

August 4, 2002

Foreign Investors Turning Cautious on Spending in U.S.

By LOUIS UCHITELLE

Foreign investors, who once joined with confident Americans in a wave of spectacular acquisitions and business spending that helped power the 1990's economic boom, are now turning cautious about the United States economy. That is compounding the current weakness and making it harder to achieve a robust recovery from last year's recession.

With fresh acquisitions almost nil, foreign direct investment in the United States — the technical name for acquiring a company or establishing one — plummeted last year to \$124 billion and started out this year at an even slower pace, the Commerce Department reports. That is down from a peak of \$301 billion in 2000.

Companies from abroad, after a big expansion here in the last two decades, now have a large enough presence in the American corporate sector to strengthen or weaken the economy by their behavior. The hope among economists was that they would renew their spending this year, given all the expectations of a rapid recovery and the bargain prices at which many companies, particularly in the high technology sector, could be purchased. But it has not happened.

"Foreigners were on the verge of investing again, until their confidence was upended by the corporate scandals and the slide in the stock market," said Mark M. Zandi, the chief economist at Economy.com, a research firm. "And now they cannot get financing and their own economies back home are weakening."

The steep falloff in foreign direct investment to set up shop in the United States contributed to an even more critical decline in capital investment by foreigners to expand or re-equip their operations here. That spending is off 15 to 20 percent, according to estimates by Joseph P. Quinlan, a global economist at [Morgan Stanley](#), from its peak of \$136 billion in 1999.

"The Europeans in particular came headlong into the American market with spectacular

acquisitions and huge capital outlays for expansions that have not paid off," Mr. Quinlan said. "After that experience they are going to tiptoe back."

Foreign companies did not just seek out existing American enterprises to take over. They also put up new factories and offices and spent constantly to expand their operations here, rapidly increasing their contribution to the nation's economic growth. Europeans led the charge in the 1990's but the Japanese, despite a long period of stagnation at home, were not far behind.

No aspect of the American economy is more vital for the recovery than capital investment, which is the spending for new factories, machinery, computers, offices and all the other tools of production that contribute to economic expansion. Capital spending generates jobs and income as these tools of production are made and used. Such investments by foreigners have nearly doubled since 1986 as a percentage of total capital spending in the United States.

But now — instead of bucking the tide, as the Japanese often did in the 1980's by outspending their American rivals — most foreign companies are pulling back in step with their hosts. And foreign companies seem even less likely these days to take chances than American companies battered by the collapse of the technology boom and the corporate scandals. "That makes the recovery tentative at best," Mr. Zandi, the economist, said.

The Random House division of Bertelsmann, the German media giant, is entering a no-investment mode. It has spent \$300 million on a headquarters building at Broadway and West 56th Street in Manhattan that will be ready for occupancy in the fall, and \$100 million on information technology and distribution center expansion and upgrades, including turning a warehouse in Crawfordsville, Ind., into a distribution center for children's books.

But once that is done, capital spending plans will be on hold. "We have what we need," said Stuart Applebaum, a Random House spokesman.

The [Sony Corporation](#), whose acquisitions of Columbia Pictures and CBS Records in the 1980's helped to stir a furor over what some American commentators described as the imperial ambitions of Japan Inc., is far less aggressive today. With its home economy in recession, Sony has slashed capital spending by 40 percent worldwide in the last two years and has closed 15 factories, two of them in the United States.

"We are investing less here," Greg Dvorken, a Sony official, said, adding hopefully, "but more strategically."

To be sure, foreign companies are not simply pulling up stakes in the United States. Many are continuing to look for opportunities to invest in what they see as the most promising industries.

In Kentucky, for example, where the state's economic development officials have been particularly successful in attracting new operations, foreign investment has fallen off less than that of American companies. In 1999, a peak year, 68 companies agreed to put manufacturing operations in Kentucky, 10 of them foreign, mainly Japanese and European. In the last two years, Kentucky has managed to attract fewer than 40 projects annually. But

the shrunken number still included seven or eight from abroad each year.

Gene Strong, a top official of the state's economic development agency, attributes that achievement in part to Kentucky's strong role in carmaking.

The auto industry is indeed a bright spot in foreign investment in the United States. While Ford, for example, is cutting costs and closing factories, foreign auto makers are expanding, and trying to take away market share.

Toyota, with several operations in Kentucky, is in the midst of investing hundreds of millions of dollars to expand four of its American plants. And Hyundai has just started construction of a \$1 billion assembly plant in Hope Hull, Ala. Once finished and operating at full tilt in four years or so, the plant, Hyundai's first in the United States, will employ 2,000 people and produce 225,000 cars a year, says Chris Hosford, a company spokesman.

"Our American sales are rising," he said, "and that justified the investment."

But apart from autos and a few other specialty areas, capital spending by foreign companies is by nearly every estimate falling from the high of \$136.3 billion reached in 1998 and again in 1999, the most recent years for which data is available from the Bureau of Economic Analysis. From the low for the decade of \$70 billion in 1993, capital spending by foreign companies shot up as the boom gathered steam to those two peak years.

The foreign contribution to the nation's capital spending in the 1990's rose to nearly 9 percent of all capital outlays in America's private sector in 1999 from less than 5 percent in 1986. The economy boomed because of the rapidly rising capital spending, particularly in telecommunications and high technology. And then the plunge in capital outlays set off a recession last year.

Today, consumers, housing, and increased federal spending sustain the weak recovery that apparently began around the beginning of this year. The uncertainty among economists is whether those sectors can hold up until capital spending revives — once again generating jobs and income. While investment is no longer falling as fast as it once did, that upturn has not happened yet. About the only bright spot was a modest increase, after seven straight quarters of declines, in outlays for software and business equipment in the most recent quarter, from April through June.

Foreign ownership has made its way into almost every industry in the United States, and the recognition of its presence and importance is in striking contrast to the 1980's. Then, Japanese incursions into automaking, banking, entertainment and trophy real estate — even the purchase of Rockefeller Center — brought stiff resistance and public warnings about a Japanese juggernaut.

But as confidence in American competitiveness returned in the 1990's, foreign investment was welcomed. Now it has become necessary.

Sensitive to the nation's increased dependence on foreign-owned companies, Robert T. Betz, the just-retired president of Cognis North America, carefully explains how Cognis has dealt with capital spending after sales dropped because of Sept. 11. Cognis, largely owned by Schroeder Ventures, a British firm, is a chemical company in Cincinnati that makes

ingredients mainly for beauty and health care products.

"None of our capital spending was stopped," Mr. Betz insisted. "It was reviewed. It was a matter of saying in December that we will do this in April. And we are starting to implement capital spending again now."

But at other foreign companies, cautiousness still reigns. At Coral Graphic Services, a unit of Bertelsmann that has four printing plants in this country, no further expansion is planned now that a new plant opened last month in Kentucky.

"There is always a little capital spending; you have to buy machines once in a while," said Gernot Wolf, a Bertelsmann spokesman.

"But no major expenditures," he added. "Not at all."