Foreign Direct Investment in the United States: An Economic Analysis

James K. Jackson
Specialist in International Trade and Finance

July 28, 2010

Congressional Research Service
7-5700
www.crs.gov
RS21857

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Foreign direct investment in the United States declined sharply after 2000, when a record $300 billion was invested in U.S. businesses and real estate. [Note: 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).] In 2008, according to Department of Commerce data, foreigners invested $325 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.

Contents

Figures

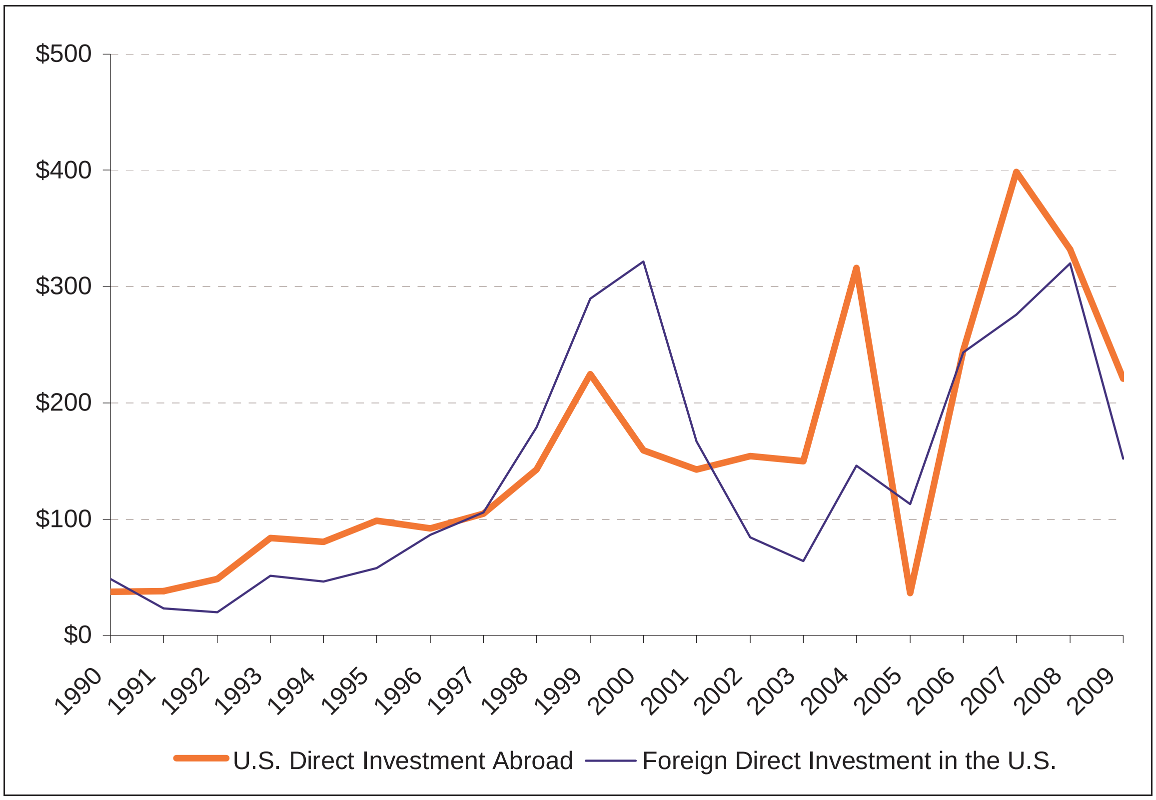
Tables

Contacts

Recent Investments

Foreigners invested $325 billion in U.S. businesses and real estate in 2008, according to data published by the Department of Commerce.[1] As **Figure 1** shows, this represents a sharp increase over the $237 billion invested in 2007. Investments abroad by U.S. parent firms fell slightly in 2008 to $318 billion, down from the $333 billion they invested abroad in 2007. The increase in foreign direct investment flows mirrors a turnaround in global flows. According to the United Nations' *World Investment Report*, global foreign direct investment inflows increased by 30% in 2007 and 38% in 2006. The data indicate that global foreign direct investment flows increased slightly in 2004 after three years of declining flows that arose from 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, 1990-2009 (in billions of dollars)



Source: U.S. Department of Commerce

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[2] rose from $2.2 trillion in 2008 to about $2.3 trillion in 2009. This marked an increase

[1] Thomas, Sarah Scott, Erin M. Whitaker, and Daniel R. Yorgason, U.S. International Transactions: First Quarter 2010. *Survey of Current Business*, July 2010, p. 54. 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.

[2] The position, or stock, is the net book value of foreign direct investors' equity in, and outstanding loans to, their (continued...)

of 7.0%, below the 14.6% percent increase experienced in 2007.[3] The rise in the value of foreign direct investment includes a large increase in equity capital that was partially offset by a large downward valuation adjustment. The downward adjustment reflects the decline in the value of equities as a result of the decline in stock values. Tightened credit conditions and the slowdown in the rate of growth in the U.S. economy, however, tended to push down such mainstays of foreign direct investment activity as mergers and acquisitions. Foreign direct investments in the U.S. manufacturing sector generally were higher, while investments in banks, finance, and real estate were down. Data for the first two quarters of 2009 indicate that foreign direct investment in the United States is about one-third the amount recorded in the comparable period in 2008. Such investments may well pick up in the second half of the year as the rate of economic growth improves.

As a share of the total amount of nonresidential investment spending in the U.S. economy, investment spending by foreign firms was equivalent to 16% in 2008, 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 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.[4]

With over $454 billion invested in the United States, the United Kingdom is the largest foreign direct investor, as is indicated in **Table 1**. Japan is the second-largest foreign direct investor in the U.S. economy with about $259.6 billion in investments. Following the Japanese are the Dutch ($259.4 billion), the Canadians ($222 billion), the Germans ($211 billion), and the French ($163 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 2009, 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

(...continued)

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 $151 billion measured at current cost to a cumulative value of $2.7 trillion, while the market value rose by $568 billion in to reach a cumulative value of $3.1 trillion in 2009.

[3] Ibarra-Caton, Marilyn, Direct Investment Positions for 2009: Country and Industry Detail, *Survey of Current Business*, July, 2010. p. 20.

[4] 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).

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 $86 billion investment in the U.S. banking and finance sectors surpasses the more than $53 billion invested in the finance sector alone by British firms (data for banking have been suppressed by the Department of Commerce), followed by Germany ($49 billion) and France ($42 billion). Foreign direct investment in the U.S. manufacturing sector is dominated by a number of countries, each with substantial investments: investments by the United Kingdom ($106 billion), Switzerland ($97 billion), the Netherlands ($82 billion), France ($81 billion), Germany ($79 billion), and Japan ($76 billion) account for nearly three-fourths 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 17% is in the banking and finance sectors, and 16% 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 6.3%, while real estate and services account for modest shares of 2.4% and 2.0%, respectively. All other industries account for the remaining 22%.

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-End 2009

(in billions of U.S. dollars)

All	All industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Othe indust
ntries	**$2,319.6**	**$790.6**	**$328.4**	**$44.3**	**$146.1**	**$111.9**	**$293.2**	**$54.5**	**$46.1**	**$5**
ada	225.8	60.9	3.9	4.9	-0.1	31.8	54.8	3.9	2.6	
ope	**1,685.3**	**609.4**	**171.1**	**32.1**	**142.3**	**56.7**	**243.5**	**25.8**	**30.9**	**3**
:ria	2.9	1.4	0.7	(D)	0.0	(D)	0.0	(D)	(D)	
ium	38.5	19.2	6.8	(D)	0.0	(D)	1.4	0.0	0.3	
ce	189.3	81.8	12.1	0.4	20.9	9.9	32.4	0.5	4.9	
many	218.2	79.3	13.3	4.6	50.4	7.9	41.1	6.9	0.8	
nd	32.6	18.6	-0.1	0.0	0.1	2.1	10.1	(D)	(D)	
	9.7	1.1	2.0	1.8	(D)	0.5	(D)	0.1	(D)	
embourg	127.8	50.4	3.4	(D)	(D)	0.0	8.1	(D)	2.1	
herlands	238.0	82.8	27.1	(D)	14.0	(D)	50.6	7.5	11.6	
den	38.9	28.9	7.3	(D)	0.7	-0.4	0.3	(D)	0.1	
zerland	189.4	97.4	9.3	3.1	(D)	(D)	39.4	0.9	0.5	
	453.9	106.2	82.1	(D)	25.2	(D)	53.1	5.2	9.3	1
merica	**27.9**	**9.5**	**13.9**	**2.2**	**1.4**	**4.6**	**-32.9**	**8.7**	**2.4**	
ca	**1.7**	**0.1**	**0.4**	**0.0**	**0.0**	**(D)**	**0.0**	**(D)**	**0.0**	
. East	**17.6**	**4.2**	**6.1**	**(D)**	**0.8**	**(D)**	**0.4**	**(D)**	**0.2**	

All	All industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Othe indust
a	**361.3**	**106.5**	**133.0**	**(D)**	**1.8**	**(D)**	**27.4**	**15.8**	**10.0**	
tralia	45.7	7.0	0.2	0.0	0.4	2.7	3.0	6.1	0.3	
n	264.2	76.6	118.2	5.0	1.2	13.4	22.4	6.9	7.2	
ea	12.0	1.8	9.7	(D)	(D)	0.1	(D)	(D)	0.0	
C	15.5	0.0	9.5	(D)	0.0	1.0	(D)	(D)	(D)	

Source: Ibarra-Caton, Marilyn, Direct Investment Positions for 2009: Country and Industry Detail. *Survey of Current Business*, July, 2010. p. 30.

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.

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 2008, outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, were $260 billion, a 3.0% increase over the $252 billion invested in 2007. According to the Department of Commerce, the increase in new investments reflected several large transactions.[5] These transactions include the acquisition of Anheuser-Busch Cos. Inc., by Stichting Interbrew SA for $52 billion, the acquisition of Alcon Inc., by Novartis AG for $10.8 billion and large investments in Commerce Bancorp, New Jersey, Morgan Stanley, and Citigroup. Acquisitions of existing U.S. firms accounted for 93% of the new investments by value. Investments by the existing U.S. affiliates of foreign firms accounted for 82% of the total transactions by investor, while other foreign direct investors accounted for the remaining 18% of transactions. Investment outlays by foreign firms increased from 2007 to 2008 in all major sectors, except wholesale trade, retail trade, and real estate. Investment in information, manufacturing, and services all posted increases.

Economic Performance

By year-end 2007, the latest year for which detailed data are available, foreign firms employed 6 million Americans, less than 4% of the U.S. civilian labor force, and owned over 36,000 individual business establishments.[6] Foreign firms have a direct investment presence in every state. Employment of these firms ranges from over 661,000 in California, to about 7,000 in South Dakota. Following California, New York (477,000), Texas (450,000), Illinois (290,000),

[5] Anderson, Thomas, Foreign Direct Investment in the United States: New Investment in 2008. *Survey of Current Business*, June 2009. p. 34.

[6] *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2007 Estimates*. Bureau of Economic Analysis, 2009, Table 1A-1.

Pennsylvania (279,000), Florida (279,000), and New Jersey (237,000) have the largest numbers of residents employed by foreign firms. In 2007, 37% 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 firms 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 $187 billion in the United States in 2007 on new plants and equipment, imported $494 billion in goods and services and exported $205 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% 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 that 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 2008 rose slightly over the amount invested in 2007, but set a record in nominal terms for the most amount of foreign direct investment in the economy in a year. Other countries have experienced a similar turnaround in foreign direct investment inflows, especially 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 to increase. 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 stems 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.

Author Contact Information

James K. Jackson
Specialist in International Trade and Finance
jjackson@crs.loc.gov, 7-7751