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, 74% of the accumulated U.S. foreign direct investment is concentrated in high income developed countries, who are members of the Organization for Economic Cooperation and Development (OECD). 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 responding primarily to domestic economic forces.

In the 113th Congress, Members introduced a number of measures that would affect U.S. multinational companies in their foreign investment activities: (1) H.R. 851, S. 337, S. 2562, and S. 2569 (Bring Jobs Home Act) that would provide certain tax exemptions to U.S. multinational firms to induce them to redirect economic activity from a foreign subsidiary to a domestic U.S. operation; and (2) H.R. 4679, H.R. 4895, S. 2360 (Stop Corporate Inversions Act) to discourage U.S. firms from incorporating themselves overseas to avoid being taxed on their foreign income by merging with or acquiring a company in a low-tax jurisdiction, termed an inversion. In the 114th Congress, Members also introduced similar measures, including: H.R. 297, Stop Tax Haven Abuse Act of 2015, introduced by Representative Lloyd Doggett on January 13, 2015, and companion measure S. 174, introduced by Senator Sheldon Whitehouse; and H.R. 415, Stop Corporate Inversions Act of 2015, introduced by Representative Sander Levin on January 20, 2015, and companion measure S. 198, introduced by Senator Richard Durbin. While H.R. 415 and S. 198 are directed at tax inversions, H.R. 297 and S. 174 address a number of tax and financial issues relative to U.S. multinational firms, including: the use of foreign tax havens to evade U.S. taxes; money laundering; corporate offshore tax avoidance; and corporate tax inversions.

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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] fell by 10% in nominal terms in 2014 from the amount invested in 2013, reflecting a slow rate of economic growth in Europe and elsewhere. Net investments fell from $399 billion in 2013 to $357 billion in 2014, including adjustments for changes in the value of some components, according to the Department of Commerce.[2] According to first quarter 2015 data, U.S. direct investment abroad was $75 billion, down by one-third from the $112 billion invested in fourth quarter 2014, but up 37% compared with the same period in 2014. A sharp 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). U.S. direct investment abroad also dropped between 2008 and 2010 below the amount recorded in 2007, reflecting the financial crisis that sharply reduced the availability of investment funds. Foreign direct investment in the United States fell by more than half from $287 billion in 2013 to $132 billion in 2014. In part, the drop in foreign direct investment reflects a $130 billion stock buyback between Verizon and France's Vodafone. 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 the flows can be quite erratic at times.

According to balance of payments data, the amount of U.S. direct investment abroad in 2014 dropped relative to that invested in 2013 as a result of a sharp reduction in intercompany debt and equity capital that overshadowed an increase in reinvested earnings. Equity capital fell from $17 billion in 2013 to $8 billion in 2014, or by slightly more than half. Reinvested earnings, which comprised about 97% of total U.S. direct investment abroad in 2014, increased by about 9% over the amount recorded in 2013. Intercompany debt fell from $67 billion in 2013 to $2 billion in 2014 as the foreign affiliates of U.S. parent companies sharply reduced their net holdings of debt instruments. An increase in stock market valuations around the world in 2012 and 2013 sharply increased the overall value of U.S. direct investment abroad, measured at market value, by $723 billion in 2012 and by $1.1 trillion in 2013 and $82 billion in 2014. During the same period, the market value of foreign firms operating in the United States experienced an increase of $462 billion in 2012, $1.1 trillion in 2013 and by $462 billion in 2014.[3]

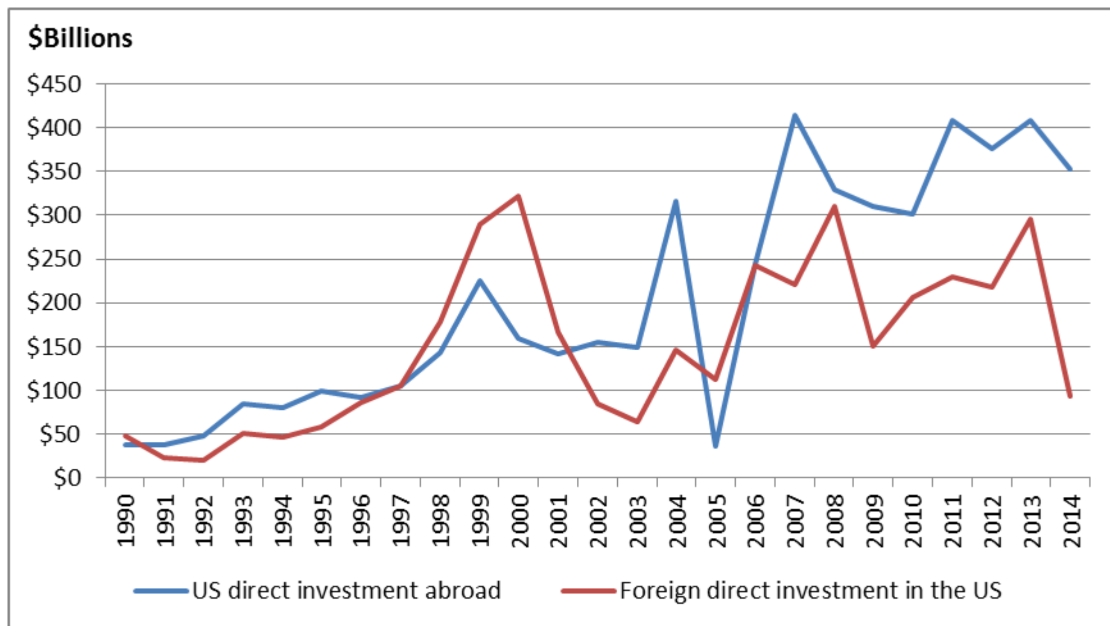
[1] The United States defines direct investment abroad as the ownership or control, directly or indirectly, by one person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. 15 CFR §806.15 (a)(1).

[2] Zeile, William J., U.S. International Transactions: Fourth Quarter of 2014 and 2014. *Survey of Current Business*, April 2015, p.1; Zeile, William and Paul Farello, *U.S. International Transactions: First Quarter 2015 and Annual Revisions*, BEA Release 15-26, June 18, 2015. 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.

[3] Westmoreland, Kyle L., The International Investment Position of the United States at the End of the Fourth Quarter of 2014 and Year 2014, *Survey of Current Business,* April 2015, p. 1.

Since the mid-1990s, the combination of strong growth and low inflation in the U.S. economy has attracted foreign investors, as indicated in **Figure 1**. From 2006 to 2010, U.S. direct investment abroad was about a third more than the amount foreigners invested in the U.S. economy. In 2010, both U.S. and foreign direct investment rose over the values of the previous year, but U.S. direct investment abroad was greater than the amount foreigners invested in U.S. businesses and real estate, reflecting the low rate of growth in the U.S. economy. Such investments picked up again in 2011-2014, reaching more than $350 billion annually. 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.

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2014



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,[4] or the cumulative amount at book value, reached $4.7 trillion in 2013, the latest year for such detailed investment position data.[5] The Department of Commerce does not attempt to deflate

[4] 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 in 2013 U.S. direct investment abroad measured at current cost increased by $311 billion and by $1,079 billion when measured by market value, to reach $5.3 trillion and $6.3 trillion, respectively.

[5] Barefoot, Kevin B., Marilyn Ibarra-Caton, Direct Investment Positions for 2012: Country and Industry Detail, *Survey of Current Business*, July, 2013. p. 26.

the annual nominal amounts for direct investment with a specific price deflator. Instead, the department publishes alternative estimates based on current cost and market value to provide other measures of the value of direct investment. About 74% of the accumulated U.S. foreign direct investment is concentrated in high income developed countries, who are members of the Organization for Economic Cooperation and Development (OECD): investments in Europe alone accounts for over half of all U.S. direct investment abroad, or $2.6 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.

Table 1. U.S. Direct Investment Position Abroad on a Historical-Cost Basis at Year-End 2013

(in billions of dollars)

	All industries	Manu-facturing	Whole-sale trade	Infor-mation	Banking	Finance	Services	Holding companies	Other
All	**$4,660.9**	**$612.4**	**$212.9**	**$157.5**	**$106.0**	**$767.2**	**$98.8**	**$2,153.3**	**$310.8**
Canada	368.3	80.9	212.0	89.0	4.6	51.8	8.5	119.9	42.1
Europe	**2,607.2**	**298.4**	**83.5**	**95.6**	**70.1**	**338.7**	**55.6**	**1,447.7**	**178.4**
Belgium	48.0	24.6	4.1	0.1	0.8	12.2	1.4	1.5	3.1
France	78.0	23.8	5.8	2.6	3.0	16.3	3.7	13.3	9.6
Germany	118.4	32.1	11.8	7.2	1.4	20.4	4.6	31.4	9.2
Ireland	239.6	26.9	-1.0	28.6	(D)	5.7	10.0	112.1	(D)
Italy	27.6	8.8	2.8	3.0	2.2	3.3	0.4	-1.3	8.2
Luxemb.	416.3	10.8	0.0	5.8	(D)	37.1	0.6	342.4	8.1
Netherl.	722.8	47.9	22.1	3.5	(D)	33.2	5.5	578.1	(D)
Spain	31.4	13.6	3.1	1.2	1.1	3.3	0.0	5.6	3.1
Sweden	36.5	3.8	1.6	1.3	(D)	11.7	0.7	13.2	(D)
Switzer.	129.8	24.7	16.9	6.0	2.9	14.9	3.1	40.9	19.7
UK	571.0	48.1	9.9	30.9	19.0	172.4	22.9	214.3	43.7
LAmerica	**884.4**	**71.7**	**48.5**	**18.0**	**-2.3**	**242.2**	**3.9**	**388.1**	**45.8**
Brazil	78.1	27.9	4.0	5.5	(D)	13.1	1.1	13.8	(D)
Chile	41.1	4.7	1.6	0.4	(D)	5.8	0.5	2.0	(D)
Venez.	14.5	6.1	0.7	(D)	0.0	1.7	0.9	2.5	0.6
Mexico	101.4	30.3	3.1	1.7	1.0	13.9	0.2	30.1	10.5
Bermuda	287.0	2.2	(D)	3.2	0.2	70.0	0.3	196.0	20.0
Dom. Re.p	1.3	1.1	0.0	0.0	(D)	(D)	0.0	0.0	(D)
UK Car.	234.2	0.1	22.5	2.9	-13.5	99.3	0.6	111.0	2.6
Africa	**60.4**	**3.7**	**2.0**	**0.1**	**2.4**	**3.9**	**0.8**	**10.4**	**1.2**
Mid. East	**45.3**	**9.9**	**1.8**	**1.3**	**1.0**	**0.9**	**1.6**	**12.2**	**1.5**
Asia	**695.3**	**147.7**	**55.8**	**33.5**	**30.1**	**129.8**	**26.4**	**175.1**	**41.9**
Australia	159.0	15.5	6.9	13.6	-0.1	16.7	8.3	59.4	7.4

	All industries	Manu-facturing	Whole-sale trade	Infor-mation	Banking	Finance	Services	Holding companies	Other
China	61.5	32.1	5.7	1.7	3.7	3.4	1.4	3.6	6.6
HK	58.8	5.2	15.2	7.3	2.1	7.7	1.8	16.6	2.9
Japan	123.2	20.3	9.5	6.3	3.7	72.3	2.1	3.4	5.5
Korea	32.8	13.2	1.7	0.2	(D)	5.7	0.6	0.6	(D)
Singapore	154.7	28.7	9.5	5.2	0.3	15.9	0.9	87.1	5.3
Taiwan	16.9	7.2	3.0	0.1	(D)	1.3	0.2	0.2	(D)
OPEC	63.1	9.5	2.8	1.6	(D)	2.4	1.2	21.4	(D)

Source: Ibarra-Caton, Marilyn and Raymond J. Mataloni, Jr. Direct Investment Positions for 2013: Country and Industry Detail, Survey of C*urrent Business*, July 2014. p. 17.

Note: A (D) indicates that the data have been suppressed by the Department of Commerce to avoid disclosing the data of individual companies. A negative position may result as foreign affiliates repay debts to their U.S. parents, and as U.S. parents borrow funds from their foreign affiliates.

Typically, U.S. firms have placed the largest share of their annual investments in developed countries, primarily in Western Europe, but this tendency increased after 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. By location, in 2013, U.S. firms focused 56% of their investments in the highly developed economies of Europe, down from a share of about 60% of total overseas direct investment recorded in 2011. Another 16% of U.S. direct investment abroad was located in Latin America (less Mexico and Chile) and 8% of investment was located in Asia (less Australia, Japan, New Zealand, and South Korea). Direct investments in Africa accounted for about 1.3% of total U.S. direct investment abroad in 2013, with investments in the Middle East accounting for about 1% of the total.

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 2000-2013 period grew by nearly five times, rising from $920 billion to $4.7 trillion. Annual investments in most sectors increased in 2013 over the amount invested in 2012, except for investment in computers, electrical equipment, and transportation manufacturing and investments in the banking sector. Generally, service-oriented sectors, particularly the information sector, continued to grow through 2013.

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 back 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. In 2012, the latest year for which U.S. direct investment abroad data are available, 8.2% of affiliate sales were sold to the U.S. parent companies.[6]

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.[7]

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. In addition, U.S. multinational companies were disproportionately negatively affected in 2008 and 2009 by the global economic recession as a result of the geographic distribution of the multinational firms' activities and the industrial composition of their operations. 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.[8] 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%.[9]

[6] *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2012 Estimates*, October 2014. Table II. E. 1.

[7] Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 1998. *Survey of Current Business*, July 2000. pp. 24-45.

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

[9] Ibid., p. 31.

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, no U.S. government agency collects data on U.S. firms in such a way that it is possible to track a plant closing in the United States with a comparable plant opening in a foreign country. As a result, most data on the activity of U.S. firms shifting plants or jobs abroad are anecdotal. 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 patterns, however, are determined by a broad range of factors, and shifts in plant locations by U.S. multinational firms likely represent a small part, at best, of the overall pattern of employment in the United States.

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. Employment fell again in 2008 to 21 million as the rate of U.S. economic growth slowed. By 2012, however, employment among U.S. parent companies rose to 23.1 million, gaining slightly over the 22.99 million employed in 2011, although the number of U.S. parent companies declined by about one percent. Employment among foreign affiliates also rose by about 2% in 2012 over the number employed in 2011 to reach 12.1 million.

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 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 2012, 8% of the sales of the foreign affiliates of U.S. firms was accounted for by exports back to the United States,[10] amounting to about $471 billion of the $5.7 trillion in total affiliate sales. Of this total amount, 60% of affiliate sales were in the local market of the affiliate and another 30% of sales were to other foreign countries.

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.[11] 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. In the 113th and 114th Congresses, Members of Congress expressed concerns over U.S. direct investment abroad through measures that would offer certain tax advantages to U.S. firms that shifted parts of their operations back to the United States and through measures that are directed at curbing tax havens and tax inversions and other practices that shift taxes from the United States to foreign locations.[12]

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[10] *U.S. Direct Investment Abroad*, Table IIF1.

[11] CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by (name redacted).

[12] See CRS Report RL34115, *Reform of U.S. International Taxation: Alternatives*, by (name redacted), and CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by (name redacted).

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