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U.S. Direct Investment Abroad: Trends and Current Issues

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Summary

The United States is the largest investor abroad and the largest recipient of direct investment in the world. For some Americans, the national gains attributed to investing overseas are offset by such perceived losses as displaced U.S. workers and lower wages. Some observers believe U.S. firms invest abroad to avoid U.S. labor unions or high U.S. wages, however, 70% of U.S. foreign direct investment is concentrated in high income developed countries. Even more striking is the fact that the share of investment going to developing countries has fallen in recent years. Most economic analysts conclude that direct investment abroad overall does not lead to fewer jobs or lower incomes overall for Americans and that the majority of jobs lost among U.S. manufacturing firms over the past decade reflect a broad restructuring of U.S. manufacturing industries. This report will be updated as events warrant.

Recent Investments

New spending by U.S. firms on businesses and real estate abroad, or U.S. direct investment abroad¹, reached \$248 billion in 2004, a 40% increase from the amount invested in 2003 and more than twice the amount foreign firms invested in the United States, according to the Department of Commerce.² This level of investment spending sets a new record in nominal terms (not accounting for inflation) that U.S. firms invested abroad during a year. The spending on foreign investment stems from a number of factors, including equity capital outflows associated with a number of large U.S. acquisitions of foreign firms. Reinvested earnings also increased as economic activity

¹ The United States defines direct investment abroad as the ownership or control, directly or indirectly, by one person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. 15 CFR § 806.15 (a)(1).

² Bach, Christopher L., U.S. International Transactions, 2004. *Survey of Current Business*, April 2005, p. 46.

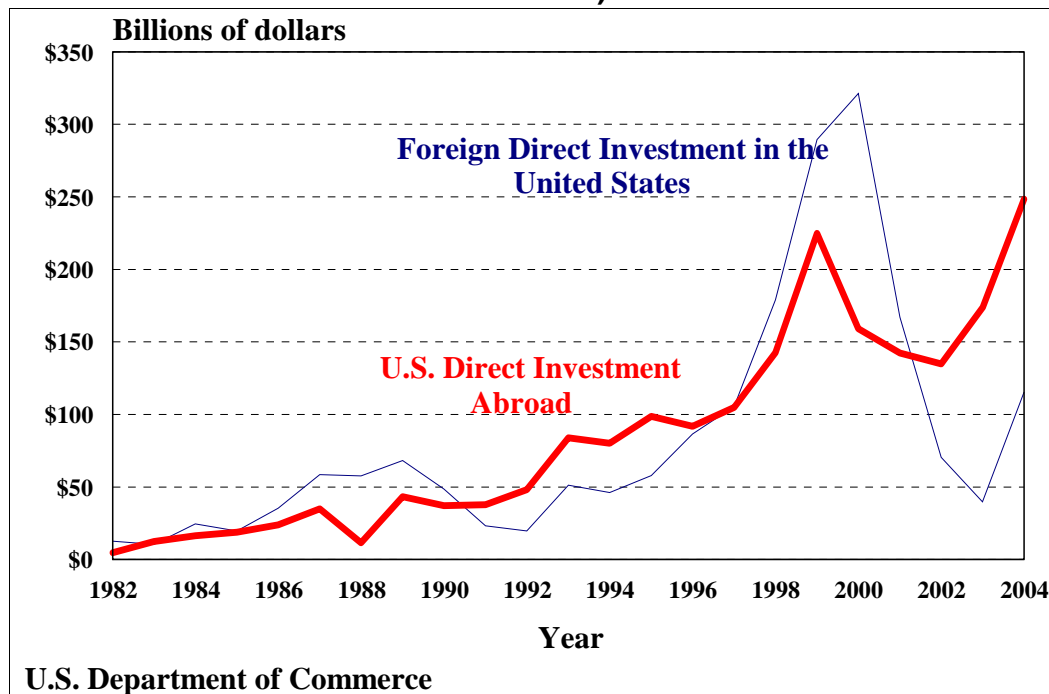
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picked up in some European countries and in the petroleum industry. Foreign direct investment in the United States also increased in 2004, chalking up \$113 billion in new investment, nearly triple the \$40 billion invested in 2003.

Relative rates of growth between U.S. and foreign economies largely determine the direction and magnitude of direct investment flows. These flows also are affected by relative rates of inflation, interest rates, and expectations about the performance of national economies, which means they can be quite erratic at times. Since the mid-1990s, the combination of strong growth and low inflation in the U.S. economy attracted foreign investors, as indicated in **Figure 1**. Since 2002, U.S. direct investment abroad has been more than twice the amount foreigners have invested in the U.S. economy, reflecting the period of slower growth in the economy from 2001-2003. U.S. firms continue to be the most prolific overseas investors: a recent study by the United Nations indicates that U.S. firms are the largest foreign direct investors in the world and own as much abroad as the British and Germans combined, the next largest foreign direct investors.

Table 1 indicates that the overseas direct investment position of U.S. firms on a

Figure 1. U.S. Direct Investment Abroad and Foreign Direct Investment in the U.S. Economy, annual Flows 1982-2004 (in billions of dollars)



historical-cost basis,³ or the cumulative amount at book value, reached \$1.8 trillion in

³ The position, or stock, is the net book value of U.S. parent company's equity in, and outstanding loans to, their affiliates abroad. A change in the position in a given year consists of three components: equity and intercompany inflows, reinvested earnings of incorporated affiliates, and valuation adjustments to account for changes in the value of financial assets. The Commerce (continued...)

2003, the latest year for such investment position data.⁴ More than 70% of these overseas investments are in developed countries: Europe alone accounts for over half of all U.S. direct investment abroad, or \$963 billion. Europe has been a prime target of U.S. investment since U.S. firms first invested abroad in the 1860s. American firms began investing heavily in Europe following World War II as European countries rebuilt their economies and later when they formed an intra-European economic union.

Table 1. U.S. Direct Investment Position Abroad on a Historical-Cost Basis at Year-end 2003
(in millions of U.S. dollars)

	All indus- tries	Manu- facturing	Whole- sale trade	Infor- mation	Bank- ing	Finance	Services	Other indus- tries
All countries	1,788,911	378,033	140,579	47,525	63,655	299,805	40,599	693,138
Canada	192,409	74,878	12,653	2,194	2,661	34,181	2,035	38,528
Europe	963,087	177,951	89,467	30,328	38,142	116,384	21,051	460,508
Belgium	25,804	8,230	2,708	201	638	7,437	1,434	5,151
France	47,914	19,942	4,016	-146	2,908	3,798	1,277	15,988
Germany	80,163	18,985	20,878	3,347	1,412	11,644	2,027	21,783
Ireland	55,463	15,002	2,998	14,048	445	8,681	1,655	(D)
Italy	30,417	18,159	2,593	1,884	239	1,831	734	4,963
Luxembourg	66,919	2,796	(D)	(D)	575	79	(D)	60,093
Netherlands	178,933	21,060	21,016	3,470	29	9,277	1,408	118,857
Spain	38,215	8,707	2,849	874	1,665	3,249	274	20,511
Sweden	28,905	1,024	1,079	166	(D)	384	183	(D)
Switzerland	86,435	8,721	11,882	-2,711	7,103	3,264	534	57,631
United Kingdom	272,640	40,548	9,901	7,675	18,596	62,359	9,794	108,158
Latin America	304,023	46,775	12,120	5,963	9,086	81,722	1,555	121,983
Brazil	29,915	10,326	1,460	415	1,948	4,406	615	7,086
Venezuela	10,859	2,698	253	(D)	(D)	337	-88	1,176
Mexico	61,526	20,089	2,030	1,230	16,867	7,193	442	12,581
Bermuda	84,609	648	2,417	362	0	45,222	20	35,708
Africa	18,960	1,266	598	1,196	618	605	121	2,458
Middle East	16,942	4,537	8	1,535	846	1,015	1,092	3,102
Asia	293,490	72,625	25,734	6,310	12,303	65,899	14,744	66,559
Australia	40,985	10,841	2,664	334	2,284	5,028	1,730	7,404
China	11,877	6,791	1,332	115	413	-49	93	1,375
Hong Kong	44,323	4,045	8,201	849	1,983	14,951	1,122	10,001
Indonesia	10,387	470	(D)	-189	406	(D)	90	541
Japan	73,435	14,422	6,544	3,179	609	34,215	9,101	5,349
Korea	13,318	6,842	827	98	2,021	1,583	559	1,386
Singapore	57,589	13,394	(D)	1,462	843	2,912	(D)	(D)

Source: U.S. Direct Investment Abroad: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003. *Survey of Current Business*, September 2004. p. 90.

Note: A (D) indicates that the data have been suppressed by the Department of Commerce to avoid disclosing the data of individual companies.

³ (...continued)

Department also publishes data on the U.S. direct investment position valued on a current-cost and market value bases. These estimates indicate that U.S. direct investment abroad increased by \$229 billion and \$690 billion in 2003, respectively, to \$2.1 and \$2.7 trillion.

⁴ Borga, Maria, and Daniel R. Yorgason, Direct Investment Positions for 2003: Country and Industry Detail, *Survey of Current Business*, July, 2004. P. 40.

Typically, U.S. firms have placed the largest share of their annual investments in developed countries, primarily in Western Europe, but this tendency has increased since the mid-1990s. In the last half of the 1990s, U.S. direct investment abroad experienced a dramatic shift from developing countries to the richest developed economies: the share of U.S. direct investment going to developing countries fell from 37% in 1996 to 21% in 2000. In 2003, U.S. firms focused a slightly greater percent of their investment funds on developing countries, which received 25% of the investment funds of U.S. multinational firms.

Patterns in U.S. direct investment abroad generally reflect fundamental changes that occur in the U.S. economy during the same period. As investment funds in the U.S. economy shifted from extractive, processing, and manufacturing industries toward high technology services and financial industries, U.S. investment abroad mirrored these changes. As a result, U.S. direct investment abroad focused less on the extractive, processing, and basic manufacturing industries in developing countries and more on high technology, finance, and services industries located in highly-developed countries with advanced infrastructure and communications systems. U.S. direct investment abroad during the 2000-2003 period increased about 36%. Investments in the finance and services sectors grew twice as fast, on the whole, as direct investment abroad overall during the 1996-2000 period. Within the manufacturing sector, food processing, chemicals, and metals lagged in growth behind the industrial machinery, electronic, and transportation sectors.

U.S. Multinationals

Nations once hostile to American direct investment now compete aggressively by offering incentives to U.S. firms. A debate continues within the United States, however, over the relative merits of U.S. direct investment abroad. Some Americans believe that U.S. direct investment abroad, directly or indirectly, shifts some jobs to low wage countries. They argue that such shifts reduce employment in the United States and increase imports, thereby affecting negatively both U.S. employment and economic growth. Economists generally believe that firms invest abroad because those firms possess some special process or product knowledge or because they possess special managerial abilities which give them an advantage over other firms. On the whole, U.S. firms invest abroad to serve the foreign local market, rather than to produce goods to export to the United States, although some firms do establish overseas operations to replace U.S. exports or production, or to gain access to raw materials, cheap labor, or other markets. On average, about 9% of affiliate sales are to the U.S. parent companies.⁵

U.S. multinational corporations (MNCs) rank among the largest U.S. firms. According to data collected by the Commerce Department's Bureau of Economic Analysis (BEA), when American parent companies and their foreign affiliates are compared by the size structure of employment classes, 40% of the more than 2,000 U.S. parent companies employ more than 2,499 persons. These large parent firms account for 95% of the total number of people employed by U.S. MNCs. Employment abroad is even

⁵ *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2002 Estimates*, October 2004. Table III. F. 1.

more concentrated among the largest foreign affiliates of U.S. parent firms: the largest 2% of the affiliates account for 90% of affiliate employment.⁶

While U.S. MNCs used their economic strengths to expand abroad during the 1980s and 1990s, the U.S.-based parent firms lost market positions at home, in large part due to corporate downsizing efforts to improve profits. U.S. MNC parent companies' share of all U.S. business gross domestic product (GDP) — the broadest measure of economic activity — declined from 32% to 25% from 1977 to 1989, comprising 24% of total U.S. private business output in 1998 (the latest year for which estimates are available).⁷ These MNC parent companies increased their share of all U.S. business GDP in the services sector, which rose from 6% to 8% of U.S. GDP during the period from 1989 to 1998. The MNC share of all other industries rose from 16% to 18% during the 10-year period, but they lost shares in the manufacturing sector (from 62% to 58%) at a time when the U.S. manufacturing sector as a whole was shrinking as a share of national GDP (from 20% to 16%).⁸

As U.S. MNC parent companies were losing their relative market positions at home, their cumulative amount of direct investment abroad doubled. This increase did spur a shift in some economic activity among the U.S. MNCs from the U.S. parent companies to the foreign affiliates. During the period from 1977 to 1997, the foreign affiliates increased their share of the total economic activity within U.S. MNCs — the combined economic output of the U.S. parent and the foreign affiliates — from 22% to 24%.⁹

Employment

One of the most commonly expressed concerns about U.S. direct investment abroad is that U.S. parent companies invest abroad in order to send low-wage jobs overseas. Such effects are difficult to measure because they are small compared with much larger changes occurring within the U.S. economy. In addition, a cursory examination of the data seems to indicate that employment losses among parent firms occurred simultaneously with gains in foreign subsidiaries, thereby giving the impression that jobs are being shifted abroad. Employment among U.S. parent companies did fall during the early 1980s, although it increased in the 1992-2002 period, from 17.5 million to 22.4 million.

After employment losses in the early 1980s, employment at both the parent firms and the foreign affiliates increased after 1992, although at different rates and in different industries. In a number of cases, U.S. parent firms and their foreign affiliates lost or gained employment in many of the same industries. Both the parent firms and the affiliates lost employment in the petroleum and finance sectors, although both gained employment in the services and wholesale trade sectors. Furthermore, employment gains

⁶ Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 1998. *Survey of Current Business*, July 2000. pp. 26-45.

⁷ Mataloni, Operations of U.S. Multinational Companies. p. 31.

⁸ Ibid., p. 31.

⁹ Ibid., p. 31.

and losses among MNCs more likely reflect fundamental shifts within the U.S. economy, than any formal or informal efforts to shift employment abroad.

Some observers also contend that U.S. direct investment abroad supplants U.S. exports, thereby worsening the U.S. trade deficit and eliminating some U.S. jobs. Most analyses indicate, however, that intra-company trade, or trade between the U.S. parent company and its foreign subsidiaries, represents a large share of U.S. trade and that foreign investment typically boosts U.S. exports more than it contributes to a rise in imports or to a loss of exports. For instance, American multinational corporations account for over 60% of U.S. exports and 40% of U.S. imports, indicating that U.S. parent firms tend to be a more important source of supply to their affiliates than the affiliates are to their parent companies.

Conclusions

American direct investment abroad has grown sharply since the mid-1990s, raising questions for many observers about the effects of such investment on the U.S. economy. These questions seem pertinent since American multinational corporations lost shares of U.S. GDP over the last decade and their domestic employment had declined until the mid-1990s. Increased economic activity abroad relative to that in the United States increased overseas affiliate employment in some industries, including manufacturing. Most of this affiliate activity, however, is geared toward supplying the local markets in which they are located. In 2001, about 9% of the sales of the foreign affiliates of U.S. firms was accounted for by exports back to the United States,¹⁰ although this share is nonetheless substantial.

Some observers believe U.S. direct investment abroad is harmful to U.S. workers because it shifts jobs abroad. There is no conclusive evidence in the data collected to date to indicate that current investment trends are substantially different from those of previous periods or that jobs are moving offshore at a rate that is significantly different from previous periods.¹¹ There are instances when firms shift activities abroad to take advantage of lower labor costs. However, it is clear from the data that the majority of U.S. direct investment abroad is in developed countries where wages, markets, industries, and consumers' tastes are similar to those in the United States. U.S. direct investment in these developed countries is oriented toward serving the markets where the affiliates are located and they tend, in the aggregate, to boost exports from the United States. In addition, foreign firms have been pouring record amounts of money into the United States to acquire existing U.S. firms, to expand existing subsidiaries, or to establish "greenfield" or new investments.

¹⁰ Mataloni, Operations of U.S. Multinational Companies. p. 41.

¹¹ CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by James K. Jackson.