

FOREIGN DIRECT INVESTMENT IN TENNESSEE

by Steven G. Livingston

It was not all that long ago that foreign investment was the last, and the least, of Tennessee's economic concerns. Until relatively recently, foreign owned firms were still exotic. The 1974 national survey of foreign direct investments, America's first systematic effort to see who owned what, found only nineteen foreign owned manufacturing firms in the state. The total book value of foreign investment was at that time a not inconsiderable \$649 million, but this paled in comparison with the amounts pouring into many other states. The few foreign owned firms were widely dispersed over the state (only Memphis and Chattanooga were host to more than one foreign affiliated manufacturer) and generally held a low profile. To most, overseas investment decisions appeared as marginal an element of Tennessee's economic growth as one could imagine.

No one could reasonably hold such a view today. Because of growing economic interdependence, firms around the world are increasingly making their investment decisions globally. As a result, foreign investment flows have mushroomed. Tennessee has recognized this fact, and the opportunities which it creates for building the state's economy, and now aggressively courts this investment. It has achieved remarkable success. A skillful policy of several Governors, along with the state's strong business environment and advantages as a distribution center, have encouraged many foreign firms, including some of the most famous names in the world, to locate here. This success has reshaped the state's economy. Foreign owned firms now play a major role in the state. Today, about a quarter of the value of all products shipped in the state of Tennessee issues from foreign owned firms. Better than one in seven manufacturing jobs is in one of these firms. Foreign investment flows, which can reach many millions of dollars in a single transaction, have become one of the engines of the state's growth. And, through their effects on the development of new industrial sectors, foreign operations are remodeling the composition of the state's economy. While a few of the biggest individual investment stories have garnered their share of media attention, most Tennesseans probably remain unaware of the total size, scope, and impact of foreign investment in their state. It's time to examine this phenomenon more closely.

Tennessee's Foreign Investment Explosion

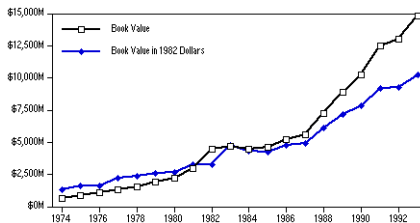
Few foreign investment decisions attracted more national publicity than Nissan's 1981 choice to locate its North American operations in Tennessee. Many might think Tennessee's foreign investment story began with this event. But Nissan's decision actually came in the midst of an explosion of foreign investment into the state. The boom started a half a dozen years earlier. Since that time, twelve to fifteen new multimillion dollar investments a year have been made in Tennessee by foreign firms. The announcement of a new investment in Tennessee is now almost a routine event. These investments have ranged from equity investments in Tennessee firms to acquiring existing plants, opening new plants, or expanding them. Many of these individual transactions are very large indeed, as the accompanying box shows, and have a tremendous impact on the local economy. (Ironically, however, the single largest transaction of this period, the purchase of the then Memphis-based Holiday Inns for \$2.2 billion by Great Britain's Bass PLC, probably had one of the smallest economic impacts.)

Big Spenders: Major Foreign Investment Transactions in Tennessee

Year	Company	Location	Investor	Investment
1981	Nissan	Smirna	Japan	\$500,000,000
1986	Crump Insurance	Memphis	UK	\$300,000,000
1985	Richard's Medical Co.	Memphis	UK	\$284,000,000
1988	Murray Ohio Mfg.	Lawrenceburg	UK	\$224,000,000
1988	Nipponkasa	Nashville	Japan	\$200,000,000
1987	Whirlpool's Hot-Dishaker Home Systems	LaVergne	Canada	\$176,000,000
1993	Whittle Communications	Knoxville	Netherlands	\$175,000,000
1976	Jersey Miners Zinc	Clarksville	Belgium	\$100,000,000
1986	General Stone Products	(several locations)	UK	\$94,000,000
1984	Nissan	Smirna	Japan	\$85,000,000

As a result of this activity, the handful of foreign owned manufacturing and distribution firms active twenty years ago has grown to just under 420: a 2100 percent increase! The total number of foreign owned firms engaged in all business sectors now exceeds 800, with a combined book value of some \$15 billion. And the explosion is not over. It continues, reaching every corner of Tennessee and affecting every aspect of its economy.

The Book Value of Foreign-owned Property, Plant, and Equipment in Tennessee

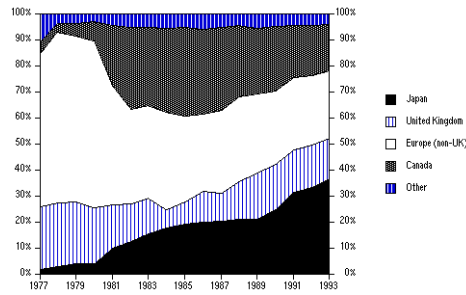


Where Does It Come From?

With the regularity of a standardized exam answer, "Japan" is everyone's response when asked where all this investment is coming from. Non-Japanese investors must feel a little like Rodney Dangerfield. While firms from more than twenty countries have significant investments in Tennessee, holding 79 percent of all foreign owned establishments and 63 percent of the book value of the state's foreign investment, they get only a fraction of the publicity given Japan. Holding nearly \$10 billion in assets in the state (over \$5 billion in manufacturing) probably does deserve respect. In fact the first significant investors were from Canada and the countries of the European Union. Britain actually led the way; indeed, there were more British owned firms in Tennessee than firms owned by any other country right up until 1992. British investments are worth more than \$2 billion. The size of their investment is exceeded only by those of Japan and Canada. Canadian activity is quieter than that of the other big investing countries, with only about 20 percent in the manufacturing sector, but it is large, nearing \$2.5 billion in total book value. The other major European economies have also been interested in Tennessee. Germany in particular merits some attention, it has recently become the fourth country with over a billion dollars in Tennessee investments (and the third with over a billion in manufacturing investment). However it is not just rich countries whose firms are putting money in the state. Developing countries now have over \$600 million in investments here; a surprise perhaps, but it is an indication of the extent of world economic integration, and of the attractiveness of Tennessee as a locale in which to do business in a globalized economy.

But, having giving the rest of the world its due, there is still no escaping the special role Japan has played in Tennessee's explosion of foreign investment. Japanese firms are the largest, the fastest growing, and most the significant investors in Tennessee. With nearly 200 firms operating in the state, together worth well over \$ 5 billion, Japan is today the largest investor in Tennessee. Its investment has skyrocketed. Japanese investment grew an astounding 23000 percent between 1977 and 1993. Japanese manufacturing investment reached \$1 billion in 1987 and has not look backed: growing almost 400 percent more by 1995. In 1977 Japanese investment was about

Gross Book Value of Foreign Direct Investment by Country



2 percent of all the state's foreign investment, today it is nearly 40 percent. And this, if anything, understates its impact. Almost all Japanese investment is in manufacturing, arguably the most economically significant sector of the economy. By 1995, almost half of all foreign investment in manufacturing came from Japan. Perhaps most importantly, Japanese investments were critical in establishing the state's automotive industry, now one of the most important and vital parts of the Tennessee economy. One can plausibly assert that Japanese investment decisions of the past two decades have as much impact on the state economy as any decision made inside this state.

Where is it Going?

Where does all this investment wind up? As it turns out, foreign investment flows to all parts of the state. At least 65 counties are home to one or more foreign owned manufacturer, for example. A quick look at the map shows firms are located throughout Tennessee.



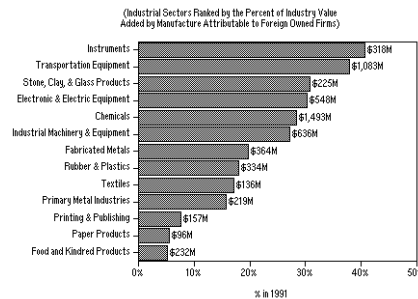
But, to be sure, the state's large cities attract the bulk of them. Memphis has long been the single favorite site of foreign investors. It held the most foreign-owned firms in the first 1974 survey, and does so today. Together Shelby (Memphis) and Davidson (Nashville) counties contain a little over a third of all the foreign affiliates operating in the state, and their respective metropolitan areas include an even larger chunk of total investment.

Foreign investment is actually more concentrated sectorally than geographically. Manufacturing (62 percent), and its associated distribution and trade (21 percent), attract the lion's share of investment. However there is slow diversification - these sectors grabbed about 93% percent of investment fifteen years ago. Real estate, services, retail trade, and even insurance are attracting relatively more interest from foreign firms. By 1993, the last year for which data is available, these four sectors had attracted just under \$1.8 billion. Ambulance services, apartment buildings, food markets, and everything in between have been bought by foreign investors.

Manufacturing investment nevertheless remains the primary interest of foreign investors. And, as with "Japan," most Tennesseans would probably respond "automobiles" if asked to name the manufacturing sector with the largest foreign presence. But this time they would be wrong. While the book value of investments in the two industries is close, the chemical industry (this includes the manufacture of plastics), has the most foreign owned firms of any industrial sector, the highest percentage of foreign owned firms (about 20% of all firms are foreign owned), and the most foreign owned employment (over 9000 workers). The value added by manufacture generated by foreign owned firms in the chemical industry is half again as large as that in the transportation sector. Generally, the sectors where the absolute size of foreign activity is the largest are, not surprisingly, the state's largest industries. The exception is the food processing industry, Tennessee's second largest as measured by value added by manufacture. This is still overwhelmingly domestic. But chemicals, the transportation (automotive) sector, and industrial machinery, the first, third, and fourth largest manufacturing sectors in the state, are also the three where foreign owned firms have the largest presence. Parenthetically, these are also the state's top exporting sectors. Perhaps this connection should not be so surprising - much of the success of these sectors is due to the foreign money which has been pumped into them.

Another way to look at where foreign investment is going is to ask which of the state's industries are most dominated by foreign owned firms. As can be seen in Figure 5, close to a third of the value added by manufacture comes from foreign owned firms in a number of Tennessee industries. Here the transportation sector does show a greater foreign presence than the chemical industry, but neither turns out to be as reliant on foreign investment as is the production of scientific and medical instruments and their related products, where forty percent of the value added by manufacture is accounted for by foreign owned firms. Moreover, about 45 percent of employment in this sector is accounted for by these firms. This is by far the greatest of any sector, although in six of the thirteen sectors shown on the chart, more than 20 percent of workers are employed in a foreign owned firm.

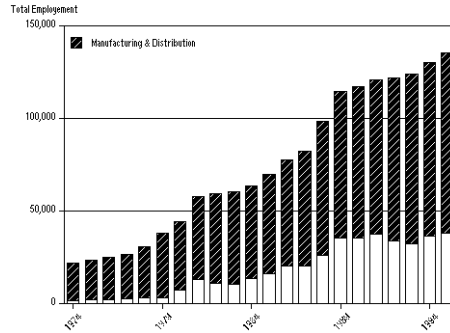
The Economic Importance of Foreign Direct Investment to Tennessee



What is the Economic Impact?

By now it should be very clear that foreign investment has an enormous impact on the state of Tennessee. Quantifying this impact is not always easy, but several figures give us a clue as to the magnitude of the impact. By any measure - employment, value added, or value of shipments - Tennessee owes about one-fifth its total manufacturing sector to foreign investment. If "foreign owned" were thought of as a separate economic category, it would be Tennessee's largest industry. Moreover, it is growing rapidly. Even ten years ago, foreign investment accounted for perhaps a little over a tenth of the state's manufacturing. Twenty years ago it was virtually nil. In 1995, as foreign owned manufacturing employment alone reaches the 100,000 jobs mark, we look back to 1974 and see a sextupling in the percent of all workers in the state who earn their pay in foreign owned firms. These figures suggest the important role foreign investment has had in Tennessee's economic growth over the past few years. This role has been even more central if we think about how critical that investment has been in the creation and expansion of the most dynamic sectors of the state's economy, and in the economic health of the particular communities in which that investment has been located.

Foreign-owned Firm Employment 1974-1995



In fact, foreign investment has been more important for Tennessee's economic health than for most other states, or for our national economy. Whether measured by employment, value added by manufacture, or value of shipments, Tennessee's economy is the seventh most reliant on foreign owned firms of the fifty states. (Interestingly, three of the six states more reliant are our neighbors North Carolina, West Virginia, and Georgia.) The size of the foreign owned impact on our state is almost a third again as large as it is for the U.S. economy as a whole.

A Threat?

Many people worry about foreign owned firms. Are they different? Are they better - or worse - than locally or nationally owned ones? Unfortunately this is an almost impossible question to answer. We can say that foreign owned firms are bigger. About four percent of all manufacturing establishments in Tennessee are foreign owned, about a quarter of those firms which employ 1000 or more workers are foreign owned. In non-manufacturing sectors, foreign owned firms tend to be the department store chain or the large apartment complex rather than to smaller enterprises.

National studies have found no statistical differences in wage rates between foreign-owned and domestic firms. Foreign owned firms tend to have somewhat higher labor productivity and capital intensity than other firms, but this is probably due more to their larger size and the type of industries in which they operate, than to any effect of foreign ownership itself. By most measures it is hard to conclude that foreign owned firms are much different from domestic ones. But *having* foreign owned firms in a state's economy does offer some clear benefits; these firms are sources of new production techniques, labor management practices, and an industrial dynamism from which all firms can draw. Combined with the value of the jobs they provide and the money they pump into the state economy, there seems little doubt Tennessee's growing foreign investment has been a positive force in the state's economy.

The Future of Foreign Investment

Will Tennessee's foreign investment explosion continue? While a full discussion of what drives global investment decisions is not possible here, three international factors heavily encourage foreign investment: the desire to form global networks, a weak dollar, and fears of U.S. protectionism. In 1994, these factors have actually combined to produce a mini-boom in foreign investment into the U.S. The Department of Commerce's Bureau of Economic Analysis is expecting investment to grow from European countries with strong currencies - especially the U.K. and Switzerland. The United Kingdom is a traditional large Tennessee investor. This suggests that the scale of investment into the state may increase. Our other large investors may not be so ready to act, however. The Canadian dollar is still weak, and protectionism is not much of a worry to our northern neighbor. While Japan's yen is strong, and U.S. protectionism is certainly a worry there, the growing Japanese financial crisis may make Japanese investors more cautious over the next few years.

The second big decision for any investor into the U.S. is, which state? Here Tennessee remains in very good shape. The state's location and infrastructure, its economic boom, its advantageous labor situation, and a history of successful investments in the state continue to make Tennessee attractive. The likely outcome, then, is for continuing, sizable foreign investments into the state. The weakness of Japan in particular may dampen the flow we would otherwise expect over the next few years, but it seems certain that Tennessee's economy will be ever more intertwined with foreign investment, as it continues to be a recipient of large levels of foreign investment in the years to come.

A look at the current picture of foreign investment in Tennessee reveals many surprises: yet whether one looks at its amount, its variety, its geographic location, or its economic effects, one constant is the immense impact of this investment. No longer relegated to last, or least, in discussions of this state's economic future, foreign direct investment will play a critical role in the future development of the state's economy.

The surveys *Foreign Direct Investment in the United States, Annual Transactions* (International Trade Administration); *Foreign Direct Investment in the United States, Operations of Foreign Companies, Annual Estimates* (Bureau of Economic Analysis); *Foreign Direct Investment in the United States, Establishment Data for Manufacturing* (Bureaus of the Census and Economic Analysis); and *Foreign Investment 1994: Tennessee and the 1995 Update* (Tennessee Department of Economic and Community Development) were the sources of the data used in preparation of this article.

Tennessee International Trade Report 2nd Quarter 1995

Tennessee exports continue their strong 1995 growth. Second quarter exports rose to \$2.33 billion, an increase of \$42 million from the first quarter, and some \$371 million over the same period last year. This rate of export growth - 19 percent above last year's second quarter - again exceeded the national average. Japan once more eclipsed Mexico as the state's second largest market. Mexico's exports dropped about 2 percent from last year in the wake of its economic problems, however its second quarter exports increased 9 percent from the first quarter of 1995. Together Canada, Japan, Mexico, and the European Union accounted for about two-thirds of the state's exports.

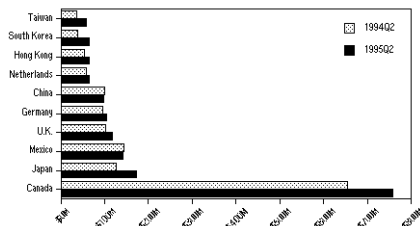
The most impressive growth, however, came on the Indian subcontinent. Tennessee's sales to that region grew 177 percent from last year, with exports to India, Pakistan, and Bangladesh each up well over 100%. Five of the state's seven largest export sectors made substantial gains over their sales of a year ago. The chemical industry wrested the crown as the state's largest export sector from transportation (automotive) equipment, posting a growth rate this quarter of better than 50 percent. But it was the forestry industry which turned in the most impressive performance: a 4587 percent export explosion.

The third quarter has opened with yet another solid performance, with July exports up 4 percent from a year ago.

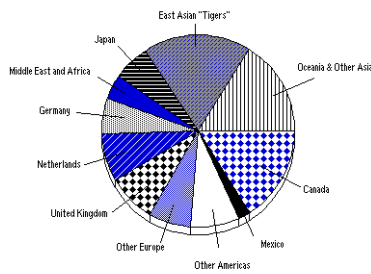
Trade Report - Chart #1
Tennessee's Largest Exports Sectors
2nd Quarter 1995

Industry	Exports	Change from 2nd Quarter 1994
Chemicals	\$465,830,296	50.29%
Transportation Equipment	\$451,729,829	13.72%
Industrial Machinery	\$286,175,730	24.25%
Agriculture	\$215,312,853	36.06%
Electronic and Electrical Equipment	\$157,075,702	(3.47)%
Paper & Allied Products	\$93,946,242	37.14%
Food and food products	\$84,790,221	(7.23)%

Trade Report Chart #2
Tennessee's Leading Trade Partners:
Growth of Exports

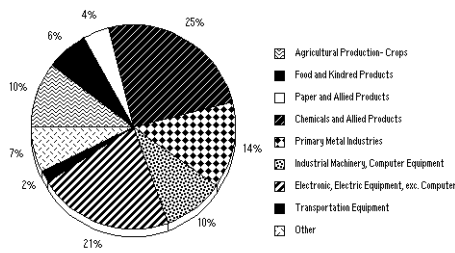


Trade Report - Chart #3
Tennessee's Chemical and Plastics Exports



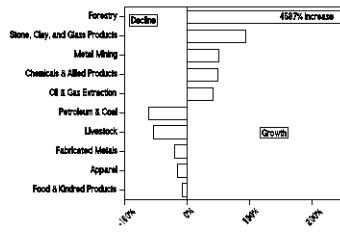
The chemical industry was the state's largest export sector in 1995Q2

Trade Report Chart #4
Tennessee's Exports to Taiwan

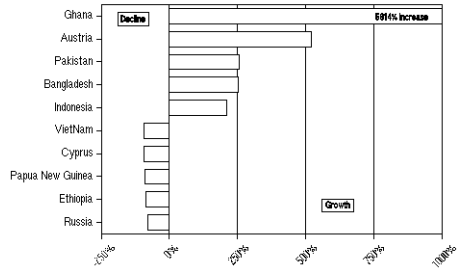


Taiwan is this quarter's new entrant as one of the state's ten top export destinations. What is Taiwan buying from Tennessee?

Trade Report - Chart 5
Growth and Decline in Exports by Industry
2nd Quarter 1995



Trade Report - Chart 6
Fastest Growing Export Destinations
2nd Quarter 1995



Trade Report - Chart 7
Tennessee Monthly Exports

