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U.S. Production Abroad

U.S. multinational corporations have expanded their overseas operations substantially during the past 15 years. In 2002 (the latest year for which data are available) the foreign affiliates in which U.S. nonbank corporations held majority ownership employed 8.2 million workers, a 77 percent increase since 1987.

What explains this increase? One view is that corporations are increasingly shifting production to low-wage countries. U.S. corporations have increased their presence dramatically in some low-wage countries between 1987 and 2001 (the latest year for which data on a country basis are available). Employment by U.S. affiliates in Mexico tripled during this 14-year period, from 264,000 workers to 802,000. U.S. firms employ more workers in Mexico than in any foreign country, other than the United Kingdom and Canada. Employment by U.S. affiliates in China also has expanded rapidly. In 1987, employment in China by U.S. affiliates was negligible. In 2001 it ranked as one of the top ten countries for U.S. affiliates, with 273,000 workers employed by U.S. firms.

Nevertheless, the data suggest that low wages are not the driving force behind much international investment. Most workers employed by foreign affiliates of U.S. corporations are located in other high-wage countries, even though the share of overseas employment by U.S. corporations in high-wage countries declined between 1987 and 2001. In 1987, 68.3 percent of workers employed by foreign affiliates of U.S. corporations were located in high-wage countries; in 2001, this share fell to 61.4 percent.¹

Although much attention has focused on the increase in foreign employment by U.S. firms, there has been a similar increase in the number of workers in the United States employed by foreign-owned corporations. The U.S.-based affiliates of foreign firms employed 5.4 million workers in the United States in 2002, more than double the number of workers in 1987. Foreign firms employ workers in all 50 states, accounting for 5 percent of U.S. private industry jobs. The decision of foreign corporations to establish or expand operations in the United States is clearly not driven by low wages.

Indeed, if wages were the key factor in a firm's decision to invest abroad then one would expect that most firms would locate in the lowest-wage countries, yet these countries see little foreign investment. In fact, the 49 countries designated by the United Nations as the least developed (with an annual per capita GDP under \$900) account for less than 1 percent of the foreign employment of U.S. foreign corporations.

One factor overlooked by the emphasis on wages is productivity. The labor cost of production depends not solely on the hourly wage a worker earns but also on how much the worker produces each hour. The productivity of workers in low-wage countries is typically lower than in high-wage countries. Other factors that are important determinants of foreign investment are the political stability of a country, the infrastructure, and the overall business climate.

Another factor driving a firm's decision to establish an overseas affiliate is access to local markets. One way to gauge the importance of market access is to look at the destination of the sales of foreign affiliates. Sixty-five percent of the sales of foreign affiliates of U.S. corporations went to the local market. An additional 24 percent of sales were shipped to other foreign countries, primarily in the local region. Only 11 percent of sales consisted of exports to the U.S. market.

Although the percentage of production in low-wage countries intended for the United States is typically higher than the 11 percent average, even in these countries the bulk of production is for the local market. For example, in 2001, 28 percent of the sales of U.S. affiliates in Mexico were exported to the United States, whereas 64 percent of the sales went to the local market.

In China, 71 percent of the production by U.S. affiliates was sold to the local market. This indicates that for some companies the attractiveness of investing in China is not the access to cheap labor but access to a billion consumers.

—Patricia S. Pollard

¹High-wage countries are the 15 countries of the European Union (as of 2001), Australia, Canada, Japan, New Zealand, Norway, and Switzerland.