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Outsourcing and Insourcing Jobs in the U.S. Economy: An Overview of Evidence Based on Foreign Investment Data

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Summary

Foreign direct investment is sparking a national debate. Local communities compete for investment projects, while many of the residents of those communities fear losing their jobs to foreign outsourcing. Some opponents argue that such job losses have a disproportionately negative impact on local communities. Economists generally argue that free and unimpeded international capital flows have a positive impact on both domestic and foreign economies. This issue is complicated by the fact that broad, comprehensive data on U.S. multinational companies was not developed to address the issue of jobs outsourcing. This report provides an overview of CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, that analyzes the extent of direct investment into and out of the economy and the relationship between direct investment and the broader economic changes that are occurring in the U.S. economy. This report will be updated as events warrant.

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The United States is the largest foreign direct investor in the world and the largest recipient of such investment funds.[1] On a historical cost basis, or book value basis, the Department of Commerce estimates that by the end of 2008 U.S. firms had accumulated $3.2 trillion worth of direct investment abroad, compared with the $2.3 trillion foreign investors had spent to acquire or establish businesses in the United States.[2] As **Figure 1** shows, direct foreign investment flows generally have increased since 2003, while U.S. direct investment abroad dropped sharply in 2005 as a result of one-time tax provisions, but then rebounded sharply in 2006.[3] Recent Department of Commerce data indicate that foreigners invested a record $325 billion in U.S. businesses and real estate in 2008, according to data published by the Department of Commerce and invested more than $200 billion in 2007.[4] New spending by U.S. firms on businesses and real estate abroad, or U.S. direct investment abroad,[5] rose sharply in 2006 to $235 billion up from the $8 billion net they brought home in 2005.

[1] This is true on a historical cost, or *cumulative* position basis, but the sharp drop in foreign direct inflows after 2000 has meant that other countries have occasionally displaced the United States as the largest recipient of annual foreign direct inflows.

[2] Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2008, *Survey of Current Business*, July 2009, p 32. 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 $247 billion, but fell when measured by market value by $2.2 trillion in 2008 to reach $3.7 and $3.1 trillion, respectively. Nguyen, Elena L., The International Investment Position of the United States at Yearend 2008, *Survey of Current Business*, July 2009, p.10.

[3] 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). Similarly, 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).

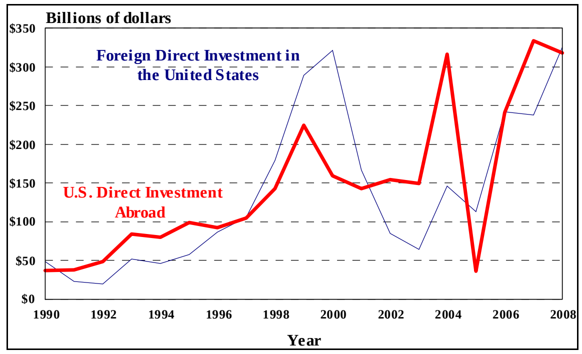
[4] Weinberg, Douglas B., Erin M. Walker, and Gregory A. Tenentes., U.S. International Transactions: Fourth Quarter and Year 2008. *Survey of Current Business*, April 2009. p. 28. Direct investment data reported in the balance of payments differ from capital flow data reported elsewhere, because the balance of payments data have not been adjusted for current cost adjustments to earnings.

[5] 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).

U.S. and Foreign Multinational Companies

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows 1990-2008

(in billions of dollars)



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

By the end of 2007, there were more than 2,300 U.S. parent companies with more than 26,000 affiliates operating abroad. In comparison, foreign firms had about 11,000 affiliates operating in the United States. U.S. parent companies employed over 22 million workers in the United States, compared with the 11.7 million workers employed abroad by U.S. firms and the 6 million persons employed in the United States by foreign firms. Although the U.S.-based affiliates of foreign firms employ fewer workers than do the foreign affiliates of U.S. firms, they paid almost as much in aggregate employee compensation in the United States as did the U.S. affiliates operating abroad. The data also suggest that U.S. parent companies are more efficient than either the U.S. affiliates of U.S. firms or foreign firms operating in the United States with higher output per employee. Foreign firms operating in the United States are more capital intensive relative to employment than U.S. parent firms or U.S. affiliates, likely reflecting the newer age of the capital stock of the foreign firms. The foreign affiliates of U.S. parent companies, however, had a third higher value of gross product than did the affiliates of foreign firms operating in the United States. In addition, the foreign affiliates of U.S. firms had total sales that were a third higher than that of the U.S. affiliates of foreign firms. The foreign affiliates of U.S. firms, however, paid more than three times more in taxes to foreign governments than did the affiliates of foreign firms operating in the United States. The overseas affiliates of U.S. parent companies also paid nearly twice as much in taxes relative to their sales as did U.S. parent companies and as did foreign-owned affiliates operating in the United States.

Table 1. Select Data on U.S. Multinational Companies and on Foreign Firms Operating in the United States, 2007

(dollar amounts are in millions of dollars)

	U.S. Multinational Companies		U.S. Affiliates of Foreign Firms
	Parent Companies	Affiliates	
Number of firms	2,270	26,342	10,941
Employment (thousands)	22,003	11,738	6,016
Employee compensation	$1,392,180	$475,595	$433,065
Gross product	$2,588,811	$1,117,585	$657,558
Total assets	$19,964,935	$14,201,291	$12,732,967
Sales	$8,614,733	$5,517,143	$3,553,593
Taxes	$257,292	$179,922	$57,731
R&D Expenditures	NA	$35,019	$44,158

Source: *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2007 Estimates;* and *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2007 Estimates.*

Within the U.S. economy, U.S. multinational corporations (MNCs) rank among the largest U.S. firms and play an important role in the U.S. economy**.** According to the total output of U.S. parent companies, or gross product, they produced $2.59 trillion in goods and services in 2007, up slightly from the $2.54 trillion dollars they produced in 2006. This amount comprised about 21% of total U.S. private industry gross product, a share of total gross product of U.S. parent companies that has remained fairly consistent since the early 1990s despite significant changes in the U.S. economy as a whole.

Employment

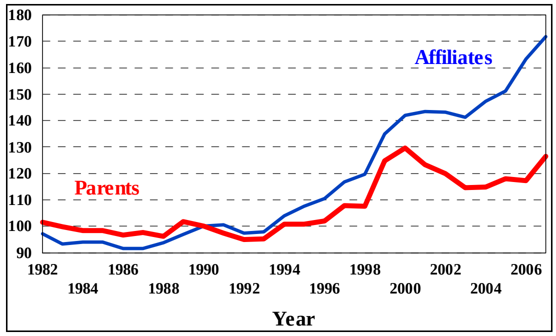
A major source of contention in the United States regarding foreign investment focuses on the impact such investment is having on U.S. employment.[6] Some observers argue that recent actions by U.S. parent companies are different from previous experiences with foreign investment because the parent companies are shifting jobs, capital, and technology offshore to their foreign affiliates in ways that are distinctly different from previous periods, and thereby are reducing employment in the United States. The Department of Commerce's Bureau of Economic Analysis provides the most comprehensive set of data on U.S. direct investment abroad and on foreign direct investment in the United States. These data, however, were not designed to link employment gains or losses in the United States, either for individual jobs, individual companies or in the aggregate, with the gains and losses of jobs abroad. The data indicate, though, that the employment trends of U.S. parent companies are sensitive to economic conditions in the U.S.

[6] For a comprehensive look at how offshore outsourcing has affected U.S. workers, see CRS Report RL32292, *Offshoring (a.k.a. Offshore Outsourcing) and Job Insecurity Among U.S. Workers*, by Linda Levine. Also, see Drezner, Daniel W., The Outsourcing Bogeyman, *Foreign Affairs,* May/June, 2004; and Engardio, Pete, Aaron Berstein, and Manjeet Kripalani, Is Your Job Next? *Business Week,* February 3, 2003. P. 50-60.

economy, particularly during periods in which economic growth slows down, as it did in the early 1980s, 1990s, and in the early 2000s.

Foreign investment data seem to indicate that, despite, or perhaps because of, the growing international linkages between economies, an expansion or a contraction in the rate of growth in the U.S. economy affects employment among U.S. parent companies more than it affects employment among the overseas affiliates of these parent companies. Nevertheless, changes in jobs among U.S. parent companies that are related to the overall rate of growth of the economy also affect the rate of growth in other countries and, therefore, in employment among the foreign affiliates, though not necessarily by the same magnitude, as indicated in **Figure 2**.

Figure 2. Index of Employment of U.S. Parent Companies and Their Foreign Affiliates, 1992-2007 (1990 = 100)



Source: Department of Commerce.

International linkages between U.S. and foreign economies mean that economic conditions in the United States have an impact on economic conditions abroad, there appears to be no distinct pattern between the creation or loss of jobs within U.S. multinational companies and a commensurate loss or creation of jobs among the foreign affiliates of those companies. Indeed, within most of the major developed countries, those economic forces that spur direct investment inflows also boost direct investment outflows. As a result, foreign direct investment may create jobs in the foreign affiliate that substitute for jobs in the parent company, but foreign investment may also positively affect job creation in both the parent company and the foreign affiliates, which makes it difficult to identify any broad trend regarding outsourcing.

Trade

Another aspect of foreign direct investment that causes concern is the impact foreign direct investment has on the amount of foreign trade associated with those investments. Some observers argue that U.S. direct investment abroad supplants U.S. exports, jobs, and research and development funds, thereby reducing employment and wages in the U.S. economy. Others are concerned that outward direct investment alters the industrial composition of domestic production and trade flows, which can affect the sectoral and regional distribution of employment and the relative demand for skilled and unskilled labor.[7] According to this scenario, as firms invest abroad, they shift production abroad and replace U.S.-based production with exports back to the United States, thereby eliminating jobs in the United States. As production shifts abroad, jobs are lost in the United States and goods that once were produced in the United States are now imported from abroad. Most studies indicate that, on balance, direct investment abroad increases U.S. exports and helps sustain employment and wages at home.[8]

[7] *International Investment Perspectives: 2006 Edition*, the Organization for Economic Cooperation and Development. p. 99.

[8] Ibid., p. 101; Brainard, S. Lael and David A. Riker, *Are U.S. Multinationals Exporting U.S. Jobs?* NBER Working (continued...)

There is little doubt that some firms do indeed replace domestic production with production from abroad, which would shift trade patterns, but the share of U.S. trade represented by U.S. parent companies and their affiliates since the 1990s did not increase as would be expected. Instead, intra-firm exports and imports fell as a share of total U.S. exports and imports during the 1990s. From 2000 to 2003, intra-firm trade, both exports and imports, increased as a share of total U.S. exports and imports respectively, but since 2003, intrafirm trade in exports and imports has fallen as a share of total U.S. exports and imports.

For some observers, another concern is that U.S. parent firms have started moving service jobs offshore, or outsourcing, in sectors that once were thought to be immune to such activities.[9] U.S. foreign affiliates had $763 billion in services sales in 2007. Of this amount, 5.2% consisted of service sales back to the U.S. parent company. The largest share—73%—of sales of services were made in the local market. This share is substantially higher than the comparable share for sales of goods and services combined and is consistent with the general view that the distinguishing feature of services is that they are consumed where they are produced..

Conclusion

Data published by the Bureau of Economic Analysis offer no conclusive evidence that current investment trends are substantially different from those of previous periods. The data also show that U.S. direct investment abroad and foreign direct investment in the United States generally move in the same direction so that those forces which encourage U.S. firms to invest abroad also encourage foreign firms to invest in the United States. From the data examined, it is not apparent that U.S. parent companies are outsourcing jobs at a faster pace or in a manner that is fundamentally different or distinct from previous periods. There is an important caveat to these conclusions, however. The data published by the BEA were not developed to address the issue of jobs outsourcing and it is not possible with the BEA data to track job losses or gains in specific industries, specific companies, or specific plants with changes in jobs abroad. In addition, the BEA data lag behind current events by two years, which means that assessing these activities may seem to be out of sync with the more limited anecdotal examples that appear in the popular press.

The data do indicate, though, that an increase in economic growth in the U.S. parent companies relative to the rate of growth in the foreign affiliates likely increases pressure within the economy to complete structural changes and to shift capital and labor from declining sectors to expanding sectors. Such changes may also lead to a greater number of jobs being outsourced, but this effect likely would be muted by the overall strong demand for jobs within the economy and by new foreign investments in the economy.

On the other hand, an economic slowdown among U.S. parent companies relative to the rate of growth among foreign affiliates likely would lead to an overall decline in employment throughout the economy. U.S. parent companies may or may not respond to an economic slowdown by outsourcing jobs abroad because the dominating presence of the U.S. economy in the world economy means that an economic slowdown in the United States likely reduces economic growth abroad as well and that the foreign affiliates of those parent companies may not be a position to

(...continued)

Paper 5958, National Bureau of Economic Research, March 1997.

[9] Lohr, Steve. "High-End Technology Work Not Immune to Outsourcing." *The New York Times*, June 16, 2004, p. C1.

add more jobs. The uneven effect of an economic slowdown among U.S. parent companies on their investment behavior abroad likely means that jobs outsourcing may appear to be more acute during periods in which the long-term structural changes in the economy coincide with the short-term economic adjustments that arise from a slowdown in the rate of growth of the U.S. economy.

For Congress, the data on direct investment seem to indicate that the number of jobs created by U.S. parent companies and by the foreign affiliates of those parent companies is tied closely to the overall performance of the U.S. economy. Such economic measures as employment, trade, and investment will rise and fall among U.S. parent companies and their foreign affiliates generally in tandem. Swings in the rate of growth in the economy that are associated with the business cycle tend to affect U.S. parent companies more than they affect their foreign affiliates and more than those U.S. firms that are purely domestic. Policies that ameliorate the business cycle, especially the downside of the cycle when the economy is experiencing a slow rate of economic growth, likely would do the most to help U.S. parent companies. Furthermore, Congress may choose to address the economic plight of those workers and communities that experience a disproportionate share of the adjustment costs that are associated with the business cycle by providing specialized assistance or other types of short-term support.

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