

Foreign Direct Investment: Agglomeration Economies and Returns to Promotion Expenditures

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ABSTRACT

The effect of a state's financial incentives to attract foreign direct investments (*FDI*) is a frequent topic for both economists and policy makers. Many studies have proved that *FDI* are disproportionately concentrated in states with agglomeration economies. This paper uses conditional logit model with *FDI* (new plants) data from 1987-1994 to explore the relationship between state efforts, state characteristics, and *FDI* attraction. Key results show that both promotion expenditures and agglomeration economies are important in attracting foreign plants. Results also indicate that promotion expenditures by states with small economies can partially offset location disadvantages because of agglomeration (urbanization and/or localization) economies and thus appear to be a useful economic development tool as states compete for investment.