



THE HIDDEN COSTS OF INSOURCING Higher Trade Deficits and Job Losses for U.S. Workers

BY ROBERT E. SCOTT

Public officials have frequently claimed that foreign companies making direct investments in the United States, or insourcing, are creating employment here. In 2006, former Treasury Secretary John Snow said, “We know that investment in America lies at the heart of creating good jobs...Indeed, 5.3 million U.S. workers alone are directly employed by U.S. affiliates of international companies” (U.S. Department of the Treasury 2006). Treasury Secretary Henry Paulson recently said that “U.S. affiliates of foreign companies bring investments to our shores, creating jobs and revitalizing communities” (U.S. Department of the Treasury 2007).

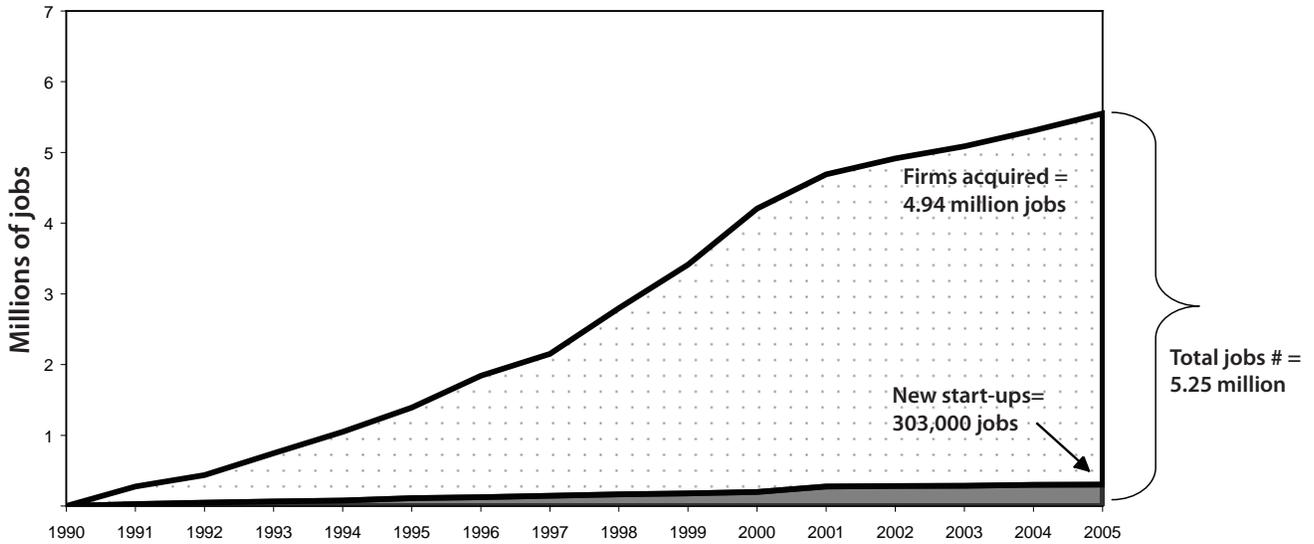
But insourcing can destroy jobs and communities, too. In fact, total U.S. payroll employment of foreign multinationals declined by 50,000 jobs in 2005, and 600,000 jobs between 2000 and 2005. Including job losses from layoffs by firms that are taken over by multinationals, employment in firms that are spun off, and jobs created in new multinational startups, these firms have reduced their overall payroll employment by 4 million jobs since 1990.

Snow and Paulson look at only one side of the ledger, counting jobs “created” without considering where those jobs came from or counting jobs eliminated. An examination of annual data collected by the Commerce Department on employment related to new foreign investment in the United States casts a different light on the employment benefits conferred by these deals. The acquisitions of ongoing U.S. firms—not new startups—account for the vast majority of employment associated with new investments by foreign companies. And these investments, on net, have not added jobs over the past 15 years.

In the Commerce Department’s data, which distinguish between acquisitions and startups, the true picture emerges. In 1990, U.S. affiliates of foreign multinational corporations (MNCs) employed 3.84 million workers. Between 1991 and 2005, foreign MNCs acquired firms employing 4.94 million workers, as shown in **Figure A**. Over that same 12 years, only 303,000 workers were employed in foreign-owned startups in the United States, or 20,000 jobs per year. Thus, foreign MNCs added or acquired firms employing 5.25 million workers over this period. If not for layoffs and the sale of parts of these firms back to U.S. owners, total employment in these firms would have been 9.09 million jobs (including the 3.84 million workers they employed in 1990 plus the 5.25 million hired or acquired), as shown in **Figure B**. However,

FIGURE A

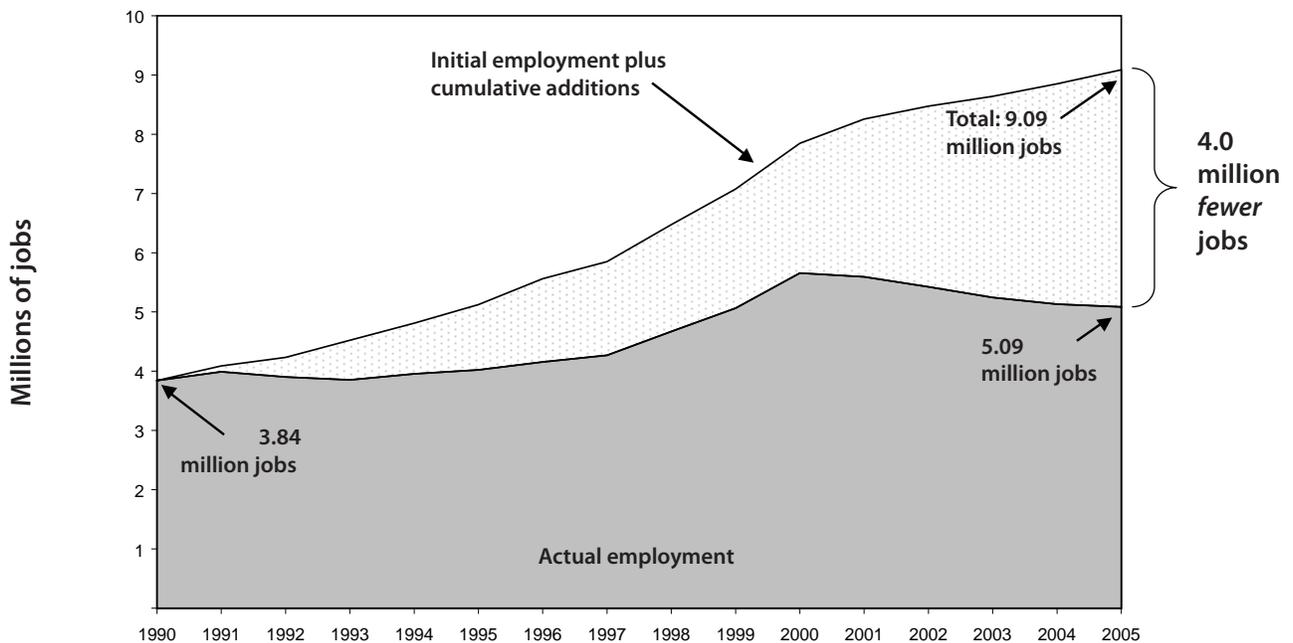
Cumulative employment in firms acquired or started up by foreign MNCs, 1991-2005



Source: BEA.

FIGURE B

Actual employment in MNC affiliates plus cumulative additions, 1990-2005



Source: BEA.

“Between 1991 and 2005, 4 million jobs were eliminated due to layoffs and selloffs of U.S. companies by foreign investors.”

in 2005, these firms actually employed just 5.09 million workers. Thus, although total employment in foreign-owned firms increased in this period from 3.84 to 5.09 million jobs, 4 million jobs in these firms were eliminated due to layoffs and selloffs of U.S. companies by foreign investors, relative to the potential 9.09 million jobs shown in Figure B.

Furthermore, actual employment by foreign-owned affiliates peaked at 5.7 million jobs in 2000, and fell to 5.1 million in 2005, a loss of 600,000 jobs. Just because foreign companies are employing millions of Americans does not mean that those companies have created more jobs in the United States.

Insourcing is often deliberately designed to remove jobs from American industries. Foreign multinationals buy U.S. firms, hollow them out, and then outsource production to their home countries. For example, the Indian firm GHLC recently acquired Dan River, a U.S. textile company. News reports confirm that “Indian firms are attracted in particular to companies whose brands enjoy considerable popularity in their home markets as those brands can be manufactured more cheaply in their Indian plants” (Business Wire 2007).

Sometimes foreign MNCs make an initial job-creating investment and then change their mind. Swedish MNC Electrolux, for example, manufactured refrigerators for years in Greenville, Michigan but recently closed the plant and moved most of its 2,700 jobs to Mexico.

Even the investments that remain can have mixed effects on employment. The Honda auto plants in Ohio, for example, increased employment as they grew and contributed solid products to the U.S. consumer market. However, Honda employs fewer U.S. workers per car sold than domestic producers employ because its vehicles have a much lower share of domestic content (the share of a car’s parts made in the United States or Canada) than comparable models made by domestic producers. A recent report estimates that Honda’s domestic content is 59%, as compared with Ford, G.M., and Chrysler, whose average domestic content is 76% (Level Field Institute 2007). Acquisitions such as Daimler’s purchase of Chrysler in 1998 are simple changes in ownership between domestic and foreign investors, and have not done much to create new production facilities in the United States.

Insourcing leads to growing imports and increases U.S. trade deficits

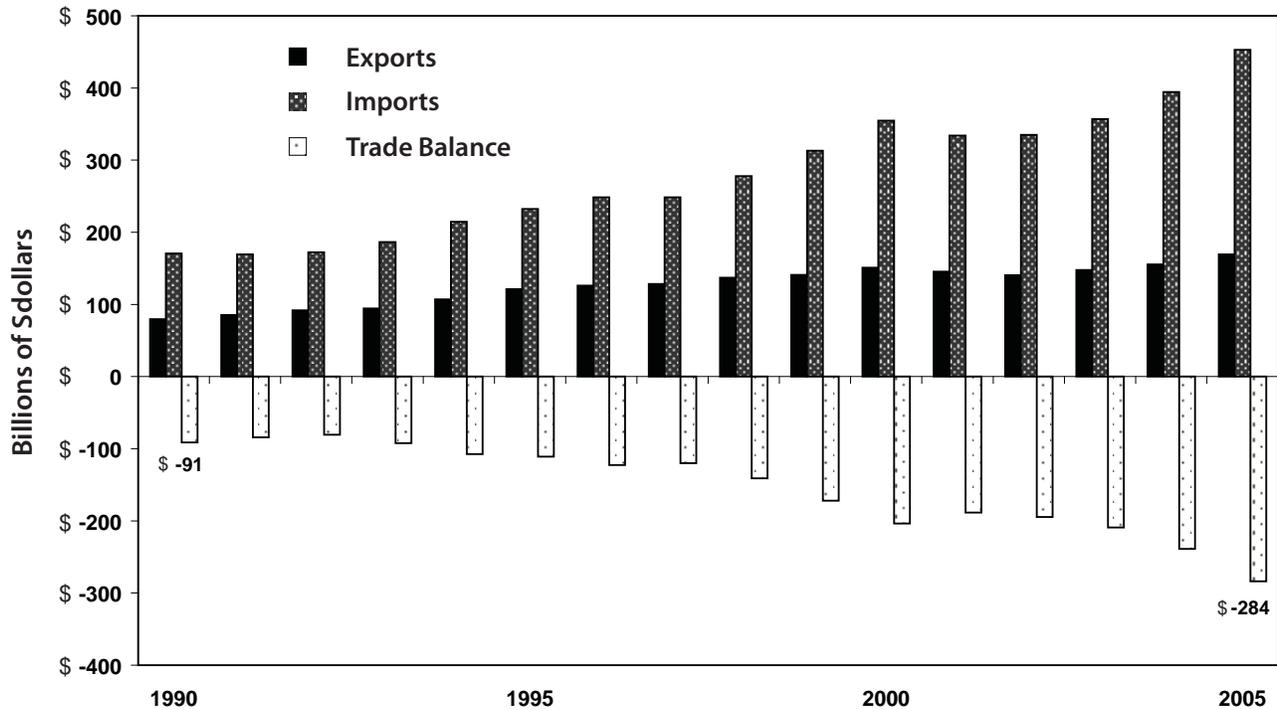
Growing job displacement suggests that foreign multinationals regularly buy U.S. firms, hollow them out, and outsource production and employment to their home countries or other countries. The firms and subsidiaries purchased often have substantial domestic market shares, extensive distribution systems, and widespread brand recognition. This outsourcing usually leads to an increase in net imports by that firm and for the United States as a whole.

Insourcing has also contributed to the rapid growth of imports by U.S. subsidiaries. **Figure C** shows imports, exports, and trade balances from 1990 to 2005 for U.S. firms owned by foreign companies. Total U.S. exports from these foreign-owned firms gradually rose from \$79 billion in 1990 to \$169 billion in 2005, an increase of 7.5% per year. At the same time, total imports of foreign-owned companies in the United States climbed from \$170 billion in 1990 to \$453 billion in 2001, or 11.0% per year. As a result, the contribution to the U.S. trade deficits of foreign-owned firms more than tripled, from \$79 billion to \$283 billion in this period, or 14.3% per year. These firms were responsible for 36.1% of the total U.S. trade deficit in 2005.

“Foreign multinationals buy U.S. firms and then outsource production to their home countries.”

FIGURE C

Rising imports fuel growing trade deficits of MNC affiliates in the United States, 1990-2005



Source: BEA.

Finally, the imports and trade deficits of foreign MNC subsidiaries grew more rapidly than their domestic sales (not shown) in this period. Total sales of these subsidiaries increased 7.2% per year, on average. Their imports increased 8.0% per year, and the trade deficit associated with these firms grew 11.8% per year. Foreign direct investment in the United States fell from a peak of \$321 billion in 2000, to an average of \$118 billion per year between 2001 and 2005, and to \$109 billion in 2005 (Bureau of Economic Analysis 2007a). The growth of sales of foreign-owned subsidiaries fell to 4.9% per year, but their imports continued to grow 8.0% per year.

Both the job and trade statistics refute the argument that insourcing offsets the negative effects of offshoring on U.S. jobs and trade. Surging trade deficits of foreign-owned companies in the United States provide solid evidence that insourcing is displacing domestic jobs, not creating them

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Endnotes

1. Recent data on employment and trade by established firms are from Anderson (2007). Information on businesses acquired or established by foreign MNCs are from McNeil (2007), and historical data for these series are from BEA (2007b).
2. These are sales-weighted averages. The average domestic content of all foreign auto producers is 40%. At 3%, Korean manufacturers have the lowest level of domestic content in the U.S. market.

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