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Foreign Direct Investment in the United States: An Economic Analysis

name redacted
Specialist in International Trade and Finance

June 30, 2015

Congressional Research Service
7-....
www.crs.gov
RS21857

Summary

Foreign direct investment in the United States in 2014 dropped by more than half from the amount recorded in 2013, reflecting in part a large stock buyback by a major U.S. communications firm. (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 2014, according to U.S. Department of Commerce data, foreigners invested $132 billion in U.S. businesses and real estate, down 54% from the $287 billion invested in 2013. 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 United States, 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.

Contents

Figures

Tables

Contacts

Recent Investments

Foreigners invested $132 billion in nominal terms in U.S. businesses and real estate in 2014, down 54% from the $287 billion foreigners invested in 2013, according to data published by the Department of Commerce.[1] According to first quarter 2015 data, foreign direct investment in the United States is estimated at $186 billion, two and a half times the amount of foreign direct investments in the fourth quarter of 2014. This increase in foreign direct investment stands in sharp contrast to the $105 billion net repayment, or net outflow, of direct investment liabilities experienced in the first quarter of 2014, which largely reflects the $130 billion stock buyback between Verizon and France's Vodafone that occurred in the period. As **Figure 1** shows, the amount foreigners invest in the United States can vary substantially from year to year, reflecting changes in broad economic conditions. The shifts in foreign direct investment inflows mirror similar changes in global flows in 2013, which experienced a growth of 9.0% over that invested globally in 2012, rising to $1.4 trillion. These global flows, however, were sharply below the $1.8 trillion invested in 2011, according to the United Nations' *World Investment Report*.[2]

According to Commerce Department data, the decline in foreign direct investment in the United States in 2014, compared with the increase experienced in 2013, was due to a sharp decline in net equity investments that shifted from a net increase of $127 billion in 2013 to a net decrease of $30 billion in 2014. In part, this shift in net equity investments may reflect the efforts by foreign firms to boost the value of their stock by buying back shares, as many U.S. firms have done since early 2014, likely reflecting the relatively large cash balances of the firms. In the first quarter of 2015, however, foreign investors increased their net acquisitions of U.S. equities by more than 200%, compared with the fourth quarter of 2014; net acquisitions of U.S. equities grew from $48.4 billion in the fourth quarter of 2014 to $153.5 billion in the first quarter of 2015. In addition, intercompany debt, or loans between the foreign parent and the U.S. affiliate, shifted from a net decrease between 2014 and 2013 to a net increase in the first quarter of 2015 compared with the fourth quarter of 2014; intercompany debt increased by more than seven times in the first quarter of 2015, rising from $4.0 billion in the fourth quarter of 2014 to $32.7 billion in the first quarter of 2015. Also, during 2014, compared with 2013, foreign reinvested earnings rose 17% overall. In the first quarter of 2015, however, reinvested earnings fell by half from that recorded in the fourth quarter of 2014.[3]

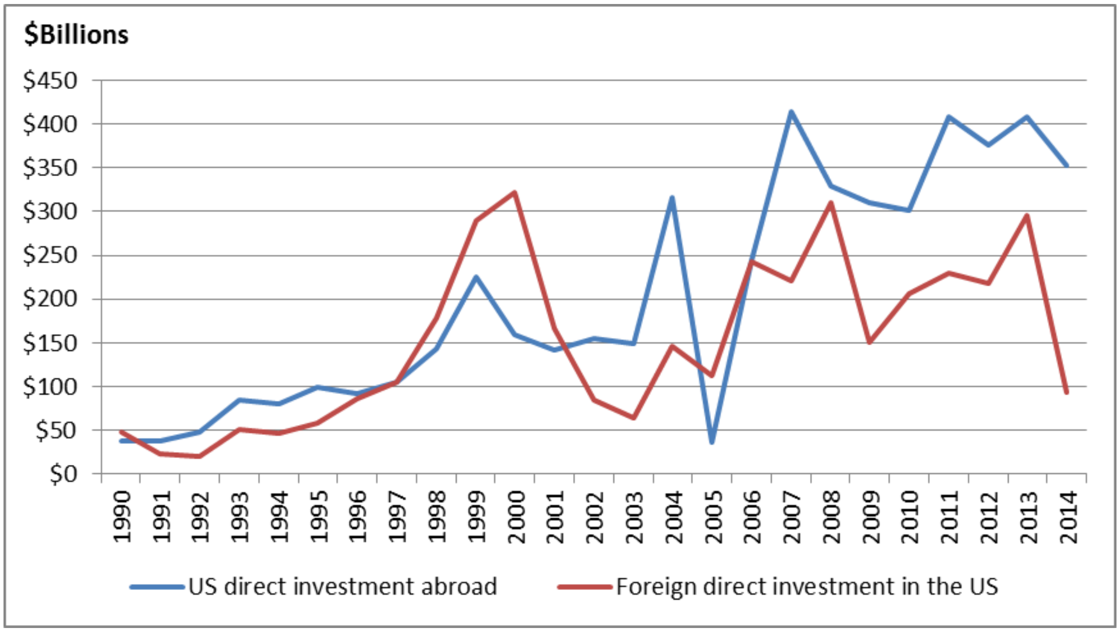
In contrast, the amount of U.S. direct investment abroad in 2014 dropped relative to that invested in 2013 as a result of a sharp reduction in intercompany debt and equity capital that overshadowed an increase in reinvested earnings. Equity capital fell from $17 billion in 2013 to $8 billion in 2014, 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.

[1] Zeile, William and Paul Farello, U.S. International Transactions: First Quarter of 2015 and Annual Revisions, BEA 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.

[2] *World Investment Report 2014*, United Nations Conference on Trade and Development, 2014.

[3] Zeile, William J., U.S. International Transactions: Fourth Quarter of 2014 and 2014. *Survey of Current Business*, April 2015, p. 9.

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.

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[4] rose from $2.76 trillion in 2013 to $2.88 trillion in 2014, or an annual increase of 4%.[5] 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 8.2% in 2013, a decrease from the 10.4% recorded in 2012. 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.

Foreign direct investments in most sectors of the U.S. economy were higher in 2013 than they were in 2012. Investments in the U.S. manufacturing sector as a whole in 2013 were up slightly more than one percent over that in 2012, accounting for around one-third of all foreign direct investment in 2013.Foreign direct investment in the banking, finance, and services sectors were

[4] 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 2014 foreign direct investment increased by $120 billion measured at current cost to a cumulative value of $3.3 trillion, while the market value measure rose by $424 billion in to reach a cumulative value of $5.0 trillion.

[5] 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.

all down in 2013, compared with investments in 2012. In comparison, investments in wholesale trade, retail trade, and information sectors all increased in 2013, compared with 2012. Foreign direct investment in the first quarter of 2015 increased by more than two and a half times that recorded in the fourth quarter of 2014, perhaps indicating renewed foreign interest in the United States as a manufacturing and production location. Estimates indicate that U.S. labor productivity, particularly in the manufacturing sector, has been robust compared not only with other sectors in the U.S. economy, but also relative to other advanced economies. From 1993 to 2010, labor productivity in the U.S. manufacturing sector doubled, while U.S. nonfarm business labor productivity increased by about 50%.[6] In addition, from 2002 to 2011, U.S. unit labor costs expressed in U.S. dollars, or the average cost of one unit of labor inputs required to produce one unit of output, fell by 15%, while unit labor costs rose in 18 other countries.[7] (See **Table 1**.)

Japan is the second-largest foreign direct investor in the U.S. economy with about $342 billion in investments. Following the Japanese are the Dutch ($274 billion), the Canadians ($238 billion), the French ($226 billion), the Swiss ($209 billion), Germans ($209 billion), and Luxembourg ($202 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 2013, 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 $67 billion investment in the U.S. finance and insurance sectors is slightly less than 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 ($32 billion) and Canada ($52 billion), although the combined investments in the U.S. finance sector by Germany and France ($57 billion) 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 ($168 billion), the Netherlands ($122 billion), Switzerland ($108 billion), Japan ($106 billion), France ($84 billion), and Germany ($76 billion), and Luxembourg ($58 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 20% of foreign direct

[6] *Jobs Supported by Exports 2013: An Update*, p. 7.

[7] *International Comparisons of Manufacturing Productivity and Unit Labor Cost Trends, 2011 Tables*, Bureau of Labor Statistics, December 6, 2012.

investment is in the banking and finance sectors, and 14% 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.% and 3.8%, 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 2013

(in billions of U.S. dollars)

All	All industries	Manu-facturing	Wholesale trade	Retail trade	Infor-mation	Banking	Finance	Real estate	Services	Other industries
All countries	**$2,764.0**	**$935.7**	**$328.5**	**$59.9**	**$148.6**	**$181.4**	**$364.7**	**$50.7**	**$104.2**	**$590.0**
Canada	237.9	53.9	5.5	8.2	1.0	38.9	51.6	4.0	2.9	71.9
Europe	**1,933.6**	**726.8**	**161.9**	**43.3**	**118.5**	**104.0**	**274.4**	**29.7**	**84.0**	**391.0**
Belgium	65.1	26.9	21.7	7.1	0.0	(D)	(D)	0.1	0.0	7.3
France	226.1	84.1	24.4	5.0	7.0	18.4	40.6	0.7	4.2	40.3
Germany	208.8	75.7	20.1	(D)	40.9	13.6	16.7	9.7	(D)	18.8
Ireland	26.2	10.9	0.8	0.0	0.0	0.1	3.8	0.0	(D)	2.3
Italy	25.4	5.9	1.9	4.3	0.2	(D)	(D)	0.2	(D)	8.3
Luxembourg	201.6	57.8	10.9	2.8	14.1	0.0	37.2	1.8	(D)	50.7
Netherlands	273.9	121.9	14.7	3.1	9.9	(D)	57.4	4.0	24.0	(D)
Spain	48.5	5.1	0.0	(D)	0.0	30.0	2.9	0.3	0.2	8.9
Sweden	44.4	29.0	6.5	(D)	0.5	(D)	0.1	(D)	(D)	1.8
Switzerland	209.4	107.6	10.6	7.5	13.2	(D)	45.6	1.8	0.2	38.1
UK	518.6	168.1	24.5	3.3	26.9	(D)	66.6	6.5	18.6	153.2
L. Am.	**99.7**	**18.4**	**0.5**	**2.2**	**0.7**	**5.1**	**-3.0**	**6.9**	**4.9**	**63.9**
Africa	**2.0**	**0.0**	**0.6**	**(D)**	**0.0**	**(D)**	**(D)**	**0.1**	**0.0**	**0.5**
Mid. East	**21.2**	**6.2**	**7.2**	**(D)**	**0.7**	**(D)**	**0.0**	**1.0**	**(D)**	**3.8**
Asia	**469.6**	**130.4**	**153.7**	**5.4**	**27.1**	**31.6**	**41.4**	**8.8**	**9.7**	**59.1**
Australia	44.7	5.7	3.4	(D)	0.1	3.1	3.2	0.8	1.2	29.8
Japan	342.3	106.0	117.9	5.3	6.2	19.4	32.3	7.4	7.4	18.4
Korea	32.5	4.5	23.5	0.0	0.0	0.8	0.2	0.1	0.0	3.3
Singapore	19.8	8.8	3.6	(D)	0.0	0.4	(D)	0.0	0.4	1.4
OPEC	16.1	3.4	(D)	(D)	0.0	1.4	(D)	0.7	0.0	3.9

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.

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 2012, the latest year for which detailed data are available, foreign firms employed 6.3 million Americans, less than 4% of the U.S. civilian labor force, and owned over 33,000 individual business establishments.[8] Foreign firms have a direct investment presence in every state. Employment of these firms ranges from over 660,000 in California, to about 7,200 in Montana. Following California, Texas (515,100), New York (490,000), Pennsylvania (306,000), Illinois (288,000), Florida (262,000), and New Jersey (259,000) have the largest numbers of residents employed by foreign firms.

In 2012, about 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 $80,000. Retail and wholesale trade each 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 80% of the employment in the wholesale trade sector. British and Japanese firms account for the largest share of affiliate employment in the professional services sector, which accounted for about 5% of total affiliate employment. Employment in the information, finance, and real estate services sectors accounts for about another 12% of total affiliate employment. In a number of cases, the Department of Commerce has suppressed data on employment by industry. Average employee compensation is highest in the finance sector—$181,000—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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[8] *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 $221 billion in the United States in 2012 on new plants and equipment, imported $777 billion in goods, and exported $343 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.[9] By other measures, foreign-owned manufacturing firms appear to be outperforming their U.S. counterparts.[10] 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 2014 fell sharply below the amount invested in 2013, reflecting a number of events including significant buybacks of stocks by firms. Globally, foreign direct investment inflows increased by 9% in 2013 to reach $1.4 trillion. While this is a

9 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.

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

positive sign, global foreign direct investment flows have not recovered from their pre-financial crisis levels: global direct investment inflows in 2007 were recorded at $2.0 trillion. Most regions experienced an increase in foreign direct investment inflows, although economies in transition experienced an increase in direct investment inflows in 2013 of about 28%. 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. First quarter 2015 data indicate that foreign direct investment in the U.S. economy increased by more than two and a half times, possibly indicating that foreign direct investment in the United States will post a substantial gain for 2015 over the amount invested in 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 national 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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