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Foreign Direct Investment in the United States: An Economic Analysis

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Summary

Foreign direct investment in the United States[1] declined sharply after 2000, when a record $300 billion was invested in U.S. businesses and real estate. In 2007, according to Department of Commerce data, foreigners invested $237 billion. Foreign direct investments are highly sought after by many State and local governments that are struggling to create additional jobs in their localities. While some in Congress encourage such investment to offset the perceived negative economic effects of U.S. firms investing abroad, others are concerned about foreign acquisitions of U.S. firms that are considered essential to U.S. national and economic security. This report will be updated as events warrant.

Recent Investments

Foreigners invested $237 billion in U.S. businesses and real estate in 2007, according to data published by the Department of Commerce.[2] As **Figure 1** shows, this represents a slight decrease from the $241 billion invested in 2006. Investments by U.S. firms abroad increased by 38% in 2007 to $333 billion, up sharply from the $36 billion they invested abroad in 2005. The increase in foreign direct investment flows, mirrors a turn-around in global flows. According to the United Nations' *World Investment Report*, global foreign direct investment inflows increased by 27% in 2005 and 38% in 2006 after a slight increase in 2004 and three years of declining flows prior to 2004 that arose from

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

[2] Sauers, Renee M. and Kristy L. Howell, U.S. International Transactions: First Quarter of 2008. *Survey of Current Business*, July 2008, p. 67. Direct investment data reported in the balance of payments differ from capital flow data reported elsewhere, because the balance of payments data have not been adjusted for current cost adjustments to earnings.

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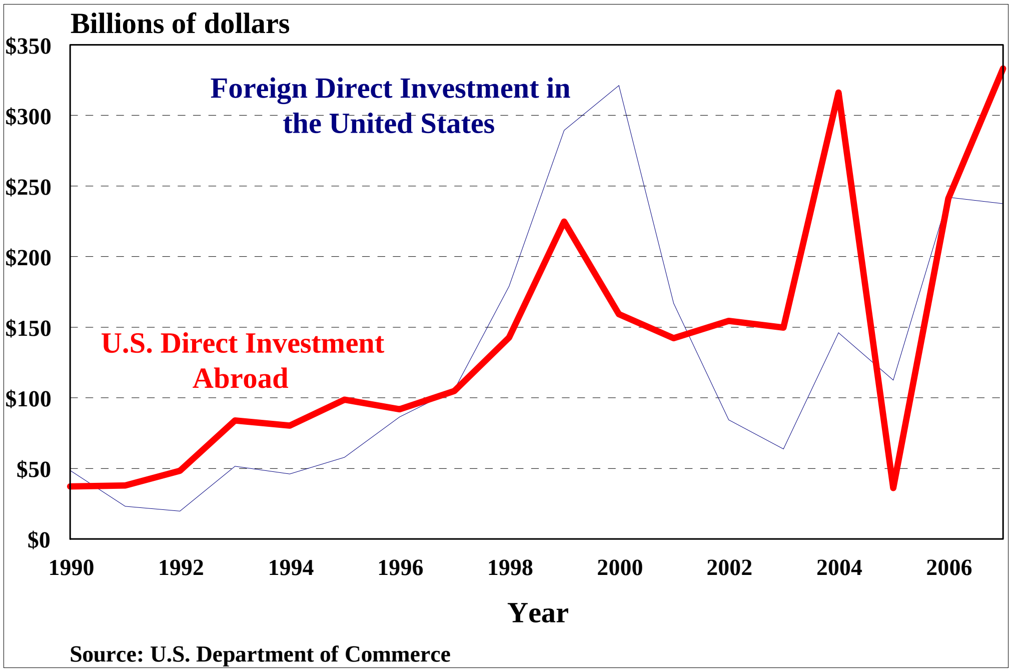
competitive international price pressures leading to greater internationalization of production, rising commodity prices, and increased international merger and acquisition activity in some areas.

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2007 (in billions of dollars)



The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[3] rose from $1.8 trillion in 2006 to about $2.1 trillion in 2007. This marked an increase of 14%, slightly more than the increase in such investment in 2006.[4] The rise in the value of foreign direct includes an upward valuation adjustment of existing investments and increased investment spending that was driven by a relatively strong growth rate of the U.S. economy, the world-wide resurgence in cross-border merger and acquisition activity, and investment in the U.S. manufacturing, chemicals, utilities, mining, health care, transportation, and the finance and insurance sectors.[5]

[3] The position, or stock, is the net book value of foreign direct investors' equity in, and outstanding loans to, their affiliates in the United States. 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 Department also publishes data on the foreign direct investment position valued on a current-cost and market value bases. These estimates indicate that foreign direct investment increased by $271 billion and $230 billion in 2007, respectively, to reach $2.4 and $3.5 trillion.

[4] Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2007: Country and Industry Detail, *Survey of Current Business*, July, 2008. p. 35.

[5] Ku-Graf, Y. Louise, Foreign Direct Investment in the United States: New Investment in 2007, *Survey of Current Business*, June 2008, pp. 33-34.

As a share of the total amount of nonresidential investment spending in the U.S. economy, investment spending by foreign firms was equivalent to 12% in 2007, far below the 27% reached in 2001. Foreign firms' spending was sustained by a large increase in intercompany debt flows as U.S. affiliates turned to net borrowing from their foreign parent companies. Direct investment was also financed through reinvested earnings and an increase in equity capital, although the increase in the amount of equity capital was the lowest amount since the 1995. The lower amount of equity capital represents the relatively slower rate of economic growth in Europe that reduced the amount of funds European parent firms had available to invest and the higher rate of economic growth among the U.S. affiliates which improved their profit position.[6]

With over $410 billion invested in the United States, Great Britain is the largest foreign direct investor, as is indicated in **Table 1**. Japan has moved into the position as second largest foreign direct investor in the U.S. economy with about $233 billion in investments. Following the Japanese are the Canadians ($213), the Dutch ($209 billion), Germans ($202 billion), and the French ($169 billion).

In some cases, investments by one or two countries dominate certain industrial sectors, suggesting that there is a rough form of international specialization present in the investment patterns of foreign multinational firms. At year end 2006, the Netherlands and the United Kingdom accounted for the bulk of foreign investments in the U.S. petroleum sector, reflecting investments by two giant companies: Royal Dutch Shell and British Petroleum. Japanese investments in the U.S. wholesale trade sector are also substantial, followed by British investments, and European investors account for the bulk of foreign investments in the retail trade sector. German investors are the largest investors in the information sector as a result of a number of large media company acquisitions. French, German, and British investments dominate other foreign investments in the banking sector, while Dutch, Canadian, British, and French investments account for over half of the investments in the finance sector. Canada's $93 billion investment in the U.S. banking and finance sectors far surpasses the $55 billion invested by British firms, followed by Germany ($50 billion) and France ($47 billion). Foreign direct investment in the manufacturing sector is represented by a number of countries, each with substantial investments: investments by Switzerland ($99 billion), the Netherlands ($95 billion). the United Kingdom ($93 billion), France ($80 billion), and Germany ($62 billion) account for two-thirds of the total amount of foreign direct investment in this sector.

Investment spending by developed economies accounts for 95% of all foreign direct investment in the United States. These investments are predominately in the manufacturing sector, which accounts for about 34% of foreign direct investment in the United States, a decline from periods when such investment accounted for a majority share of the total. Another 19% is in the banking and finance sectors, and 15% is in the retail and wholesale trade sectors, reflecting purchases of department stores and other investments to assist foreign firms in marketing and distributing their products. The fast-growing information sector accounts for 7.0%, while services and real estate account for

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[6] At the same time, U.S. direct investment abroad plummeted in 2005 as U.S. parent firms reduced the amount of reinvested earnings in their foreign affiliates for distribution to the U.S. parent firms to take advantage of one-time tax provisions. U.S. direct investment abroad in 2005 totaled $21 billion (in nominal terms).

modest shares of 3.0% and 2.6%, respectively. All other industries account for the remaining 19%.

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-End 2007
(in millions of U.S. dollars)

	All industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Other industries
All countries	**2,093,049**	**709,545**	**278,353**	**41,591**	**146,428**	**141,033**	**263,993**	**55,277**	**62,956**	**393,873**
Canada	**213,224**	**43,118**	**10,177**	**7,797**	**7,081**	**22,022**	**71,218**	**2,744**	**1,690**	**47,378**
Europe	**1,482,978**	**557,115**	**139,133**	**26,505**	**133,039**	**100,392**	**160,130**	**25,797**	**53,500**	**287,368**
Austria	2,512	1,711	(D)	(D)	–6	(D)	(D)	74	(D)	19
Belgium	19,520	9,369	1,881	(D)	2	(D)	1,248	230	–42	3,231
France	168,576	79,636	8,999	932	11,802	17,709	29,144	434	6,663	13,257
Germany	202,648	61,901	10,772	3,995	48,585	16,406	34,148	8,110	197	18,533
Ireland	33,557	15,742	174	(D)	(D)	(D)	2,691	(D)	–36	7,058
Italy	15,482	2,766	1,511	2,371	25	649	(D)	52	(D)	(D)
Luxembourg	134,310	61,886	1,296	(D)	7,048	0	6,884	282	(D)	49,297
Netherlands	209,449	94,998	21,444	(D)	16,815	(D)	36,766	3,484	6,742	20,213
Sweden	31,857	12,878	7,442	(D)	847	–254	264	(D)	54	(D)
Switzerland	155,696	98,672	7,865	(D)	12,064	(D)	29,388	(D)	474	8,130
United Kingdom	410,787	92,682	72,240	2,641	22,264	49,118	16,023	5,267	28,616	121,936
Latin America	**62,955**	**9,694**	**8,687**	**1,480**	**2,536**	**4,243**	**7,479**	**9,720**	**307**	**18,811**
Africa	**1,124**	**–450**	**592**	**(D)**	**(D)**	**(D)**	**(D)**	**264**	**–2**	**484**
Middle East	**12,937**	**2,028**	**5,908**	**(D)**	**(D)**	**1,305**	**(D)**	**640**	**109**	**2,090**
Asia and Pacific	**319,832**	**98,040**	**113,857**	**5,735**	**(D)**	**(D)**	**24,916**	**16,113**	**7,353**	**37,742**
Australia	49,100	4,656	2,349	(D)	1,023	1,762	4,605	9,190	(D)	25,047
Japan	233,148	79,951	97,827	5,699	1,821	8,273	17,753	6,073	4,685	11,066
OPEC	13,589	47	10,351	(*)	–3	1,383	–9	(D)	–9	(D)

Source: Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2007: Country and Industry Detail. *Survey of Current Business*, July, 2008. p. 35.
Note: The position is the stock, or cumulative, book value of foreign direct investors' equity in, and net outstanding loans to, their U.S. affiliates. A negative position may result as U.S. affiliates repay debts to their foreign parents, and as foreign parents borrow funds from their U.S. affiliates. D indicates that data have been suppressed by the Department of Commerce to avoid the disclosure of data of individual companies. An asterik (*) indicates that the value of the cell is less than $500,000.

Acquisitions and Establishments

Another way of looking at foreign direct investment is by distinguishing between transactions in which foreigners acquire existing U.S. firms and those in which foreigners establish new firms — termed "greenfield" investments. New investments are often preferred at the local level because they are thought to add to local employment, whereas a foreign acquisition itself may add little, if any, new employment. In 2007, outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, were $277 billion, a 67%increase over the $166 billion invested in 2006. According to the Department of Commerce, the increase in new investments reflected faster economic growth in the United States and an increase in merger and acquisition activity.[7] Acquisitions of existing U.S. firms accounted for 92% of the new investments by value. Investments by the existing U.S. affiliates of foreign firms accounted for 63% of the total transactions by investor, while other foreign direct investors accounted for the remaining 37% of transactions. Investment outlays by foreign firms increased from 2006 to 2007 in all major sectors, except wholesale trade, information, and finance. Investment in retail trade, manufacturing, and services all posted substantial increases.

Economic Performance

By year-end 2005, the latest year for which detailed data are available, foreign firms employed 5.5 million Americans, less than 4% of the U.S. civilian labor force, and owned over 30 thousand individual business establishments.[8] Foreign firms have a direct investment presence in every state. Employment of these firms ranges from over 543 thousand in California, to about 7 thousand in North Dakota. Following California, New York (378 thousand), Texas (345 thousand), Pennsylvania (232), Illinois (226 thousand), and Florida (226 thousand), and have the largest numbers of residents employed by foreign firms. In 2005, 40% of the foreign firms' employment was in the manufacturing sector, more than twice the share of manufacturing employment in the U.S. economy as a whole, with average annual compensation (wages and benefits) per worker of about $63,000.

Retail and wholesale trade accounted for another 22% of total affiliate employment. Dutch-affiliated firms are the largest single employers in the retail trade sector and account for nearly one-third of total affiliate employment in this sector, while Japanese and British firms account for over half of the employment in the wholesale trade sector. Employment in the information, finance, real estate and technical services sectors accounts for another 13% of total affiliate employment. Average employee compensation is highest in the finance sector — $229,000 — where Swiss, Canadian, Japanese, and British account for three-fourths of the employment. The rest of the affiliate employment is spread among a large number of other industries.

The affiliates of foreign firms spent $140 billion in the United States in 2005 on new plant and equipment, imported $468 billion in goods and services and exported $181 billion in goods and services. Since 1980, the total amount of foreign direct investment in the economy has increased eight-fold and nearly doubled as a share of U.S. gross domestic product (GDP) from 3.4% to 6.4%. It is important to note, however, that these data do not imply anything in particular about the role foreign direct investment has played in the rate of growth of U.S. GDP.

Foreign-owned establishments, on average, are far outperforming their U.S.-owned counterparts. Although foreign-owned firms account for less than 4% of all U.S. manufacturing establishments, they have 14% more value added on average and 15%

[7] Ku-Graf, Louise, Foreign Direct Investment in the United States: New Investment in 2007. *Survey of Current Business*, June 2008. p. 33.

[8] *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2005 Estimates*. Bureau of Economic Analysis, 2007, Table 2A-1.

higher value of shipments than other manufacturers. The average plant size for foreign-owned firms is much larger — five times — than for U.S. firms, on average, in similar industries. This difference in plant size apparently rises from an absence of small plants among those that are foreign-owned. As a result of the larger plant scale and newer plant age, foreign-owned firms paid wages on average that were 14% higher than all U.S. manufacturing firms, had 40% higher productivity per worker, and 50% greater output per worker than the average of comparable U.S.-owned manufacturing plants. Foreign-owned firms also display higher capital intensity in a larger number of industries than all U.S. establishments.

These differences between foreign-owned firms and all U.S. firms should be viewed with some caution. First, the two groups of firms are not strictly comparable: the group of foreign-owned firms comprises a subset of all foreign firms, which includes primarily very large firms; the group of U.S. firms includes all firms, spanning a broader range of sizes. Secondly, the differences reflect a range of additional factors, including the prospect that foreign firms which invest in the United States likely are large firms with proven technologies or techniques they have successfully transferred to the United States. Small foreign ventures, experimenting with unproven technologies, are unlikely to want the added risk of investing overseas. Foreign investors also tend to opt for larger scale and higher capital-intensity plants than the average U.S. firm to offset the risks inherent in investing abroad and to generate higher profits to make it economical to manage an operation far removed from the parent firm.

Conclusions

Foreign direct investment in the United States in 2005 rose slightly, but still equaled far less than the record amount recorded in 2000. Other countries have experienced a similar turn-around in foreign direct investment inflows, especially to some of the less developed economies where there is a great potential for investment. As the rate of growth of the U.S. economy rises, interest rates stay low, and the rate of price inflation stays in check, foreign direct investment in the United States likely will continue the rebound. Of particular importance will be public concerns over foreign direct investment in the economy as a whole and on the overall phenomenon referred to as "globalization," with its impact on jobs in the economy. Concerns over foreign direct investment, where they exist, stem not so much from the perceived potential losses of international competitiveness that characterized similar concerns in the 1980s, but from potential job losses that could result from mergers and acquisitions, although such losses could occur whether the acquiring company is foreign- or U.S.-owned. Such concerns are offset, at least in part, by the benefits that are perceived to be derived from the inflow of capital and the potential for new jobs being created in local areas.

Although job security is an important public issue, opposition to some types of foreign direct investment stem from concerns about the impact of such investment on U.S. economic and security interests, particularly in light of the terrorist attacks of September 11, 2001. The U.S. economy, however, remains a prime destination for foreign direct investment. As the pace of economic growth in the Nation increases relative to that of foreign economies, foreign direct investment likely will increase as new investments are attracted to the United States and existing firms are encouraged to reinvest profits in their U.S. operations.