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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 States¹ declined sharply after 2000, when a record \$300 billion was invested in U.S. businesses and real estate. In 2004, according to preliminary data, foreigners invested about \$100 billion. Foreign direct investments are highly sought after by State and local governments that are struggling to create additional jobs in their localities. In addition, many in Congress encourage such investment to offset the perceived negative economic effects of U.S. firms investing abroad. On a cumulative basis, the British remain the largest foreign direct investors in the U.S. economy, with French, Dutch, and Japanese investors trailing behind. This report will be updated as events warrant.

Recent Investments

Foreigners invested about \$100 billion in U.S. businesses and real estate, in 2004, according to partial-year data by the Department of Commerce.² As **Figure 1** shows, this represents more than a doubling in the amount invested in 2003, but about half as much as U.S. firms invested abroad and far below the record \$300 billion foreigners invested in 2000. The decline in foreign direct investment flows, although particularly sharp for the United States, is not unique. According to the United Nation's World Investment Report, global foreign direct investment flows dropped by 41% in 2001 and 21% in 2002 due to slow economic growth in most of the parts of the world, falling xxxFig1stock market valuations, lower corporate profitability, a slowdown in corporate restructuring, and a slowdown in privatization efforts in some areas.

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 Weinberg, Douglas B., and Kelly K. Pierce U.S. International Transactions: Third Quarter 2004. Survey of Current Business, January 2005, p. 54.

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis³ increased by \$38 billion in 2003 to nearly \$1.4 trillion. This marked an increase of less than three percent over the previous year and an improvement over the decrease the position in the previous year when some affiliates repaid substantial loans to their foreign parent companies and the foreign parent companies wrote down the value of acquisitions they had made prior to the slowdown in the U.S. economy.⁴

As a share of the total amount of investment spending in the U.S. economy, investment spending by foreign firms fell to 3.5% in 2003, far below the 19 % reached in 2000. Foreign firms' spending was sustained by growth in their equity capital position. Reinvested earnings showed a slight increase over the previous year, but intercompany debt flows were negative reflecting an increase in payments from the affiliates to the foreign parent company and a reversal in affiliates' receivables from their parent companies.⁵

With over \$230 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 \$159 billion in investments. Following the Japanese are the Germans (\$149 billion) and Dutch (\$146 billion), with the French close behind (\$143 billion).

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-End 2003
(in millions of U.S. dollars)

	All Industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Other industries
All countries	1,378,001	475,475	182,176	24,171	120,122	87,537	185,655	46,999	28,358	227,509
Canada	105,255	29,046	2,640	1,447	5,160	10,535	25,623	4,560	1,405	24,838
Europe	1,000,532	376,603	106,670	17,950	97,928	61,141	132,400	20,774	24,788	162,277
Belgium	10,678	3,391	1,619	(D)	(D)	(D)	586	317	69	1,420
France	143,341	54,978	12,156	380	26,159	11,373	26,796	400	5,741	5,358
Germany	148,774	52,514	12,589	544	21,427	18,449	15,069	5,599	433	22,149

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 \$49 billion and \$410 billion in 2003, respectively, to \$1.5 and \$2.4 trillion.

⁴ Borga, Maria, and Daniel R. Yorgason, Direct Investment Position for 2003: Country and Industry Detail, Survey of Current Business, July, 2004. P. 40.

⁵ At the same time, U.S. direct investment abroad rose in 2003 as U.S. parent firms increased their acquisitions of foreign firms and their overall investment spending abroad. U.S. direct investment abroad in 2003 totaled \$174 billion (in nominal terms).

	All Industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Other industries
Ireland	26,793	2,711	3,186	(D)	(D)	(D)	2,900	601	(D)	12,541
Italy	6,695	1,047	1,043	1,189	(D)	1,217	(D)	85	(D)	1,301
Luxembourg	104,452	23,940	1,373	(D)	4,012	0	(D)	152	(D)	74,489
Netherlands	146,117	63,608	7,882	(D)	7,426	(D)	34,264	4,562	2,681	12,770
Sweden	19,823	8,092	5,295	(D)	76	(D)	64	(D)	339	3,679
Switzerland	112,856	72,274	4,013	292	11,715	(D)	23,005	600	531	(D)
U. Kingdom	230,374	70,795	55,723	2,257	16,909	18,357	27,429	4,629	12,312	21,963
L. America	69,557	8,302	9,669	1,719	3,443	2,988	15,622	4,921	753	22,138
Africa	2,187	653	448	(D)	(D)	(D)	(D)	(D)	(D)	614
Middle East	7,931	1,518	2,889	(D)	(D)	(D)	(D)	(D)	(D)	455
Asia	192,539	59,353	59,860	3,011	13,222	11,282	11,910	15,345	1,370	17,186
Australia	24,652	3,665	515	-4	(D)	(D)	3,551	3,296	(D)	2,571
Japan	159,258	54,293	56,625	(D)	(D)	8,187	8,191	11,012	1,136	13,250

Source: Foreign Direct Investment in the United States: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003. *Survey of Current Business*, September, 2004. p. 78.

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.

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 2003, 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 \$36 billion investment in the U.S. banking and finance sectors is matched by the \$35 billion invested by British firms, followed by France (\$28 billion) and Germany (\$23 billion). Foreign direct investment in the manufacturing sector is represented by a number of countries, each with substantial investments: investments by Switzerland (\$72 billion), the United Kingdom (\$71 billion), the Netherlands (\$64 billion), France (\$55 billion), and Germany (\$53 billion) account for 70% 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 35% of foreign direct investment in the United States, a decline from periods when such investment accounted for a majority share of the total. Another 18% 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 14%, while real estate and services account for modest shares of 3.8% and 3.0%, respectively. All other industries account for the remaining 10%.

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 2003, outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, were \$60 billion, slightly above the \$54 billion invested in 2002, the lowest amount since 1994, reflecting continuing weakness in the U.S. economy. According to the Department of Commerce, the low level of acquisitions and investments also reflected a weak market in some industries in which foreign direct investment had been active in previous years and a general fall off in merger and acquisition activity in a number of countries.⁶ Acquisitions of existing U.S. firms accounted for 87% of the new investments by value, while investments by U.S. affiliates accounted for 55% of the transactions by investor. Investment outlays by foreign affiliates declined in a number of sectors, including manufacturing, wholesale trade, information, real estate, and services. Investment outlays increased sharply in the finance sector and modestly in the retail trade sector. There were two investments over \$5 billion in 2003, double the number in 2002, but down sharply from the 12 recorded in 2000.

Economic Performance

By year-end 2002, the latest year for which detailed data are available, foreign firms employed 5.4 million Americans, less than 4% of the U.S. civilian labor force, and owned over 9 thousand business establishments.⁷ Foreign firms have a direct investment presence in every state. Employment of these firms ranges from over 700 thousand in California, to less than 7 thousand in South Dakota. Following California, New York (480 thousand), Texas (428 thousand), Illinois (321 thousand), and Florida (303 thousand) have the largest numbers of residents employed by foreign firms. In 2002, 40% of the foreign firms’ employment was in the manufacturing sector, about 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. The largest share of these employees -18% - worked for British-owned affiliates. An additional 13% of the employees worked for affiliates owned by Japanese firms with employment shares of German (12%), French (9%), Dutch (9%), Canadian (9%) and Swiss (8.6%) close behind.

Retail and wholesale trade accounted for another 20% 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

⁶ Anderson, Thomas W., Foreign Direct Investment in the United States: New Investment in 2003. Survey of Current Business, June 2004. P. 59.

⁷ Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2002 Estimates. Bureau of Economic Analysis, 2003, Table A-1.

accounts for another 13% of total affiliate employment. Average employee compensation is highest in the finance sector — \$158,000 — 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 \$127 billion in the United States in 2002 on new plant and equipment, imported \$337 billion in goods and services and exported \$146 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 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 2002 fell to levels not experienced since 1994 as foreign investors faced a number of uncertainties. Other countries have seen investment inflows increase markedly. Direct investment inflows going to China, for instance, were \$70 billion in 2002. In 2003, preliminary data indicate that foreign direct inflows to the United States likely doubled from \$40 billion to about \$80 billion. As the U.S. economy recovers, interest rates stay low, and the rate of price inflation stays in check, foreign direct investment in the United States likely will grow in nominal terms

from the low levels experienced recently. In addition, public concerns seem to be focused on the overall phenomenon referred to as “globalization,” and how it affects jobs in the economy. Concerns over foreign direct investment, where it exists, stem not so much from 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.

With concerns over job security emerging as an important public issue, opposition to foreign direct investment has dissipated. Indeed, nations and sub-national jurisdictions expend considerable resources vying for foreign investment projects with the capital, technology, and jobs that accompany them. The U.S. economy 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.