Assessing Trends and Policies of Foreign Direct Investment in the United States

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Introduction

Foreign direct investment (FDI) is an essential component of the U.S. economy. This paper analyzes FDI trends and examines policies that may affect foreign investment in the United States.

Foreign investment contributes to productivity growth, generates U.S. exports, and creates high-paying jobs for American workers. Advanced and developing economies have recognized the value of foreign investment, resulting in an increasingly competitive international environment for FDI flows (see Figure 1). Each member of the Organization for Economic Cooperation and Development (OECD) now maintains an investment promotion agency to attract foreign investment.

The United States welcomes foreign investment and provides international investors a stable and open economy. President George W. Bush recently reaffirmed America’s long-standing policy of openness to foreign direct investment.¹

Although the United States has historically been the most attractive destination for FDI, this leadership position has eroded since the late 1980s.² To maintain competitiveness in attracting inward investment, the United States should address specific issues that concern foreign investors.
Economic Effects of Foreign Direct Investment

The Bureau of Economic Analysis (BEA) defines foreign direct investment as “an investment in which a resident of one country obtains a lasting interest in, and a degree of influence over the management of, a business enterprise in another country.” FDI is generally divided into two categories: greenfield investment, which is the creation of new enterprises and the development or expansion of production facilities, and mergers and acquisitions, which involve the purchase of an existing enterprise.

The United States is the world’s largest recipient of FDI. In 2007, the United States received $237 billion in FDI (see Figure 2). The total stock of FDI in the United States in 2006 was equivalent to 13.6 percent of U.S. gross domestic product (GDP).

Foreign direct investment benefits the U.S. economy in many ways:

Creates new jobs. U.S. affiliates of majority-owned foreign companies employ over 5 million U.S. workers, or 4.5 percent of private industry employment. Between 2003 and 2007, more than 3,300 new projects were announced or opened by foreign companies, yielding $184 billion in investment and about 447,000 new jobs.

Boosts wages. U.S. affiliates of foreign companies tend to pay higher wages than other U.S. companies. Internationally owned companies support an annual U.S. payroll of $335.9 billion, with average annual compensation per employee of more than $66,000. On average, U.S. subsidiaries of foreign firms pay 25 percent higher wages and salaries than the rest of the private sector.

Increases U.S. exports. Approximately 19 percent of all U.S. exports ($169.2 billion) come from U.S. subsidiaries of foreign companies (see Figure 3). U.S. companies use multinationals’ distribution networks and knowledge about foreign tastes to export into new markets.

Strengthens U.S. manufacturing and services. Of the jobs supported by U.S. affiliates of foreign companies, 39 percent are in the manufacturing sector. That sector accounts for 12 percent of overall private sector employment. Furthermore, approximately 60 percent of all foreign investment in the United States is in the services sector, which improves the global competitiveness of this critical segment of the U.S. economy.

Brings in new research, technology, and skills. In 2005, U.S. affiliates of majority-owned foreign companies spent nearly $32 billion on research and development and $121 billion on plants and equipment.

Foreign Investment Fact
With 66,000 employees in the United States, Siemens (Germany) employs more people to the United States than Microsoft and Coca Cola combined.
Source: Siemens, Microsoft, and Coca Cola.
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Contributes to rising U.S. productivity. Inward investment leads to higher productivity growth through an increased availability of capital and resulting competition. Productivity increases U.S. competitiveness abroad and raises living standards at home.

Foreign Direct Investment Trends

U.S. Trends
Most international investment in the United States originates from OECD countries. In 2006, approximately 80 percent of FDI inflows (measured by dollar value) came from Europe and Japan. The United Kingdom held the largest FDI position in the United States at $303 billion. The United Kingdom accounted for 17 percent of all foreign investment in the United States, followed by Japan (12 percent), Germany (11 percent), Netherlands (11 percent), Canada (9 percent) and France (9 percent).11

Although OECD countries continue to dominate foreign investment in the United States, it is important to recognize the growing role of several emerging markets. Between 2002 and 2006, India’s FDI position grew by a compound annual growth rate of 72 percent (see Figure 4). Other countries followed India, including Russia (64 percent), Chile (54 percent), South Korea (31 percent), and Brazil (23 percent).12

Global Trends
Although the United States continues to be the largest recipient of FDI inflows, it has lost significant position in the global race for FDI. The United States continues to attract large FDI inflows, but the share has declined from 31 percent of global FDI in 1980, to 13 percent in 2006.14 China and the United Kingdom each attracted more FDI in 2003 and 2005, although the United States regained its lead position in 2006. The 2007 Economic Report of the President analyzes the U.S. position in the context of global trends:

"First, while the U.S. affiliate share of U.S. output has grown over the past two decades, it has stagnated and even declined in recent years. Second, the U.S. affiliate share of employment has declined, from 5.1 percent in 2000 to 4.7 percent in 2004. Third, the share of inward FDI in the U.S. capital account - that is, FDI in the United States as a share of all the assets owned by foreign interests - has declined since 1999. It is not yet clear whether these are benign and temporary trends or whether this development is symptomatic of deeper issues with respect to the attractiveness of the United States as a country in which to make direct investment."

Sovereign wealth funds, while not a new phenomenon, are also beginning to play an increasingly important role in international capital flows. Due to substantial trade surpluses, some governments have accumulated significant savings and are now searching for opportunities to earn a higher rate of return. This may present an opportunity for the United States to strategically access sovereign wealth funds as another source of foreign investment. As of April 2008, the United Arab Emirates (Abu Dhabi) is believed to have the largest sovereign fund in the
world, which is estimated at between $500 and $875 billion.\textsuperscript{16} This is followed by Norway ($375 billion), Singapore ($200 to $330 billion), Saudi Arabia ($270 billion), Kuwait ($213 billion), China ($200 billion) and Russia ($128 billion).\textsuperscript{17}

Although sovereign wealth funds are traditionally long-term investors that are not highly leveraged, the lack of transparency and sheer size of these funds have elicited some apprehension, which may spark new protectionist measures against foreign investment around the world. In his testimony before Congress on February 13, 2008, David H. McCormick, Under Secretary of the Treasury for International Affairs, stated, “...sovereign wealth funds could provoke a new wave of investment protectionism, which would be very harmful to the U.S. and global economies. Protectionist sentiment could be partially based on a lack of information and understanding of sovereign wealth funds, in part due to limited transparency and clear communication on the part of the funds themselves.”\textsuperscript{18} As additional sovereign wealth funds come online throughout the globe, there is no question that they will have an important effect on foreign investment flows.

**Bilateral Comparisons**

The United States attracted a significantly larger percentage of global FDI inflows during the 1980s than did the United Kingdom. Since 1990, however, the United States has experienced increased competition and a loss of global FDI. In 1980, the United States attracted approximately 30 percent of total global FDI, while the United Kingdom captured approximately 20 percent.\textsuperscript{19} By 2006, the situation changed in that the United States attracted only 13 percent of global FDI inflows while the United Kingdom captured 11 percent (see Figure 5).\textsuperscript{20}

Likewise, from 1980 to the present, China’s share of global FDI has grown.\textsuperscript{21} In 2003, China captured a larger percentage of FDI inflows than the United States (see Figure 6).\textsuperscript{22}

Although the United States has historically been the most attractive destination in the world for foreign direct investment, changing dynamics within the global economy are challenging that paradigm.

**U.S. Competitiveness**

Despite its decreasing share of global FDI flows, the United States remains an attractive location for foreign investment. Investing in the United States has many advantages. The United States has more than 300 million people, a landmass of 3.7 million square miles, an economy larger than any other single country, and is the most important market for a global company. The American workforce ranks as one of the best educated, most productive, and most innovative in the world. As a place to do business, the United States offers a transparent...
legal system, outstanding infrastructure, and access to the world’s most lucrative consumer market.

Economy
The United States has the largest and most technologically powerful economy in the world, with a per capita GDP of approximately $45,000. Compared with many countries, the U.S. economy has relatively low levels of regulation and government participation. Both individuals and corporations have freedom to make economic decisions. The United States consistently ranks at or near the top of most major indicators for an attractive business and investment climate. The United States is ranked number one in the most recent United Nations FDI Potential Index, the Global Competitiveness Index, and the Global Innovation Index. The United States is consistently the most competitive, innovative and open economy in the world.

Consumer Market
Global companies invest in the United States to be closer to suppliers and customers in a dynamic market. The United States accounts for 42 percent of the global consumer goods market, with a per capita disposable income of approximately $32,000. In addition, the United States maintains free trade agreements with 14 partner countries and has bilateral investment treaties in force with 40 partner countries, thus giving foreign investors access to additional markets worldwide.

Research and Development
The United States is a center for global innovation. In 2006, the United States was responsible for 45 percent of total OECD research and development expenditures (see Figure 7). Since 1990, the United States has been home to more Nobel laureates in the sciences than all other countries combined.

Technology
American companies are at or near the forefront in technological advances and innovation, especially in computers; information technology; and the medical, aerospace, and military equipment sectors. This is due in part to the dynamic entrepreneurial activity that occurs in the United States. A 2006 study found that the United States “is spawning twice the level of early-stage entrepreneurial activity as its major industrialized peers.” This report also stated that in comparison with other developed economies, the “pace of new-business formation in the U.S. is both more dynamic and more stable.”

Intellectual Property Rights Protection
Foreign investors come to the United States to fund research and development and to commercialize the results of their creativity. The United States provides a strong regime of intellectual property rights protection and enforcement. In 2006, of the 173,000 patents granted by the U.S. Patent Office, 48 percent originated from a foreign country.

Education
The U.S. higher education system is unparalleled. According to Times Higher Education, 6 of the top 10 universities in the world are in the United States. Over 580,000 international students were enrolled in U.S. colleges and universities for the 2006/2007 academic year. There are more than 4,000 universities and colleges in the United States, including branch campuses. Furthermore, 56 million Americans have obtained a bachelor’s degree or higher. This intellectual environment not only creates a highly skilled labor pool but also helps drive research and development through partnerships and grants with industry and government. The United States also boasts a community college system that provides...
cost-efficient education and training within thousands of communities throughout the United States. This system gives the American workforce and U.S.-based companies (including foreign affiliates) a competitive edge to succeed in a globalized job market.

**Productive Workforce**
Investors in the United States gain access to a highly productive and adaptable workforce. American workers are highly trained and are quick to use and capitalize on innovative technologies to improve productivity. Federal and state governments spend billions of dollars each year on workforce training and some states offer customized training programs. Since 2000, U.S. business productivity has risen at an average annual rate of approximately 3.2 percent. On average between 1992 and 2006, labor productivity in manufacturing in the United States grew faster than in any other country in the G-7.

**Transportation and Infrastructure**
Of the top 10 economies in the world by GDP, the United States has the largest roadway system, railway network, and number of airports. Five of the top 10 airports by air cargo volume are in the United States, including the busiest cargo airport in the world. Several of the world’s busiest ports for international bulk cargo and container traffic are also in the United States.

**Hospitable Society**
The United States is a friendly and hospitable country, where many citizens of other countries live and invest. As a nation of immigrants, the United States boasts some of the largest cultural diasporas in the world.

**Opportunities to Increase Competitiveness**
The global contest to attract FDI is becoming increasingly competitive. The United States needs to continually assess its strengths while addressing issues that may place it at a competitive disadvantage within the international economic community.

**International Perceptions**
In the past few years, there has been a visible negative shift in international perceptions of U.S. openness to foreign direct investment, which has been exacerbated by the failed investments of Dubai Ports World and China National Offshore Oil Corporation. Furthermore, one recent survey of Asian executives ranked the United States and France as the most difficult Western countries in which to operate.

In February 2007, Robert M. Kimmitt, Deputy Secretary of the Treasury stated that issues related to the process of the Committee on Foreign Investment in the United States have, “raised questions in the minds of global investors about whether the doors to foreign investment remain open both in Europe and in the United States.” In a May 2007 survey of chief executive officers conducted by the Organization for International Investment (OFII), one quarter of respondents claimed that their parent company colleagues were convinced that the United States is becoming closed to FDI. Furthermore, the most recent FDI Confidence Index by A.T. Kearney found that for the first time since 1998, the United States dropped from the second to the third most attractive future FDI location - behind China and India.

**Business Visas**
Foreign investors view the ease with which they can travel to the United States as a key indicator of how easy it will be to make or administer an investment. Under the Visa Waiver Program, nationals of many countries do not require visas for simple business visits of fewer than 90 days. Other potential investors not from Visa Waiver Program countries must obtain a visa before they travel to the United States for business discussions, site selection, due diligence, and other activities needed to properly assess an investment. Timing of trips can be critical. Visas are required to relocate to the United States for the purpose of managing an investment once it has been made.

The timely availability of business visas is a significant concern. It is viewed as a critical business issue, and not just for the FDI community. Preliminary results from a recent survey by the State International Development Organizations found that...
"over 75 percent of states have encountered significant problems with an export or investment deal due to visa problems." The presence or perception of delays in obtaining the necessary visas can give an international investor the impression that it may be difficult to finalize or oversee an investment in the United States. It is important that the United States has the people and facilities it needs to efficiently handle the demand for visas. Myths and misperceptions regarding the difficulty of the visa process must also be promptly debunked to prevent an inaccurate assessment of the system. For example, residents of certain countries such as Brazil, China, and India perceive that it is extremely difficult to obtain a visa to the United States. Yet the substantial majority of visa applicants in those countries do receive visas. In 2006, more than 1.1 million U.S. nonimmigrant visas were issued for those three countries alone, almost 19 percent of all nonimmigrant visas issued worldwide that year.

Legal Environment
Many foreign investors view the U.S. legal environment as a liability when investing in the United States. In a joint U.S. Chamber and Eurochambres report published in 2004, European companies ranked "legal liabilities – fear of legal action" as the second-largest barrier to investing in the United States. Furthermore, in a recent survey by the Organization for International Investment (OFII), CEOs of U.S. affiliates of foreign firms indicated that the nature of the U.S. legal system (including features such as class action lawsuits) was a major drawback to investing in the United States. A report by Robert Litan of the Brookings Institution concludes that the uncertainty and complexity of the U.S. legal system may inhibit small and medium foreign enterprises from investing in the United States.

Health Care System
In the same OFII survey noted earlier, CEOs also ranked rising health care costs as another major concern. Since 2000, employment-based health insurance premiums have increased 87 percent. The rising costs not only serve as a barrier to new foreign investments, but also weigh heavily in corporate decisions on the expansion of existing operations in the United States.

Corporate Taxes
Although the United States increased its global competitiveness by lowering its corporate taxes in the 1980s, many countries have since followed suit, eliminating any resulting competitive advantage. With the exception of Japan, the U.S. statutory corporate tax rate is now the highest for OECD countries.

Investment Promotion Agencies
Investment promotion agencies (IPAs) can play an important role in attracting FDI inflows. In 2004, according to the United Nations Conference on Trade and Development, 160 countries had national-level IPAs. A sound rationale is driving this global trend; economists have established that investment promotion is linked with greater FDI flows.

A 2003 empirical study by the World Bank showed that "greater investment promotion is associated with higher cross-border FDI flows." A 2006 United Nations policy brief reaffirmed the critical role of IPAs because of the possibility of market failure in investors’ decision-making processes. Since greenfield foreign investors typically have incomplete information on markets and investment opportunities, investment decisions may be based on incomplete knowledge.

The Lead Role of States
The United States is unique within the global investment community with regard to the number, scope, and lead role that states play in attracting foreign direct investment. Individual states compete (often against each other) for investments on a global scale by employing highly skilled investment officials and, in some cases, by maintaining field offices in major financial centers worldwide. Furthermore, there are many regional and local economic development agencies that also work to attract and facilitate international investment. These agencies play an important role in investment promotion and highlight the comparative advantage of their regions and localities.

Considering the diversity and size of the U.S. economy, sub-national investment promotion agencies are in a unique position to offer

Foreign Investment Fact
In September 2007, Sany (China) announced that it would invest $30 million into building its North American headquarters in Peachtree City, Georgia. Sales, services, assembly, testing and distribution, as well as research and development, will all take place at the new facilities. This initial investment will create 200 jobs, with the potential for 300 more over the next 10 years.

Source: OCO Monitor database.
tailored services that meet the needs of international investors. This is because these agencies can efficiently allocate human and financial resources toward achieving investment goals. This decentralized system has successfully operated for decades and has yielded billions of dollars in international investment throughout the United States.

The State International Development Organizations (SIDO) plays an important role in those activities for its members. International trade directors of the states’ development agencies created SIDO, and it provides a forum for individual states to share ideas, to advocate policies, and to collaborate in investment promotion. The International Economic Development Council also has an important role in helping economic development officers do their job more effectively through professional development, networking opportunities, and advisory services. Additionally, the National Governors Association and the U.S. Conference of Mayors could play a growing role, beyond their current economic development efforts, in the promotion of FDI to the United States.

The Federal Government Role
Overall, without a national-level focus on foreign direct investment, there is a potential for conflicting messages. International perceptions related to the implementation of the Exon-Florio provision by the Committee on Foreign Investment in the United States, visa policy, and other federal policy issues impair the ability of individual states to compete on a global level.

Such concerns are legitimate. Hence, a federal focus is necessary to complement existing state efforts that already have a strong track record of attracting foreign investment into the United States. By adding to each state’s investment promotion efforts a consistent federal message that America is open for business and welcomes international investment, the federal government can make each state’s promotion efforts stronger and more resonant while enhancing the country’s overall ability to attract FDI.

Foreign Investment Fact
On February 27, 2007, Japanese automaker Toyota Motor Corporation announced that it would spend $1.3 billion to build a new manufacturing facility near Tupelo, Mississippi. This facility is initially expected to have 2,000 employees. In 2005, Toyota had 38,340 employees in North America.

Source: David Ellis, “Toyota to Build New SUV Plant in Mississippi.”

Invest in America
Invest in America is the primary U.S. Government mechanism to coordinate federal inward investment promotion. Invest in America handles initial investment inquiries while promoting the U.S. economy as a whole. Invest in America remains neutral in any competition between states for foreign investment. Efforts are focused on outreach to foreign governments and investors, support for state governments’ investment promotion efforts, and addressing business climate concerns of international investors. Invest in America also serves as ombudsman in Washington, D.C. for the international investment community, working across the Federal Government to act as a voice to address investor concerns and issues involving Federal agencies. Invest in America is located within the U.S. Department of Commerce’s International Trade Administration and is supported through a global network in 80 countries around the world.

Future Trends and Areas of Interest
Foreign direct investment will continue to have a significant and positive influence on the U.S. economy. FDI creates jobs, introduces new technologies, and increases U.S. competitiveness. Although the United States has traditionally led the world in FDI inflows, stronger global competition for FDI has changed the playing field. Not only are developed economies successfully competing for increased levels of FDI, but developing countries are also gaining access to large capital inflows.

The latest FDI trends show that most foreign investment in the United States originates from OECD countries. At the same time, countries such as Brazil, China, India, Russia and South Korea are expanding their FDI positions in the United States at a rapid rate. Additional focus should

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U.S. Department of Commerce, International Trade Administration
be placed on drawing FDI from those emerging-source countries.

Moving forward, the effect of economic communities on FDI, such as the European Union, merits increased attention. Although investment flow comparisons have traditionally been made between individual countries (for example, between the United Kingdom and the United States and between Germany and the United States), the ongoing integration of the EU into a single market will make comparisons with the EU more relevant. At its peak in 1984, the United States attracted approximately 43 percent of global FDI, while the countries making up the modern-day EU-27 attracted 13 percent. As Figure 8 shows, by 2006, those numbers had essentially reversed - the United States attracted 13 percent of global FDI inflows, while the EU captured 41 percent. Those numbers need to be qualified, however. The data include intra-EU cross-border investment flow numbers that should be netted out for a true comparison to be made. It is worth noting, however, that even if 65 percent of the European Union’s reported FDI inflows in 2006 represented intra-EU cross-border investments, its global inflows would have still been larger than the FDI inflows of the United States.

The United States has many competitive advantages to attract foreign direct investment and states will continue to take the lead in individual investment promotion. Nevertheless, issues stemming from international perceptions and other economic factors have raised concerns about the future competitiveness of the U.S. economy. Invest in America has an important role to play in addressing broader investor concerns while working to improve U.S. competitiveness for foreign investment.

Notes
2 Based on percentage share of global FDI inflows captured by the United States (by dollar value).
17 Ibid.
20 Ibid.
21 Ibid.
23 OECD, Main Science and Technology Indicators, May 2007. www.oecd.org/document/26/0,3343,en_2649_33703_1901082_1_1_1_1,00.html.
31 Zanatta, et al.
32 Currently, there is an ongoing US/EU Investment dialogue.
35 Remarks of Deputy Treasury Secretary Kimmitt before the American Chamber of Commerce, February 12, 2007.
The International Trade Administration's mission is to create prosperity by strengthening the competitiveness of U.S. industry, promoting trade and investment, and ensuring fair trade and compliance with trade laws and agreements.

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