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# Foreign Investment in the United States and Three Latin American Countries

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*Individuals and businesses in one country may transfer wealth to another country by investing in its business enterprises; this kind of wealth transfer is called foreign direct investment. Similarly, citizens of a given country may also put their money in another country's banks, which will in turn make loans to individuals and enterprises; this activity is known as indirect foreign investment.*

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Yet another option is to buy bonds issued by a foreign government.

**Why Foreigners Invest.** Individuals and businesses invest in other countries because they can obtain more benefits by investing abroad than inside their own countries. In this sense, scarcity plays a big role. Theoretically, investments might be expected to flow from where capital is abundant to where it is in short supply. In a perfect world, wealthy nations would invest much of their capital in poorer nations, where capital is scarcer and therefore offers a higher rate of return.

However, rich countries typically invest in other rich countries. Why? Because investors are reluctant to put money in poor countries with unstable governments, where they may never recoup their investment. Constant changes of personnel or policies create risks that the conditions under which the investment was made could change — the most drastic change being outright confiscation, or nationalization, by the government.

Widespread corruption is another deterrent to investment, as it is to economic activity in general. Thus, countries that rank high on the international index of corruption, compiled by Transparency International, are unlikely to attract international investments on a scale their natural resources or economic potential might otherwise justify.

In addition, many poorer countries impose controls on the flow of capital in and/or out of the country, called capital controls. When capital cannot get out easily, it is less likely to go in. Poverty does not deter foreign investment in these countries; rather, their structural problems and policies discourage foreign investors.

**Foreign Investment in the United States.** Among the factors that helped the United States grow from a small agricultural nation to an industrial giant, one factor, perhaps the most important, was an inflow of capital from Western Europe in general and from Britain in particular. These vast resources enabled the United States to build canals, factories and transcontinental railroads to tie the country together economically. As of the 1890s, for example, foreign investors owned about one-fifth of the stock of the Baltimore & Ohio Railroad, more than one-third of the stock of the New York Central, more than half the stock of the Pennsylvania Railroad, and nearly two-thirds of the stock of the Illinois Central.

Foreign investment is still important to the U.S. economy. In fact, the United States is both the source and the recipient of more foreign direct investment than any other country in the world. Thus:

- In 2011 the United States received a flow of foreign direct investment of nearly $227 billion, and Americans invested directly abroad almost $400 billion.

- At the end of 2012, people in other countries held 48 percent of the government bonds sold to the public by the United States.

**Economic Freedom and Investment.** Typical restrictions on investment freedom are part of the Heritage Foundation's *Index of Economic Freedom*. For instance, some countries have different rules for foreign and domestic investment; some restrict access to foreign exchange; and some restrict payments, transfers and capital transactions. Labor regulations, corruption, red tape, weak infrastructure, and political and security conditions can also affect the freedom to invest.

With a score of 70 out of an ideal 100 for the investment freedom component of the Heritage index, the United States and Mexico are classified as countries with some restrictions on foreign investment, mainly in particular industries, but a relatively high overall level of investor protection. [See the table.] For instance, the United States limits foreign ownership of domestic airlines to 25 percent, and foreign ownership of television stations is completely banned. However, the entire oil industry in Mexico and Venezuela is off limits to foreign investors. In both countries, state-owned enterprises are responsible for producing and exporting oil, and they resist foreign investment. Those policies have had a clear consequence in both countries: a diminishing volume of oil production in recent years. Despite these limits, U.S. investment in both Mexico and Venezuela is significant. By contrast, in Cuba there is very little foreign direct investment from any country. The level of U.S. investment in Mexico, Venezuela and Cuba is reflective of investment freedom in those countries, illustrated by the following facts.

*Mexico.* Historically, the United States has been the main source of foreign investment in Mexico. In the first nine months of 2012, U.S. investors accounted for 49 percent of all foreign direct investment in Mexico. In 2011, Mexico received a flow of $19.5 billion from the United States. Mexico receives the second largest amount of foreign direct investment in the whole Latin American region.

*Venezuela.* Political and economic uncertainty, state intervention in the economy, and a volatile legal and regulatory framework make Venezuela a difficult place for foreign investors. Venezuela's investment freedom score of 5 rates it as a country where threats of expropriation and hostility to foreign investment are permanent. However, a significant number of U.S. companies still operate in Venezuela. In 2011 the inflow of foreign direct investment in Venezuela was $5.3 billion, with American businesses representing a large part of this amount.

*Cuba.* Foreign direct investment in Cuba is minimal, but that is not due to the embargo imposed in the 1960s after the Cuban government nationalized the property of U.S. citizens and businesses. Most countries have few or no restrictions on trade with Cuba. Even so, the United Nations estimates the inflow of foreign direct investment to Cuba in 2011 was only $110 million, one of the lowest amounts of any country in the world. It is impossible to know what country the money comes from, since the Cuban regime's statistics stopped being credible long ago. Cuba receives an investment freedom score of 0.

**Conclusion.** Everyone wins when investments create a growing economy. Despite some countries' fears that foreign investors will carry off much of their national wealth, leaving the local population poorer, there is probably no country in history from which foreigners have carried away more wealth than the United States. By that reasoning, Americans ought to be some of the poorest people in the world, rather than consistently maintaining one of the world's highest standards of living. Why have we achieved prosperity? Because economic transactions and trade are not a zero-sum activity; they create wealth.

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## 2013 Country Indicators Based on Index of Economic Freedom

| | Investment Freedom Score (100 point scale) | Gross Domestic Product per capita (US$) |
|---|---|---|
| **United States** | 70.0 | $48,387 |
| **Mexico** | 70.0 | $14,610 |
| **Venezuela** | 5.0 | $12,568 |
| **Cuba** | 0.0 | $10,704 |

Source: Heritage Foundation, 2013 Economic Freedom Index. Available at http://www.heritage.org/index/ranking#.