Foreign Direct Investment In the Southeast: An Historical Perspective

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Toward the close of 1985, newspapers were full of news that America, for the first time since 1914, has become a net debtor nation in world accounts. That is, our net foreign assets are now negative, meaning they are net liabilities. Some predicted that by the end of 1985 the country's net external debt would reach $100 billion; Federal Reserve Bank of New York President Gerald Corrigan predicted that our net debtor position would rise to $500 billion in five years.

Foreign direct investment is a small but important part of our nation's total foreign liabilities. According to the Department of Commerce, foreign direct investment in the United States approached $160 billion at the end of 1984. If we add U.S. business abroad, equaling $233 billion, we still have a positive balance; however, the gap clearly is closing.

The press seldom differentiates among the types of foreign investments. In the academic world, students of international finance and of foreign direct investment employ different terminology, look at different data, and ask different questions. For example, research on international capital flows often studies interest rate differentials, the nature of international debt, the role of banks, the relationship between financial flows and compensating real flows, and international money markets. Bankers are concerned with foreign deposits and loans made with these funds. By contrast, students of foreign direct investment prefer to focus on how, when, where, and why companies invest abroad.

Fundamental to the notion of foreign direct investment is the question of control. When a foreigner puts money in an American bank account, he wants to know that the bank is secure but he is not interested in actively joining the bank's management. Mostly the depositor looks at interest rates and at the duration of a certificate of deposit. Likewise, if through an American, London, or Tokyo broker a foreigner purchases U.S. corporate securities or U.S. Treasury bills, he does not expect to control the corporation or the U.S. government. His crucial considerations are security of capital, the current and expected value of the dollar, and interest rates.

By contrast and by definition, foreign direct investment entails not only capital transfer but an extension of the firm (or company). Thus, the firm plans to gain returns from its investment by controlling the business' activities. For instance, when the Canadian real estate firm Cadillac Fairview makes an investment in Florida, it intends to control the project. This approach is different from the role of a financial intermediary. The fundamental difference between foreign capital transfer in general and foreign direct investment in particular lies in whether the investor intends to exercise control over the activity.

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Foreign direct investment refers to activities of a business across borders. Beyond mere capital flow, such business involves the transfer of know-how, production skills, marketing knowledge, sometimes trademarks, often patents, but always management or at least the potential of managing. This interchange means the costs and benefits of each type of foreign investment are dissimilar. The pace of such investments also may differ: foreign direct investments and foreign portfolio investments need not necessarily be synchronized, since the motives for such investment are not the same.

"In the Southeast as in the nation, both foreign direct investment and foreign portfolio investment have been characterized by periods of large-scale activity followed by retrenchment."

Historically, both types of foreign investment have existed in the American Southeast, and in large amounts. The Louisiana Purchase of 1803 was financed by monies from Britain and Holland—standard portfolio-type investments. In the 1830s, foreigners invested heavily in the Southeast through state government bonds. In the early 1840s, Florida and Mississippi defaulted on their bonds, and the Mississippi debt is still in default. After the Civil War there were again huge foreign investments in state government bonds in our region; and once more, in the early 1870s, major defaults occurred.

The antebellum years saw minor foreign direct investments. In the 1830s, for example, some banks in Louisiana were owned and controlled by foreign capital. Two decades later a German pencil-maker acquired timberland and built a mill in Cedar Key, Florida.

After the Civil War, foreign direct investment in the Southeast began to mount. Some of it, like investment today, was in land speculation and land development, and some was in transportation. For instance, much of Alabama's railroad system was owned and controlled by British capital. Some foreign investment was channeled into the region's earliest industries. Especially in the 1870s and 1880s, the developing iron and steel industry in Tennessee and in the vicinity of Birmingham, Alabama benefited substantially from foreign direct investment. In fact, the first iron furnace in Tennessee was built by a British company in a town named South Pittsburg, near the Alabama border. From its origins, Florida's phosphate industry attracted foreign direct investment. A British firm introduced some of the most technologically advanced dredging machinery at the industry's inception in the state. Before World War I, German and French companies also participated in Florida's phosphate industry.

British foreign direct investment in the southeastern United States extended into other sectors. Lever Brothers' first manufacturing in this country took place in 1884 in a cottonseed oil mill in Vicksburg, Mississippi. The mill was designed to supply Lever's soap factory in the United Kingdom with a substitute for cottonseed oil from Egyptian sources. The British also invested in cotton and rice growing in Mississippi and Louisiana. Before World War I, British insurance companies maintained an important presence in the region. An 1890 Macon, Georgia business directory listed 17 British insurance companies in that city alone. In the years between 1880 and 1914 a number of British companies, principally Scottish, were active in granting mortgages in the Southeast. I could enumerate many more foreign direct investments in the Southeast in the years before 1914, when the U.S. was a debtor nation in world accounts.

The important point in reviewing foreign investment is that both foreign portfolio and direct investment have been characterized by periods of aggressive entry activities and then periods of retreat. Foreign portfolio investments—foreign bank deposits, loans, and investments in American securities—are highly liquid, interest rate-sensitive investments. Traditionally, students of foreign direct investment have argued that direct investments are less liquid. A change in interest rates makes little difference once an investment has been made in property, plant, and equipment and a commitment extended to develop business in an area. The market for the goods or services, rather than the cost of money, is what influences the direct investor's decisions.

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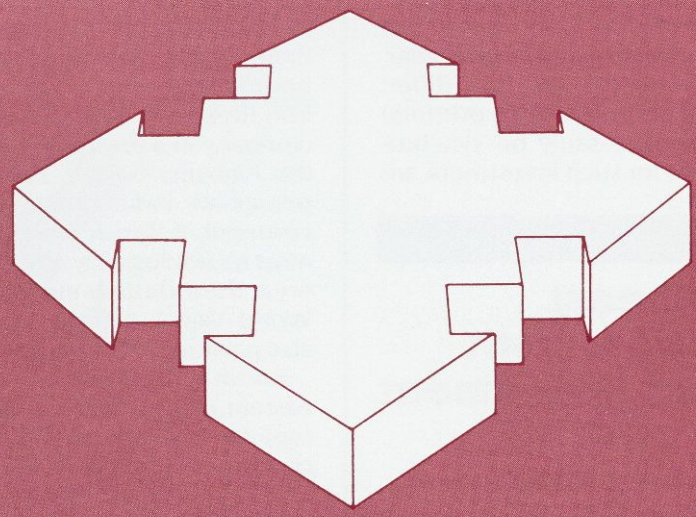

With interstate banking an accepted fact in many states, indeed in several regions, the financial community needs to consider a new realm of practical and theoretical concerns. In November 1984, a Federal Reserve Bank of Atlanta conference explored the interests and strategies needed to compete with financial services firms expanding over state lines. Blue-ribbon panelists tackled the issues of large versus small bank strategies, marketing innovations, legal questions, and consumers' worries. The recently published essays will inform and challenge anyone interested in the future of banking. To order your copy, please fill out the coupon below.

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Even though they lack such liquidity, foreign direct investors clearly do exit as well as enter, but perhaps not at the same time and pace as foreign portfolio investors. The timing of the ebbs and flows of foreign direct investment and the changes in the level as compared with foreign portfolio investments need to be studied.

Most countries or regions greet foreign investment with mixed feelings. We like the idea of more investment, more jobs, more economic activity, a larger tax base, and so forth. On the other hand, when Mississippi defaulted on its $5 million bond issue of 1838, a debt largely held abroad, the governor declared righteously that the state would not allow the Rothschilds and other British bankers to make serfs of its children.

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During the mid and late 1970s, the United States was considerably agitated about foreign ownership of agricultural land. Roughly 100 years ago, Representative William C. Oates of Alabama unsuccessfully sponsored legislation that would have forbidden non-resident foreigners from owning land anywhere in the United States. Land always has been a far more sensitive matter than foreign investment in mining or manufacturing, or in selling insurance. (However, Americans have wanted to be sure that foreign sellers of insurance held adequate U.S. reserves to pay American claims.)

In the Southeast as in the nation, both foreign direct investment and foreign portfolio investment have been characterized by periods of large-scale investment followed by retrenchment. During the late 1970s, both types of foreign investment accumulated rapidly. Recently, however, except for the spectacular influx of foreign direct investment in Tennessee, there has been a relative slowdown in the entry by foreign direct investors.

In Florida, new foreign investment in land and real estate is substantially lower than in the peak years. Since the owner controls his property, we consider this to be foreign direct investment. Charles Kimball, Miami's resident expert on foreign investment in land and real estate, has commented that whereas everyone was thinking of foreigners in 1981, foreign investment seems much less important today. It has receded to 1975 levels of less than 10 percent of the dollar sales of land and commercial income properties selling for $300,000 or more. In south Florida, foreign investors accounted for just 8.1 percent of such sales in the most recent quarter, compared with 41.4 percent of the dollar volume during the 1979 banner year. As recently as 1981, foreigners accounted for 33.6 percent of the dollar volume. The surge in oil prices that occurred in 1979 brought in its wake large amounts of Arab and Venezuelan monies, which typically went through banks, as well as into land and real estate. Since 1981, oil prices have tumbled and, as a consequence, the flow of those monies slowed. Additionally, the economic malaise of many Latin American countries has retarded the influx of foreign investment into Florida land and real estate.

While as a nation we are steadily becoming the largest debtor in the world, at the same time we are seeing a sharp decline in foreign investment in south Florida land and real estate. Foreign direct investment in other activities, which comes primarily from Canada, England, Japan, and Germany, typically has not experienced this kind of roller coaster downturn. Indeed, recent studies suggest that most southeastern states continue luring foreign direct investment successfully.

In 1975, when I began researching foreign direct investment in Florida, the state had 11 foreign-owned manufacturing plants. A decade later more than 210 such plants are in operation. In short, the Southeast is attracting substantial foreign direct investment, and its pace and nature apparently differ from those of the investments that bankers previously considered.