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James K. Jackson
Congressional Research Service

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James K. Jackson
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

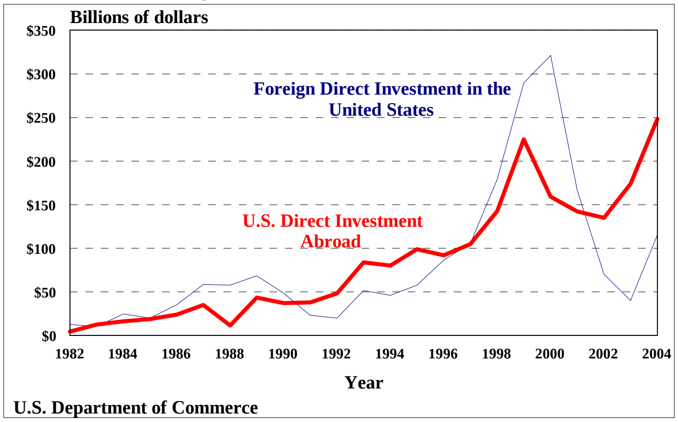
Summary

Foreign direct investment is provoking a national debate.[1] 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 disproportionate 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. The issue is made more difficult because broad, comprehensive data on U.S. multinational companies were not developed to address the issue of jobs outsourcing.[2] This report provides an overview of CRS Report RL32461 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 updated as events warrant.

[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). 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).

[2] Data for this report were taken from the annual surveys by the Bureau of Economic Analysis on U.S. direct investment abroad and on foreign direct investment in the United States. See *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates*; and *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies*. Preliminary results from surveys are published in the *Survey of Current Business* generally 18 months after the end of the reporting calendar year, with the more detailed reports issued in the fall of that year.

Figure 1. U.S. Direct Investment Abroad and Foreign Direct Investment in the U.S. Economy, Annual Flows 1982-2004



The United States is the largest foreign direct investor in the world and the largest recipient of such investment funds.[3] On a historical cost basis, or book value basis, the Department of Commerce estimates that by the end of 2003 U.S. firms had accumulated $1.8 trillion worth of direct investment abroad, compared with the $1.4 trillion foreign investors had spent to acquire or establish businesses in the United States.[4] As **Figure 1** shows, the 2000 — 2002 slowdown in the U.S. economy significantly reduced direct foreign investment flows. Foreign direct investment in the United States on an annual basis peaked at $320 billion in 2000 before plummeting to about $40 billion in 2002, according to Commerce Department data.[5] Recent Department of Commerce data indicate that foreign direct investment rose to $113 billion in 2004, nearly triple in the amount foreigners invested in 2004. U.S. direct investment abroad followed a similar trend: on an annual basis, U.S. direct investment abroad totaled $160 billion in 2000, down from $225 billion in 1999, and fell to $138 billion in 2002. Recent data indicate that U.S. direct investment abroad rose to a record amount (in nominal terms) of $248 billion, 40% more than U.S. firms had invested abroad in 2003.

U.S. and Foreign Multinational Companies

By the end of 2002, there were more than 2,400 U.S. parent companies with over 24,000 affiliates operating abroad, as **Table 1** indicates. In comparison, foreign firms had

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[3] 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 recently displaced the United States as the largest recipient of annual foreign direct inflows.

[4] Borga, Maria, and Daniel R. Yorgason, Direct Investment Positions for 2003, *Survey of Current Business*, July 2004, p. 40. The Department of Commerce publishes two additional estimates of the value of U.S. direct investment abroad and foreign direct investment in the United States. These methods represent the current cost method and the market value method. According to these methods, U.S. direct investment abroad would be valued at $2.1 trillion and $2.7 trillion, respectively; foreign direct investment would be valued at $1.6 trillion and $2.4 trillion, respectively. Abaroa, Patricia E.., The International Investment Position of the United States at Yearend 2003, *Survey of Current Business*, July 2004, p. 38-39.

[5] Bach, Christopher, L., U.S. International Transactions, 2004. *Survey of Current Business*, April 2005. p. 46.

under 6,000 affiliates operating in the United States. U.S. parent companies employed 22 million workers in the United States, compared with the 9.7 million workers employed abroad by U.S. firms and the 5.9 million persons employed in the United States by foreign firms. The foreign affiliates of U.S. firms employ more workers than do the affiliates of foreign firms and they paid slightly more in aggregate employee compensation than the affiliates of foreign firms paid in the United States. The foreign affiliates of U.S. parent companies, however, had a 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 17% higher than the U.S. affiliates of foreign firms. The foreign affiliates of U.S. firms, however, paid nearly two and a half 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, 2001

(in millions of dollars unless otherwise indicated)

	U.S. Multinational Companies		U.S. Affiliates of Foreign Firms
	Parent Companies	Affiliates	
Number of firms	2,418	24,607	5,726
Employment (thousands)	22,413.4	9,665.9	5,932.2
Employee compensation	$1,150,738	$311,678	$307,133
Gross product	$1,857,354	$611,456	$453,637
Total assets	$14,647,487	$6,865,705	$5,213,336
Sales	$6,426,628	$2,973,212	$2,225,352
Taxes	$146,672	$117,919	$44,848
R&D Expenditures	$137,968	$21,151	$27,508

Source: *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2002 Estimates*; and *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2002 Estimates.*

U.S. multinational companies play an important role in the U.S. economy**.** U.S. parent companies produced $1.86 trillion in goods and services in 2002, down slightly from the amount they produced in 2001 as a result of the slowdown n the U.S. economy. This amount comprised about 22% of total U.S. private industry gross product, a share U.S. parent companies managed to improve upon slightly throughout the 1990s despite significant changes in the U.S. economy as a whole. As a result, these data seem to challenge the notion that U.S. multinational companies were engaged in some new effort to shift a significant portion of their operations abroad, at least through 2002.

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

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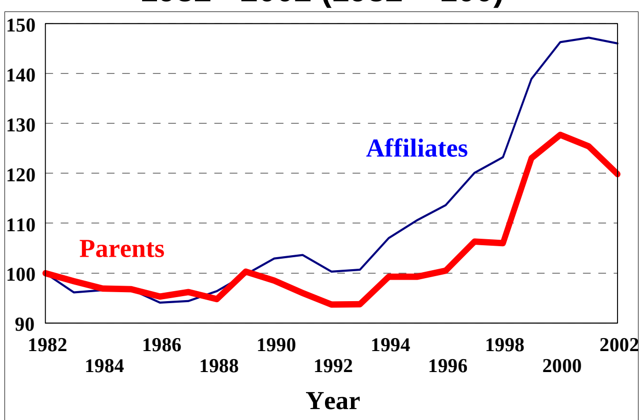
[6] For a comprehensive look at how offshore outsourcing is affecting U.S. workers, see CRS Report RL32292, *Offshoring (a.k.a. Offshore Outsourcing) and Job Insecurity Among U.S.* (continued...)

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, but these data 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. 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 their overseas affiliates. Nevertheless, changes in jobs among U.S. parent companies that are related to the overall growth rate of the economy also affect the growth in employment among the foreign affiliates, though not necessarily by the same magnitude. As a result, the number of employees in the parent companies and in the affiliates tends to rise and fall in a generally similar pattern as is indicated in **Figure 2**.

Figure 2. Employment of U.S. Parent Companies and Their Foreign Affiliates, 1982 - 2002 (1982 = 100)



International linkages between U.S. and foreign economies mean that economic conditions in the United States have an impact on economic conditions abroad, but 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. The apparent lack of a direct linkage between job gains and losses among parent companies and their foreign affiliates likely arises from the

[6] (...continued)
Workers, by Linda Levine. Also, see Drezner, Daniel W., The Outsourcing Bogeyman. *Foreign Affairs*, May/June, 2004; and Engardio, Pete, Aaron Bernstein, and Manjeet Kripalani, Is Your Job Next? *BusinessWeek*, February 3, 2003. P. 50-60.

many factors that can affect job gains and losses both within individual companies and within the economy as a whole.

Trade

Another aspect of foreign direct investment that causes concern is the impact it has on the amount of foreign trade associated with those investments. Some observers argue that foreign direct investment and trade are substitutes, so that overseas investment reverses trade patterns by shifting production and jobs abroad; as production shifts abroad, jobs are lost in the United States and goods once produced in the United States are now imported from abroad. If foreign direct investment is a substitute for trade and replaces jobs in the parent company, then it would be reasonable to expect the share of intra-firm trade to increase over time along with the flow of foreign investment. Such intra-firm trade represents trade between U.S. parent companies and their foreign affiliates and the U.S. affiliates of foreign firms and their foreign parent company. In particular, if foreign investment is displacing jobs and domestic production, or outsourcing jobs, it would be reasonable to expect imports from U.S. foreign affiliates to the U.S. parent company to increase over time.

There is little doubt that some firms do indeed replace domestic production with production from abroad, which would shift trade patterns. The data indicate, however, that the share of U.S. trade represented by U.S. parent companies and their affiliates during the 1990s did not increase. Instead, intra-firm exports and imports fell as a share of total U.S. exports and imports during the 1990s.

For some, 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.[7] U.S. foreign affiliates had $420 billion in services sales in 2002. Of this amount, 3.6% consisted of service sales back to the U.S. parent company. The largest share — 81% — 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.

Conclusions

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,

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

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. This overall decline in employment would make it difficult to distinguish between those sectors that are undergoing long-term structural changes compared with those sectors that are experiencing short-term job losses due to the relatively slower rate of economic growth. 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 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.

Workers and communities that are involved with economic activities that are facing long-term structural decline may require support to assist displaced workers regain employment or to find new business partners to sustain economic development in those communities. Workers in industries that are undergoing long-term structural decline may well see production and jobs move abroad. Addressing such long-term structural decline, however, is especially challenging, because the economic forces that are working against such industries can be immense.