



Global Commerce

Tennessee and the International Economy

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FOREIGN INVESTMENT

VOLKSWAGEN IN CONTEXT

by Steven G. Livingston

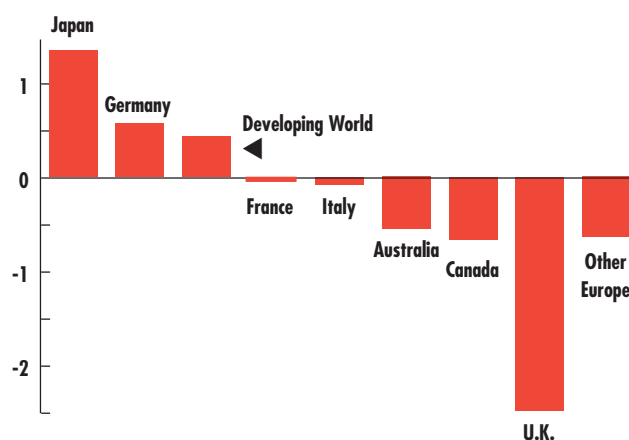
The decision of Volkswagen to locate in the Chattanooga area heralds the largest single foreign investment into this state in some years. Its announced investment (\$1 billion) will equal five percent of all current foreign investment in the state. Perhaps it's a good time to look more generally at recent trends in foreign investment into Tennessee. Net foreign direct investment (FDI) into Tennessee has grown by nearly \$5 billion over the past 10 years. According to the state's Department of Economic and Community Development, foreign companies hold investments valued at \$19.47 billion in the state as of July 2008. On the other hand, this net investment position is down by \$3 billion from its peak two years ago. This is mostly due to a significant decline in net investment from Canada and the U.K. Net foreign investment is, however, perhaps not the best way to measure the impact of foreign investment on the Tennessee economy, as it includes the sales of previously owned operations as well as new purchases and new investment put into the economy. If we look at gross foreign investment into the state, we find that it has expanded rather steadily throughout the past decade.

By this summer, there were 667 foreign-owned operations in the state.¹ This is nearly 200 more than a decade ago. Sixty-seven new foreign operations have begun in just the past three years. There are probably not too many surprises regarding where this investment comes from. Japan remains by far the largest source of foreign investment in Tennessee. It is the home of one-fifth of the state's foreign-owned facilities and just under 60 percent of all announced foreign investment. Even before the Volkswagen announcement, Germany was the state's second-largest source of foreign investment (\$2.1 billion). Tennessee has added six new German-owned operations in the past three years, placing it behind Japan, the U.K., and Canada in the number of foreign facilities operating in the state. An interesting change is the steady growth of foreign investment from the developing world. Ten years ago, the state hosted only 19 operations, with an investment value of about \$270 million, from what used to be called the "third world." Today there are 51 operations valued at \$631 million. With 19 operations, Mexico leads in number, but Brazil leads in value, with Brazilian-owned investment worth \$273 million.

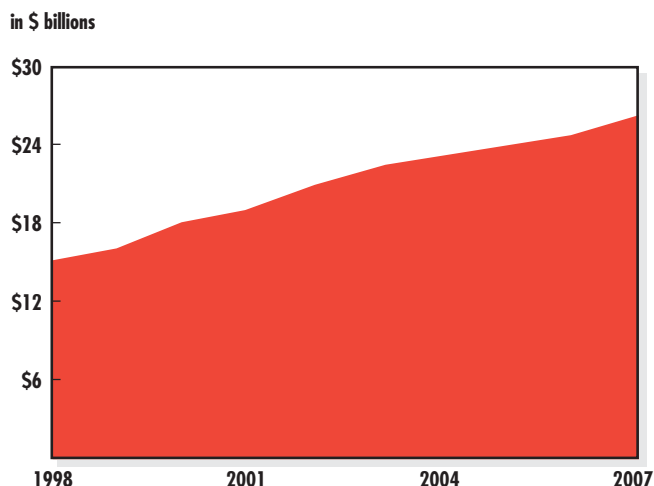
Foreign operations are overwhelmingly in either the manufacturing sector or in wholesaling and distribution. The state continues to hold a higher percentage of employment in foreign-owned firms than does the nation. Almost

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Change in Investment since 2005

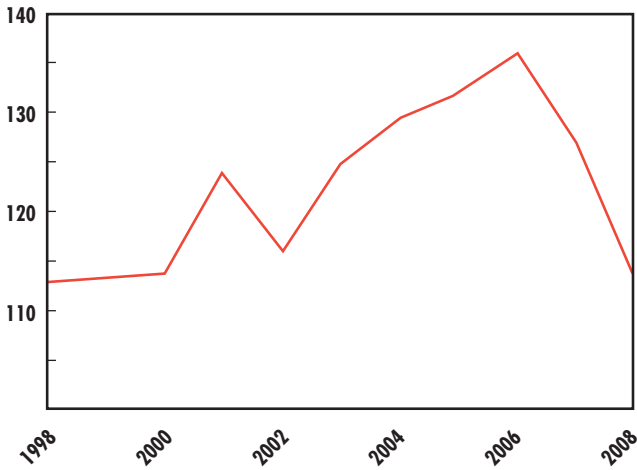


Gross Foreign Investment in Tennessee



Employment in Foreign-Owned Firms

in thousands



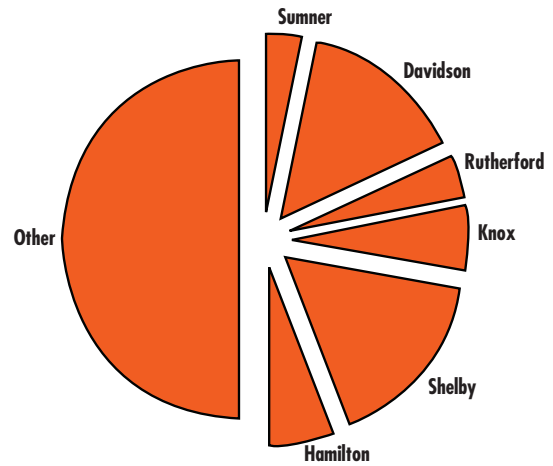
FOREIGN

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18 percent of Tennessee's manufacturing employment is in foreign-owned operations versus 11 percent for the nation. This gap has actually been increasing over the past decade. However, overall employment in foreign-owned firms has dropped a bit in recent years after peaking in 2006. In 2008, about 113,276 individuals held jobs in foreign companies, barely more than the 112,903 of 10 years earlier.

The lion's share of this investment remains in electronics and automotive-related manufacturing. Denso's December 2007 announcement that it was expanding its Maryville plant, at a cost of \$185 million, is just one of several large automotive investments made recently by Japanese companies. Nissan continues to be the state's

Foreign-Owned Firms, by County

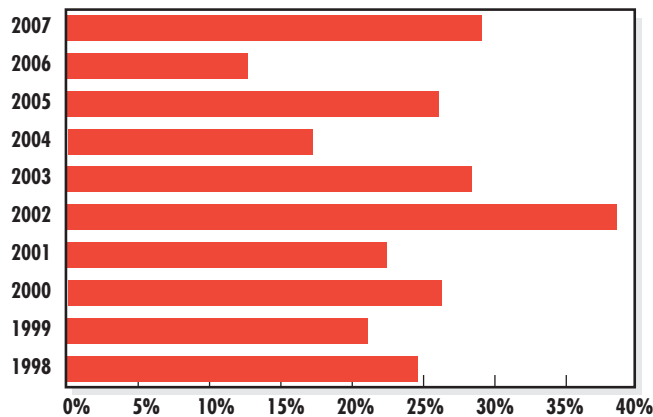


biggest single foreign investor. The Volkswagen decision, of course, reinforces this concentration.

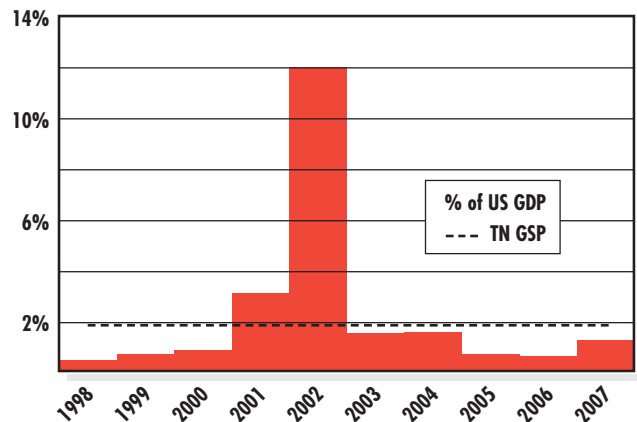
One hundred and twenty-two Tennessee cities and towns are host to at least one foreign-owned operation. But foreign investment still congregates around Tennessee's larger metropolitan areas. Exactly 50 percent of all foreign operations are in six counties. They are all metro counties: Shelby (Memphis), Knox (Knoxville), Hamilton (Chattanooga) and Davidson, Rutherford, and Sumner (all Nashville area). Shelby County remains the most heavily invested county in the state, while the Nashville metro area

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Foreign Direct Investment as % of Total State Investment



Tennessee's % of New American Greenfield Investment



2nd Quarter 2008

FIVE OF THE TOP SEVEN SECTORS POSTED DOUBLE-DIGIT GAINS.



Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$975,897,487	3.2%	-5.7%
Chemicals	\$938,472,114	16.9%	8.1%
Computer and Electronic Products	\$829,757,540	12.0%	-1.8%
Miscellaneous Manufactured Goods	\$680,442,738	20.1%	14.3%
Nonelectrical Machinery	\$565,058,063	13.3%	17.5%
Primary Metal Manufacturing	\$211,420,650	-10.2%	-5.1%
Fabricated Metal Products	\$200,727,625	13.1%	6.9%

2nd Quarter 2008

THE MIDDLE EAST WAS HOME TO BOTH THE BEST AND THE WORST OF THE STATE'S MARKETS.



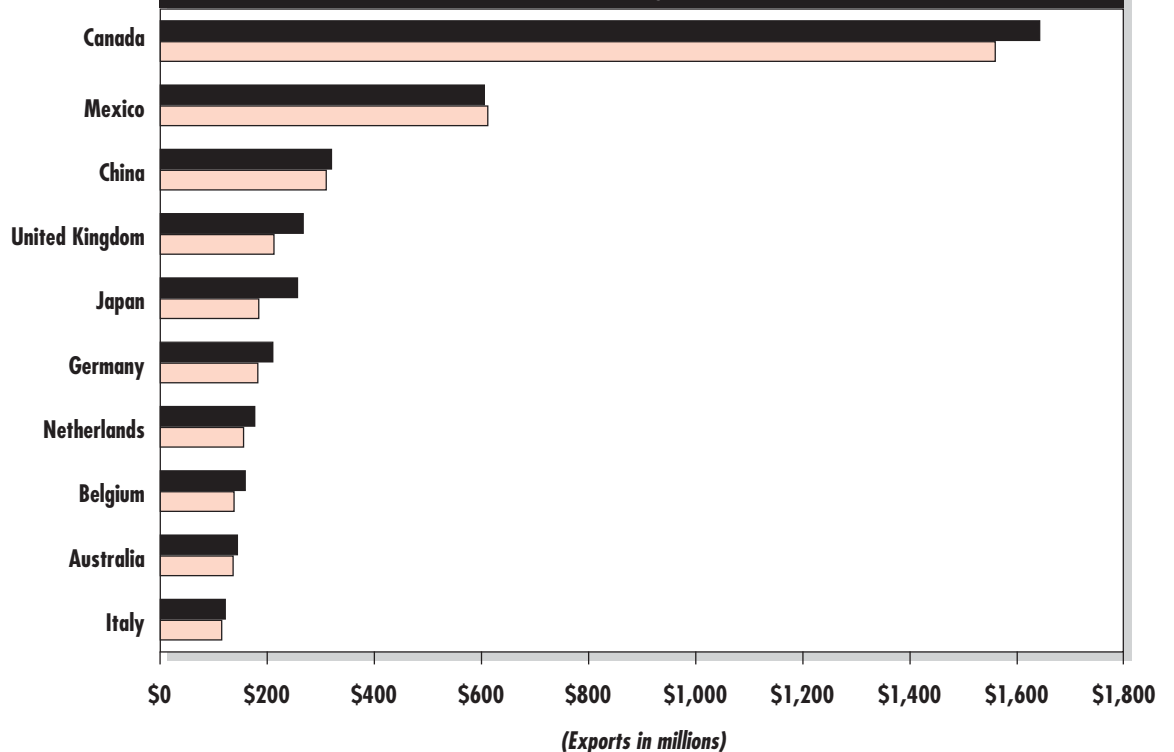
Fastest-Changing Export Destinations

	Value of Exports	Gain	Decline
COUNTRIES WITH THE GREATEST GROWTH			
Oman	\$18,024,774	680.2%	
Hungary	\$11,103,497	155.4%	
Vietnam	\$21,554,455	143.6%	
Poland	\$7,421,648	134.1%	
United Arab Emirates	\$92,204,797	133.5%	
COUNTRIES WITH THE GREATEST DECLINE			
Afghanistan	\$190,911		-95.3%
Portugal	\$2,842,513		-60.4%
Kuwait	\$14,566,432		-33.6%
Jamaica	\$8,993,707		-31.9%
Denmark	\$7,251,615		-30.3%

(Among countries averaging more than \$2 million in sales per quarter)

2nd Quarter 2008
 2nd Quarter 2007

Tennessee's Leading Trade Partners



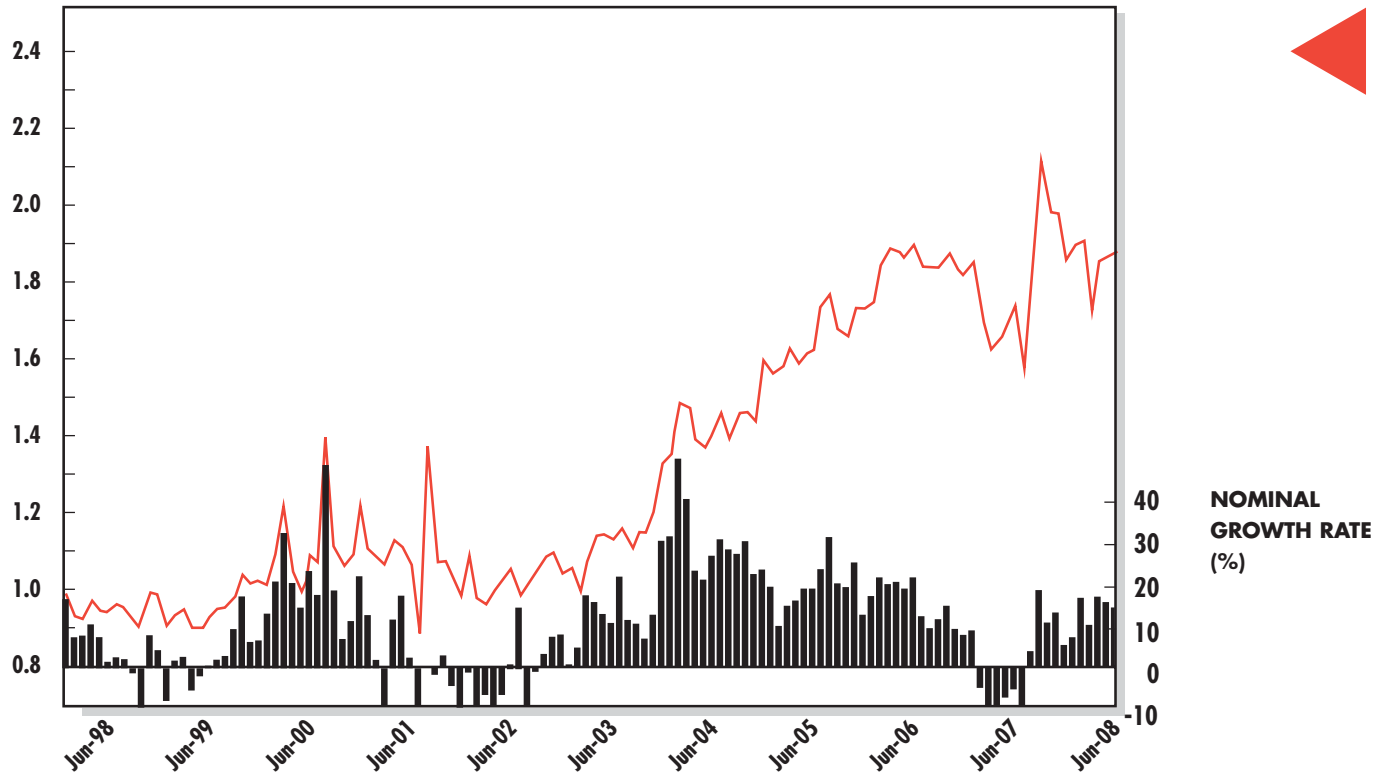
MEXICO WAS THE ONLY MAJOR MARKET IN THE RED.



Tennessee Monthly Exports

Exports in \$ billions

(Seasonally adjusted, expressed in year 2000 dollars)



2nd Quarter 2008

What's Hot and What's Not*

	Value of Exports	Growth	Decline
SECTORS WITH THE GREATEST GROWTH			
Tapeless Video Player/Recorder	\$13,132,420	28,866.2%	
Chemical Woodpulp	\$16,392,741	1,515.5%	
Machinery for Mixing Bitumen Substances	\$17,921,781	287.0%	
Electronic Integrated Circuits	\$43,494,305	279.5%	
Miscellaneous Nonwired Sheet Glass	\$17,054,931	262.9%	
SECTORS WITH THE GREATEST DECLINE			
Turbojets > 25kn	\$20,250,000		-67.6%
Charitable Donations	\$22,062,382		-52.2%
Road Tractors for Semi-Trailers	\$12,793,549		-44.3%
Nonplasticized Cellulose Acetates	\$50,272,413		-34.4%
Aluminum Plates > .2mm	\$72,853,283		-34.1%

*Among Tennessee's top 100 exported goods

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ONCE AGAIN, TENNESSEE'S PERFORMANCE PALED COMPARED TO THAT OF THE NATION.

In the second quarter, Tennessee exports grew by more than \$500 million. This amounts to a healthy 11.7 percent gain over the second quarter of last year. But once again, Tennessee's performance paled compared to that of the nation. American exports were up 18.8 percent over this same period. If Tennessee's foreign sales had grown as fast, the state would have earned an additional \$380 million. In that light, the state's figures don't look quite as impressive.

The good news was provided by a variety of export industries that were able to leverage the cheap dollar into large gains throughout the world. The bad news came from only several sectors and was confined to but a few markets. Unfortunately, both the sectors and the markets were big ones.

Canada, Mexico, and China are Tennessee's — and America's—largest markets. In each, the state far underperformed the nation. U.S. exports to Canada grew more than 12 percent for the quarter. Tennessee's were up 5.45 percent, from \$1.561 to \$1.646 billion. This was still one-fifth of the state's total export gain for the quarter, but this rate of growth is substantially lower than that to which Tennessee has become accustomed. Laptop computers were at the heart of the state's problems. Sales to Canada dropped \$30 million for the quarter. Auto-related sales also could have been better. Car exports were up (especially at the end of the quarter, suggesting that we may soon see better news). But SUV sales were off (down from \$44 to \$32 million), and auto body parts fell as well. Because these products are the state's largest exports to Canada, the very strong performance by other state exporters could not make up the difference. Exports of machinery, appliances, fabricated metals, and software were all up substantially. There would be little to complain about if computers and automobiles could return to something close to their export growth of two years ago.

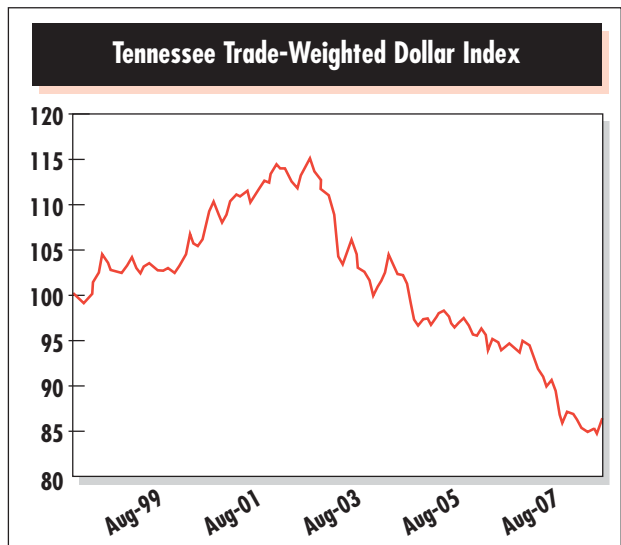
Tennessee's trade with Mexico remains overwhelmingly automotive-based. The slowdown in that sector cost the state heavily in the second quarter. Exports to Mexico actually declined (\$618 to \$611 million), while those of the United States advanced by 10 percent. The bad news was indeed all automotive. Transportation exports fell by \$40 million, and shipments of aluminum alloy plates, destined for building cars and SUVs, fell by another \$30 million. Just as with Canada, robust growth in other sectors, such as paper products and chemicals, could not compensate.

China completes the triad. American exports rose 16.4 percent, while Tennessee eked out a 2.87 percent

gain (to \$325 million). Tennessee exports to China were up only \$11 million in total, in spite of a \$5 million increase in artificial filament exports, a \$13 million gain in textiles, and a further \$11 million gain in the chemical sector. This is because growth elsewhere was offset by a substantial fall in cotton shipments (from \$47 to \$28 million). Computer and electronics sales also fared poorly, losing \$5 million for the quarter.

It's not often that the biggest markets are also the worst performers, but that was the case for Tennessee this past quarter. Elsewhere in the world, state exporters did extremely well. Medical equipment sales were again very strong. They are by now the state's largest single exported product (\$362 million in the 2nd quarter). Japan (up \$14 million) and Belgium (up \$25 million) were their two best markets. Orthopedics also had a fine quarter, with exports up more than \$30 million, roughly to the same markets. Car sales may have been slow in Canada and Mexico, but the Middle East was a different story. Kuwait, Oman, and the other Gulf States increased their auto purchases by more than \$40 million for the quarter. Artificial filament continued its recent strong sales, with gains in a number of countries, such as China, Russia, Indonesia, and Turkey. Global chemical sales grew almost 17 percent, enough to allow the industry to reclaim its old position as the state's second largest export industry (at the expense of the computer industry). Purchases in Switzerland led to a gain of more than \$40 million in integrated circuitry exports. The result is that, outside the big three markets, the state did very well. Exports to the U.K., Eastern Europe, Japan, and the Middle East all increased by over 20 percent. Sales to the euro markets and to South America each grew by more than \$100 million. So there were undoubtedly plenty of bright spots for the quarter.

July 2008 figures offer an early hint that the third quarter might at last reverse the state's recent lagging export performance. Tennessee exports grew more than 20 percent for the month, finally beating the figures for the entire U.S. (16 percent). ■



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has moved ahead of metro Memphis as the state's largest center of foreign investment. However, Chattanooga attracted more new operations over the past decade than did any other location in Tennessee. In 1998, there were 17 foreign facilities operating in Chattanooga; today there are 28. Knoxville is right behind with an increase of 17 operations. La Vergne and Jackson are the other two cities in the state that saw an increase of 10 or more foreign operations in their localities over the decade.

For most people, the bottom line on foreign investment is the size of the economic benefit it brings to the state. In Tennessee, that benefit is sizable. Over the past decade, foreign investment in manufacturing and distribution has accounted for 20 percent or more of Tennessee's total new investment in these sectors in every year but two. Whether Tennessee is getting its "fair share" of foreign investment is a little more difficult to ascertain. The accompanying chart is a first cut. It shows the percentage of American greenfield investment that the state has attracted in each of the past 10 years. (Greenfield investment is new investment; it excludes investment that is simply a foreign company buying an existing U.S. firm. Most analysts believe that greenfield investment has by far the

bigger economic impact.) The dotted line shows the size of Tennessee's economy compared to that of the nation. One way to think about "fair share" is to ask whether foreign investment into the state at least equals the amount that we would expect, simply based on the size of Tennessee's economy. Over the entire decade, the state appears to have exceeded this benchmark, thanks to very large investments in 2001 and 2002. On the other hand, since 2002, the state has annually underperformed in attracting investment. Because foreign investment comes in "clumps" of different sizes and at different times, it wouldn't be realistic to expect any state to beat the national average in every year. The Volkswagen decision will almost certainly end the recent relative dearth of foreign investment.

Foreign-owned operations are significant players in the state economy. Though still primarily dependent upon Japanese investment, the state continues to diversify both sources of investment and the economic sectors into which it goes. The history of the past decade, as well as the impact of the Volkswagen decision, shows the degree to which Tennessee's economic development, particularly in the manufacturing sector, is now linked to foreign investment. ■

1. The federal Bureau of Economic Affairs actually credits Tennessee with nearly 800 foreign-owned operations, due to differences of recording and definition. It also reports a higher figure for employment in foreign-owned operations. The figures given here are those announced by the state's Department of Economic and Community Development.