

## Rationality of Investment on White Elephants: The Case of Public Investments in Tourist Facilities in Mexico\*

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### Abstract

In this paper we analyze the rationality that sustains the public investments on white elephants applied to the construction of tourist facilities in Mexico. The main result of this paper is that there exist two kinds of rationalities in the construction of white elephants. One is a similar rationality to that existent in the prisoner's dilemma, there is also a political rationality that involves politicians and social groups of individuals interested in exploiting tourist activities. If the winner of an electoral process is the same party that proposed the white elephant, then the construction is completed. Otherwise it is abandoned. This means that in the construction of white elephants, the political rationality prevails over economic rationality.

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## 1 Introduction

Sustainable tourism is a broader concept widely spread after the 1992 Rio Earth Summit on sustainable development (McMinn, S. 1997). This concept involves an ample range of aspects of the tourist activity. On one hand, sustainable tourism seeks to make the mass tourism industry more sustainable, while, on the other hand, its main concern is ecotourism. However, sustainable tourism cannot be reduced to these considerations. Nowadays it is a theory that attempts to explain the interaction among different groups of individual tourists, residing in a tourist place, and their relations with the cultural or natural patrimony of the place where the activity is developed. Its main objective is to look for the permanence of the tourist activity. In this sense, (Bramwell and Lane, 1993) say that sustainable tourism is part of the economic theory, conceived to improve the quality of life of the local community, and to provide the visitor a high-quality experience of the environment of the place where the host community and the visitors are. Sustainable tourism is also related with a cultural aspect: it should protect the cultural identity of the local community, assuring a positive interaction between the local community and the tourists.

The main purpose of this paper is to analyze, from the point of view of the sustainable tourism, the rationality of the investment on the so called white elephants in tourist places. The concept of white elephant is given in (Robinson, J. A. and R. Torvik, 2005). We introduce this concept in the framework of tourist activities, and we analyze the rationality of this kind of investment on these activities. We show that this rationality is supported by political and “myope” considerations rather than by a rational economic behavior of the whole society. This is confirmed by the fact that investment on white elephants increase in electoral times. It is in these times that the political party in exercise tries to remain in power by using, if necessary, public resources to capture votes. White elephants only benefit a small part the population (and in some cases for a short time) and their high costs are supported by the whole society. Serious damage to the environmental quality can result from the investment on white elephants in a tourist place. These damages can be irreversible.

We show some examples of white elephants in tourist regions of Mexico. These examples may be considered as proof that underdevelopment cannot only be explained by underinvestment, but also by inefficient investment. We can observe countries with high levels of investment and low rates of growth of GDP. In this paper we show that there exists rationality in the construction of white elephants. Certainly, this rationality (which may be considered as the rationality of underdevelopment) has negative consequences for the sustainable tourism and for the future of the tourist region.

## 2 The Notion of “White Elephants”

We begin this section with the definition of white elephants.

**Definition 1** *White elephants are big constructions of public investment that are announced strategically in electoral times to satisfy political interests. These constructions don't have some planning that assures a social welfare and does not take care of damages to the environmental quality or to the cultural patrimony or traditional architecture of the place where it will be constructed.*<sup>1</sup>

In terms of sustainable tourism, white elephants have a negative impact on the environment and do not reward the expected benefits of such large investments. In addition, the construction of a white elephant causes damages to the sustainable tourism, economical activity that involves the whole society. These kinds of constructions are supported by privileged particular groups looking only after their own welfare, generally contrary to the social welfare.

The main characteristics of white elephants are:

1. They are included in investment projects with negative social surplus, especially for the sustainable tourism.
2. Their construction is part of an exchange relationship between politicians and voters. This action gives important advantages to the incumbent party, and some immediate benefit to the voters, local inhabitants or builders.
3. Some politicians face commitment with builders, businessmen, or local inhabitants, offering policy favors or employment in exchange for votes. This commitment is associated with inefficient forms of redistribution of the wealth.

The journalistic literature treats white elephants as the worst symptoms of the megalomania of rulers. Yet, a more plausible explanation is that they constitute some form of inefficient redistribution.

These socially inefficient investments or white elephants intend to represent spectacular investments in an electoral period. The benefits implied to the population by their construction are partial and do not take care of the economical future of the region or of the local populations. The objective of these constructions is to obtain the electoral support of the small social group that obtains immediate

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<sup>1</sup> The term “White Elephant” is derived from Thailand. The expression comes from a legendary former Siamese custom whereby an albino elephant, considered sacred, could only be owned by the king. The king would bestow such an animal on a subject with whom he was displeased and wait until the high cost of feeding the animal, which could not be slaughtered, ruined the owner. The story was told in England in the 1600s, and in the 1800s the term began to be used figuratively. The expression was popularized in the USA after New York Giants manager John McGraw told the press that Philadelphia businessman Benjamin Shibe had “bought himself a white elephant” by acquiring the Philadelphia Athletics baseball team in 1901. The Athletics manager Connie Mack subsequently selected the elephant as the team symbol and mascot. The team is occasionally referred to as the White Elephants.

privileges. Then, their construction ends up harming the rest of the society and the future of the local population. The approval to this construction by the local inhabitants in some cases is related with a lack of perception of the future (myopia). The construction of a white elephant implies future losses in the welfare and economical potentiality of a tourist place. Note that, for example, a luxury hotel development proposal in an area not assisted by air travel is likely to become a white elephant if developed.

The rationality of the construction of a white elephant is supported in a bounded vision of the future by the politician and/or local inhabitants and builders. This bounded vision can be explained by means of the existence of a small discount factor in the inter-temporal utility functions of these social groups or individuals. This kind of myopia implies an evaluation of the immediate future rather than that of the mediate or remote future. By assuming that the society will take care of the future, this myopic point of view is in contradiction with the position that the society as a whole should evaluate the future by means of a greater discount factor. In this way it is possible to explain the “*rationality*” of a white elephant.

At the same time, these constructions can raise the credibility of the promises of some politicians, specially the promises of those who can obtain public resources to begin the construction of a white elephant. As a result, this possibility gives this group a strategic advantage in the electoral dispute. Socially efficient projects do not have this effect since all politicians can commit to building them, thus having a symmetric effect on political outcomes (Robinson, J. A. and R. Torvik, 2005).

Hence, the white elephants are:

- (a) Part of an exchange relationship between politicians and voters (a situation known by political scientists as “*clientelism*”) given important advantages of incumbency,
- (b) A politician’s commitment offering policy favors in exchange for the votes of the social groups interested in the construction of the white elephant (Besley, and Coate, 1998; Dixit, 2003), and
- (c) This commitment may lead to inefficient forms of redistribution of the social wealth.

### **3 Main Examples**

In some cases, the construction of white elephants may be carried out for individuals interested in the tourism of a region where a ruler protects temporarily this activity (for example the use of vacation homes, see Accinelli, E., Brida, J. G., and Carrera, JS. E. 2006). This protection can create an incentive to build if, for instance, the government gives some kind of privileges to individuals that invest in hotels. These privileges can result in an unjustified investment that is supported within these prerogatives. However, the situation may change after the election

and the hotels are no longer a good business, then some will be abandoned or the construction stopped. Therefore, in the region we can see a large number of hotels whose construction was only justified by the support given for the ruler, with the purpose of convincing local inhabitants and investor to support his political party in the election. A good example of this situation is the Ryugyong Hotel in North Korea<sup>2</sup>. The construction of this hotel in Pyongyang consumed 2% of the Gross Domestic Product of the country. Originally intended to rival Western bloc greats such as the Sears Tower, the building now sits as an unfinished, windowless concrete shell. As the building is seen as being structurally unsound, it will likely never be completed. There are some examples in Mexican tourist facilities that have the characteristics (above) of white elephants. Such constructions have not been finished as they were promises of an electoral campaign with the moral hazard case.

### **3.1 San Francisco River Stroll, Puebla**

The San Francisco River Stroll is a white elephant because the initial investment was made in electoral times. It was the last project carried out by Governor Manuel Bartlet, being inaugurated in the last week of his position. President Zedillo attended the inauguration. This public investment (as a tourist facility) has social negative surplus. There are losses of social welfare. A lot of public money has been invested and the benefit has not paid off. Certain social groups obtained high benefits from this project. The project continued during the periods of Governors Melquiades Morales and Mario Marín. Many industrial groups linked to the government have been favored with the project.

The project includes a convention center, a five star hotel, a pond that has been closed for ten years, and the House Aguayo. With the construction of this house the State government has three headquarters, the House Puebla for offices and the governor's residence, the Building of the State government in Reforma Avenue, and now the House Aguayo.

### **3.2 Thematic Park "el Tajin", Veracruz**

It is another example of a white elephant. This park was also built during electoral times. It was built in the first year of Miguel Alemán Velasco's government of

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<sup>2</sup> The Ryugyong Hotel is a towering, empty concrete shell intended for use as a hotel in Sojang-dong, in the Potong-gang District of Pyongyang, North Korea. The hotel's name comes from one of the historic names for Pyongyang: Ryugyong or "capital of willows". If the building were ever completed it would be the world's tallest hotel, and the seventh largest building in the world. Today, however, it remains unfinished and uninhabited. Construction on the pyramid-shaped hotel began in 1987. A firm, the Ryugyong Hotel Investment and Management Co., was established to attract an estimate of 230 million dollars in foreign investment. A representative for the North Korean government promised relaxed oversight, saying, "The foreign investors can even operate casinos, nightclubs or Japanese lounges if they want to." The basic structure is complete, but it has never been certified as safe for occupancy. As a result, no windows, fixtures or fittings have been installed. The concrete used in building the Ryugyong Hotel is of unsuitable quality and therefore unsafe. The building is sagging so badly that it will never open as presently constructed.

Veracruz, only to gain the support of the principal managers that could give him their votes.

It has a negative social surplus, but there are social groups such as bureaucrats, owners, etc., that have profited with this construction, which means votes for the ruling politician. It is an immense construction at national level, this meant votes from other regions of the State as well, but also deterioration of the floor and atmosphere, and it harmed the inhabitants, thus the negative social surplus.

### **3.3 Motorcar race track of Cancun**

Contrary to what happened with the Thematic park El Tajin built in the first year of Miguel Aleman's government, the construction of the Cancun racing circuit was announced in the final stage of Joaquín Hendricks' government, during electoral times. He made the announcement of a project with electoral purposes and with benefits to particular groups of the ruling politician. However, after the elections the construction was stopped. It was a co-investment between the State and the Federal government through the Secretary of Tourism and Fonatur, with principal managers interested in winning the electoral campaign. Recently, municipal officials indicated that the construction is retarded due to a litigation of the lands, with no short term solution. Presumably, the lands (where it was being built) are of ecological preservation.

### **3.4 World Trade Center México (Mexico City, Mexico)**

The WTC México began its existence as the Hotel de México, a building and complex that never really performed their intended functions. The Hotel de México project included, of course, a hotel building as well as a cultural center housing the Polyforum Cultural Siqueiros, parking facilities and its most famous and recognizable feature, the 52-story, 172m (564ft) high Torre WTC. It also includes several other facilities aimed at making the complex a hub for business, culture, tourism and architecture. Slated to be ready for the 1968 Olympics, the project ran over schedule and over budget, and, although the main tower was completed in 1972, it never really functioned as a hotel, then, due to political and economical reasons, the tower and the rest of the complex were left unfinished, except for the Polyforum. In some cases, a white elephant can be built and continue operating if the ruling party wins; however, in other cases, after the election, the activities related with this white elephant are suspended.

## **4 Rationality in the Investment in White Elephants**

Democratic societies delegate the power to tax and provide public goods to the elected representatives. A common complaint made by citizens and by the press is that a large fraction of public spending is not devoted to projects of genuine public interest. The redistribution of the wealth associated with a large part of these projects does not seem to improve the social welfare, then they become white elephants (Lizzeri, A., N. Persico, 2001). However, local inhabitant and certain

groups of citizens agree, at least for a short period of time, with the construction of the white elephant. This situation could be understood if we consider this construction as the result of a one shot game, similar to prisoner's dilemma (about the Game Theory and its applications, see Osborne, M.; Rubinstein, A, 1994). People looking for their own welfare obtain a Pareto dominated situation. However, this result can be different if the participant in the game, politician or these groups of citizens, looks at the game as an infinitely repeated game. These games capture the idea that the behavior of each player has an effect in the future behavior of the others, and phenomena like cooperation, revenge, and threats appear. However, even in this case, it is possible to improve the situation if the discount factor of this people is large enough, in other cases we obtain the same result, i.e. the white elephant is built. This is a rational result if we look for the interest of the player. However, the rest of the population is also interested in the game, and from the society's point of view this result is not rational because it can be Pareto improved. In many cases it makes no sense to consider the possibility of repeating the game, so the rationality of this white elephant is based on the rationality of a one shot game. However, we can distinguish between situations where all interests (agent and politician) remain reasonably well-aligned even after the white elephant is built, and those involving unavoidable posterior conflicts. This is the case when one of the players is myopic and there exists ex-post repentance.

Consider the following situation: two different political parties have two different projects for a tourist region, and suppose that both of them are white elephants. The winner in an electoral dispute decides the project that will be operating after the election. It could happen that the most inefficient project from an economic point is the one in execution, because this was the most efficient from the political perspective. Hence, the construction of a white elephant related with tourist activities can obtain a larger number of votes, thus imply a serious damage in environmental quality and a decrease in social welfare.

## **5 Conclusion**

If the ruling politician undertakes the construction of a white elephant, he is searching to obtain advantages in the result of the election, which means favoring certain social groups in exchange for their votes, even if the social cost of the project is larger than the obtained benefit. Also, obtaining a larger number of votes, through the construction of a white elephant, implies a decrease in the social welfare of the tourist region. The rationality in this situation can be represented by the rationality of a one shot game. The socially efficient projects begun by a previous government are always concluded and operated by the following government, regardless of the political party in power. Nevertheless, a socially efficient project increases the individual benefit of all the politicians, but this project does not alter the electoral result or the probability of winning the elections. This is no the case of socially inefficient projects, so if an inefficient project captures more votes for a certain political party, then the efficient projects of more impact and social benefit are displaced by this white elephant that increases the probability of winning the elections.

We show the existence of a double rationality in the construction of a white elephant, one rationality from the political point of view, with the purpose of winning the election rather than obtaining economically efficient projects. This political rationality prevails over the economical rationality. The other rationality is the rationality of the game theory, basically the rationality of the one shot game.

An example of a white elephant in tourist activities is the investment in tourist facilities in the Riviera Maya and Cancun. The Riviera Maya has 26,980 hotel rooms, and 3,000 new rooms are built every year. The annual flow of tourism is over 2 million people; leaving an income of more than 1,400 million dollars. Cancun has 26,000 hotel rooms. So it is possible to obtain large benefits from this investment. But, is it sustainable?

Mexico should be careful in licensing new tourist projects because massive investments concentrated in coastal areas could adversely impact the environment and zoning master plans. Tourist projects often occupying large areas in prime locations, then the financial capacity and professionalism of investors should be assessed thoroughly before green lighting construction. Investment officials need to carefully assess these factors to grant licenses, or risk creating white elephants that leave large tracts of land and partially constructed facilities unusable for large periods of time.

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