also bring with them parts suppliers and other industries related to auto manufacturing. Alabama, for example, has seen major steel mill investments, including $4.6 billion from Germany's Thyssen Krupp.

Over the next decade, these investments could transform the nation's industrial structure. Alabama and Kentucky already produce almost as many cars as Michigan. According to the U.S. Dept. of Labor, Michigan still leads the country in auto employment with 181,000 jobs, followed by Indiana. But the next three states are Kentucky, Tennessee and Alabama.

Why is this happening? Managers in foreign firms, suggests Taylor, who previously worked for Ford and Toyota, believe Southern workers have not picked up the bad habits and work rules common among their unionized Midwestern brethren. Unions certainly are much less of an issue in the Southeast. Though Alabama has seen a huge jump in the number of its auto workers in recent years, according to its state department of labor, only 7,100 are unionized. Nationwide, according to the Bureau of Labor Statistics, around 12 percent of workers belong to unions, compared to just over 10 percent in Alabama. Less than 5 percent of workers in Georgia, Texas, South Carolina, Virginia and North Carolina belong to them.

Unions are not the only issue. The South also enjoys a strong network of rail and highway lines that make transport to key markets easy and affordable. Energy costs tend to be lower. Furthermore, many Southeastern port cities — notably Houston, Charleston, Mobile, Hampton Roads — have made big infrastructure investments in recent years.

The Southeast also plans to become a research hub for the auto industry. The Clemson University International Automotive Research Center is the nation's only school to offer a Ph.D. in automotive engineering and has secured $200 million in commitments. Additionally, the South Carolina center has created partnerships beyond auto manufacturers with other universities in the area: Auburn, Mississippi State, Alabama, Alabama-Birmingham, Kentucky and Tennessee.

The overall impact of the Southeast's auto industry may not be fully felt for a few years. But long-term prospects are excellent. U.S. manufacturers, notably GM and Chrysler, make most of their money on fuel-guzzling trucks and SUVs. GM's Volt, its much-hyped fuel-efficient car, has so far proved an expensive dud. In contrast, the major foreign manufacturers — particularly Volkswagen, Honda, Toyota, and Kia — have long experience in building reliable, fuel-efficient cars. Demographically the high-end makers, notably BMW and Mercedes, increasingly dominate the luxury market, particularly among younger customers.

Battle tested in world markets, these firms — and their counterparts in steel and other metals-related industries — are successful competitors and reliable employers. Overall, according to the U.S. Department of Commerce, foreign manufacturing firms, in autos and elsewhere, have proven far less susceptible to layoffs than their domestic competitors. They also tend to offer higher salaries on average than U.S.-based firms.

Some observers, such as the American Prospect's Harold Meyerson, decry these investments. He believes foreign firms, particularly from Europe, come to "slum." America, as he puts it, is where Europeans now go "to get the job done cheap."

Meyerson points out, correctly, that these companies generally invest in mostly Southern "right to work" states in order to avoid entanglements with unions. They also avoid stricter environment controls in green-dominated juristictions such as California. Not surpsingly these plants are often seen as regressive at Berkeley salons or at AFL-CIO headquarters. But they may seem far more congenial in the historically poor backwaters of the Southeast , long lacking in steady, relatively well-paid and skilled work.

When Toyota recently announced plans to establish a plant for the Prius near Tupelo, Miss., (birthplace of Elvis), one imagines few locals were singing the blues. Instead the new plant received 35,000 applications for 1,300 available spots.

To be sure, these new jobs may not pay as well as top-grade UAW contracts, and a lack of unions could expose workers to undue management pressure. But in an economy where $8 hour jobs are king, an entry level job that involves learning technical skills and starts at $14 may appear akin to manna from heaven .

Of course, some will denounce this "foreign" influence as pernicious or even neo-colonialist. But the overseas investment surge might also be seen as confirming, once again, that at least some places in the country remain fields of opportunity for people other than geeks, corporate rent-seekers or investment bankers.


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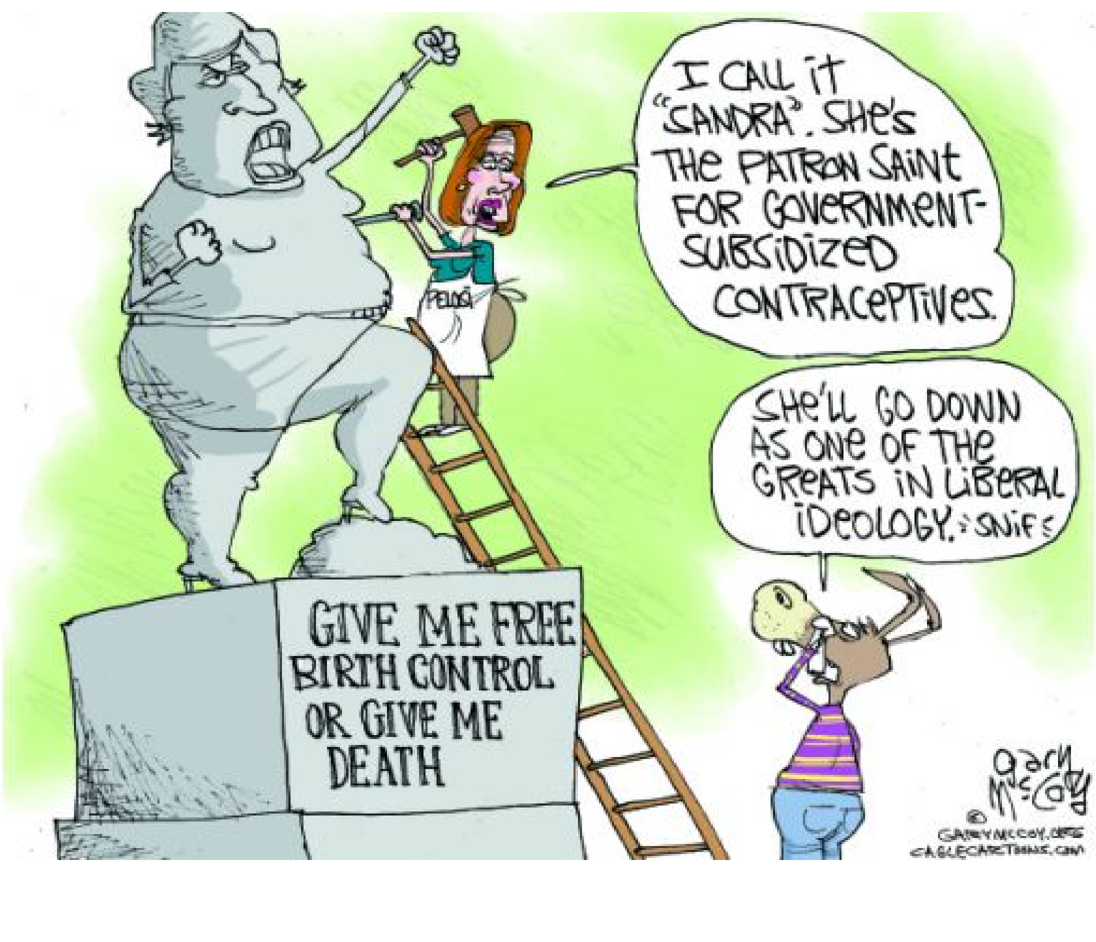
OUR JOB IS TO KEEP THIS ECONOMIC ENGINE CHURNING.
HOPE IT DOESN'T NEED GAS...
PUMP PRICE UP, UP, UP


I CALL IT "SANDRA". SHE'S THE PATRON SAINT FOR GOVERNMENT-SUBSIDIZED CONTRACEPTIVES.
PELOSI
SHE'LL GO DOWN AS ONE OF THE GREATS IN LIBERAL IDEOLOGY. SNIF
GIVE ME FREE BIRTH CONTROL OR GIVE ME DEATH
Gary McCoy