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Foreign Direct Investment in the United States: An Economic Analysis

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Abstract

[Excerpt} Foreign direct investment in the United States dropped sharply in 2012 after rebounded slowly in 2010 and 2011 after falling from the $310 billion recorded in 2008. According to preliminary data, foreign direct investment in the United States in 2013 could fall by 10% below the amount recorded in 2012. (Note: 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]). In 2012, according to U.S. Department of Commerce data, foreigners invested $166 billion in U.S. businesses and real estate, down 28% from the $230 billion invested in 2011. Foreign direct investments are highly sought after by many state and local governments that are struggling to create additional jobs in their localities. While some in Congress encourage such investment to offset the perceived negative economic effects of U.S. firms investing abroad, others are concerned about foreign acquisitions of U.S. firms that are considered essential to U.S. national and economic security.

On October 31, 2013, the Obama administration launched a new initiative, known as Select USA, to attract more foreign direct investment to the United States. According to the Administration, the aim of the program is to make attracting foreign investment as important a component of U.S. foreign policy as promoting exports. As a result, the President reportedly instructed commerce and state department officials to make attracting foreign investment one of their "core priorities." In addition, the program has designated global teams led by U.S. ambassadors in 32 key countries to encourage foreign investment into the U.S., and has established a "coordinated process" to connect prospective investors with senior U.S. officials. The initiative (selectusa.commerce.gov) offers a number of tools for foreign investors looking to invest in the United States, including a list of various state and federal programs that may be available to foreign investors.

Keywords

foreign investment, acquisitions, economic security, national security, Congress

Comments

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Summary

Foreign direct investment in the United States dropped sharply in 2012 after rebounded slowly in 2010 and 2011 after falling from the $310 billion recorded in 2008. According to preliminary data, foreign direct investment in the United States in 2013 could fall by 10% below the amount recorded in 2012. (Note: 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]). In 2012, according to U.S. Department of Commerce data, foreigners invested $166 billion in U.S. businesses and real estate, down 28% from the $230 billion invested in 2011. Foreign direct investments are highly sought after by many state and local governments that are struggling to create additional jobs in their localities. While some in Congress encourage such investment to offset the perceived negative economic effects of U.S. firms investing abroad, others are concerned about foreign acquisitions of U.S. firms that are considered essential to U.S. national and economic security.

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Recent Investments

Foreigners invested $166 billion in nominal terms in U.S. businesses and real estate in 2012, according to data published by the Department of Commerce.[1] According to preliminary data, foreign direct investment in the United States in 2013 is estimated at $147 billion, a drop of 11% from the amount invested in 2012. As **Figure 1** shows, the amount foreigners invested in the United States in 2012 represents a decrease of 28% from the $230 billion foreigners invested in 2011. The decrease in foreign direct investment inflows mirrors a similar decrease in global flows in 2012, following increases in 2010 and 2011. According to the United Nations' *World Investment Report*, global foreign direct investment inflows fell by 18% in 2012 compared with the amount invested in 2011. Such investment rose by 16% in 2010 and by 17% in 2011 to reach $1.6 trillion, short of the $2.0 trillion invested globally in 2007.

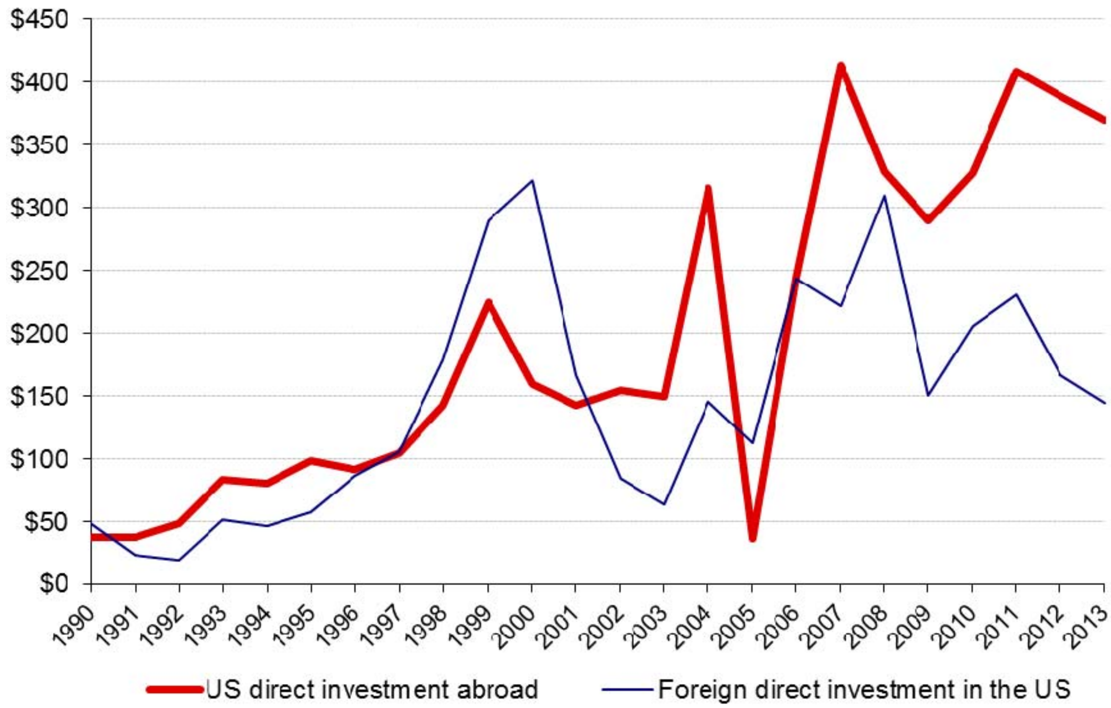
According to Commerce Department data, U.S. direct investment abroad in 2012 was about $388 billion, a drop of 5% from the amount invested in 2011.[2] The drop in U.S. direct investment abroad in 2012 compared with 2011 was due to reductions in reinvested earnings, intercompany debt investment, and net equity investment by the overseas affiliates of U.S. parent firms. Despite increases in income and earnings in 2012 compared with 2011, foreign direct investment in the United States fell by more than $60 billion due to a sharp reduction in net equity investment and in intercompany debt by the U.S. affiliates of foreign firms.

[1] Scott, Sarah P., U.S. International Transactions: Second Quarter of 2013. *Survey of Current Business*, October 2013, p. 74. 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.

[2] Scott, Sarah P., U.S. International Transactions: Fourth Quarter and Year 2012. *Survey of Current Business*, April 2013, p. 28.

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2012

(in billions of dollars)



Source: U.S. Department of Commerce.

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[3] rose from $2.5 trillion in 2011 to $2.65 trillion in 2012. This marked an increase of 6.0%.[4] The Department of Commerce does not attempt to deflate 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.

As a share of the total amount of nonresidential investment spending in the U.S. economy, investment spending by foreign firms was equivalent to 11% in 2012, far below the 20% reached in 2009. Better credit conditions and a slight rise in the rate of growth in the U.S. economy tended to push up such mainstays of foreign direct investment activity as mergers and acquisitions. Despite increases in income and earnings in 2012 compared with 2011, foreign direct investment

[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 Department of Commerce also publishes data on the foreign direct investment position valued on a current-cost and market value bases. These estimates indicate that in 2011 foreign direct investment increased by $311 billion measured at current cost to a cumulative value of $2.9 trillion, while the market value measure rose by $112 billion in to reach a cumulative value of $3.5 trillion.

[4] Nguyen, Elena L., the International Investment Position of the United States at the End of the First Quarter of 2013 and Year 2012, *Survey of Current Business,* July 2013, p. 14.

in the United States fell by $66 billion to $166 billion in 2012, a drop of 28% compared with the $230 billion invested in 2011, due to a sharp reduction in net equity investment and intercompany debt. Equity values, which accounted for 40% of the total amount of foreign direct investment in 2011, dropped to account for 35% of foreign direct investment in the United States in 2012. Reinvested earnings rose by nearly 30% to account for 67% of total foreign direct investment, as U.S. affiliates relied more on their own earnings than on funds borrowed from their foreign parent companies. Intercompany debt accounted for the rest of the total amount of foreign direct investment, or about 1.0%. In comparison, U.S. direct investment abroad in 2012 was comprised primarily of reinvested earnings, which accounted for 86% of the total amount invested, followed by equity capital (9.0%) and intercompany debt (5.5%).

Foreign direct investments in most sectors of the U.S. economy were down in 2012 from the amount invested in 2011. Investments in the U.S. manufacturing sector as a whole in 2012 were below that in 2011, but still accounted for nearly half of the overall increase in foreign direct investment in 2012. Foreign direct investment in the banking, finance, real estate, and information sectors were all down in 2012, compared with investments in 2011. In comparison, investments in retail trade, professional services, and information sectors all increased in 2012, compared with 2011. Estimates for foreign direct investment based on the first two quarters of 2013 indicate that foreign direct investment in the United States could be down by 22% from the amount recorded in the comparable period in 2012. Such investments may well continue to lag behind similar investments in 2012 in the second half of 2013, depending on the rate of economic growth.

With a cumulative investment of $487 billion, the United Kingdom is the largest foreign direct investor in the United States, as indicated in **Table 1**. Japan is the second-largest foreign direct investor in the U.S. economy with about $308 billion in investments. Following the Japanese are the Dutch ($275 billion), the Canadians ($225 billion), the French ($209 billion), the Swiss ($204 billion), Luxembourg ($202), and the Germans ($200 billion).

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 yearend 2012, the cumulative amount of investment, or the investment position measured at historical cost, indicates that 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. German investors are the largest investors in the information sector as a result of a number of large media company acquisitions. French, German, and British investments dominate other foreign investments in the banking sector, while Dutch, Canadian, British, and French investments account for over half of the investments in the finance sector.

Britain's $68 billion investment in the U.S. finance and insurance sectors surpasses the more than estimated $74 billion invested in the finance sector alone by British firms (data for banking have been suppressed by the Department of Commerce), followed by Japan ($37 billion) and Canada (estimated at more than $34 billion), although investments in the U.S. finance sector by Germany and France likely are larger than investments by either Japan or Canada. Foreign direct investment in the U.S. manufacturing sector is dominated by a number of countries, each with substantial investments: investments by the United Kingdom ($138 billion), the Netherlands ($118 billion), Switzerland ($107 billion), Japan ($93 billion), Luxembourg ($74 billion), France

($76 billion), and Germany ($67 billion) account for nearly three-fourths 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 34% of foreign direct investment in the United States, a decline from periods when such investment accounted for a majority share of the total. Another 21% of foreign direct investment is in the banking and finance sectors, and 13% 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 5.0%, while real estate and services account for modest shares of 1.9% and 4.0%, respectively. All other industries account for the remaining 21%.

Table 1. Foreign Direct Investment Position in the United States on a Historical-Cost Basis at Year-End 2012
(in billions of U.S. dollars)

All	All industries	Manufacturing	Wholesale trade	Retail trade	Information	Banking	Finance	Real estate	Services	Other industries
All countries	**$2,650.8**	**$898.9**	**$292.4**	**$51.7**	**$123.8**	**$198.1**	**$365.8**	**$50.5**	**$106.7**	**$562.8**
Canada	225.3	39.9	5.3	(D)	1.4	(D)	64.4	2.2	(D)	67.6
Europe	**1,876.2**	**717.6**	**142.3**	**38.8**	**113.5**	**108.8**	**279.8**	**25.5**	**75.9**	**374.1**
Belgium	88.7	55.3	17.0	7.1	0.0	(D)	(D)	(D)	0.0	7.7
France	209.1	75.8	21.4	5.0	12.5	17.3	30.1	0.5	6.4	40.3
Germany	199.0	67.4	16.6	(D)	40.9	14.0	26.1	90	(D)	11.7
Ireland	24.9	10.7	0.8	0.0	0.0	0.1	3.4	0.0	(D)	(D)
Italy	23.3	7.2	1.4	3.5	0.2	(D)	(D)	0.2	(D)	(D)
Luxembourg	202.3	73.7	(D)	2.8	14.1	0.0	45.5	2.2	(D)	50.7
Netherlands	274.9	118.3	19.5	2.6	6.9	(D)	58.1	2.8	(D)	(D)
Spain	47.4	6.2	0.0	(D)	0.0	28.6	3.0	0.3	(D)	8.9
Sweden	42.4	29.0	6.6	(D)	0.5	(D)	0.2	(D)	(D)	1.8
Switzerland	204.0	106.6	10.6	6.5	(D)	(D)	42.5	1.6	0.5	38.1
UK	486.8	137.6	26.1	3.3	22.9	(D)	67.8	5.0	(D)	(D)
L. America	**98.6**	**12.3**	**3.6**	**(D)**	**0.9**	**5.1**	**-16.8**	**13.1**	**(D)**	**56.7**
Africa	**5.3**	**(D)**	**0.6**	**(D)**	**0.0**	**(D)**	**(D)**	**0.1**	**0.0**	**3.9**
Mid. East	**20.6**	**(D)**	**7.2**	**(D)**	**0.7**	**(D)**	**(D)**	**1.6**	**(D)**	**3.0**
Asia	**427.7**	**123.4**	**133.5**	**5.4**	**7.3**	**45.6**	**37.4**	**8.0**	**9.7**	**57.6**
Australia	42.7	3.8	0.7	(D)	0.1	3.0	3.6	0.9	(D)	29.8
Japan	308.3	93.4	105.9	5.1	6.2	36.9	29.5	6.4	6.5	18.4
Korea	24.5	3.9	16.8	0.0	0.0	0.6	0.2	0.1	0.0	2.8
Singapore	26.2	15.8	3.9	(D)	0.0	0.4	(D)	(D)	(D)	1.4
OPEC	15.5	(D)	(D)	(D)	0.0	1.1	(D)	1.2	0.0	2.8

Source: Lowe, Jeffrey H., Direct Investment Positions for 2009-2011: Detailed Historical-Cost Positions and Related Financial and Income Flows, Survey of C*urrent Business*, September 2012. p. 80.

Notes: 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.

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 2008 (the last year such data were collected and published by the Bureau of Economic Analysis), outlays for new investments, which include investments made directly by foreign investors and those made by existing U.S. affiliates, were $260 billion, a 3.0% increase over the $252 billion invested in 2007.

Acquisitions of existing U.S. firms generally account for more than 90% of the new investments by value. Investments by the existing U.S. affiliates of foreign firms have accounted for more than 80% of the total transactions by investor, while other foreign direct investors accounted for the remaining 20% of transactions. Investment outlays by foreign firms decreased from 2011 to 2012. The Department of Commerce halted publication of the annual report on foreign acquisitions after the June 2008 edition. Instead, it reportedly is developing a separate survey that it expects will better capture the construction of new plants by foreign-owned firms that are operating in the United States.

Economic Performance

By year-end 2011, the latest year for which detailed data are available, foreign firms employed 6.1 million Americans, less than 4% of the U.S. civilian labor force, and owned over 33,000 individual business establishments.[5] Foreign firms have a direct investment presence in every state. Employment of these firms ranges from over 590,000 in California, to about 6,100 in Montana. Following California, Texas (460,100), New York (410,000), Illinois (268,300), Pennsylvania (267,500), Florida (238,600), and New Jersey (228,600) have the largest numbers of residents employed by foreign firms.

In 2011, 37% 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, with average annual compensation (wages and benefits) per worker of about $84,000. Retail and wholesale trade accounted for another 10% 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 German firms account for over half of the employment in the wholesale trade sector. Canadian, French, and Japanese firms account for the largest share of affiliate employment in the services sector, which accounted for about 22% of total affiliate employment. Employment in the information, finance, and real estate services sectors accounts for another 12% of total affiliate employment. Average employee compensation is highest in the finance sector—$163,000—where British, Canadian, Swiss, French, and Dutch firms account for three-fourths of the employment. The rest of the affiliate employment is spread among a large number of other industries.

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[5] *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2011 Estimates*. Bureau of Economic Analysis, September 2013, Table 1A-1.

The affiliates of foreign firms spent $191 billion in the United States in 2011 on new plants and equipment, imported $647 billion in goods, and exported $311 billion in goods. 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.

The performance of foreign-owned establishments, on average, compared with their U.S.-owned counterparts presents a mixed picture. Historically, foreign-owned firms operating in the United States have had lower rates of return, as measured by return on assets, than U.S.-owned firms, although the gap between the two groups appears to have narrowed over time. According to the Bureau of Economic Analysis, this narrowing of the gap in the rate of return appears to be related to age effects, or the costs associated with acquiring or establishing a new business that can entail startup costs that disappear over time and market share.[6] By other measures, foreign-owned manufacturing firms appear to be outperforming their U.S. counterparts.[7] Although foreign-owned firms account for less than 3% of all U.S. manufacturing establishments, they have had six times more value added on average and seven times higher value of shipments than other manufacturing establishments. The average plant size for foreign-owned firms is much larger—six times—than for other U.S. firms, on average, in similar industries. This difference in plant size apparently rises from an absence of 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 60% higher than other U.S. manufacturing firms, had 40% higher productivity per worker, and had 58% 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 that 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 2012 fell below the amount invested in 2011, similar to a world-wide decline in foreign direct investment. Most regions experienced a similar decline in foreign direct investment inflows, especially among the most highly developed

[6] Mataloni, Raymond J. Jr., An Examination of the Low Rates of Return of Foreign-Owned U.S. Companies, *Survey of Current Business*, March 2000, p. 55.

[7] *Foreign Direct Investment in the United States, Establishment Data for 2002*, Bureau of Economic Analysis, June 2007.

economies where the impact of the financial crisis and economic recession was most concentrated. As the rate of growth of the U.S. economy improves relative to other advanced economies, interest rates stay low, and the rate of price inflation stays in check, foreign direct investment in the United States likely will increase. Preliminary data for 2013, however, indicate that a rebound in foreign direct investment in the U.S. economy likely will not materialize until 2014.

Of particular importance will be public concerns over foreign direct investment in the economy as a whole and on the overall phenomenon referred to as "globalization," with its impact on jobs in the economy. Concerns over foreign direct investment, where they exist, stem not so much from the perceived 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.

Although job security is an important public issue, opposition to some types of foreign direct investment stems from concerns about the impact of such investment on U.S. economic and security interests, particularly in light of the terrorist attacks of September 11, 2001. Particular foreign investments have raised national security concerns, but likely have not been a major factor in deterring foreign investors. Despite the national security complications, 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.

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