FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

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Executive Summary

The United States has been the world's largest recipient of **foreign direct investment (FDI)** since 2006. Every day, foreign companies establish new operations in the United States or provide additional capital to established businesses. With the world's largest consumer market, skilled and productive workers, a highly innovative environment, appropriate legal protections, a predictable regulatory environment, and a growing energy sector, the United States offers an attractive investment climate for firms across the globe.

Foreign direct investment in the United States is substantial

- In 2012, net U.S. assets of foreign affiliates totaled $3.9 trillion. The United States consistently ranks as one of the top destinations in the world for foreign direct investment (FDI), with inflows totaling $1.5 trillion in FDI just since 2006. For 2012, FDI inflows totaled $166 billion.
- The U.S. manufacturing sector draws a considerable share of FDI dollars, led by pharmaceuticals and petroleum and coal products. Outside manufacturing, wholesale trade; mining; non-bank holding companies; finance and insurance; and banking receive the greatest shares of foreign investment.
- Investment flows into the United States come mostly from a small number of industrial countries. Since 2010, Japan, Canada, Australia, Korea, and seven European countries[1] collectively have accounted for more than 80 percent of new FDI. Although still small, flows from emerging economies like China and Brazil are growing rapidly.

Foreign direct investment benefits the U.S. Economy

- In 2011, value-added by majority-owned U.S. affiliates of foreign companies accounted for 4.7 percent of total U.S. private output.
- These firms employed 5.6 million people in the United States, or 4.1 percent of private-sector employment. About one-third of jobs at U.S. affiliates are in the manufacturing sector.
- These affiliates account for 9.6 percent of U.S. private investment and 15.9 percent of U.S. private research and development spending.
- In the 2008-09 recession and subsequent recovery, employment at U.S. affiliates was more stable than overall private-sector employment. As a result, U.S. affiliates' share of total U.S. manufacturing employment rose from 14.8 percent in 2007 to 17.8 percent in 2011.
- Compensation at U.S. affiliates has been consistently higher than the U.S. average over time, and the differential holds for both manufacturing and non-manufacturing jobs.

Looking ahead, the United States will remain an attractive destination for foreign investment, and this investment will help bolster our economy. However, we need to continue to nurture and build upon the underlying strengths of the U.S. economy that make firms want to invest here; including an open investment regime, a large economy, a skilled labor force, community colleges, world-class research universities, predictable and stable regulatory regime, adequate infrastructure, and new energy sources.

Foreign Direct Investment in the United States

Every day, foreign companies establish new operations in United States or provide additional capital to established businesses. The United States consistently ranks as one of the top destinations in the world for this foreign direct investment (FDI) and has been the largest recipient of FDI since 2006, with investments totaling more than $1.5 trillion.[2]

This investment strengthens our economy by supporting good-paying jobs for millions of American workers, expanding our exports, and funding research and development. This paper reviews the factors that individually and collectively make the United States a sought-after destination for foreign investment, examines recent trends in FDI, and outlines benefits from FDI for the entire economy.

IN-SOURCING: THE DOMESTIC EQUIVALENT OF FDI?

There has been much interest recently in the phenomenon of "in-sourcing," which describes decisions by U.S.-owned firms to move certain of their operations back from abroad. While this is not FDI into the United States (because the investor is not foreign), in-sourcing decisions are motivated by many of the same considerations that motivate FDI.

The 2013 Economic Report of the President contains a detailed discussion of in-sourcing that includes the role of our productive workers, highly innovative environment, appropriate legal protections, and growing energy sector in attracting investment by U.S. firms back to the United States. That discussion also explains the concept of hidden costs. These matter also for FDI but are very concretely grasped in the context of in-sourcing.

In earlier decisions to locate abroad, many U.S. firms may have been motivated by a quest to pay low wages, but may not have had a full picture of the productivity drag that they would bear because of less productive workers, inadequate legal protections, and a generally more risky environment. As these costs became apparent, some firms moved operations back.

Distance itself can be costly. Compared with operating in the United States, setting up a supply chain far away and learning to communicate with suppliers requires many long trips and much time of top executives—time that could be spent on introducing new products or processes at home. There is also greater risk from a long supply chain, because shipping prices and delivery times can vary enormously. In addition, U.S. companies are coming to value more highly the advantages that come from having production, innovation, and design close together. For example, the experience of manufacturing often motivates ideas for new products. Thus, Intel manufactures its most advanced chips in the United States, near where they are designed. Some in-sourcing clearly traces to a greater recognition of the benefit that comes from recognizing and avoiding these costs, and a desire to capture that benefit.

Drivers of foreign direct investment in the United States

The U.S. is increasingly attractive as a destination for business investment, including FDI, for many reasons and companies and experts from around the world agree. In A.T. Kearney's June 2013 FDI Confidence Index, the U.S. surged past countries like China, Brazil and India to become the country with

the top FDI prospects globally, as ranked by 302 companies representing 28 countries and multiple industry sectors. 2013 marks the first time that the US occupies the #1 spot in the survey since 2001. No single factor explains why the United States is an attractive destination for investment. This discussion highlights a few, and the way they interact:

- An open investment regime
- A large economy with big and diverse consumer markets
- A skilled labor force
- Community colleges, incorporating skill-development missions
- The world's top research universities
- Predictable and stable regulatory regime, including appropriate intellectual property protections
- Adequately capacitated infrastructure
- New sources of energy

For decades, and across presidential administrations, the United States has upheld an open investment policy, which affords companies national treatment regardless of country of origin. President Obama reaffirmed the U.S. commitment to an Open Investment Policy in 2011. A recent study finds that access to markets is one of the factors that significantly affect the decisions of multinationals to locate in the United States.[3] For example, a policy of "build where you sell" allows firms to gain deep insight into how local consumers use a firm's product, uses that may differ significantly from in a multinational's home market. In our bilateral investment treaties (BIT), national treatment is a core obligation that ensures that investors and investments receive treatment no less favorable than each treaty party accords to its own investors and investments within its own territory.

The U.S. economy is the largest in the world, and with median household income of $51,017, offers a large and steady demand for a variety of products.[4] The workforce is highly skilled and innovative. Our business regulations are among the most transparent and least cumbersome, including appropriate intellectual property protections. Exporting from the United States is relatively easy and inexpensive.[5] To these long-standing American strengths, we add the more recent increases in energy availability and decreases in energy costs.[6]

In the past, low wages and cost competitiveness were considered synonymous, with businesses "chasing low wages" with an eye on achieving cost savings, regardless skill and productivity differences between the low-wage and American workforces. However, experience in low-wage countries has given businesses a more nuanced point of view, especially as wage inflation in some countries has exceeded productivity growth. Put another way, businesses have learned that today's low wages may be gone tomorrow and that other costs and risks can offset the savings from cheap labor.

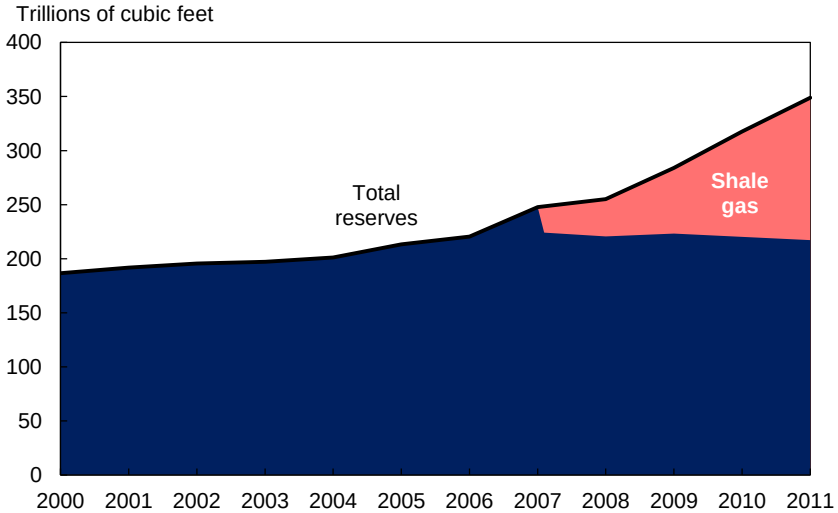
The United States' strong community college system increasingly emphasizes industry-focused training for high-demand occupations, with those efforts bolstered by various Administration efforts to ensure the availability of skilled workers for all firms operating in the United States. Our research universities are top ranked (15 of the top 20 universities in the world are located here); they are essential partners for companies making R&D investments here. The United States sits among the top five of the World Intellectual Property Organization's rankings in both investment in knowledge as a share of GDP and innovation.[7]

Those investments further benefit from the world's best intellectual property (IP) protection regime.[8] Government fees for obtaining a U.S. patent are among the lowest in the industrialized world.[9,10] Appropriate trademark protections protect companies' investments in brand and reputation. The U.S. Patent and Trademark Office bolsters those protections by performing "relative grounds examination" of trademark applications, ensuring that potential trademarks are not likely to be confused with currently active, registered trademarks. This up-front vetting of a brand or mark guards against potentially costly trademark disputes in the future. These protections benefit the owners of the IP and may benefit the United States as a whole. Empirical evidence points to a positive correlation between such protection of IP and economic growth.[11] This appropriate IP regime is just one example of the stable and predictable regulatory environment that the United States has on offer. This makes doing business easier. In 2013, the World Bank ranked the United States fourth out of 185 countries in terms of the "ease of doing business."

Also important to the ease of doing business is the ability to move goods and services around. Although U.S. infrastructure would benefit from significant investment, as the President has proposed, the United States does have world class ports plus a freight rail, air transportation, and a road network that are capable of not only serving the large U.S. market but making the United States a base for exports as well.

Increased domestic energy production has brought down prices and brightened the energy outlook, most notably for natural gas. Between 2007 and 2012, U.S. prices dropped nearly 60 percent as production rose and new reserves were uncovered. The country's natural gas boom has catalyzed domestic and foreign investment in petrochemical manufacturing as well as in the manufacturing of steel and equipment needed for gas extraction. Multiple industries benefit directly from inexpensive U.S.-produced natural gas because of its diverse industrial uses, ranging from on-site electricity generation to process heating, space heating, steam generation, and petrochemical processing. In addition, rapidly growing demand for renewable energy offers opportunities for firms to produce domestically in order to offset high shipping costs for heavy parts such as wind turbine towers and blades.

Figure 1: U.S. Natural Gas Proved Reserves, 2000-2011

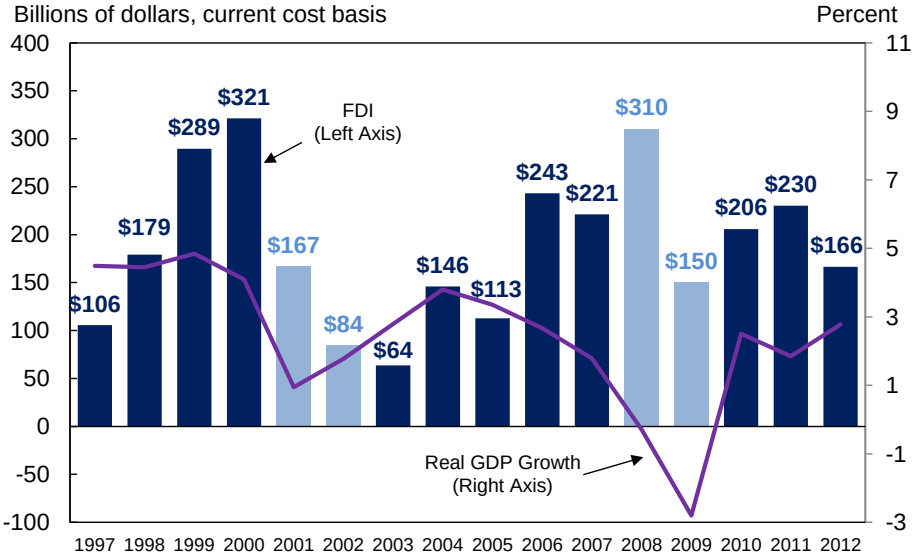


Source: Department of Energy, Energy Information Administration
Note: The energy Information Administration began to collect separate estimates of shale gas reserves in 2007.

There is already substantial foreign direct investment in the United States

In 2012, the foreign investment position, or stock of foreign investment, in the United States was $3.9 trillion (at market value), including new inflows of $166 billion[12]. Inflows fluctuate broadly from year to year, with large drops in FDI flows roughly coincident with global recession years and relatively slow growth in FDI flows in the years immediately following.[13] Since 1997, the inflows reached a peak of $321 billion in 2000, coinciding with a peak in the business cycle, before falling to a low of $64 billion in 2003. Investment flows climbed in the subsequent economic expansion to a high of $310 billion in 2008. In 2009, FDI inflows dropped to $150 billion, rebounded in the next two years, and then edged down to $166 billion in 2012.

Figure 2: Foreign Direct Investment in the U.S.
1997-2012



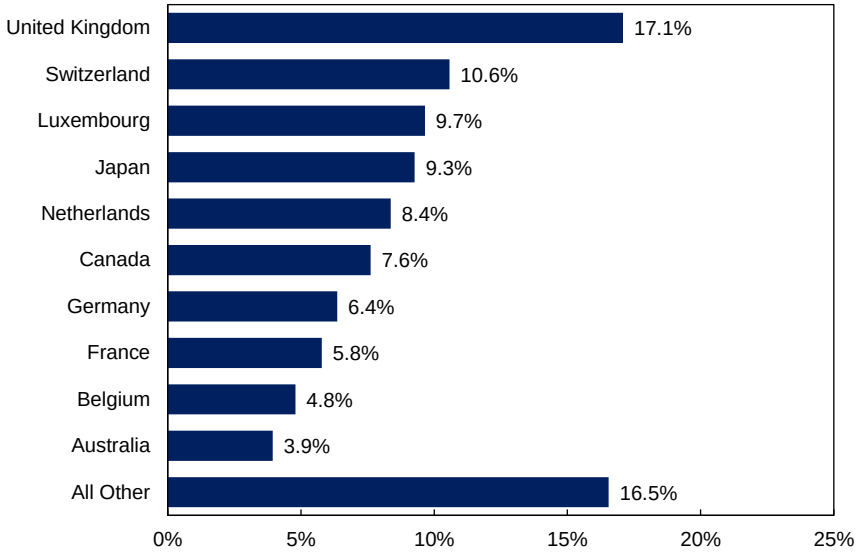
Source: Department of Commerce, Bueau of Economic Analysis; International Monetary Fund
Note: Light blue shading denotes a global recession year (real GDP growth was below 3 percent).

Investment flows into the United States come mostly from a small number of industrial countries. From 2010 to 2012 (roughly -- the current expansion), Japan, Canada, Australia, and seven European countries collectively accounted for 83.5 percent of FDI inflows to the United States.[14] Companies from the United Kingdom have been the biggest recent investors, accounting for 17.1 percent of FDI inflows from 2010 to 2012. Switzerland is the second biggest source of FDI, with 10.6 percent of FDI inflows, largely concentrated in chemicals, followed by 9.7 percent from Luxembourg, concentrated in the finance and insurance industries.

Investment inflows from emerging markets remain relatively small. For example, FDI from China averaged slightly less than $1 billion in 2010-2012, or 0.5 percent of total FDI into the U.S, while inflows from Brazil averaged $1.9 billion, or 1.0 percent of the total. But these investments from emerging nations mark a dramatic increase from the negligible levels a decade earlier. Historically, investment from emerging nations into the United States has been hindered by factors such as the lack of financial resources, uncompetitive products for the U.S. market, unfamiliarity with the U.S. market, and low labor costs at home. Many of these factors are changing. Some emerging economies, such as China, Taiwan, and Brazil, have accumulated large foreign exchange reserves through trade surpluses. For many

companies in these countries, financing investment projects abroad is becoming easier, and some of these companies have acquired the size, expertise, and networks to compete worldwide. Rising wages associated with economic development in these countries has narrowed wage gaps with the United States. This narrowing, along with high U.S. labor productivity and market-friendly features of the United States, makes undertaking new investment here an attractive option.

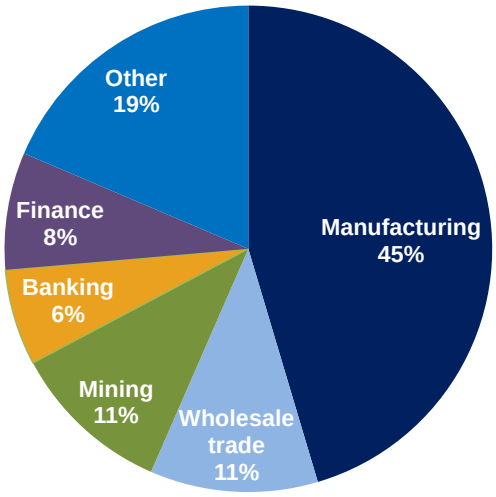
Figure 3: Foreign Direct Investment into the U.S.
Top 10 Investor Countries, 2010-2012 Average



Source: Department of Commerce, Bureau of Economic Analysis

The U.S. manufacturing sector draws a considerable share of FDI dollars. Over the last ten years, manufacturing's share of FDI averaged 39.2 percent, and has increased to 45.4 percent in the last two years. From 2010-2012, pharmaceuticals accounted for nearly one-quarter (23.6 percent) of manufacturing FDI, followed by petroleum and coal products (16.5 percent); electrical equipment, appliances, and components industry (9.6 percent); basic chemicals (9.0 percent), and transportation equipment (9.0 percent). A look under the hood finds that the transportation equipment investments were mostly in the motor vehicle industry; German investors funded one-third of such inflows, and Japanese investors one-fifth.

Figure 4: Foreign Direct Investment into the U.S. by Industry
Percent of Total, 2010-2012



Source: Department of Commerce, Bureau of Economic Analysis

Aside from manufacturing, sectors that received significant FDI from 2010-2012 were wholesale trade (11.1 percent of total FDI), mining (10.7 percent), non-bank holding companies (10.6 percent), finance (except banking) and insurance (7.8 percent), and banking (6.4 percent).[15] Between 2009 and 2011 outflows of investment from the United States information sector exceeded inflows, leading to some net disinvestment in that sector. However, net investment flows turned positive again in 2012. About 5 percent of the foreign investment position (or net financial claims) are in this industry.

Foreign direct investment benefits the U.S. economy

Inbound foreign direct investment funds a number of physical assets, including production plants, research and development (R&D) facilities, sales offices, warehouses, and service centers. It can take the form of a "greenfield" establishment that creates something from scratch or a merger or acquisition ("M&A") of a sufficiently large stake in an existing enterprise. Whatever the form, it ultimately translates into output, jobs, exports, and R&D on American soil—data on which are captured in the Bureau of Economic Analysis' operations statistics on majority-owned U.S. affiliates of foreign firms. The vast majority of U.S. affiliates of foreign firms involve at least a 50 percent foreign ownership stake, and BEA publishes its most detailed operational data on these "majority owned" firms, which will be referred to as U.S. affiliates of multinational companies or "affiliates" from here on. [16]

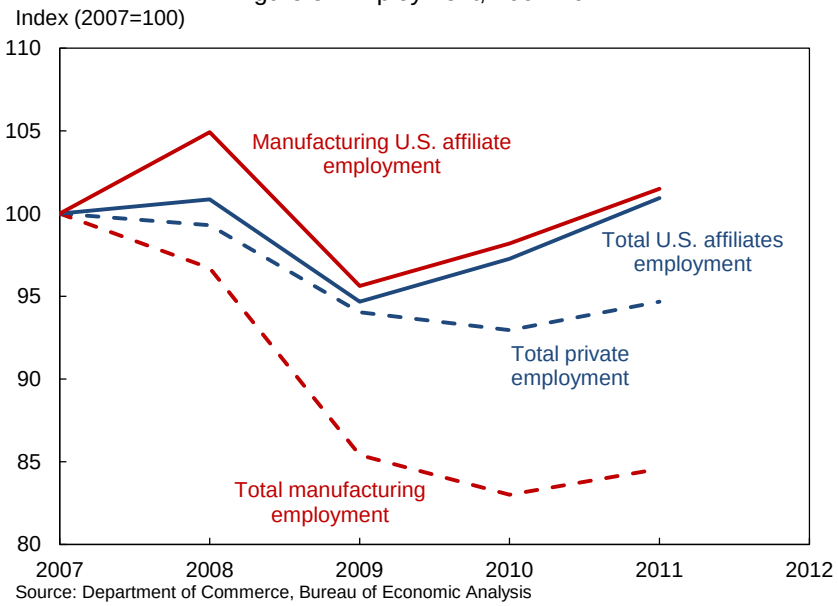
Between 2010 and 2011, the value-added production of affiliates rose 11.4 percent to $736 billion. This output accounted for 4.7 percent of total U.S. private output. These firms employed 5.6 million people in the United States, or 4.1 percent of private sector employment. Consistent with estimates of the investment position by industry, about one-third of jobs at U.S. affiliates are in the manufacturing sector.[17] Manufacturing employment at U.S. affiliates was 2.1 million in 2011, or 17.8 percent of all U.S. manufacturing employment. Next to manufacturing, the largest industry sectors for employment by U.S. affiliates are wholesale trade, which employed 546,600 workers in 2011; retail trade with 488,500; and administration, support, and waste management, with 482,200.

In the 2009-09 recession and subsequent recovery, employment at U.S. affiliates proved more stable than overall private-sector employment. Total affiliate employment increased by 0.9 percent between 2007 and 2011, while total U.S. private employment fell 5.3 percent. Likewise, employment at manufacturing affiliates edged down just 1.5 percent from 2007 to 2011, compared to a 15.4-percent drop in overall U.S. manufacturing employment. As a result, U.S. affiliates' share of total U.S. manufacturing employment rose from 14.8 percent in 2007 to 17.8 percent in 2011.

DATA ON FOREIGN DIRECT INVESTMENT IN THE UNITED STATES[1]

Data in this report are from the Bureau of Economic Analysis (BEA) unless otherwise noted. BEA collects two broad sets of data on foreign direct investment in the United States: (1) international transactions (balance of payments) and direct investment position data, and (2) financial and operating data of U.S. affiliates. Each of these data sets focuses on a distinct aspect of foreign direct investment. The financial and operating data provide a picture of the overall activities of the U.S. affiliates, and the international transactions and direct investment position data cover foreign investors' transactions with, and position in, both new and existing U.S. affiliates.

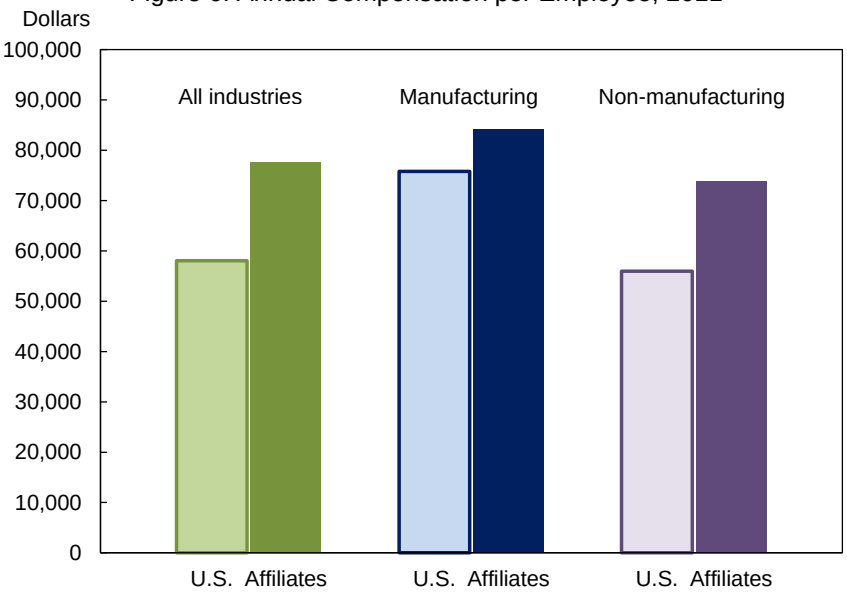
Figure 5: Employment, 2007-2011



Source: Department of Commerce, Bureau of Economic Analysis

U.S. affiliate firms make substantial investments in capital equipment and R&D, tend to hire highly skilled workers and pay excellent wages. These firms paid wages and other forms of compensation that averaged more than $77,000 per U.S. employee in 2011 as compared to average earnings of $58,000 for workers in the economy as a whole. Compensation at U.S. affiliates has been consistently higher than the U.S. average over time, and the differential holds for both manufacturing and non-manufacturing jobs, with a slightly higher differential in manufacturing.

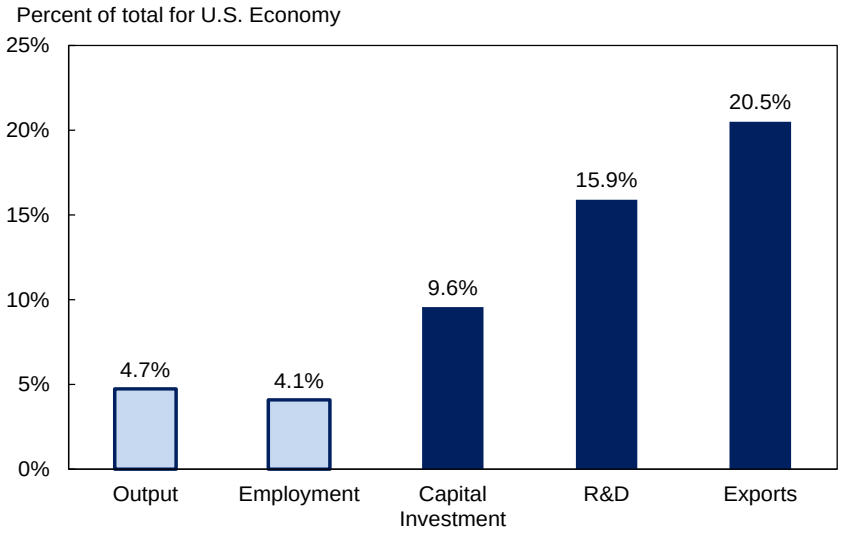
Figure 6: Annual Compensation per Employee, 2011



Source: Department of Commerce, Bureau of Economic Analysis

More generally, the U.S. affiliates are typically high-productivity firms that are major private-sector contributors to efforts to innovate and build. U.S. affiliates contribute 9.6 percent of total U.S. private investment and 15.9 percent of total U.S. private R&D. U.S. affiliates are also well-integrated globally and are the source of 20.5 percent of total U.S. goods exports.

Figure 7: Economic Activities of Majority-Owned U.S. Affiliates of Foreign Companies, 2011

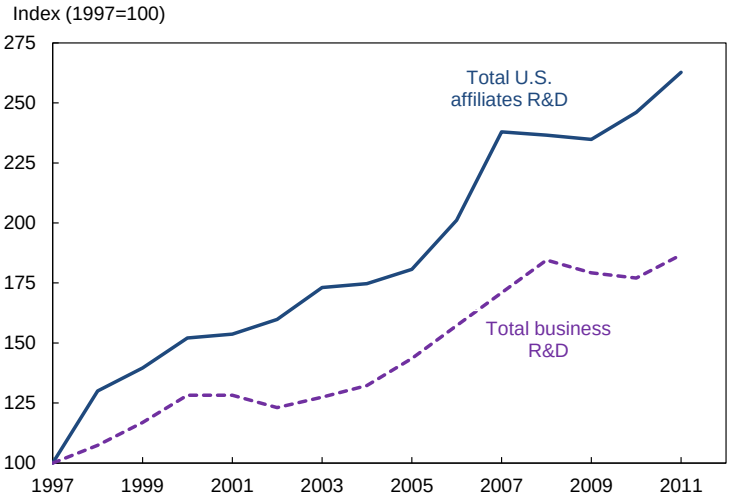


Source: Department of Commerce, Bureau of Economic Analysis; National Science Foundation

A second positive benefit of U.S. affiliates is their high research and development (R&D) spending. U.S. affiliates account for a rising amount and share of U.S. businesses' research and development

expenditures. In 2011, these firms spent $45.2 billion on R&D, accounting for 15.9 percent of total R&D spending by businesses.[18] Since 1997, when the data were first published, R&D expenditures of U.S. affiliates have climbed 163 percent, close to double the 87 percent growth among overall business spending on R&D.

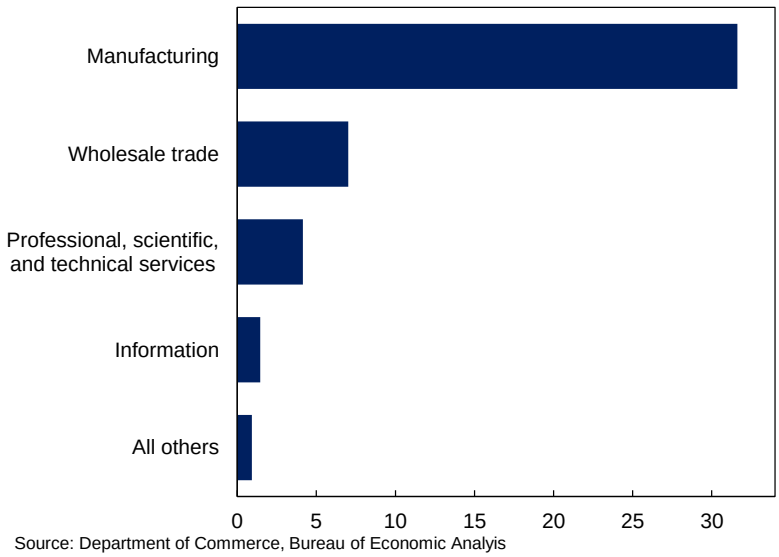
Figure 8: R&D Expenditures, 1997-2011



Source: Department of Commerce, Bureau of Economic, Analysis; National Science Foundation
Note: Prior to 2007, FDI data do not include U.S. affiliates of foreign banks.

The bulk of the R&D investments were in the manufacturing sector, with the manufacturing sector accounting for 69.9 percent of total R&D expenditures by U.S. affiliates, nearly equal to the 68.5 percent manufacturing share of business R&D spending across all firms. Affiliates in the wholesale trade sector spent $7.0 billion on R&D in 2011,[19] followed by the professional, scientific, and technical services sector ($4.1 billion), and the information sector ($1.5 billion).

Figure 10: R&D Expenditures by U.S. Majority-Owned Affiliates
Billions of Dollars, 2011



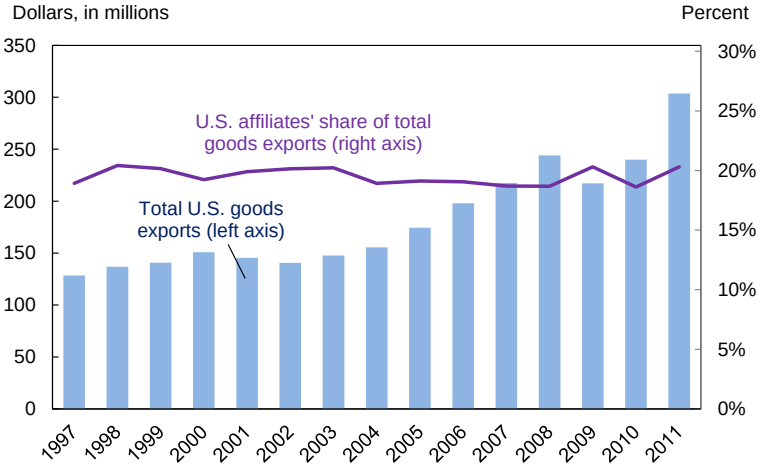
Source: Department of Commerce, Bureau of Economic Analysis

In 2011, the majority of R&D expenditures by U.S. affiliates were from the top investor countries – specifically, Switzerland, the United Kingdom, Japan, France, and Germany. Swiss-owned affiliates have

spent the most of any country on R&D since 2009, holding steady at approximately $9.0 billion annually during that time.

Finally, U.S. affiliates of foreign firms account for a disproportionate share of total U.S. exports (relative to their employment size). In 2011, U.S. affiliates exported $303.7 billion of goods, accounting for 20.5 percent of total U.S. exports, the second highest share since 1995. As the chart highlights, goods exported by U.S. affiliates follow the broad trends of overall exports, but tend to do better during economic downturns, likely because U.S. affiliates tend to trade heavily with their parent group and related parties, such as subsidiaries, foreign affiliates and sister companies. In fact, a significant portion of their exports – 59.0 percent in 2011 – is classified as a related-party transaction. This share of transactions has been constant throughout the time period and remains an important source of overall exports. These firms are heavy importers of goods as well, accounting for 28.4 percent of total U.S. imports—contributing to our negative trade balance but also further illustrating how these firms link the United States to the global economy.

Figure 10: Exports of Goods by Majority-owned U.S. Affiliates of Foreign Firms, 1997-2011



Source: Department of Commerce, Bureau of Economic Analysis
Note: Data prior to 2007 do not include U.S. affiliates of foreign banks.

Conclusions

FDI supports a host of benefits in the United States, notably good jobs and innovation led by research and development investment. While industrial countries are the primary source of FDI to the United States, emerging markets are becoming a bigger source of FDI and their share should be expected to increase as institutional and structural barriers in those countries decline.

Looking ahead, the United States will remain an attractive destination for foreign investment, and this investment will help bolster our economy. However, we need to continue to nurture and build upon the underlying strengths of the U.S. economy that make firms want to invest here; Including an open investment regime, a large economy, a skilled labor forced, community colleges, world-class research universities, predictable and stable regulatory regime, adequately capacitated infrastructure, and new energy sources.

Notes

[1] These seven European countries, in descending order of direct investment in the U.S. from 2010 to 2012, are: the United Kingdom, Switzerland, Luxembourg, the Netherlands, Germany, France, and Belgium.
[2] UNCTAD World Investment Report, Annex table 01,
http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx
The combined inflows to mainland China and Hong Kong were larger than those to the United States in 2012. However, under the "One Country, Two Systems" principle, transactions in direct investment between Hong Kong and mainland China are treated as external transactions. Hong Kong FDI data include investments from China. Likewise, inflows to mainland China include investments from Hong Kong.
[3] Friedman, J., Gerlowski, D.A., Silberman, J., 2006. "What Attracts Foreign Multinational Corporations? Evidence from Branch Plant Location in the United States," Journal of Regional Science 32(4), 403-418.
[4] DeNavas-Walt, C., Proctor, B., Smith, J., 2013. "Income, Poverty, and Health Insurance Coverage in the United States: 2012," U.S. Census Bureau.
[5] See http://acetool.commerce.gov/regulatory-compliance-costs.
[6] Please refer to Department of Commerce's Assess Costs Everywhere website for further details.
http://acetool.commerce.gov/
[7] http://www.wipo.int/pressroom/en/articles/2013/article_0016.html
[8] http://acetool.commerce.gov/intellectual-property
[9] http://www.gpo.gov/fdsys/pkg/BILLS-112hr1249enr/pdf/BILLS-112hr1249enr.pdf
[10] http://www.uspto.gov/web/offices/pac/mpep/mpep-9015-appx-l.html#al_d1b0d9_16b04_f6
[11] Maskus, K., 2000. "Intellectual Property Rights in the Global Economy", Institute for International Economics, Washington D.C., provides a comprehensive analysis of policy reform issues pertaining to IP protection; Fink, C., and Maskus, K.E, (Eds), 2005. "Intellectual Property and Development: Lessons from Recent Economic Research," World Bank, Washington, D.C., present a set of empirical studies that assess the effects of stronger standards of protection on measures of various economics and social performance.
[12] http://www.bea.gov/scb/pdf/2013/09%20September/0913_inward_direct_investment_tables.pdf, Table 2 in current costs and market value.
[13] Years in which global real GDP growth, as published in the International Monetary Fund's World Economic Outlook Database, falls below 3 percent are commonly referred to as periods of global recession, or global economic slowdowns.
[14] Because of data availability, these estimates do not include a current cost adjustment.
[15] Holding companies hold investments of other companies. The industry categorization of these other companies is not reported. An example of a non-bank holding company is a financial holding company participating in banking-related activities including insurance underwriting, securities dealing and underwriting, etc. Further information is available from
https://www.ffiec.gov/nicpubweb/Content/HELP/Institution%20Type%20Description.htm.
[16] This section analyzes "majority-owned" U.S. inbound foreign direct investment for reasons of data availability. Although the vast number of affiliates are majority owned, there are important foreign investments in U.S. businesses that involve less than a 50 percent foreign ownership stake
[17] These estimates are based on the industry of sales. See box note titled "Using Employment Data to Estimate Affiliate Shares of the U.S. Economy by Industry" in "U.S. Affiliates of Foreign Companies: Operations in 2010," Survey of Current Business, August 2012.

[18] Data on all U.S. business R&D expenditures are available from the National Science Foundation, http://nsf.gov/statistics/industry/.

[19] Wholesale trade is an industry not necessarily associated with R&D. The relatively high share of R&D expenditures may stem from the fact that each U.S. affiliate is classified in a single industry, even though a single affiliate may be involved in a wide range of business activities. In particular, among U.S. affiliates, the wholesale trade industry includes many companies that also have substantial activities in manufacturing.