



CRS Report for Congress

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, 70% of U.S. foreign direct investment is concentrated in high income developed countries. 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. This report will be updated as events warrant.

Recent Investments

New spending by U.S. firms on businesses and real estate abroad, or U.S. direct investment abroad,¹ fell sharply in 2005 to \$9 billion, from the \$252 billion U.S. firms invested in 2004, according to the Department of Commerce.² This drop in investment spending contrasts with a slight increase in spending by foreign firms in 2005 to reach \$109 billion. The drop in U.S. direct investment abroad reflects actions by U.S. parent firms to reduce the amount of reinvested earnings going to their foreign affiliates for

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 Argersinger, Matthew J., and Erin M. Whitaker, U.S. International Transactions, Third Quarter of 2006. *Survey of Current Business*, January 2006, p. 19. 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.

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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). Estimates based on third quarter data indicate that U.S. direct investment abroad in 2006 could top \$150 billion.

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 they can be quite erratic at times. Since the mid-1990s, the combination of strong growth and low inflation in the U.S. economy attracted foreign investors, as indicated in **Figure 1**. From 2002 to 2005, U.S. direct investment abroad averaged more than twice the amount foreigners invested in the U.S. economy, reflecting the period of slower growth in the economy from 2001-2003. 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. U.S. Direct Investment Abroad and Foreign Direct Investment in the United States, Annual Flows 1990-2006

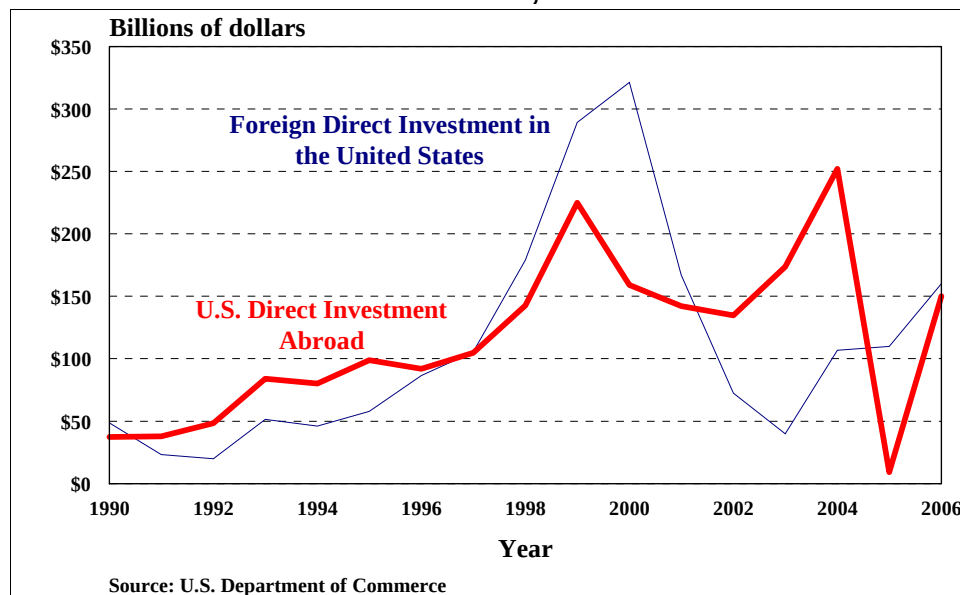


Table 1 indicates that the overseas direct investment position of U.S. firms on a historical-cost basis,³ or the cumulative amount at book value, reached \$2.1 trillion in

³ 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 \$55 billion and \$237 billion in 2005, respectively, to \$2.5 and \$3.5 trillion.

2005, the latest year for such investment position data.⁴ More than 70% of these overseas investments are in developed countries: Europe alone accounts for over half of all U.S. direct investment abroad, or \$1.1 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 2005
(in millions of U.S. dollars)

	All industries	Manufac- turing	Wholesale trade	Informa- tion	Banking	Finance	Services	Other industries
All countries	2,069,983	451,402	142,960	55,479	70,331	393,723	49,202	792,500
Canada	234,831	86,013	12,663	3,809	3,923	37,860	2,180	54,666
Europe	1,059,443	233,608	86,795	33,514	39,021	176,838	30,052	434,057
Belgium	36,733	12,635	3,895	(517)	829	9,580	4,407	5,892
France	60,860	22,214	5,909	1,559	1,901	4,342	1,909	22,957
Germany	86,319	22,200	18,964	2,818	1,385	13,560	4,235	22,653
Ireland	61,596	22,949	4,109	13,260	(D)	7,002	2,675	8,718
Italy	25,931	15,717	1,810	3,716	(D)	1,207	826	2,742
Luxembourg	61,615	4,921	314	(D)	637	2,236	20	51,418
Netherlands	181,384	29,508	14,152	4,385	49	28,695	2,388	98,189
Spain	43,280	10,286	3,117	1,632	1,617	5,328	295	20,948
Sweden	33,398	2,562	932	250	0	4,388	258	25,009
Switzerland	83,424	13,059	11,306	(2,651)	8,610	11,555	2,426	38,740
United Kingdom	323,796	60,355	13,963	6,937	17,018	85,474	9,863	124,190
Latin America	353,011	42,967	15,408	6,496	11,066	111,883	2,300	145,666
Brazil	32,420	13,486	430	804	3,271	4,412	362	7,614
Chile	9,811	1,683	754	371	1,347	2,472	37	2,106
Mexico	71,423	19,395	2,057	1,089	17,671	13,307	469	15,353
Bermuda	90,358	(199)	3,186	18	(*)	48,533	68	38,634
Caribbean	85,295	(1,620)	4,692	(D)	(11,703)	35,437	580	53,497
Africa	24,257	2,364	1,001	174	1,031	341	174	3,865
Middle East	21,591	5,499	723	1,802	277	1,150	981	5,542
Asia	376,849	80,951	26,369	9,684	15,014	65,651	13,514	148,704
Australia	113,385	13,174	2,532	510	2,804	6,455	1,948	80,903
China	16,877	8,840	2,245	772	753	13	285	2,253
Hong Kong	37,884	2,369	6,643	1,594	2,518	10,134	558	14,068
Japan	75,491	15,264	8,024	2,667	156	34,032	6,688	8,647
Singapore	48,051	14,307	1,886	1,608	849	(D)	1,225	685

Source: U.S. Direct Investment Abroad: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003-2005. *Survey of Current Business*, September 2006. p. 106.

Note: A (D) indicates that the data have been suppressed by the Department of Commerce to avoid disclosing the data of individual companies.

Typically, U.S. firms have placed the largest share of their annual investments in developed countries, primarily in Western Europe, but this tendency has increased since the mid-1990s. In the last half of the 1990s, U.S. direct investment abroad experienced

⁴ Koncz, Jennifer L., and Daniel R. Yorgason, Direct Investment Positions for 2005: Country and Industry Detail, *Survey of Current Business*, July, 2006. p. 20.

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. In 2004, U.S. firms focused a slightly greater percent of their investment funds on developing countries, which received 29% of the investment funds of U.S. multinational firms.

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. U.S. direct investment abroad during the 2000-2004 period increased about 56%. Investments in the finance and services sectors grew twice as fast, on the whole, as direct investment abroad overall during the 1996-2000 period. Within the manufacturing sector, food processing, chemicals, and metals lagged in growth behind the industrial machinery, electronic, and transportation sectors.

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 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. On average, about 8% of affiliate sales are to the U.S. parent companies.⁵

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.⁶

⁵ *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2004 Estimates*, October 2006. Table III. F. 1.

⁶ Mataloni, Raymond J. Jr. *U.S. Multinational Companies: Operations in 1998. Survey of* (continued...)

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. 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, comprising 24% of total U.S. private business output in 1998 (the latest year for which estimates are available).⁷ These MNC parent companies increased their share of all U.S. business GDP in the services sector, which rose from 6% to 8% of U.S. GDP during the period from 1989 to 1998. The MNC share of all other industries rose from 16% to 18% during the 10-year period, but they lost shares in the manufacturing sector (from 62% to 58%) at a time when the U.S. manufacturing sector as a whole was shrinking as a share of national GDP (from 20% to 16%).⁸

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 1977 to 1997, 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 24%.⁹

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, 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 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 in 2004 to 21.4 million as U.S. economic growth picked up. Employment among foreign affiliates also rose in 2004 by nearly 4% to 10 million, from 9.7 million in 2003.

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. In a number of cases, U.S. parent firms and their foreign affiliates lost or gained 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

⁶ (...continued)

Current Business, July 2000. p. 24-45.

⁷ Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 2003. *Survey of Current Business*, July 2005. p. 15.

⁸ *Ibid.*, p. 31.

⁹ *Ibid.*, p. 31.

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, however, 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 2004, 9.5% of the sales of the foreign affiliates of U.S. firms was accounted for by exports back to the United States,¹⁰ although this share is nonetheless substantial.

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.

¹⁰ Mataloni, Operations of U.S. Multinational Companies. p. 41.

¹¹ CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by James K. Jackson.