Foreword

This report on the research project, *Analysis of the Performance of U.S. Investment Abroad and Its Implications for Developing Countries and Japan,* is produced by the Institute for International Monetary Affairs (IIMA). The project, commission by the Japanese Ministry of Finance, started in August 2005 and completed in February 2006. This report brings together the findings and analysis of the research.

The U.S. maintains a positive return in its income account of the Balance of Payments despite its accumulating large net foreign liabilities since 1986 when U.S. net international investment position plunged into negative zone. It could be considered that the U.S., in effect, keeps net foreign assets position in that it still renders a net return on its international investment position. The key contributing factor enabling a positive return on its negative net international investment position is that the return on U.S.-owned assets abroad has consistently exceeded the return on foreign-owned assets in the U.S. Indeed, the rate of return on the former has been outperforming by far that on the latter. Would this situation remain unchanged for years to come? If it would, the U.S. could be deemed it remains, in effect, in a positive net international position, with continuing positive return in its investment income account, thus conceivably having positive implications for the sustainability of the U.S. current account deficit. If not, its investment income account would deteriorate to show eventually negative figures, thus causing not only the U.S. current account deficit to increase but also to topple the U.S. into a negative net international investment position both in nominal and effective terms, which, as contrasted with the earlier case, would have negative implications for the sustainability issue. It is on this account that the prospects of the future rate of return gap between U.S. outward and inward direct investments will have a significant bearing on the implications of the sustainability of the current account deficit.

The project, motivated by such observation, focused mainly on finding answers to the question why the return on U.S. foreign direct investment abroad has consistently outperformed that on foreign direct investment in the U.S. Chapters 1 and 2 of the report devoted to the analysis in this regard. Capitalizing on such analysis, Chapter 3 then discussed the prospects of the gap of the rate of return between U.S. outward and inward direct investments. The IIMA also conducted head-on-head interviews with a small number of leading U.S. corporations as well as industry analysts of major U.S. investment banks to supplement macro-data-based analysis. Chapter 4 simulated multiple scenarios using Vector Autoregressive (VAR) model to analyze the level of the income account that would be considered to secure the sustainability of the U.S. current account. Finally, Chapter 5 examined US investment abroad in conjunction with its role for economic development in developing countries.

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