



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 economists conclude that direct investment abroad 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.

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Recent Investments

New spending by U.S. firms on businesses and real estate abroad, or U.S. direct investment abroad,¹ although substantial, fell slightly in 2008 compared to 2007. Net investments fell from \$333 billion in 2007 to \$318 billion in 2008, according to the Department of Commerce.² A drop in U.S. direct investment abroad that occurred in 2005 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 tax provisions in the American Jobs Creation Act of 2004 (P.L. 108-357).

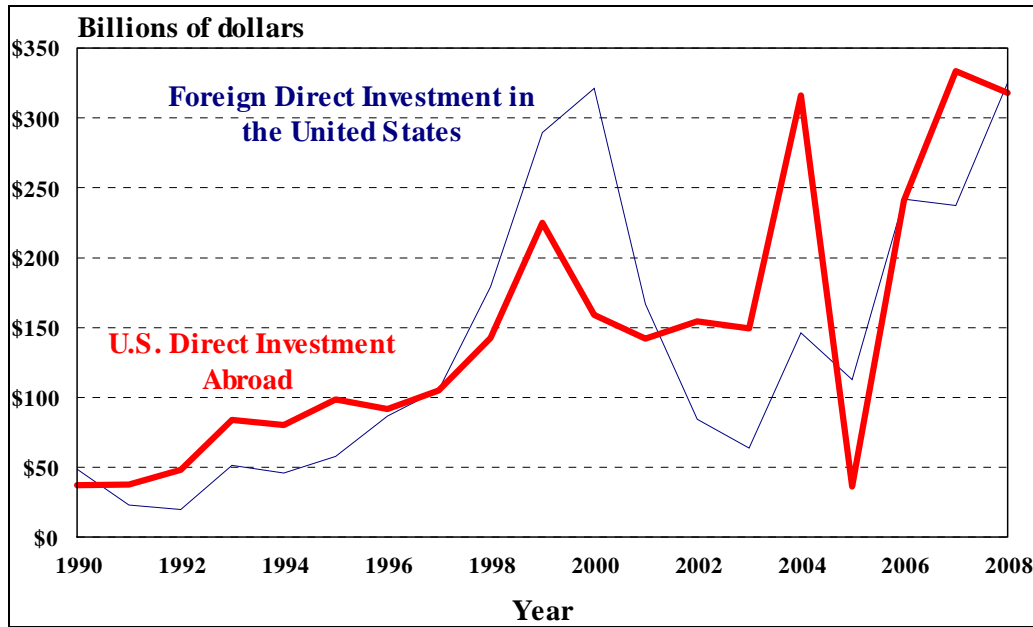
Generally, relative rates of growth between U.S. and foreign economies largely determine the direction and magnitude of direct investment flows. These flows also are affected by relative rates of inflation, interest rates, and expectations about the performance of national economies, which means they can be quite erratic at times. The drop in U.S. direct investment abroad in 2008 compared with 2007 reflected an increase in equity capital, a decrease in intercompany debt, an increase in reinvested earnings arising from an increase in distributed earnings, and a large currency devaluation. The sharp drop in stock market valuations around the world in 2008 devalued U.S. direct investment abroad, measured at market value, by \$2.2 trillion. During the same period, the market value of foreign firms operating in the United States experienced a loss of over \$1.0 trillion in 2008.

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 2007, U.S. direct investment abroad averaged more than twice the amount foreigners invested in the U.S. economy, reflecting the period of slower growth in the economy from 2001-2003. Data for the first two quarters of 2009 indicate that U.S. direct investment abroad is about half 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. 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.

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 Weinberg, Douglas B., Erin M. Whitaker, and Gregory A. Tenentes, U.S. International Transactions: Fourth quarter and Year 2008. *Survey of Current Business*, April 2009, p. 28. 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.

Figure I. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2008 (in billions of dollars)



Source: U.S. Department of Commerce

Note: The drop in U.S. direct investment abroad in 2005 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 tax provisions in the American Jobs Creation Act of 2004 (P.L. 108-357).

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 \$3.2 trillion in 2008, 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 \$1.8 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.

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 measured at current cost increased by \$247 billion, but fell when measured by market value by \$2.2 trillion in 2008, to reach \$3.7 and \$3.1 trillion, respectively.

⁴ Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2008: Country and Industry Detail, *Survey of Current Business*, July, 2009. p. 32.

Table I. U.S. Direct Investment Position Abroad on a Historical-Cost Basis at Year-End 2008

(in millions of dollars)

	All industries	Manu- factur- ing	Whole- sale trade	Informa- tion	Bank- ing	Finance	Services	Hold- ing comp- anies	Other
All	3,162,021	512,293	178,213	121,864	141,557	634,046	81,242	1,128,538	212,409
Canada	227,298	72,523	18,332	4,113	3,676	32,728	8,164	30,511	33,472
Europe	1,809,876	259,844	99,980	80,971	80,823	328,307	53,845	750,883	116,716
Belgium	65,054	20,058	6,234	-758	(D)	31,434	1,811	2,857	(D)
France	75,040	29,207	4,850	2,250	2,059	9,201	2,602	12,398	12,375
Germany	110,784	33,993	10,501	2,495	2,321	14,441	5,401	32,769	8,450
Ireland	146,194	19,051	1,249	15,723	10,227	24,235	(D)	27,596	26,588
Italy	28,653	11,684	3,153	1,967	412	3,071	1,160	1,925	5,221
Luxemb.	163,167	6,305	2,684	1,734	1,033	30,383	80	120,320	467
Netherl.	442,926	33,026	17,120	8,099	(D)	49,629	(D)	306,257	(D)
Spain	69,649	11,379	3,337	254	986	7,506	2,123	40,850	3,138
Sweden	43,391	3,286	736	749	(D)	15,618	546	19,862	(D)
Switzer.	123,358	8,996	21,423	2,649	7,240	4,844	632	70,100	7,284
Turkey	6,089	1,507	1,749	-42	2,703	65	20	-4	93
UK	420,873	56,685	17,689	42,867	19,727	122,854	13,913	101,062	37,060
LAmerica	563,809	60,709	24,265	8,609	12,699	195,083	2,078	204,950	24,724
Brazil	45,500	20,357	980	2,210	3,096	9,286	616	6,287	444
Chile	12,613	2,238	968	127	1,394	3,978	129	617	2,104
Venez'	17,332	3,951	263	81	(D)	3,057	206	7,610	(D)
Mexico	95,618	21,821	2,361	2,758	(D)	15,736	460	16,865	(D)
Bermuda	165,857	1,303	3,790	632	(D)	81,179	272	72,566	(D)
Dom. Republic	960	599	137	(D)	(D)	1	1	(*)	10
UK Car.	139,290	695	10,699	436	-16,963	(D)	98	(D)	1,716
Africa	36,640	2,856	1,157	128	1,899	1,814	372	8,664	1,375
Middle East	32,488	11,763	2,145	1,447	720	569	933	7,594	799
Asia	491,910	104,598	32,334	26,596	41,740	75,544	15,850	125,935	35,324
Austral.	88,549	12,743	3,856	13,100	2,285	11,275	3,762	13,875	7,310
China	45,695	21,428	3,219	223	(D)	1,895	773	1,556	(D)
HK	51,505	3,742	6,858	833	3,694	11,535	2,931	19,552	2,360
Japan	79,235	17,380	9,036	5,609	1,144	28,032	2,806	5,911	9,316
Korea	27,673	9,165	1,812	448	(D)	3,625	332	(D)	(D)

	All industries	Manu- factur- ing	Whole- sale trade	Informa- tion	Bank- ing	Finance	Services	Hold- ing comp- anies	Other
Sing.	106,529	16,544	3,322	2,130	(D)	6,782	1,329	71,250	(D)
Taiwan	16,604	3,816	2,018	310	(D)	7,141	295	102	(D)
OPEC	69,299	9,879	1,909	146	(D)	4,206	828	29,774	(D)

Source: Ibarra, Marilyn, and Jennifer Koncz, *Direct Investment Positions for 2008: Country and Industry Detail. Survey of Current Business*, July 2009. p.32.

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 2000. In 2008, U.S. firms focused a slightly greater percent of their investment funds in Europe and Latin America, while scaling down the share of their investment spending in Canada. Developed countries received 70% of the investment funds of U.S. multinational firms, while developing countries received 30%.

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. The total amount of U.S. direct investment abroad, or the position, during the 2000-2008 period more than doubled, rising from \$920 billion to \$2.4 trillion. Investments in the banking, finance, and insurance sectors all fell in 2008, reflecting the financial crisis. Generally, service-oriented sectors continued to grow through 2008. Within the manufacturing sector, the direct investment position fell in most sectors in 2008, reflecting the economic recession that had started earlier in that year.

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

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 1989.⁷ In 2007 (the latest year for which estimates are available), U.S. parent companies accounted for about 21% of total U.S. business activity. These MNC parent companies accounted for about 41% of total U.S. manufacturing activity, down from 46% in 2000.

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 2000 to 2007, 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 30%.⁸

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 12% to 21.1 million, before rising after 2003 to reach 22 million in 2007 as U.S. economic growth picked up. Employment among foreign affiliates also rose in 2007 by 4.0% to 10.0 million, from 9.6 million in 2006.

⁵ U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2004 Estimates, October 2006. 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.

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

⁸ *Ibid.*, p. 31.

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. Both the U.S. parent companies and the foreign affiliates lost employment during the first part of the 2000s as the U.S. economy recovered from a period of slow growth. During such downturns, U.S. parent firms and their foreign affiliates often lose or gain 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.

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 2004, 9.5% of the sales of the foreign affiliates of U.S. firms was accounted for by exports back to the United States,⁹ 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.¹⁰ 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.

⁹ Mataloni, *Operations of U.S. Multinational Companies*. p. 41.

¹⁰ CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by James K. Jackson.

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