

FOREIGN DIRECT INVESTMENT IN THE SOUTHERN US: A CASE STUDY OF THE ALABAMA AND THE AUTOMOTIVE SECTOR

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CASE DESCRIPTION

The primary subject matter of this case concerns foreign direct investment (FDI) in the southern U.S., specifically automobile FDI in Alabama. Secondary issues concern the aggressive competition, using incentives and state-specific features, of southern states in recruiting foreign investment and the employment opportunities that FDI brings. This case has a difficulty level of three, is suitable for a junior level course, and can be taught in a 90 minute class with two hours of outside preparation by students. It is also applicable for use in a senior-level international management class to illustrate the reach of globalization into local corners of the world. It may further be used as a template for professors in other states in illustrating the proximity and consequences of FDI. We propose that there is international activity in the form of FDI here or abroad as well as exporting and importing in virtually all states and the case provides a template for that scenario as well. Students should relate to the importance of international business as they see its relevance to their lives.

CASE SYNOPSIS

This case is designed to illustrate the concepts of foreign direction investment, job creation, state incentives as a factor in FDI, and the unique features that a foreign investor wants from a state. The case can be used in its entirety or in part as appropriate. For example, one could investigate recruiting methods used by U.S. states in the pursuit of FDI and the results of that pursuit.

Countries are faced with numerous challenges as they compete for the same Foreign Direct Investment dollars. FDI is increasing as the world evolves into a global marketplace for industry. The U.S. government continually adjusts its policies and tax procedures in order to be a viable player in the world market. Many southern states, including Alabama, have been successful in improving their economies and providing new employment opportunities by offering the incentives required to attract FDI and industries to the area.

INTRODUCTION

In today's global marketplace, governments increasingly must compete aggressively to attract multinational companies. Companies engage in foreign direct investment (FDI) for the purpose of actively controlling property, assets, or companies located in a host country. International business competition among multinational companies frequently involves fiscal incentives. FDI patterns have changed and the level of activity, when considered to GDP, has tripled in the past 20 years.

Countries vary in the importance of issues that affect their FDI. In comparison to the U.S., Japanese investors are more influenced by factors such as infrastructure, wage inflation, elementary school enrollment, and country risk, described as economic and social uncertainty of the host

country. The United States is the largest foreign direct investor country with 1953 foreign direct investment projects since 2002 and is also hosts the world's largest inflow of FDI. During the 1990's, the U.S. experienced a sharp growth in FDI generated by the booming economy. During 2004, FDI capital investments reached \$13.90 Billion U.S. dollars. The United Kingdom, Netherlands, Japan, Germany and Canada provided the largest amounts of direct investment in the U.S. and these countries also received large amounts of investment from the U.S.

Many foreign countries choose the southern section of the U.S. as a desirable location for their FDI. Despite the escalating costs of incentives packages, southern states continue to invite large industrial employers in order to continue the evolution from an agricultural economy to a manufacturing economy. In the first quarter of 2004, "Relocate America" named the top five places to live in the U.S. and they were all located in the South. The southern states tax policies have changed within recent years to impact FDI decisions. Infrastructure improvements, business incentives, and job training programs are part of the incentives offered to foreign investors as competition among states takes place.

The southern U.S. has been very aggressive in recruiting international companies. Economic development is one of the first job priorities of southern politicians. Tennessee, Alabama, Georgia, Kentucky, South Carolina and Texas have been eager to grow their manufacturing bases and have welcomed foreign automakers with numerous incentives, many industrial sites, a skilled work force and a non-union environment. Each state has adopted a unique strategy to attract FDI because they realize they are competing for the same limited investments. The following section discusses what Texas, South Carolina, Mississippi, and Alabama have been willing to offer in their pursuit of international investment.

TEXAS, FDI AND INCENTIVES

Texas Governor Rick Perry has made job creation and economic development a foundation of his administration. The Governor and the legislature established a \$295 million dollar Texas Enterprise Fund to allow the state to respond quickly and aggressively to opportunities to bring jobs and employers to Texas. This enables the governor's office to tailor incentive packages to best meet the needs of local communities and businesses. The fund focuses on ways to attract new business to the state or assist with a substantial expansion of an existing business as part of a competitive recruitment situation. The Governor's and legislature's reform of the state's workers' compensation system is also an example of the state's commitment to successful partnership.

SOUTH CAROLINA, FDI AND INCENTIVES

South Carolina started its modern Foreign Direct Investment (FDI) program in 1988, which resulted in the securing of Fujifilm Medical in Greenwood and the BMW Plant in Greer (1992). Since this program started, South Carolina has continued to reap success in the development of jobs through in-sourcing or FDI. According to the Organization for International Investment, South Carolina ranks first in the nation in the share of its private sector workforce supported by U. S. subsidiaries of companies headquartered abroad.

The 1992 BMW package, thought to be the most costly state supported economic initiative ventured at the time, offered incentives totally \$155 million in return for the promise of 1900 jobs for a ratio of \$81,479 per employee (adjusted to 2001 dollars). These dollars came in the form of property tax abatements, labor training, income tax credits, revenue bonds, a 900 acre plant site, road and airport improvements, and a \$6 million dollar local county contribution. While raising dire doubts among politicians and some economist concerning government's direct support of foreign owned private business, the economic impact has been beyond even the most aggressive projections.

MISSISSIPPI, FDI AND INCENTIVES

Mississippi was slow in realizing the worth of recruiting foreign capital. However, it launched a serious effort the late 1990's, which resulted in a major catch; Nissan came to Canton in 2000. Mississippi held special secessions of the state legislature which resulted in cutting the time frame for incentive decisions from the normal 18 months to five. The package included \$295 million of direct incentives in return for a promise of 4000 jobs paying an average of \$23/hour. In addition to the state's effort, Mississippi went one step further when its United States Senator sponsored special federal tax reduction legislation for the Canton area. It is ironic, in light of the state's lethargy in getting into the game, that the facility was expanded by 40 percent a full year before it was scheduled to open. As in South Carolina for BMW, many of the dollars in the incentive package were devoted to infrastructure improvements, employee training, and tax credits. Nissan Vice-President, Emil Hassan, reflected in his statement, "The partnership between local firms and Tier 1 automotive suppliers demonstrate a win-win scenario that will be good for the smaller firms, for Nissan, and for Mississippi."

ALABAMA, FDI, AND INCENTIVES

Alabama has been at the forefront in offering incentives packages and deriving a considerable benefit from the industries relocating in the state. For example, Alabama's auto industry has generated 30,180 direct jobs, creating another 53,530 indirect jobs, for a total of 83,710. These job totals translate to \$1.4 billion in direct payroll and \$1.62 billion for indirect payroll as of the end of 2002. It is estimated that 5 to 6.2 spin off jobs are associated for every single assembly job. Alabama possesses many natural resources that make it attractive to foreign multinational corporations. Other areas that Alabama emphasized in their quest for automotive FDI were tax incentives, anti-union sentiment, education development activities, and state training programs.

Due to Alabama's commitment to the promotion and maintenance of a competitive business climate, the state has developed one of the most aggressive tax incentive programs in the nation for new and expanding industry. Since the Alabama tax incentives have a statutory basis, industries in the state have a stable framework for long-term investment.

Competition for FDI is influenced by government policies. While offering tax incentives is often effective in attracting foreign investors, improving the quality of a country's infrastructure, to include human capital enrichment, appears to have a longer lasting impact. Alabama offers unique training programs. Alabama Industrial Development Training (AIDT) is among the most highly rated workforce-training program in the U.S.

FINANCIAL INCENTIVES AND RETURN ON INVESTMENT IN ALABAMA

Currently, more than 300 foreign-based manufacturers from more than 30 nations operate in Alabama. Of these foreign-based companies, three are major automobile manufacturers; Honda, Hyundai, and Mercedes. Another foreign-based automobile manufacturer, Isuzu, just announced that it will be expanding its operations into Alabama in the near future.

In 1993, when Mercedes announced that it would be moving the assembly of the M-Class outside of Germany, Alabama was not anywhere near the top of the list of possible locations. However, Alabama ended up being the state of choice because of its generous incentives package. Based on the incentives offered, those 1,500 jobs cost Alabama taxpayers \$168,000 per job. After its \$600 million expansion in 2005, Mercedes total capital investment in the plant increased to \$1 billion with 4,000 employees. Although it cost a substantial amount of money to get Mercedes to locate in Alabama, it put Alabama on the automotive map which led to future investments from other foreign auto makers.

In 1999, the state was not as generous to Honda as it was to Mercedes in 1993, but Honda still received \$102 million in direct incentives that included site preparation grants, preparation for the construction site, free employee training programs, industrial access programs, and the biggest thing of all: enough affordable land to accommodate its 3.25 million square foot manufacturing facility.

In 2002, Alabama gave Hyundai an incentive package worth \$252.8 million to locate in Montgomery. This package included \$76.7 million in tax breaks; \$61.8 million in training grants; and \$34 million in land purchase assistance, road and bridge development, and water and sewer improvements. Hyundai has invested \$1 billion in its 2 million square foot plant and has created an additional 5,500 jobs through its 34 suppliers in Alabama.

CONCLUSIONS

Alabama has invested millions of dollars into the automotive industry. As a result, their existing automakers, Mercedes, Honda, Hyundai, and Toyota have demonstrated that they can operate efficiently and profitably in Alabama. With deals like these, it's no wonder foreign automakers have stepped up production in the U.S. States continue to offer attractive incentives, hoping that these will solve some of the problems facing them at home. For example, in early 2007, Louisiana and Alabama are in a bidding war for a German steel company. It is reported that the incentive package offered by both has exceeded \$1 billion.

This case focuses student interest by posing questions in the fields of: FDI's economic impact, enhanced employment opportunities, tax initiatives, effects of unionization, the influence of sound infrastructure, and the importance of state government's aggressive participation.

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