

Chapter 1 Overview of Current Trends of U.S. Direct Investment Abroad and Foreign Direct Investment in the U. S.

Before we examine rate of return on U.S. investment in the subsequent chapters, we overview below U.S. international assets and liabilities position, U.S. income account structure and U.S. outward and inward direct investment compositions by industry and area.

1. International Assets and Liabilities Position of the U.S. and its Income Account

U.S. international investment position as of 2004-end stood at a net liabilities position of US\$2,484.2 billion, with U.S.-owned assets of US\$9,052.7 billion and foreign-owned assets of US\$11,537.0 billion on a current-cost basis¹. The net liabilities position is equivalent to 21.2% of U.S. GDP (Table 1-1).

U.S. international investment position plunged into negative zone on a net basis in 1986. Ever since then, the net liabilities position has been increasing every year except in 1990, 1993, and 1999. Despite its increasing cumulative international net liabilities position, however, the return on the U.S.-owned assets abroad, i.e., receipts by the U.S., exceeds every year that on the foreign-owned assets in the U.S., i.e. payments by the U.S. The U.S., with its net return on the international investment position, could be deemed, as a country that holds in effect net foreign assets, rather than a country in net foreign liability position.

Table1-1 U.S. International Assets and Liabilities Position (1983-2004)

	(US\$ billion)									
	U.S. assets abroad			Foreign assets in the U.S.			U.S. net international position			as % of GDP
	FDI	Other	Total	FDI	Other	Total	FDI	Other	Total	
1983	355.6	855.3	1,211.0	193.7	719.0	912.7	161.9	136.4	298.3	8.4%
1984	348.3	856.6	1,204.9	223.5	820.7	1,044.2	124.8	35.9	160.7	4.1%
1985	371.0	916.4	1,287.4	247.2	985.8	1,233.1	123.8	-69.5	54.3	1.3%
1986	404.8	1,064.6	1,469.4	284.7	1,220.9	1,505.6	120.1	-156.3	-36.2	-0.8%
1987	478.1	1,168.5	1,646.5	334.6	1,392.0	1,726.5	143.5	-223.5	-80.0	-1.7%
1988	513.8	1,315.9	1,829.7	401.8	1,606.4	2,008.1	112.0	-290.5	-178.5	-3.5%
1989	553.1	1,517.8	2,070.9	467.9	1,862.5	2,330.4	85.2	-344.7	-259.5	-4.7%
1990	616.7	1,562.5	2,179.0	505.3	1,919.0	2,424.3	111.3	-356.7	-245.3	-4.2%
1991	643.4	1,643.1	2,286.5	533.4	2,062.3	2,595.7	110.0	-419.2	-309.3	-5.2%
1992	663.8	1,667.9	2,331.7	540.3	2,222.6	2,762.9	123.6	-554.8	-431.2	-6.8%
1993	723.5	2,030.1	2,753.6	593.3	2,467.3	3,060.6	130.2	-437.2	-307.0	-4.6%
1994	786.6	2,200.6	2,987.1	618.0	2,692.5	3,310.5	168.6	-492.0	-323.4	-4.6%
1995	885.5	2,600.8	3,486.3	680.0	3,264.7	3,944.7	205.4	-663.9	-458.5	-6.2%
1996	989.8	3,042.5	4,032.3	745.6	3,781.7	4,527.4	244.2	-739.2	-495.1	-6.3%
1997	1,068.1	3,499.8	4,567.9	824.1	4,564.5	5,388.6	243.9	-1,064.6	-820.7	-9.9%
1998	1,196.0	3,899.5	5,095.5	920.0	5,070.9	5,990.9	276.0	-1,171.3	-895.4	-10.2%
1999	1,414.4	4,560.0	5,974.4	1,101.7	5,638.9	6,740.6	312.6	-1,078.9	-767.2	-8.3%
2000	1,531.6	4,707.2	6,238.8	1,421.0	6,199.0	7,620.0	110.6	-1,491.8	-1,381.2	-14.1%
2001	1,693.1	4,615.6	6,308.7	1,518.5	6,709.6	8,228.1	174.7	-2,094.1	-1,919.4	-19.0%
2002	1,860.4	4,785.3	6,645.7	1,517.4	7,235.5	8,752.9	343.0	-2,450.3	-2,107.3	-20.1%
2003	2,062.6	5,578.4	7,641.0	1,585.9	8,211.8	9,797.7	476.7	-2,633.4	-2,156.7	-19.7%
2004	2,367.4	6,685.4	9,052.8	1,708.9	9,828.1	11,537.0	658.5	-3,142.7	-2,484.2	-21.2%

FDI: Foreign Direct Investment

(Source: Department of Commerce)

Table 1-2 presents US income receipts/payments in two categories, namely (i) U.S. outward and inward foreign direct investment and (ii) U.S. outward and inward foreign investment excluding direct investment (hereinafter referred to as "other investment" in this section). The data indicate U.S. net receipts of foreign direct investment has consistently more than offset U.S. net payments of other

¹ Please refer to Box 1 (pp. 8), "Valuation Methods of Direct Investment Balance", for definition of current-cost basis, etc.

investment.

Table 1-2 US Income Receipts/Payment of Foreign Investment (1983-2004)

	(US\$ billion)								
	Investment income (receipts)			Investment income (payments)			Net investment income		
	FDI	Other	Total	FDI	Other	Total	FDI	Other	Total
1983	31.8	58.3	90.0	-4.1	-49.5	-53.6	27.6	8.8	36.4
1984	35.3	73.5	108.8	-8.4	-65.3	-73.8	26.9	8.2	35.1
1985	35.4	63.1	98.5	-6.9	-65.9	-72.8	28.5	-2.7	25.7
1986	36.9	59.2	96.2	-6.9	-72.0	-78.9	30.1	-12.8	17.3
1987	46.3	60.9	107.2	-7.7	-83.9	-91.6	36.6	-23.0	13.6
1988	58.4	77.3	135.7	-12.2	-104.0	-116.2	46.3	-26.8	19.5
1989	62.0	98.3	160.3	-7.0	-132.1	-139.2	54.9	-33.8	21.1
1990	66.0	104.6	170.6	-3.5	-136.3	-139.7	62.5	-31.7	30.8
1991	58.7	89.2	147.9	2.3	-123.3	-121.1	61.0	-34.1	26.9
1992	57.5	74.3	132.0	-2.2	-102.6	-104.8	55.3	-28.2	27.2
1993	67.2	67	134.2	-7.9	-97.7	-105.6	59.3	-30.7	28.6
1994	77.3	87.2	164.6	-22.2	-121.3	-143.4	55.2	-34.0	21.2
1995	95.3	112.8	208.1	-30.3	-152.8	-183.1	64.9	-40.0	25.0
1996	102.5	121.4	223.9	-33.1	-164.4	-197.5	69.4	-43.0	26.4
1997	115.3	139.2	254.5	-43.0	-194.6	-237.5	72.3	-55.4	17.0
1998	104.0	155.4	259.4	-38.4	-212.1	-250.6	65.5	-56.7	8.8
1999	131.6	159.6	291.2	-53.4	-218.6	-272.1	78.2	-59.1	19.1
2000	151.8	196.2	348.1	-56.9	-265.4	-322.3	94.9	-69.2	25.7
2001	128.7	156.7	285.4	-12.8	-242.3	-255.0	115.9	-85.5	30.3
2002	145.6	122.3	267.8	-45.8	-206.6	-252.4	99.8	-84.3	15.5
2003	193.3	113.6	306.9	-71.4	-183.6	-255.0	121.8	-70.0	51.8
2004	233.1	143.4	379.5	-105.1	-235.1	-340.3	127.9	-91.7	36.2

FDI: Foreign Direct Investment

(Source: Department of Commerce)

Given the accumulated U.S. external debt and continuing current account deficit, U.S. net payments of other investment should increase due to increasing flow of foreign funds to the U.S. This implies whether the U.S. would maintain its net assets position in effect (i.e. maintaining net surplus in its investment income account) or would become a country in net liabilities position both in nominal and effective terms (i.e., running net deficit in its investment income account) is dependent on whether the U.S. can earn sufficient level of net receipts of foreign direct investment to offset U.S. net payments of other investment. In the event that the U.S. should record annual deficit in its income account, it would be the first time since 1911.

The U.S.'s consistent sizable net receipts in foreign direct investment income account is due mainly to the rate of return gap between U.S. outward and inward direct investment (the former outperforms the latter) while it is due, to a lesser extent, to U.S. net assets position, i.e. U.S.-owned assets abroad exceeding foreign-owned assets in the U.S.

In order to confirm the above argument, we conducted below a factor analysis based on the data in Tables 1-1 and 1-2 on the U.S. income receipts/payments of foreign investment in 2004. The income receipts/payments consist of those of direct investment and those of other investment. Rate of return gap factor and investment position difference factor are analyzed in respect of each investment category by factor analysis (see Table 1-3). Please refer to the note to the table for our methodology.

We can point out the following from the analysis:

- Net surplus US\$36.2 billion of income receipts of foreign investment consists of net surplus US\$127.9 billion for foreign direct investment and net deficit US\$91.7 billion for other investment;
- The above US\$127.9 billion net surplus income receipt of foreign direct investment consists of US\$80.0 billion attributable to the rate of return gap factor (namely, 10.5% return on U.S. direct investment abroad *versus* 6.4% return on foreign direct investment in the U.S.) and US\$48.0 billion attributable to the investment position difference factor (namely, US\$2,215.0

billion U.S. direct investment abroad *versus* US\$1,647.4 billion foreign direct investment in the U.S.). This indicates the rate of return gap is the major factor for the net surplus of income receipts of U.S. direct investment; and

- Net deficit US\$91.7 billion of income payments of other investment consist of US\$20.3 billion attributable to the rate of return gap factor (namely, 2.3% return on U.S. other investment abroad versus 2.6% return on foreign other investment in the U.S. and US\$71.4 billion attributable to the investment position difference factor (namely, US\$6,131.9 billion of U.S. other investment abroad *versus* US\$9,020.0 billion of foreign other investment in the U.S. This indicates the investment position difference is the major factor for the net deficit of income payments of U.S. foreign other investment.

Table 1-3 Factor Analysis of Net Income Receipts/Payments of Foreign Investment in 2004

		(US\$ billion)
Net investment income		30.4
	Net income from direct investment	128.0
X1	of which: attributable to difference in rate of return	80.0
Y1	attributable to difference in investment position	48.0
	Income from other investment	-97.4
X2	of which: attributable to gap of rate of return	-23.9
Y2	attributable to difference of investment position	-73.5

Minus (-) denotes amount paid exceeds amount received

Data for factor analysis		
A1	Position of U.S. direct investment abroad (US\$ billion)	2,215.0
a1	Rate of return on U.S. direct investment abroad (%)	10.5
B1	Position of foreign direct investment in the U.S. (US\$ billion)	1,647.4
b1	Rate of return on foreign direct investment in the U.S. (%)	6.4
A2	Position of U.S. "other investment" abroad (US\$ billion)	6,131.9
a2	Rate of return on U.S. "other investment" abroad (%)	2.4
B2	Position of foreign "other investment" in the U.S. (US\$ billion)	9,020.0
b2	Rate of return on foreign "other investment" in the U.S. (%)	2.7

Each position is an arithmetic mean of year-end balance of 2003 and 2004.

Rate of return: income divided by investment position

(Note) Factor analysis has been conducted as below.

As a first step, net investment income can be described by the following formula: $a1*A1-b1*B1$

The above can be transformed to the following identical equation.

$$a1*A1-b1*B1=(a1-b1)*(A1+B1)+(a1+b1)*(A1-B1)-(a1*A1-b1*B1)$$

The above can be re-arranged as below.

$$a1*A1-b1*B1=(a1-b1)*(A1+B1)/2+(A1-B1)*(a1+b1)/2$$

The first term of the right-hand side of the above equation indicates the difference between the rate of return on U.S. direct investment abroad and that of foreign direct investment in the U.S. In other words, the term represents the factor attributable to the difference of rate of return.

The second term of the right-hand side of the above equation can be regarded as the difference of position between U.S. outward and inward direct investment. In other words, the term represents the factor attributable to the difference of position.

We follow the same steps regarding "other investment", and obtain the following equation.

$$a^2 \cdot A^2 - b^2 \cdot B^2 = (a^2 - b^2) \cdot (A^2 + B^2) / 2 + (A^2 - B^2) \cdot (a^2 + b^2) / 2$$

The first term of the right-hand side of the above equation represents the factor attributable to the difference of rate of return, and the second term the factor attributable to the difference of position.

The above indicates whether the U.S. would maintain its net assets position in effect by maintaining net surplus in its investment income account or would become a country in net liabilities position both in nominal and effective terms (i.e., running net deficit in its investment income account) is dependent, aside from the issue of fast growing income payments of U.S. external debts, on the level of the rate of return gap between U.S. outward and inward direct investment.

2. Recent Trend of U.S. Direct Investment Abroad

We overview in the sections below recent trend of U.S. direct investment abroad (hereinafter referred to as "USDIA") and foreign direct investment in the U.S. (hereinafter referred to as "FDIUS") by industry and area.

Table 1-4 presents USDIA position by industry since 1999 on a historical-cost basis. Please refer to Box 1 for the definition of the evaluation of investment position.

Table 1-4 USDIA Position by Industry (1999-2004)

	(US\$ billion, % (share))					
	1999	2000	2001	2002	2003	2004
All Industries	1,216.0	1,316.2	1,460.3	1,616.5	1,791.9	2,064.0
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Mining	72.5	72.1	79.4	81.8	87.7	101.5
	6.0%	5.5%	5.4%	5.1%	4.9%	4.9%
Utilities	22.5	22.0	25.5	26.4	21.8	19.0
	1.8%	1.7%	1.7%	1.6%	1.2%	0.90%
Manufacturing	327.3	343.9	328.0	337.7	375.3	428.2
	26.9%	26.1%	22.5%	20.9%	20.9%	20.7%
Food	23.3	23.5	21.3	19.2	23.9	26.0
	1.9%	1.8%	1.5%	1.2%	1.3%	1.3%
Chemicals	81.7	75.8	79.2	82.5	96.3	107.9
	6.7%	5.8%	5.4%	5.1%	5.4%	5.2%
Metals	21.6	21.6	21.8	20.8	22.1	26.3
	1.8%	1.6%	1.5%	1.3%	1.2%	1.3%
Machinery	21.5	22.2	17.7	18.3	21.1	24.5
	1.8%	1.7%	1.2%	1.1%	1.2%	1.2%
Computers, etc.	46.8	59.9	58.7	49.6	51.1	58.6
	3.8%	4.6%	4.0%	3.1%	2.9%	2.8%
Electric products	8.2	10.0	9.6	9.7	11.0	12.4
	0.7%	0.8%	0.7%	0.6%	0.6%	0.6%
Transportation equipment	43.3	49.9	40.5	45.3	47.5	48.4
	3.6%	3.8%	2.8%	2.8%	2.7%	2.3%
Wholesale trade	86.3	93.9	112.9	111.2	122.0	136.9
	7.1%	7.1%	7.7%	6.9%	6.8%	6.6%
Information	50.1	52.3	43.0	41.7	49.1	56.4
	4.1%	4.0%	2.9%	2.6%	2.7%	2.7%
Depository institutions	40.9	40.2	44.6	54.7	62.6	68.1
	3.4%	3.1%	3.8%	3.4%	3.5%	3.3%
Finance (excluding depository institutions) and insurance	198.7	217.1	240.3	285.2	328.9	371.0
	16.3%	16.5%	16.5%	17.6%	18.4%	18.0%
Professional, technical services	30.0	32.9	34.3	31.1	35.3	42.1
	2.5%	2.5%	2.3%	1.9%	2.0%	2.0%
Other industries	387.7	441.9	541.3	646.7	709.3	840.8
	31.9%	33.6%	37.1%	40.0%	39.6%	40.7%

(Compiled from the Department of Commerce data)

- Total investment position increased from US\$1,216.0 billion in 1999 to US\$2,064 billion in 2004, with an average increase of 11.2% annually.
- All industries increased investment position in absolute terms during the period. The growth rate, however, differs substantially for each industry. The shares of each industry segment changed accordingly.
- The industry segment which underwent the most noticeable change is “other industries.” Its share already as high as at 31.9% in 1999 reached 40.7% in 2004.
- Industry segment whose share increased along with “other industries” during the period is “finance (except depository institutions) and insurance” only, with its share at 16.3% in 1999 and 18.0% in 2004. All other industry segments decreased their shares during the period.
- As a result, combined shares of the two industry segments, namely “other industries” and “finance (except depository institutions) and insurance” accounted for nearly 60% of total USDIA in 2004.
- Meanwhile, the manufacturing sector substantially decreased its share during the period from 26.9% to 20.7%.
- “Other industries” segment that increased its share substantially during the period include a wide variety of industries. More specific industry segment showing substantial increase in its share is “holding companies, except bank holding companies,” that belongs to Code No.5412 of U.S. Industry Classifications. The investment position of “holding companies, except bank holding companies” as at 2004-end stood at US\$705.4 billion, accounting for 85% of US\$840.8 billion of “other industries”, or 34% of US\$2,064.0 billion of all USDIA. Please note that “bank holding companies” are classified as “depository institutions” in Table 1-3. Section 5 of Chapter 2 discusses “holding companies” in more detail.

Table 1-5 presents USDIA position by area since 1999 on a historical-cost basis.

Table 1-5 USDIA Position by Area (1999-2004)

	(US\$ billion, % (share))					
	1999	2000	2001	2002	2003	2004
All	1,215,960	1,316,247	1,460,352	1,616,548	1,791,891	2,063,998
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Canada	119,590	132,472	152,601	166,473	189,754	216,571
	9.8%	10.1%	10.4%	10.3%	10.6%	10.5%
Europe	627,754	687,320	771,936	859,378	982,737	1,089,941
	51.6%	52.2%	52.9%	53.2%	54.8%	52.8%
Germany	53,399	55,608	63,396	61,073	68,358	79,579
	4.4%	4.2%	4.3%	3.8%	3.8%	3.9%
Ireland	25,157	35,903	39,541	51,598	62,547	73,153
	2.1%	2.7%	2.7%	3.2%	3.5%	3.5%
Luxembourg	22,148	27,849	50,771	62,181	70,025	74,902
	1.8%	2.1%	3.5%	3.8%	3.9%	3.6%
Netherlands	121,315	115,429	147,687	158,415	186,102	201,918
	10.0%	8.8%	10.1%	9.8%	10.4%	9.8%
Switzerland	40,532	55,377	63,768	74,229	88,940	100,727
	3.3%	4.2%	4.4%	4.6%	5.0%	4.9%
United Kingdom	216,638	230,762	228,230	247,952	278,745	302,523
	17.8%	17.5%	15.6%	15.3%	15.6%	14.7%
Latin America and Other Western Hemisphere	253,928	266,576	279,611	289,413	300,690	325,891
	20.9%	20.3%	19.1%	17.9%	16.8%	15.8%
Mexico	37,151	39,352	52,544	56,303	59,070	66,554
	3.1%	3.0%	3.6%	3.4%	3.3%	3.2%
Bermuda	50,847	60,114	84,969	89,473	85,077	91,266
	4.2%	4.6%	5.8%	5.5%	4.7%	4.4%
Africa	13,118	11,891	15,574	16,040	18,978	22,259
	1.1%	0.9%	1.1%	1.0%	1.1%	1.1%
Middle East	10,950	10,863	13,212	15,158	17,363	19,235
	0.9%	0.8%	0.9%	0.9%	1.0%	0.9%
Asia and Pacific	190,621	207,125	227,418	270,086	282,370	390,101
	15.7%	15.7%	15.6%	16.7%	15.8%	18.9%
Japan	55,120	57,091	55,651	66,468	68,097	80,246
	4.5%	4.3%	3.8%	4.1%	3.8%	3.9%
Singapore	20,665	24,133	40,764	50,955	50,343	56,900
	1.7%	1.8%	2.8%	3.2%	2.8%	2.8%

(Compiled from the Department of Commerce data)

- Latin America decreased its share during the period while Canada, Europe, and Asia and Pacific increased respective share. Africa and Middle East maintained respective share.
- The U.K. and Germany decreased respective share whereas Europe as a whole increased its share. The U.K., however, remained as by far the largest destination of USDIA.
- Of the European countries, Ireland, Luxembourg, and Switzerland increased respective share. Ireland has increased its importance in USDIA as manufacturing cite in Europe. Luxembourg and Switzerland have increased their relative importance as locations for holding companies for mega M&A deals, compared with the Netherlands and the U.K.
- Japan's share was on a decreasing trend during the period while Asia and Pacific increased their share as a whole. The data also shows a sharp increase in share of Asia and Pacific in 2004. This appears to be due to mega M&A deals in Australia. The relevant detailed numbers are, however, specified as (D) in the U.S. Department of Commerce data, indicating not disclosed,

3. Recent Trend of Foreign Direct Investment in the U.S.

Table 1-6 presents FDIUS position by industry since 1999 on a historical-cost basis.

Table 1-6 FDIUS Position by Industry (1999-2004)

	(US\$ billion, % (share))					
	1999	2000	2001	2002	2003	2004
All industries	955.7 100.0%	1,256.90 100.0%	1,344.00 100.0%	1,344.70 100.0%	1,410.70 100.0%	1,526.30 100.0%
Manufacturing	406.4 42.5%	480.6 38.2%	476.5 35.5%	469.8 34.9%	492.0 34.9%	519.4 34.0%
Food	15.0 1.6%	18.1 1.4%	18.6 1.4%	19.8 1.5%	19.5 1.4%	21.1 1.4%
Chemicals	96.6 10.1%	120.4 9.6%	128.6 9.6%	123.3 9.2%	136.5 9.7%	148.0 9.7%
Metals	18.8 2.0%	21.2 1.9%	20.0 1.5%	18.5 1.4%	17.7 1.3%	18.9 1.2%
Machinery	30.5 3.2%	32.3 2.6%	43.3 3.2%	47.8 3.6%	48.1 3.4%	49.5 3.3%
Computers, etc	62.6 6.6%	92.8 7.4%	54.7 4.1%	42.4 3.2%	44.0 3.1%	41.9 2.7%
Electrical equipment	13.4 1.4%	43.1 3.4%	53.6 4.0%	45.8 3.4%	12.6 0.9%	13.6 0.9%
Transportation equipment	52.8 5.5%	55.8 4.4%	62.3 4.6%	61.5 4.6%	66.5 4.7%	70.0 4.6%
Wholesale trade	106.7 11.2%	174.0 13.8%	184.7 13.8%	197.6 14.7%	180.8 12.8%	201.1 13.2%
Retail trade	22.4 2.3%	26.7 2.1%	22.6 1.7%	20.8 1.6%	22.7 1.7%	26.1 1.7%
Information	78.0 8.2%	146.9 11.7%	146.9 10.9%	116.1 8.7%	124.7 8.8%	117.2 7.7%
Depository institutions	62.0 6.5%	64.2 5.1%	67.2 5.0%	75.5 5.6%	87.5 6.2%	123.3 8.1%
Finance (except depository institutions)	132.2 13.8%	167.0 13.3%	173.8 12.9%	169.2 12.6%	190.2 13.5%	206.5 13.5%
Real estate and rental and leasing	47.8 5.0%	50.0 4.0%	44.3 3.3%	47.3 3.5%	44.5 3.2%	47.6 3.1%
Professional, scientific, and technical services	11.7 1.2%	30.5 2.4%	31.5 2.3%	27.0 2.0%	34.5 2.5%	38.8 2.5%
Other industries	88.5 9.3%	117.0 9.3%	196.4 14.6%	221.4 16.5%	232.9 16.5%	246.3 16.1%

(Compiled from the Department of Commerce data)

- Total investment position increased from US\$955.7 billion in 1999 to US\$1,526.3 billion in 2004, with an average increase of 9.8% annually.

- The industry sectors whose investment position at 2004-end decreased from 1999-end are computers and electric products segment (whose share decreased to less than half to 2.7% from 6.6% during the period due to the IT bubble burst), and real estate and rental and leasing segment (decreased to 3.1% from 5.0%).
- Information segment doubled its investment position in 2000 and 2001 from 1999, to increase its share to 12%. It, however, decreased to 7.7% at 2004-end due to the withdrawal from the U.S. telecommunication market after the IT bubble burst.
- Growth rate of industry whose investment position increased in absolute terms during the period varies significantly by industry: “other industries” sector increased from 9.3% to 16.1%, depository institution sector from 6.5% to 8.1%, and wholesale sector from 11.2% to 13.2%. Other industry segments decreased their shares in general.
- Total share of manufacturing sector decreased from 42.5% to 34.0%.
- Like USDIA’s “other industries” sector, FDIUS’ “other industries” sector also increased its share during the period. However, the latter is not so concentrated on holding companies as the former. As of 2004-end, while holding companies of USDIA accounted for 85% of “other industries” segment, that of FDIUS accounted for only 34% (US\$84.1 billion) of “other industries” sector (US\$246.3 billion) of FDIUS. This represented only 5.5% of total FDIUS, which is significantly smaller than 34% for USDIA.

Table 1-7 FDIUS Position by Area 1999-2004 on a Historical-Cost Basis

(US\$ billion, % (share))

	1999	2000	2001	2002	2003	2004
All	955,726	1,256,867	1,343,987	1,344,697	1,410,672	1,526,306
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Canada	90,599	114,309	92,420	95,344	101,568	133,761
	9.5%	9.1%	6.9%	7.1%	7.2%	8.8%
Europe	639,923	887,014	999,069	980,036	1,021,349	1,078,287
	67.0%	70.1%	74.3%	72.9%	72.4%	70.8%
France	89,945	125,740	154,984	141,588	139,265	148,242
	9.4%	10.0%	11.5%	10.5%	9.9%	9.7%
Germany	112,126	122,412	162,314	139,247	156,290	163,372
	11.7%	9.7%	12.1%	10.4%	11.1%	10.7%
Netherlands	125,010	138,894	145,554	150,263	152,708	167,280
	13.1%	11.1%	10.8%	11.2%	10.8%	11.0%
Switzerland	52,973	64,719	129,478	123,867	129,032	122,944
	5.5%	5.1%	9.6%	9.2%	9.1%	8.1%
United Kingdom	153,797	277,613	197,651	215,531	219,735	251,562
	16.1%	22.1%	14.7%	16.0%	15.6%	16.5%
Latin America and Other Western Hemisphere	40,771	53,691	64,842	74,561	81,768	85,864
	4.3%	4.3%	4.8%	5.5%	5.8%	5.6%
Africa	1,361	2,700	2,346	2,242	2,179	1,611
	0.1%	0.2%	0.2%	0.2%	0.2%	0.1%
Middle East	4,362	6,506	6,082	7,319	7,641	8,200
	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
Asia and Pacific	178,749	192,647	179,228	185,196	196,167	218,583
	18.7%	15.3%	13.3%	13.8%	13.9%	14.3%
Japan	153,815	159,690	149,859	151,333	160,452	176,906
	16.1%	12.7%	11.2%	11.3%	11.4%	11.6%

(Compiled from the Department of Commerce data)

- Europe significantly increased its share in recent years due to growing number of mega M&A deals by European companies actively having acquired U.S. corporations. It is of note that Europe’s share has exceeded 70% since 2000. It is also of note that the U.K., the Netherlands, and Germany hold respective share greater than 10%.
- A sharp drop of the U.K.’s share in 2001 and a sharp increase of Switzerland’s share in the same year were due mainly to changing the lender of U.S. affiliates of U.K. company from U.K. parent to Swiss affiliate of the relevant U.K. company.
- While Europe’s share was on an increasing trend during the period, Japan’s was on a decreasing

trend for the same period. Japan, however, is still the second largest investor after the U.K.

4. Trend of Rate of Return of USDIA and FDIUS

This section overviews the trend of rate of return of USDIA and FDIUS. Rate of return of foreign direct investment can be calculated with slightly different results depending on which investment position base is used as denominator. The Department of Commerce releases data on foreign direct investment in accordance with the following three bases:

- Based on historical-cost
- Based on current-cost method
- Based on market-value method

Please refer to Box 1 for each of valuation base of investment position. It should be noted that current cost method and market-value method capture statistics only on all areas and all industries basis. Data by area and industry are available only on a historical-cost basis.

Box 1: Valuation Methods of Direct Investment Balance

The Department of Commerce releases direct investment position in accordance with the three methods, namely historical-cost method, current-cost method, and market-value method. The following is the excerpt from the relevant article of the *Survey of Current Business* by the Department of Commerce.

Historical-cost base: All balance sheet items are recorded at historical cost (Table A).

Current-cost base: Only tangible assets—inventories and property, plant, and equipment (PP&E)—are revaluated at current cost. Financial assets (current and noncurrent) are recorded at historical cost. Owners' equity is revalued to reflect the adjustment in the value of the tangible assets. Liabilities are not subject to revaluation (Table B).

Market-value base: Owners' equity is revalued to reflect yearend stock market prices. Liabilities are not subject to revaluation. Assets side is revalued to reflect the adjustment in the value of owners' equity (Table C).

Table A: Balance Sheet at Historical Cost

Assets		Liabilities and owners' equity	
Current:		Liabilities	
Inventories	\$103,803	Current liabilities and	\$504,956
Other	\$407,341	long-term debt	
Total	\$511,144	Other liabilities	\$107,942
		Total	\$612,898
Noncurrent		Owners' equity	
PP&E	\$420,720	Owners' equity	\$387,102
Less accumulated	-187,149		
depreciation		Total	\$387,102
Net PP&E	\$233,571		
Other	\$255,286		
Total	\$488,856		
Addenda: Net tangible asse	\$337,374		
		Total liabilities and	\$1,000,000
Total assets	\$1,000,000	owners' equity	

In table B, using the current-cost method revalues only tangible assets (PP&E) on the left side of the balance sheet. Net PP&E is revalued from US\$233,571 at historical cost to US\$359,092 at current cost, and inventories are revalued from US\$103,803 at historical cost to US\$117,318 at current cost.

Thus, the value of the tangible assets is US\$139,036 greater at current cost than at historical cost. Financial assets are not subject to revaluation, as the historical costs of these assets are assumed to equal or approximate their current-period prices. On the right side of the balance sheet, owners' equity is revalued from US\$387,102 to US\$526,139 to reflect the adjustment in the value of the tangible assets on the left side.

Table B: Balance Sheet Using Current-Cost Method

Assets		Liabilities and owners' equity	
Current assets		Liabilities	
Inventories	\$117,318	Current liabilities and	\$504,956
Other	\$407,341	long-term debt	
Total	\$524,659	Other liabilities	\$107,942
		Total	\$612,898
Noncurrent		Owners' equity	
PP&E	\$646,816	Owners' equity	\$526,139
Less accumulated depreciation	-\$287,723	Total	\$526,139
Net PP&E	\$359,092		
Other	\$255,286		
Total	\$614,378		
Addenda: Net tangible asse	\$476,410		
Total assets	\$1,139,037	Total liabilities and owners' equity	\$1,139,037

In table C, using the market-value method revalues owners' equity on the right side of the balance sheet, to reflect year-end stock market prices. Owners' equity is revalued from US\$387,102 (at historical cost) to U\$793,559 (at market value). Liabilities are not subject to revaluation, as they are assumed to be approximately at current-period prices. The counter-entry on the left side of the balance sheet is assumed to be in good will, which is included under "other" noncurrent assets.

Table C: Balance Sheet Using Market-Value Method

Assets		Liabilities and owners' equity	
Current assets		Liabilities	
Inventories	\$103,803	Current liabilities and	\$504,956
Other	\$407,341	long-term debt	
Total	\$511,144	Other	\$107,942
		Total	\$612,898
Noncurrent		Owners' equity	
PP&E	\$420,720	Owners' equity	\$793,559
Less accumulated depreciation	-\$187,149	Total	\$793,559
Net PP&E	\$233,571		
Other	\$661,742		
(of which, goodwill)	(\$406,457)		
Total	\$895,314		
Addenda: Net tangible asse	\$337,374		
Total assets	\$1,406,457	Total liabilities and owners' equity	\$1,406,457

Table 1-8 presents the trend of rate of return of USDIA and FDIUS since 1983 on each of the three bases. Net profits used as numerators to calculate ratios are prorated in accordance with the shares of the relevant equity providers of USDIA and FDIUS.

Table 1-8 Trends of Investment Return Ratio of USDIA and FDIUS (1983-2004)

	Historical-cost basis			Current-cost basis			Market-value basis		
	USDIA	FDIUS	Gap	USDIA	FDIUS	Gap	USDIA	FDIUS	Gap
1983	13.0%	4.0%	9.0%	8.7%	2.2%	6.5%	12.7%	2.9%	9.8%
1984	14.3%	6.3%	8.0%	10.0%	4.1%	6.0%	13.0%	5.2%	7.8%
1985	12.8%	4.3%	8.5%	9.8%	3.0%	6.9%	10.8%	3.5%	7.2%
1986	12.3%	3.7%	8.6%	9.5%	2.6%	6.9%	8.1%	2.8%	5.3%
1987	13.4%	3.6%	9.8%	10.5%	2.5%	8.0%	8.3%	2.6%	5.7%
1988	15.5%	4.4%	11.1%	11.8%	3.3%	8.5%	9.1%	3.4%	5.7%
1989	14.8%	2.2%	12.6%	11.6%	1.6%	10.0%	8.1%	1.5%	6.6%
1990	14.3%	0.8%	13.5%	11.3%	0.7%	10.6%	8.4%	0.6%	7.8%
1991	11.6%	-0.7%	12.3%	9.3%	-0.4%	9.7%	7.5%	-0.4%	7.9%
1992	10.4%	0.3%	10.1%	8.8%	0.4%	8.4%	7.1%	0.3%	6.8%
1993	11.1%	1.6%	9.5%	9.7%	1.4%	8.3%	7.2%	1.1%	6.2%
1994	11.7%	4.4%	7.3%	10.2%	3.7%	6.6%	7.1%	2.9%	4.2%
1995	13.3%	6.1%	7.2%	11.4%	4.7%	6.7%	7.7%	3.4%	4.2%
1996	12.5%	5.4%	7.2%	10.9%	4.6%	6.3%	6.9%	3.0%	3.9%
1997	12.6%	6.2%	6.3%	11.2%	5.5%	5.7%	6.6%	3.0%	3.6%
1998	9.7%	4.4%	5.2%	9.2%	4.4%	4.8%	5.0%	2.0%	3.0%
1999	10.3%	5.4%	5.0%	10.1%	5.3%	4.8%	5.1%	2.1%	3.0%
2000	10.6%	4.3%	6.2%	10.3%	4.5%	5.8%	5.5%	2.0%	3.4%
2001	7.9%	0.3%	7.6%	8.0%	0.9%	7.1%	5.1%	0.5%	4.7%
2002	8.1%	2.6%	5.5%	8.2%	3.0%	5.2%	6.7%	2.0%	4.7%
2003	10.1%	4.3%	5.8%	9.9%	4.6%	5.2%	8.2%	3.2%	5.0%
2004	10.9%	6.3%	4.4%	10.5%	6.4%	4.1%	7.8%	4.1%	3.7%

(Compiled from the Department of Commerce data)

As Table 1-8 indicates, rate of return of USDIA has consistently exceeded that of FDIUS on any of the basis of the three calculation methods. At the same time, the table also reveals that there are substantial discrepancies of rate gaps among the three calculations. Which one of the three methods is the most appropriate one to gauge the profitability of the operations of foreign direct investment? Given the objectives of the calculation are to compute the rate of return on investment position for certain period and to analyze the trends over years, the following points should be noted:

- Historical-cost method calculates rate of return by dividing net profit of a given period by a denominator that is equal to the simple aggregation of the amounts invested in the past and those subsequently invested, without giving consideration to time factor. A major drawback of this method is calculating rate of return higher for seasoned investment while lower for younger investment. Given the fact that USDIA operations were already full-fledged in the 1950s whereas full-scale FDIUS operations started only in the late 1970s, rate of return on USDIA obviously tends to be calculated higher than that on FDIUS. If we look at the rate gap between USDIA and FDIUS from 1983 to 1992 in Table 1-8, we will notice the rate gaps calculated on a historical-cost basis are consistently higher than those on a current-cost basis by 2-3% points.
- Market-value method is revaluing owners' equity (investment position) in accordance with year-end stock price, which means the denominator is based on the present value of the expected future cash flow. Such denominator would not be considered appropriate to calculate rate of return on USDIA/FDIUS for a given period and analyze the trend.
- Calculating rate of return using current-cost method means revaluing invested position in accordance with adjustment reflecting price changes in tangible assets. We consider this method, among the three, is the most appropriate to gauge rate of return for a given period. However, the data on a current-cost basis are available only for all industries and all areas. Data by industry or by area are available only on a historical-cost basis. It should be noted, however, that the rate gap between historical-cost and current-cost methods in Table 1-8 has narrowed significantly since 1998. Therefore, the drawback of using historical-cost method is considered not material for recent years. Two factors conceivably contributed to the narrowed rate gap. One: nearly thirty years have passed since FDIUS gathered its momentum in the late 1970s, resulting in less

difference in age effect. Two: the prices stayed stable in the late 1990s compared with the 1980s and early 1990s. The data on a historical-cost basis, therefore, can be considered less biased by age effect recently. For this reason, we use in the following sections historical-cost method for rate of return analysis for recent years without reservation.

We occasionally come across a misunderstanding that rate of return of USDIA (FDIUS) is distorted due to fluctuation of exchange rate of US dollar (foreign currency), citing net profit reflects current exchange rate whereas investment position does not, thus rate of return of USDIA would be calculated higher (lower) with weaker (stronger) US dollar, and that of FDIUS would be calculated lower (higher) with weaker (stronger) US dollar. The above is based on a misunderstanding that “investment position does not reflect current exchange rate.” As is footnoted in the relevant data of the Department of Commerce (i.e., composition of changes in US-owned assets abroad with direct investment at current cost, composition of changes in US-owned abroad with direct investment at market value, composition of changes in foreign-owned assets in the United States with direct investment at current cost, and composition of changes in foreign direct investment at market value), “price change” and “exchange rate change” are specified as factors for valuation adjustment. The footnote to “exchange rate change” reads as follows: “Represents gains or losses on foreign-currency denominated assets and liabilities due to this revaluation at current exchange rate.” The above indicates exchange rate factor is reflected both in numerator (i.e., net profit) and denominator (i.e., investment position) for current-cost and market-value methods, and that the exchange factor does not distort the level of rate of return of USDIA and FDIUS.

If we look at the trend of the rate of return of USDIA and FDIUS on a current-cost basis for the period from 1983 to 2004 in Table 1-8, the following should be pointed out:

- Rates of return of USDIA for the above period were within 8-11% range, averaging at 10%. The average for 2000-2004 was 9.4%.
- Rate of return of FDIUS for the period fluctuated with a wide range from -4% (1991) to 6.4% (2004). The average for 1983-2004 was 3.1% while that for 2000-2004 was 3.9%.
- Reflecting the above, rate gap between USDIA and FDIUS ranged from 10.6% (1990) to 4.1% (2004), with an average 6.9% for 1983-2004 and 5.5% for 2000-2004.

In contrast to direct investment, the gap between rate of return of income receipts on U.S. other investment abroad and that of income payments on foreign other investment in the U.S. has been extremely small in the range from -1.0% to 0.1% with an average of 0.4%, as shown in Table 1-9.

Table 1-9 Rate of Return of Other Investment on a Current-Cost Basis (1983-2004)

	U.S. receipts	U.S. payments	Gap		U.S. receipts	U.S. payments	Gap
1983	7.3%	7.5%	-0.2%	1994	4.1%	4.7%	-0.6%
1984	8.6%	8.5%	0.1%	1995	4.7%	5.1%	-0.4%
1985	7.1%	7.3%	-0.2%	1996	4.3%	4.7%	-0.4%
1986	6.0%	6.5%	0.6%	1997	4.3%	4.7%	-0.4%
1987	5.5%	6.4%	1.0%	1998	4.2%	4.4%	-0.2%
1988	6.2%	6.9%	0.7%	1999	3.8%	4.1%	-0.3%
1989	6.9%	7.6%	0.7%	2000	4.2%	4.5%	-0.3%
1990	6.8%	7.2%	0.4%	2001	3.4%	3.8%	-0.4%
1991	5.6%	6.2%	0.6%	2002	2.6%	3.0%	-0.4%
1992	4.5%	4.8%	0.3%	2003	2.2%	2.4%	-0.2%
1993	3.6%	4.2%	0.5%	2004	2.3%	2.6%	-0.3%

(Compiled from the Department of Commerce data)