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Foreign Direct Investment in the United States: An Economic Analysis of the Data and Current Issues

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Summary

Foreign investors poured record amounts (in nominal terms) of funds into U.S. businesses and real estate in 1998 and 1999, continuing the expansion that began in 1993. British investors lead all others; Europeans as a whole are the largest foreign direct investors,[1] both in terms of annual investments and in terms of their cumulative holdings of investments in the United States. Japanese investors have reduced their annual investment expenditures in U.S. businesses, although they still rank as the second largest foreign investors in the U.S. economy. Some Americans believe foreign investments could eventually have a negative impact on the U.S. economy, but most economic assessments indicate that foreign direct investment yields net national benefits to both the recipient and the investing countries. By most measures, foreign investors have become fully integrated into the U.S. economy and are indistinguishable in many ways from firms that are wholly-owned by Americans. This report will be updated as events warrant. Additional information on this and other trade-related issues is available from the CRS Electronic Briefing Book on Trade at: [http://www.congress.gov/brbk/html/ebtra1.html].

Recent Investments

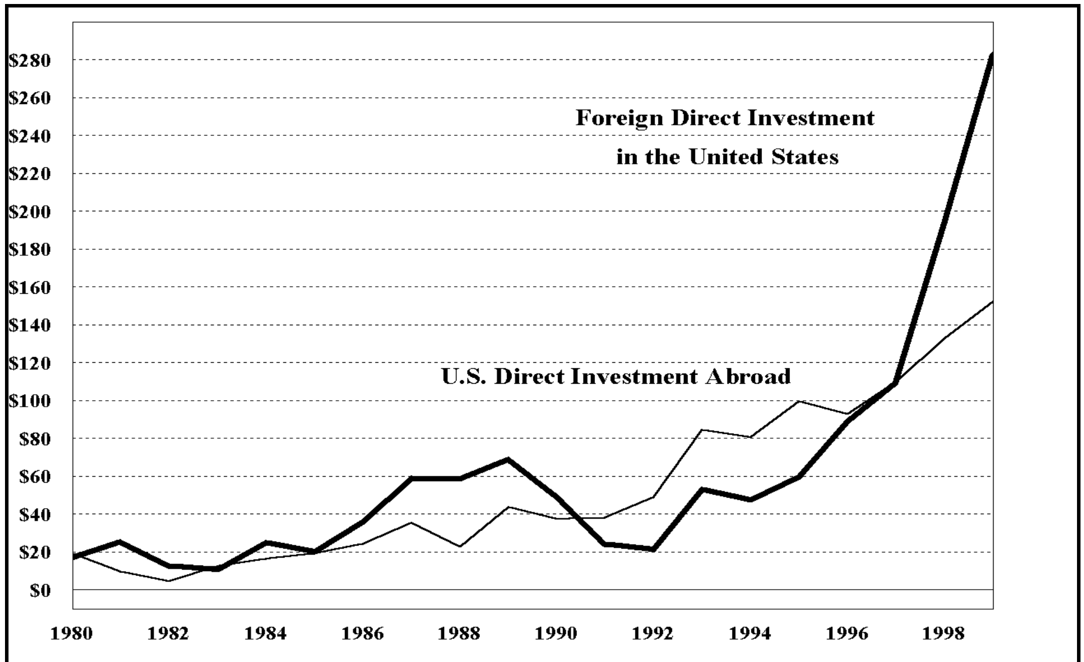
Foreigners invested nearly $300 billion in direct investment, or investment in U. S. businesses and real estate, in 1999, according to Commerce Department data,[2] a three fold increase over the record amount foreigners invested in 1997. The data for 1999 indicate

[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, Fourth Quarter and Year 1999. *Survey of Current Business*, April 2000. p. 174.

that foreigners are investing record sums on acquiring or establishing businesses in the United States. The cumulative amount of foreign direct investment, or the position,[3] increased by nearly $200 billion in 1998 and by close to $300 billion in 1999, when adjusted for changes in the value of existing investments and currency values. As figure 1 shows, spending by foreigners on businesses and real estate in the United States during the past two years has grown to levels that far surpass anything experienced previously. As a share of the total amount of investment spending in the U.S. economy, investment spending by foreign firms reached 17 % in 1999, exceeding the share such spending accounted for in the U.S. economy in the late 1980s. Foreign firms' spending is being sustained by growth in their reinvested earnings and in intercompany debt, but is arising primarily from equity capital outlays that reflect a sharp increase in corporate merger and acquisition activity in the United States.[4]

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad - Annual Flows, 1980-1999 (in billions of U.S. dollars)



Source: *U.S. Department of Commerce*

[3] The position 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.

[4] At the same time, U.S. direct investment abroad rose in 1999 as U.S. parent firms increased their acquisitions of foreign firms and their overall investment spending abroad. U.S. direct investment abroad in 1999 totaled $152 billion (in nominal terms), a record for overseas investment by U.S. firms.

With over $150 billion invested in businesses in the United States, Great Britain is the largest foreign direct investor. Japan, with foreign direct investment of $133 billion stands as the second largest investor. Sluggish economic growth and other economic problems in Japan have caused Japanese firms at times to slow down their investment spending in the United States to shore up their balance sheets back in Japan.[5] Losses on real estate and on parts of their U.S. operations also deterred Japanese investors. Investment spending by other foreign firms, however, has been especially strong since the mid-1990s, reflecting the continued fast-paced economic growth in the United States and increases in U.S. productivity. Besides British and Japanese investors, Dutch, Canadian, French, German, and Swiss investors have been investing heavily in U.S. businesses and real estate.

On a historical cost, or book value basis (value at the time of the initial investment), foreign direct investment in the United States reached $812 billion in 1998, the latest year for complete data.. This represents an 17% increase over 1997 in the overall direct investment position of foreign investors. Table 1 (page 4) shows that investments by developed economies account for nearly 92% of all foreign direct investment in the United States. These investments are predominately in the manufacturing sector, which accounts for about 41% of foreign direct investment in the United States. Another 14% 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. Other sectors account for modest shares: insurance (10.0%), the petroleum sector (7.0%), services (6.2%), finance (6.0%), and real estate (5.5%).

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. By year end 1998, 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. Japan is the single largest foreign investor in U.S. real estate, nearly equalling the value of all European holdings. In addition, the Swiss, the Dutch, and the British are the largest foreign investors in the insurance sector. Japan's $26 billion investment in the U.S. banking and finance sectors is more than twice as large as comparable investments by any European country and means that the Japanese are the single largest foreign investor in those sectors. Foreign direct investment in the manufacturing sector is also represented by a relatively small number of countries: investments by the United Kingdom, the Netherlands, Japan, Germany, and France account for 71% of the total amount of foreign direct investment in this sector.

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[5] U.S. Library of Congress. Congressional Research Service. *Japan's Economy: From Bubble to Bust*. CRS Report 94-226 E, by James K. Jackson.

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-end 1998 (in millions of U.S. dollars)

	All Industries	Petroleum	Manufacturing	Wholesale trade	Retail trade	Banking	Finance	Insurance	Real estate	Services	Other industries
All countries	811,756	53,254	329,346	96,261	18,778	44,785	50,858	80,378	44,436	50,252	43,409
Canada	74,840	2,633	26,152	5,098	1,039	2,569	7,130	7,861	9,084	2,488	10,786
Europe	539,906	42,771	252,893	43,554	14,479	26,725	18,914	65,745	14,303	36,463	24,059
Belgium	9,577	(D)	4,232	1,018	935	(D)	306	1	51	1,489	(D)
France	62,167	(D)	37,820	1,972	515	3,851	5,545	4,886	(D)	3,018	3,261
Germany	95,045	312	51,018	12,405	2,520	5,712	1,741	9,657	3,547	5,924	2,209
Ireland	13,227	739	4,874	1,980	(D)	(D)	-268	1,649	31	816	638
Italy	3,830	(D)	907	423	595	1,094	(D)	(D)	65	(D)	188
Luxembourg	20,214	0	(D)	1,311	(D)	0	110	(D)	(D)	4,315	(D)
Netherlands	96,904	11,505	35,109	5,606	4,696	6,473	4,301	16,844	6,612	3,625	2,131
Sweden	14,564	(D)	9,065	2,028	(D)	(D)	(D)	-6	744	2,036	333
Switzerland	54,011	252	26,310	2,579	183	(D)	2,478	17,112	211	2,341	(D)
U. K.	151,335	26,277	64,022	10,099	3,894	3,210	1,957	14,265	1,801	12,058	13,752
L. America	32,210	4,072	4,329	1,858	897	3,526	4,859	5,356	4,105	1,472	1,736
Africa	884	-4	-90	21	17	47	432	0	116	234	111
Middle East	7,831	1,061	966	131	392	931	216	0	3,728	125	280
Asia	156,085	2,720	45,096	45,598	1,954	10,988	19,307	1,416	13,101	9,469	6,436
Australia	14,755	3,202	2,982	-55	14	157	(D)	(D)	691	(D)	4,202
Japan	132,569	234	39,918	43,114	1,868	9,043	17,445	990	10,743	7,304	1,910

Note: The position is the 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.

Source: Lowe, Jeffrey H. Foreign Direct Investment in the United States: Detail for Historical-Cost Position and Related Capital and Income Flows, 1998. *Survey of Current Business*, September, 1999. p. 37.

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 adds little, if any, new employment. In 1998, outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, rose by 250% from the amount invested in 1997 to $200 billion (in nominal terms). Acquisitions of existing U.S. firms accounted for 62% of the new investments by number and 90% by value, while investments by U.S. affiliates accounted for 78% of the transactions by investor.[6] Part of the increase in foreign investment to acquire or establish new establishments can be traced to a substantial increase in very large investments. The number of investments over $2 billion rose from 3 in 1997 to 12 in 1998, while there was a slight decrease overall in the total number of investments.

[6] Fahim-Nader, Mahnaze. Foreign Direct Investment in the United States: New Investments in 1998. *Survey of Current Business*, June 1999. p. 16-23.

Included among these investments are the purchase of Amoco Corporation by British Petroleum PLC. for $55 billion and Daimler-Benz AG's acquisition of the Chrysler Corporation for $40 billion.

Economic Performance

By year-end1997, the latest year for which detailed data are available, foreign firms employed 5 million Americans, about 5% of U.S. employment, and owned over 9 thousand business establishments.[7] In 1997, 45% 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. The affiliates of foreign firms spent $100 billion in the United States in 1997 on new plant and equipment and $20 billion on research and development. 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 6.0%. 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 only 3.4% 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.

The 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.

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[7] *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 1997 Estimates*. Bureau of Economic Analysis, 1999, Table A-1.

Conclusions

Foreign direct investment in the United States far surpasses the record-breaking amounts set in the 19890s, when both Congress and the American public expressed concerns over the potential economic impact of such investments. Presently, public concerns seem to be focused not so much on foreign direct investment per se, but on the overall phenomenon referred to as"globalization." Within this context, these concerns seem not to stem from potential losses of international competitiveness that characterized similar concerns in the 1980s. Instead, concerns over foreign direct investment seem to arise from potential job losses that could result from mergers and acquisitions, although such losses could occur wether the acquiring company was foreign- or U.S.-owned.

Looking ahead, the pace of economic growth in U.S. and foreign economies and the resultant pull between domestic sources of and demands for capital determine the role and amount of foreign capital in the economy. Within this broader context, the federal government's budget deficits or surpluses relative to the credit conditions in the rest of the economy also influence capital conditions in the economy and the importance of foreign capital. In addition to credit conditions, foreign direct investment seems to be tied closely to the overall performance of the economy and will rise and fall with economic conditions. Strong economic growth, such as the United States has experienced over the last six years, increases direct investment by attracting new investments and by encouraging firms to reinvest profits in their U.S. operations.

As long as the U.S. economy continues growing at favorable rates and the rate of price inflation stays in check, foreign direct investment in the United States likely will grow in nominal terms as it has since 1992. It seems unlikely, however, that the pace set over the last two years can be sustained. Additional increases in interest rates by the Federal Reserve could restrain corporate profits, reducing somewhat the attractiveness of additional large-scale investments. Moreover, a slow pick-up in economic growth in Europe could make investments there more attractive and compete for funds that European investors have been placing in investments in the U.S. economy. Additionally, a long-expected slow down in the annual growth rate of the U.S. economy likely would reduce activity in the mergers and acquisitions market as well and, thereby, reduce the pace of foreign direct investment.