The Impact of State Incentives on Foreign Investors' Site Selections

State development agencies in the Southeast spent over $2 million in 1978 on promoting foreign investment in their states. They are also increasing incentives to foreign firms to locate in their states. Despite this increased activity, evidence suggests that investors place more emphasis on investment climate than on special incentives.

The classic vaudeville line, "now take my wife . . . Please . . .," seems increasingly applicable to state development agencies across the United States in their promotional efforts to attract new investment. From the Snowbelt to the Sunbelt, from the Sierras to the Appalachians, individual states are knocking on doors in far away places with strange sounding names in an effort to arrange marriages between their states and potential suitors (investors) — and, in many cases, offering substantial doweries!

State development agencies in the Southeast spent over $2 million on promotional activities — investment trips, overseas offices, literature, and presentations — in 1978. They also offered an undetermined (but substantial) amount in direct incentives — tax breaks, worker training, road and site improvements, industrial revenue bonds, gifts of land, and the like.

The motive behind this activity is clear: each state desires to gain its share of economic development *vis-a-vis* the nation as a whole and other competing states. If the state is not successful, it will lose people, employment, investment and income to other states. Indeed, large foreign investments are one of the most highly publicized measures of competition between states. Despite the recent explosion in promotional activities, however, current research suggests that foreign investors do not consider incentives as important as the overall investment climate in a state.

[1]For more detail on the foreign investment promotional activities and costs of the southeastern states, see the dissertation by Spero Peppas listed in the references at the end of this article.

Why Do States Seek Foreign Investment?

One answer is that state agencies apparently believe foreign investment offers greater benefits (jobs, incomes, taxes) than domestic investment. These investments are seen as new injections of economic activity with new multiplier effects, rather than diversions of internal activity. Another possibility is that while the initial promotional costs are higher for attracting foreign investors, states find the subsequent costs are lower. A third possibility is that foreign investment is somehow sexier, more interesting, and more newsworthy in the eyes of the state and local officials. After ten years of research experience on foreign investments in the U.S., I believe all three reasons are often at work.

Foreign investment maintains its appeal despite the fact that there are certain costs associated with it — both in real and opportunity terms. First, scarce resources could be better allocated to other areas. Second, additional and/or better investments could be attracted.

In addition under U.S. law it is illegal (in most cases) for a state to discriminate either in favor of or against a foreign investor. Any basic incentive the state offers must be available to all potential investors — in-state, out-of-state, or out of the country. The problem for state agencies, obviously, is that promotional problems and costs are greater in attracting true foreign investment: there is a greater educational effort required (because foreign investors have less knowledge about a particular

state); foreign investors have different needs and often require special assistance (acculturation assistance for their foreign employees and families); and promotion methods are more expensive due to greater distances, maintenance of foreign offices, and adaptation/translation of materials. Nevertheless, states clearly believe the benefits of foreign investment outweigh the costs.

How Do Southeastern States Try to Attract Foreign Investment?

In examining the promotional activities and investment incentives of the southeastern states,[2] one finds few significant differences. Virtually all of the respective state development agencies conduct periodic investment missions (primarily to Europe and the Far East), have overseas offices or representatives (almost all of them in Europe, and many in Japan), have special divisions specifically charged with increasing foreign investment in the state, and offer special promotional packages for new investors. The basic "pitch" used by the southeastern states is also very similar, stressing abundant, low cost, hard working, non-union labor; cheap and abundant land and utilities; low work stoppage rates; low taxes; good transportation; worker training programs; nice climate; conservative, pro-business state government and a nice place to raise a family!

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The basic homogeneity in the state's offerings reflects the area's similar characteristics. And while hard-core southerners may adamantly refute the "commonalities" among states in the region, the nuances are far too fine to be understood by foreigners. What foreigners do understand are the basic differences between the southeastern region and the other major regions of the United States.

Even this broad regional distinction however, has only come about fairly recently. Until the mid 1970s, few foreign investors could name any of the southeastern states, and knew virtually nothing of the region except for its colonial heritage or civil rights infamy. But with the Carter Presidency came an increased global awareness of the region and the entire "Sunbelt" phenomenon. Increased foreign awareness led to promotional strategies. As certain nationalities and industries began to cluster in a particular state, states began targeting them more specifically. And somewhere along the line, an intense competition emerged: virtually all states stepped up their promotional activities and increased the range of incentives offered to potential investors. These incentive packages might include tax holidays or exemptions, free worker training, road paving, industrial revenue bonds, special water considerations, and outright gifts of land.

As a first step in constructing the incentive package, state agencies must ascertain whether the investment climate (economic opportunity) is itself strong enough to generate new investment, or whether some special incentives will be necessary either to increase the profitability or lower the risk (cost) for potential investors.

For example, state officials visiting potential foreign investors can help identify and clarify the investors' needs: how much and what kind of land, how many and what kind of workers, how much and what kinds of financial assistance, and so forth. Based on this information, the state can then assess whether or not it possesses what the foreign investor needs. In this process, the state should also demonstrate why its proposals better suit the needs of the investor than those of other competing states.

Finally, the size and particular importance to a state of a specific investment may play a role in the importance and size of the incentives offered. A state that desperately wants a major foreign investment may feel compelled to offer a truly substantial incentive package — much more than typically offered (for example, Pennsylvania with Volkswagen, or Ohio with Honda or Tennessee with Nissan).

What Are the Customers Looking For?

The "customers" of the state development boards are the foreign investors: historically the largest firms in their country's industries,

[2]For this article, the southeastern states include Virginia, the Carolinas, Florida, Georgia, Alabama, Mississippi, Louisiana and Tennessee.

and more recently, also the medium size and even some smaller size firms.

These investors do not need to be sold on the United States. In almost all cases, this decision has already been made. What the state must sell is itself as the particular state for the investment site. The basic "product" it offers is a place: a profitable, safe, and pleasant environment. In general, components of the basic offering include logistical factors (ports, highways, railroads), labor factors (wages, available supply, unionization levels, skill levels, and productivity, absenteeism, turnover and work stoppage rates), utility factors (availability and cost of water, energy, etc.), construction factors (availability and cost of land, construction costs, and so forth.), financial factors (types and levels of taxes, financial assistance packages), and lifestyle factors (climate, recreational and educational facilities, cultural activities, etc.). All but the lifestyle factors will jointly determine the potential profitability of the investment, along with providing some estimate of the risk.

For the customer to "buy" this product, the state's offering must fit the needs of the customer *and* be competitive with the offerings of other competing states. If both conditions are not present, the state is wasting its time, money, and effort in promotion, and could better use them to rectify its weak areas. For example, instead of spending hundreds of thousands of dollars annually on unsuccessful promotion, the state could construct a deep-water port, fund worker training programs for new investors, or offer a tax holiday.

It might also conduct preliminary environmental impact studies for sites providing good potential for heavy industry in order to help speed up local, state, and federal approval once a specific investment proposal is made. This activity might also reveal potential community acceptance problems (resistance to investment) of which the state is unaware, and which might result in stopping the investment from being made (and embarrassing the state development officials).

Another factor state agencies should be aware of is that certain nationalities may have more difficulty than others in getting money out of their home countries to invest in the United States, or bad economic conditions in their home markets may have decreased the parent's ability to fund sufficiently the American venture from internal sources. In such cases, favorable financial incentives from state or local authorities are likely to be perceived as more important. Larger multi-national firms also have greater access to lower cost financing than smaller firms, and as a result, financial incentives such as industrial revenue bonds, gifts of land, free worker training and the like may loom more important for smaller firms.

In addition, capital intensive and utility intensive industries generally require different conditions than labor intensive industries. Special incentives involving water or energy conditions may be more important for the first group than they are for the latter, as would tax incentives related to the use of heavy equipment and machinery.

How Successful Are the State Efforts?

"General wisdom" seems to say that incentives play an important role. However, recent studies on this question suggest that investors do not consider incentives as important as investment climates, and in many cases, do not consider them important at all. Two of the most recent studies of foreign investments in the Southeast were those of Bernard Imbert and G. Lynn Derrick.

Imbert studied the southeastern investments of 16 French companies, and, among other topics, asked for a ranking of the most important factors that influenced the companies to locate in the Southeast and in the particular state. Of the more than 15 factors listed, five were mentioned as being "most important" by two-thirds of the firms. These factors were, in order of ranking: the attitude of the labor force, the quantity and quality of labor, transportation facilities, the life style of the area, and the availability (and cost) of suitable plant sites. Three other factors were cited by more than one-third of the firms as also being extremely important: the availability and cost of water and energy, salary levels, and the proximity and ease of access to markets in the United States.

On the other hand, inducements/incentives of state and local authorities ranked eleventh out of sixteen factors, and were ranked as a "major" factor by only two firms, and an "important" factor by only two other firms. In

the cases of the two French firms who ranked the incentives as "most important," both parents were strapped for financial resources to investment in the U.S., and were offered such favorable conditions that it was almost impossible for them not to be taken into consideration: long term taxation advantages, free or virtually free land, state construction of a road to their plant site, and so forth. However, both cases occurred in the early 1960s, and such inducements by state and local authorities are now seldom as extensive.

In Derrick's study of German investments in South Carolina, he concluded that labor conditions had also been the most important factor in German firms' decisions to locate in South Carolina, along with the abundance of low cost utilities and suitable plant sites. As was the case with French investors, incentives of state and local authorities were not ranked as critical factors.

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Other studies have touched in part on the relative importance of incentives: Young and Kedia (for Louisiana), Arpan and Ricks (for the U.S.), and H. C. Tong (for the U.S.). The Young and Kedia study of Louisiana revealed that most of the investments were made via acquisition of existing Louisiana companies, and, as a result, government incentives did not play a major role. For those investments *not* made by acquisition, incentives still played a very minor role compared to investment climate factors. However, their study did show that state incentives were relatively more important in foreign firms' decisions to *expand* in Louisiana once the investment had been made.

Arpan and Ricks' study of foreign investments in the entire U.S. also showed that incentives did not play a major role in the site selection process compared to investment climate factors, and Tong's study of foreign investors' reasons for choosing a particular site consistently showed government incentives to rank in the bottom sixth of factors mentioned (although local tax rates usually ranked near the middle).

Thus, it is difficult to reconcile the apparent differences in importance placed on government incentives by investors and government authories. Government authorities apparently perceive such incentives to be important to potential investors, while the admittedly scant empirical evidence suggests that the incentives are not that important.

Yet, it can still be argued that from an individual state perspective, or even possibly a regional perspective, such competition is necessary. So long as a competitive state offers such incentives, there is considerable pressure for the other states to offer comparable packages. In other words, all things being equal in terms of investment climate and possibly even life style, a special incentive may make a difference. And from an individual state's perspective, it clearly does make a difference whether the firm involved makes the investment in their state rather than in another state.

The real key issue, however, appears to be the significantly higher importance placed by firms on the investment climate, rather than on special incentives. Investment is a long term, profit-oriented decision, and virtually no amount of special incentives (particularly those which are short term in nature) is likely to attract and keep a firm in an area in which the long term profitability criteria are not present. This suggests that state and local authorities should examine more carefully their investment climate before going overboard on incentives. If the state doesn't already possess them, it would be advised in the long run to spend its time, money, and effort on developing these preferred investment climate factors rather than on special incentives. And, in terms of special incentives, the state should determine scientifically which ones are most likely to result in increased investment, rather than simply matching the overall offerings of competing states.

Foreign Investment in the Southeast

As of year end 1979, FDI (Foreign Direct Investment) in the United States totaled $52.3 billion, up 23 percent from 1978 (in which a similar percentage increase had taken place). This increase was more than twice the average annual percentage increase from 1975 to 1977, and nearly three times larger than from 1968 to 1972.

The gross book value of all FDI in the Sixth District at the end of 1977 was over $8.5 billion, an increase of 46 percent from 1974. Louisiana had by far the largest single amount (36 percent of the total), followed by Georgia (16 percent), Tennessee (15 percent), Alabama and Florida (14 percent each) and Mississippi (5 percent).

Because of growth rates in excess of 140 percent for four of the six states in the district, and a 31 percent disinvestment in Louisiana, Louisiana's rank in the district in manufacturing FDI fell from an overwhelmingly dominant first position (41 percent) to a third place tie with Georgia (19 percent each), while Tennessee moved from second place into first (25 percent). In terms of nationalities, the British dominate with nearly 120 companies (31 percent of all), followed by the Canadians and West Germans (17 percent each), the French and the Dutch (9 percent each), and the Japanese (six percent).*

Within the manufacturing sector, FDI in the chemical industry led by a wide margin in terms of both employment and gross book value of property, plant and equipment. These chemical investments were heavily concentrated in Louisiana, Alabama, and Tennessee.

What these numbers suggest is that foreign investment in the Sixth District increased dramatically from 1974 to 1977 and is heavily concentrated in British hands. However, different states received different types of investment. FDI in Louisiana and Mississippi was primarily in the petroleum sector; in Tennessee, Alabama, and Georgia in the manufacturing sector, and in Florida in the real estate sector, followed by the manufacturing sector. Thus there appeared to be an East-West split within the Sixth District, based largely on state comparative advantage. The comparative labor advantages of Tennessee, Alabama, Georgia, and Florida attracted foreign investment in manufacturing, while the oil advantages of Louisiana and Mississippi attracted foreign investment in the petroleum sector.

Direct Employment of FDI in 6th District, by State: 1977

	Total Number of Employees (thousands)	Total Number of Employees in Manufacturing (thousands)
Alabama	14	10
Florida	26	12
Georgia	29	18
Lousiana	18	7
Mississippi	5	3
Tennessee	25	21
6th District Total	117	71

Source: **Survey of Current Business,** July 1980, p. 39, and Office of Foreign Investment in the US, US Department of Commerce.

*Japanese investment in the region has increased since the cut-off date (1979) for data in this article.

Gross Book Value of Property, Plant, and Equipment in 6th District by State: 1974 & 1977

(millions of dollars)

	All FDI			Manufacturing & Industrial FDI		
	1974	1977	% increase 1974-1977	1974	1977	% increase 1974-1977
Alabama	645	1214	88%	328	889	171%
Florida	904	1163	29%	188	502	167%
Georgia	639	1373	114%	358	731	104%
Louisiana	2616	3032	16%	1059	732	(-31%)
Mississippi	330	473	43%	30	72+	140%
Tennessee	736	1283	74%	644	980+	152%
Total	5870	8538	46%	2607	3896+	50%

Source: For 1974 data, US Department of Commerce, **Foreign Direct Investment in the United States** (Washington, DC, GPO, 1976).
For 1977 data, **Survey of Current Business,** July 1980, p. 36.

FDI in 6th District's Manufacturing & Petroleum Sectors, 1977

Number of Employees (thousands)

	Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
All Manufacturing	10	12	18	7	3	21
Food	1	1	2	1	1	(+)
Paper	2	(+)	(+)	(+)	(+)	1
Chemicals	3	5	3	3	1	7
Metals	(+)	1	1	1	1	3
Machinery	1	3	2	(+)	1	8
Other	3	2	9	1	(+)	2
Petroleum	(+)	1	1	4	(+)	1

Gross Book Value of Plant & Equipment ($ millions)

	Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
All Manufacturing	850	362	693	700	72	980
Food	3	9	(D)	33	(D)	4
Paper	(D)	2	(D)	(D)	(D)	(D)
Chemicals	438	(D)	(D)	538	(D)	426
Metals	4	26	50	(D)	13	281
Machinery	(D)	20	19	(D)	7	(D)
Other	198	(D)	178	39	4	12
Petroleum	(D)	71	129	1920	236	980

Source: Office of Foreign Investment in US, US Department of Commerce.

D = data suppressed for disclosure reasons
+ = less than one thousand

Number of Foreign Owned Manufacturing/Petroleum Firms in 6th District, by State and Nationality of Owner: 1979

	Belgium	Canada	France	Japan	Nether-lands	Sweden	Switzer-land	United Kingdom	W. Germany	Other	1979 Total	1974 Total
Alabama		8	5	2	1	4	3	11	6	1	41	7
Florida	1	15	8	5	8	5	5	26	20	4	97	10
Georgia	5	18	17	15	5	1	1	38	12	8	120	36
Louisiana	5	7	6	0	10	1	4	23	9	9	74	25
Mississippi	0	5	0	0	0	0	0	1	3	1	9	4
Tennessee	1	9	1	3	7	2	6	18	14	7	68	17
	62	12	37	25	31	13	18	117	64	30	409	99

Source: Jeffrey Arpan and David Ricks, "Directory of Foreign Owned Manufacturers in the United States (Atlanta, Georgia: Business Publishing Division, College of Business Administration, Georgia State University; 1st edition, 1974, and 2nd edition, 1979.)

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