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

James K. Jackson
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

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 economists 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, fell sharply in 2005 to \$21 billion, or less than one-tenth of the \$252 billion U.S. firms invested in 2004, according to the Department of Commerce.² This drop in investment spending contrasts with a 20% increase in spending by foreign firms in 2005 to reach \$129 billion. The drop in U.S. direct investment abroad reflects actions by U.S. parent firms to reduce the amount of reinvested earnings going to their foreign affiliates for distribution to the U.S. parent firms in order to take advantage of one-time

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 in 2005. *Survey of Current Business*, April 2005, p. 468. 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.

tax provisions in the American Jobs Creation Act of 2004 (P.L. 108-357). Foreign direct investment in the United States increased by 20% in 2005, chalking up \$129 billion in new investment.

Generally, 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**. From 2002 to 2005, U.S. direct investment abroad was more than twice the amount foreigners invested in the U.S. economy, reflecting the period of slower growth in the economy from 2001-2003. On the whole, U.S. firms are 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.

Figure 1. U.S. Direct Investment Abroad and Foreign Direct Investment in the U.S. Economy, Annual Flows 1990-2005 (in billions of dollars)

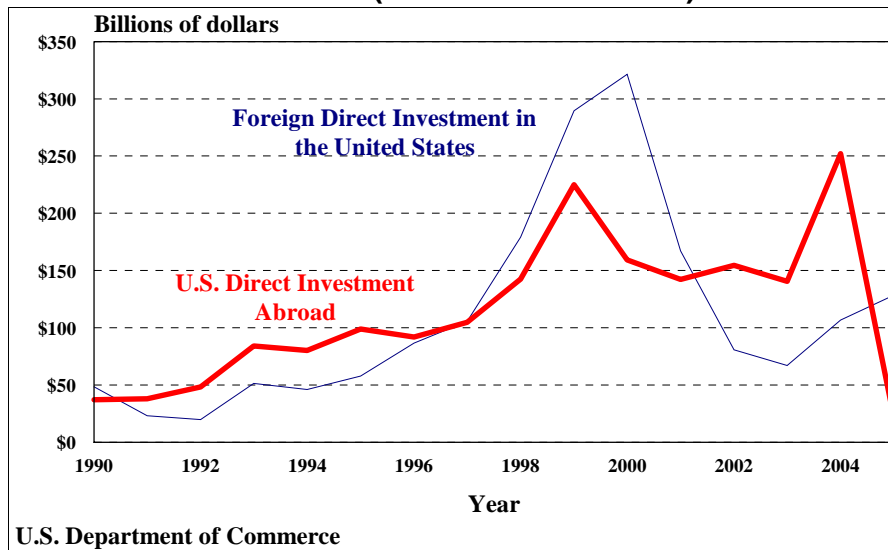


Table 1 indicates that the overseas direct investment position of U.S. firms on a historical-cost basis,³ or the cumulative amount at book value, reached \$2.1 trillion in

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 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 \$304 billion and \$569 billion in 2004, respectively, to \$2.4 and \$3.3 trillion.

2004, 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 \$1.1 trillion. 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 2004
(in millions of U.S. dollars)

	All industries	Manufacturing	Wholesale trade	Information	Banking	Finance	Services	Other industries
All countries	2,063,998	428,235	136,949	56,422	68,100	370,965	42,110	840,755
Canada	216,571	76,786	11,797	3,485	2,981	36,889	2,281	50,085
Europe	1,089,941	217,088	81,805	34,849	40,293	163,393	21,987	503,346
Belgium	27,761	8,912	4,085	-306	809	8,240	1,129	4,880
France	58,927	21,330	5,778	1,238	3,269	4,407	1,724	21,122
Germany	79,579	20,147	16,406	2,216	1,674	10,518	3,646	24,371
Ireland	73,153	21,290	4,598	17,029	(D)	11,101	1,968	16,094
Italy	33,378	22,039	2,664	2,862	-26	2,135	969	(D)
Luxembourg	74,902	6,632	179	(D)	667	2,083	29	(D)
Netherlands	201,918	24,977	13,397	4,431	34	22,495	1,573	131,059
Spain	45,251	11,359	2,933	1,295	1,861	4,672	(D)	22,751
Sweden	36,399	1,435	1,100	227	(D)	4,344	243	(D)
Switzerland	100,727	10,785	10,083	-2,373	7,920	4,528	513	(D)
United Kingdom	302,523	52,295	14,146	6,217	18,009	84,475	8,772	108,230
Latin America	325,891	46,913	11,118	7,061	8,555	98,998	2,194	128,622
Brazil	33,267	12,220	755	732	2,433	4,688	378	7,654
Chile	10,196	1,767	693	522	1,184	2,329	38	(D)
Mexico	66,554	19,438	1,954	1,495	16,811	11,160	567	12,858
Bermuda	91,265	-42	1,691	487	0	50,960	111	37,953
Caribbean	63,066	1,255	2,337	668	-12,452	22,881	479	46,221
Africa	22,259	2,255	1,116	1,273	797	141	141	3,459
Middle East	19,235	4,657	581	1,745	237	1,064	852	4,280
Asia	390,101	80,537	30,531	8,010	15,237	70,480	14,654	150,963
China	15,430	8,222	1,825	368	534	-2	688	(D)
Hong Kong	43,743	3,608	8,625	927	2,178	12,291	1,451	14,614
Japan	80,246	14,598	8,242	3,701	244	39,189	7,697	6,565
Korea	17,332	7,826	1,089	211	3,833	2,062	781	1,529
Singapore	56,900	14,435	(D)	1,383	835	2,529	425	(D)

Source: U.S. Direct Investment Abroad: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003. *Survey of Current Business*, September 2005. p. 136.

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

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

⁴ Koncz, Jennifer L., and Daniel R. Yorgason, Direct Investment Positions for 2003: Country and Industry Detail, *Survey of Current Business*, July, 2005. P. 53.

2000. In 2004, U.S. firms focused a slightly greater percent of their investment funds on developing countries, which received 29% 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 2000-2004 period increased about 56%. 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 8% 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 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

⁵ *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2003 Estimates*, October 2005. Table III. F. 1.

⁶ Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 1998. *Survey of Current Business*, July 2000. pp. 24-45.

While U.S. MNCs used their economic strengths to expand abroad between the 1980s and early 2000s, 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 fell during the early 1980s, but increased in the 1992-2000 period, from 17.5 million to 23.9 million. From 2000 to 2003, however, employment among U.S. parent companies fell by 9% to 21.7 million in 2003 during the slowdown in the rate of U.S. economic growth.

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

⁷ Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 2003. *Survey of Current Business*, July 2005. p. 15.

⁸ *Ibid.*, p. 31.

⁹ *Ibid.*, p. 31.

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 2003, about 8% 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.