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What Tata Tells Us

By Matthew J. Slaughter

Yesterday [Ford Motor Company](#) announced it will sell its Jaguar and Land Rover divisions to India's [Tata Group](#). Upon the closing of this transaction, the many Ford associates currently working in these divisions in the United States will join the ranks of Americans who work at insourcing companies -- i.e., at U.S. affiliates of foreign multinational firms.

Foreign direct investment (FDI) has long been a source of strength for the American economy. In 2005, insourcing companies employed nearly 5.1 million Americans, 4.4% of the private-sector labor force. Beyond their employment, insourcing companies perform large amounts of the crucial activities that make their workers and the overall economy more productive. They invest in physical capital and in research and development, and they help connect the U.S. to the global economy through international trade. The bottom line is larger paychecks. In 2005, compensation per worker at insourcing companies was \$66,042 -- 31.8% above the average for the rest of the private sector of \$50,124.

What is notable about the Tata transaction is not its incremental addition to these numbers, but its demonstration of two critical but little-known aspects of insourcing: how and from whom it arises.

Consider first the how question. How do foreign multinationals undertake new FDI into the U.S.? It is well known that new FDI can come via "greenfield" investments that build new businesses from scratch. Think photo opportunities of business executives and government officials turning fresh dirt with shiny shovels.

But foreign multinationals can also merge with, or acquire part or all of, an existing U.S. company. Greenfield investments can protect proprietary technologies. Acquisitions can yield quicker presence, and can build on target-firm assets such as customer connections and managerial talent.

So what do the data show? From 1987 through 2006, the U.S. received a lot of greenfield FDI: \$220 billion worth. But over that same period, it received \$1.78 trillion of new FDI via mergers and acquisitions (M&A) with existing U.S. businesses. M&A activity, not greenfield investment, is far and away the predominant method foreign companies use to invest in the U.S. It accounts for more than 88% of new FDI in the U.S. over the past two decades. M&A

transactions have been essential for insourcing companies to expand in -- and generate benefits for -- the U.S.

The second key feature of insourcing that the Tata transaction underscores is who does it. For many decades, the bulk of FDI into the U.S. flowed from other high-income countries such as Germany, Japan and the United Kingdom. But in recent years there has been a rise of FDI from multinational firms based in developing countries such as China and India. In 2006, outward M&A transactions by Indian companies totaled \$23 billion, more than five times the 2005 total and approximately 20 times the annual total in 2000.

Two major forces are driving this FDI wave. One is sustained, rapid economic growth in developing countries. This strong growth has fostered new world-class companies that are now expanding abroad into America for reasons that include serving the world's largest and most-stable single-country market.

The other major force driving this FDI wave is the evolving pattern of global imbalances. The U.S. current-account deficit has grown dramatically in recent years. At \$739 billion in 2007, it now accounts for about 70% of the world's total. At the same time, the collection of offsetting, current-account-surplus countries has expanded to include fast-growth countries such as China, Russia and Saudi Arabia. Some of the expanding asset purchases of these new surplus countries are taking the form of insourcing M&A.

So FDI arises overwhelmingly via M&A transactions and increasingly from new source companies and countries. In recent U.S. policy discussions about inward FDI, however, these facts have largely been ignored. Instead, many voices are calling for new restrictions on inward M&A -- especially on transactions from nontraditional countries. All this, despite the sound operations of the Committee on Foreign Investment in the U.S., which for a generation has capably reviewed insourcing M&A transactions for possible national-security risks.

There is no law of physics that the U.S. will continue receiving transactions like Tata's. The world has recently enjoyed some of strongest, most widely shared growth ever seen -- in large part due to dramatically liberalized trade and investment regimes. For globally engaged companies like Tata, all this means an ever-wider range of countries in which they can expand. For the U.S., all this means stiffer competition to attract and retain these companies. The U.S. share of global FDI inflows has already been declining for decades: from 31.5% in 1988-1990 to 24% in 1998-2000 and to just 16% in 2003-2005.

American policy makers should strive to make the U.S. a premier location for the dynamic, high-productivity activities of globally engaged companies -- both insourcing companies and U.S. multinationals alike. To truly be such a location would require dramatic progress on many fronts: renewing the president's trade promotion authority; resuscitating the World Trade Organization's Doha Development Round; passing comprehensive immigration reform. But to start such a journey with a single step, let us all pause to appreciate yesterday's good news from Tata.

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