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CRS Report for Congress

Foreign Direct Investment in the United States: An Economic Analysis

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

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 2006, according to Department of Commerce data, foreigners invested $184 billion. Foreign direct investments are highly sought after by 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

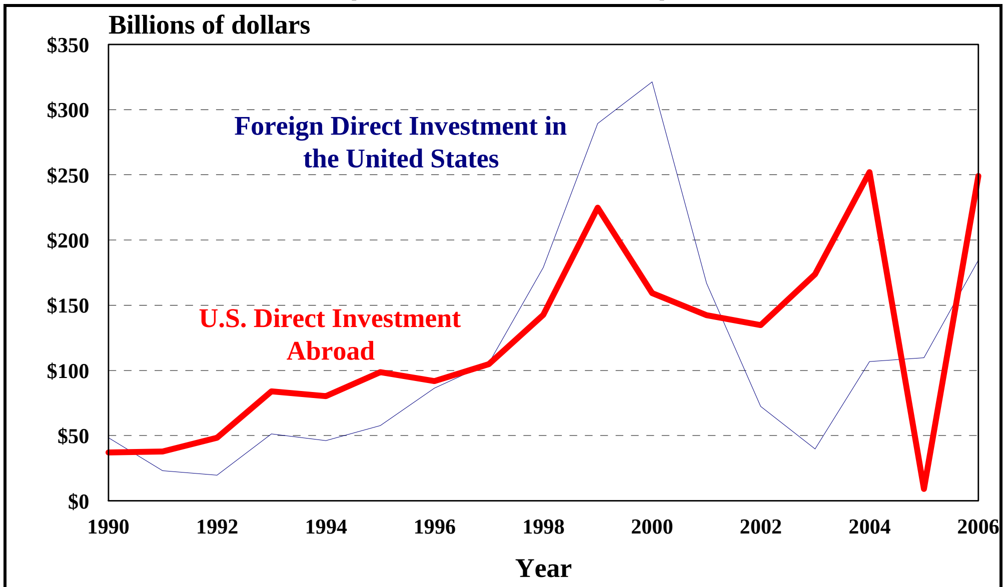
Foreigners invested $184 billion in U.S. businesses and real estate in 2006, according to balance of payments data published by the Department of Commerce.[2] As **Figure 1** shows, this represents an increase over the amount invested in 2005. Investments by U.S. firms abroad also rebounded in 2006 to $249 billion, up sharply from the $9 billion they invested abroad in 2005. The increase in foreign direct investment flows, mirrors a turn-around in global flows. According to the United Nation's *World Investment Report*, global foreign direct investment inflows increased by 29% in 2005 after a slight increase in 2004 and three years of declining flows prior to 2004 that arose from competitive

[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] Bach, Christopher L., U.S. International Transactions in 2006. *Survey of Current Business*, April 2007, p. 46. 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.

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, 1990-2006 (in billions of dollars)



Source: CRS from U.S. Department of Commerce data

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[3] increased by $115 billion in 2005 to over $1.6 trillion. This marked an increase of 8% over the previous year and a significant change from the decline in foreign investment spending that had occurred since 2000.[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 the stronger growth rate of the U.S. economy, the world-wide resurgence in cross-border merger and acquisition activity, and investment in the U.S. financial and insurance industries as overseas banks and finance and insurance companies sought access to the profitable U.S. financial market.[5]

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[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 $147 billion and $93 billion in 2005, respectively, to $1.9 and $2.8 trillion.

[4] Koncz, Jennifer L., and Daniel R. Yorgason, Direct Investment Positions for 2005: Country and Industry Detail, *Survey of Current Business*, July, 2006. p. 20.

[5] McNeil, Lawrence, Foreign Direct Investment in the United States: New Investment in 2005, *Survey of Current Business*, June 2006, pp. 33-34.

As a share of the total amount of nonresidential investment spending in the U.S. economy, investment spending by foreign firms accounted for 9% in 2005, far below the 19% reached in 2000. 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 $282 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 the second largest foreign direct investor in the U.S. economy with over $190 billion in investments. Following the Japanese are the Germans ($184 billion), the Dutch ($171 billion), and the French ($143 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 2004, 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. The French are the largest investors in the information sector as a result of a number of large media company acquisitions. German and British investments dominate other foreign investments in the banking sector, while Dutch, British, French, and Canadian investments account for over half of the investments in the finance sector. Canada's $60 billion investment in the U.S. banking and finance sectors is nearly matched by the investments by British firms, followed by France ($44 billion) and Germany ($34 billion). Foreign direct investment in the manufacturing sector is represented by a number of countries, each with substantial investments: investments by the United Kingdom ($77 billion), Switzerland ($76 billion), the Netherlands ($72 billion), Germany ($70 billion), and France ($45 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 33% of foreign direct investment in the United States, a decline from periods when such investment accounted for a majority share of the total. Another 21% 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 8.7%, 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 2.6% and 2.5%, respectively. All other industries account for the remaining 17%.

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-End 2005
(in millions of U.S. dollars)

	All industries	Manufac-turing	Wholesale trade	Retail trade	Informa-tion	Banking	Finance	Real estate	Services	Other indus-tries
All countries	**1,635,291**	**538,122**	**230,104**	**29,686**	**142,556**	**130,940**	**207,552**	**41,006**	**41,879**	**273,444**
Canada	**144,033**	**30,588**	**4,192**	**6,077**	**6,122**	**15,811**	**43,735**	**2,818**	**2,451**	**32,240**
Europe	**1,143,614**	**414,852**	**124,349**	**16,557**	**109,677**	**98,544**	**130,356**	**20,618**	**37,103**	**191,557**
-Belgium	9,712	3,209	1,305	(D)	-2	(D)	530	(D)	-1,134	2,128
-France	143,378	45,480	13,316	508	26,202	16,194	28,215	399	2,529	10,535
-Germany	184,213	70,943	14,972	2,154	29,971	16,445	18,353	6,032	485	24,857
-Ireland	21,898	5,268	402	(D)	(D)	(D)	1,072	-25	(D)	12,369
-Italy	7,716	1,056	991	1,512	(D)	1,261	(D)	45	(D)	2,085
-Luxembourg	116,736	26,305	952	0	5,256	0	(D)	249	(D)	76,770
-Netherlands	170,770	72,459	9,691	(D)	12,283	(D)	40,847	2,839	8,611	11,761
-Sweden	24,774	9,236	9,026	(D)	(D)	(D)	353	(D)	152	(D)
-Switzerland	122,399	76,385	7,055	395	(D)	(D)	19,637	1,708	454	8,254
-U. Kingdom	282,457	76,792	62,392	2,707	17,918	(D)	(D)	4,849	18,052	28,956
L. America	**82,530**	**21,968**	**10,936**	**1,682**	**1,316**	**3,510**	**15,188**	**6,194**	**-813**	**22,550**
Africa	**2,564**	**721**	**(D)**	**(D)**	**(D)**	**(D)**	**(D)**	**266**	**(D)**	**945**
Middle East	**9,965**	**882**	**(D)**	**(D)**	**809**	**(D)**	**(D)**	**(D)**	**(D)**	**(D)**
Asia	**252,584**	**69,112**	**86,473**	**(D)**	**(D)**	**(D)**	**18,177**	**(D)**	**3,050**	**(D)**
-Australia	44,061	4,986	1,722	2	(D)	(D)	2,447	5,013	327	6,375
-Japan	190,279	62,934	76,732	4,965	1,880	7,573	14,119	4,777	1,492	15,806

Source: Foreign Direct Investment in the United States: Detail for Historical-Cost Position and Related Capital and Income Flows, 2002-2005. *Survey of Current Business*, September, 2006. p. 59.
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 2005, outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, were \$86.8 billion, slightly above the \$86.2 billion invested in 2004. According to the Department of Commerce, the nearly flat increase in new investments reflected slower economic growth in the United States and in Europe.[7] Acquisitions of existing U.S. firms accounted for 91% of the new investments by value.

[7] McNeil, Lawrence R., Foreign Direct Investment in the United States: New Investment in 2005. *Survey of Current Business*, June 2006. p. 32.

Investments by the existing U.S. affiliates of foreign firms accounted for 50% of the total transactions by investor, while other foreign direct investors accounted for the remaining 50% of transactions. Investment outlays by foreign firms increased from 2004 in a number of sectors, including: manufacturing, information and banking. Investment outlays decreased in the finance and insurance sectors.

Economic Performance

By year-end 2004, the latest year for which detailed data are available, foreign firms employed 5.6 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 547 thousand in California, to less than 5 thousand in North Dakota. Following California, New York (377 thousand), Texas (341 thousand), Florida (238 thousand), and Illinois (236 thousand) have the largest numbers of residents employed by foreign firms. In 2004, 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, insurance, 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 $124 billion in the United States in 2004 on new plant and equipment, imported $393 billion in goods and services and exported $164 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 the fact that there are no 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

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[8] *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2004 Estimates*. Bureau of Economic Analysis, 2006, Table 2A-1.

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 exists, 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.