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Foreign Direct Investment in the United States—Advantages and Barriers

by Julius L. Katz*

Mr. Katz provides an insightful introduction to this issue on foreign investment. He explores the prejudices against foreign investment and explains why foreign investment is essential. More importantly, he discusses the international political and economic ramifications of investment, thereby forcefully demonstrating the need for non-discriminatory treatment of foreign investment in the United States.

I. INTRODUCTION

In 1977, FOREIGN direct investment in the United States stood at $34.1 billion. Since 1972, foreign direct investment in the United States has increased about thirteen percent a year—close to two and one-half times the average rate over the previous thirteen years and almost five percent above the average growth of United States direct investment abroad during the same five year period. Yet, in 1977, United States foreign direct investment abroad stood at $148.8 billion, or over four times the value of foreign direct investment in the United States.

United States capital inflows are increasing relative to outflows, while European outflows are increasing relative to inflows. Canada, the largest host country to foreign direct investment, saw its stock of foreign investment drop from eighteen percent of the world's total in 1967 to fifteen percent in 1975. The United States, as the second-largest host country, saw its share rise from nine percent to eleven percent in the same period.

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2 Id.

3 Id.


5 Id. at 237.

6 Id.
Congressional concern over foreign investment in the United States has been stimulated by publicity following the 1973 oil embargo, when fears arose over how OPEC countries might use their newly acquired wealth. While this concern regarding foreign investment in the United States is recent, the rise of foreign direct investment in the United States is not.

Foreign ownership of United States land began as early as 1776. The American Commissioner to France during the Revolutionary War attempted to sell the French shares in a company claiming to hold title to lands located in Indiana, Ohio and Illinois. In addition to foreign land companies, foreign mortgage, cattle, mining and oil companies played important roles in United States economic life at various times. From the 1770's, foreign firms owned United States commercial and industrial enterprises. Household words such as Lever Brothers soap and Pillsbury flour appeared in the 1890's via subsidiaries of United Kingdom firms. Some of these foreign enterprises dominated certain United States industrial sectors. At the turn of the century, for example, two German-owned firms produced one half of the magnetos sold in America. Foreign direct investment in the United States peaked in 1914. With the onset on World War I, assets of many of these firms were liquidated to earn dollars for the purchase of war materials. Thereafter, the level of foreign investment in the United States never recovered due to the Depression and World War II. Only recently has foreign direct investment become a significant feature of the economy again.

II. WHY FOREIGN DIRECT INVESTMENT IS MORE IMPORTANT TODAY

Foreign investment in the United States has increased recently for numerous reasons. First, foreign multinational enterprises (MNE's) are looking for investment opportunities. Jean-Jacques Servain-Schreiber's "American Challenge" has been met through the vigorous competition of many non-United States MNE's. In 1967, the United States was

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7 C. LEWIS, AMERICA'S STAKE IN INTERNATIONAL INVESTMENT 78 (1938).
8 Id. at 78.
9 Id. at 113.
10 Id. at 100.
11 Id. at 101.
12 Id. at 102.
13 Id. at 114.
the home country\(^\text{15}\) for fifty-four percent of the world’s foreign direct investment, compared to forty-two percent from Europe and Japan. By 1976, the United States share had dropped to forty-eight percent compared to forty-seven percent for the other developed countries.\(^\text{16}\) According to Fortune magazine, twenty-eight of the world’s fifty largest enterprises are not American-owned.\(^\text{17}\) Further, in the last seventeen years there has been a dramatic increase in the share of world markets held by foreign MNE’s at the expense of United States MNE’s.\(^\text{18}\) Foreign MNE’s, with an eye on new markets, have moved from the exporting stage to the investment stage of their development, and are investing in the United States.

The second reason for the rise in foreign investment is that the United States market is large, homogeneous and growing. The size and nature of the United States economy encourage foreign investment. The United States has a robust economy which, despite inflationary pressures, is out-performing many other developed-country economies which have been slower to recover from the 1974-75 recession. Future United States growth opportunities are attractive to foreign investors.

Third, foreign investors fear an increase in protectionism in the United States. Like the United States MNE’s who invested in Europe ten to fifteen years ago to avoid European Economic Community tariff barriers, foreign MNE’s are trying, through direct investment, to safeguard United States markets currently served via exports. Recent Japanese electronics company investment in the United States may be the counterpart to that earlier defensive United States investment. Faced with export restrictions (either voluntary or government-imposed), these firms have established assembly plants in the United States in part to avoid these and anticipated future trade restrictions. A perceived increase in United States protectionism may lead to even more foreign investment in the United States.

Fourth, the investment climate in other parts of the world is unfavorable. Most foreign investors regard developing countries as uncertain hosts for direct investment. Investors see uncompensated expropriations, discriminatory treatment of foreign firms, and sharp

\(^\text{15}\) Home country is defined herein as the country in which the MNE parent is located while a host country is the country in which an MNE subsidiary or affiliate is located.

\(^\text{16}\) U.N. Centre on Transnational Corporations, supra note 4, at 236.


shifts in political orientation as characteristics of the developing country investment environment. Some investors now see their home countries and other developed countries as possessing the same characteristics. Increased political uncertainty at home, and concern about home government involvement in business activities leads some foreign MNE's to regard the United States as a stable and predictable location for investment in an increasingly disorderly world. Relatively stable and predictable United States labor conditions add to the attractiveness of the United States environment.

Fifth, the United States dollar has depreciated. Since the early 1970's the depreciation of the dollar has made acquisition of United States firms and their stocks more attractive, especially for Germany, Switzerland, Japan and the Netherlands. These exchange rate movements have made United States assets less expensive but have made exports to the United States more expensive. Such developments encourage foreign investment here to avoid loss of the United States export market. One example is Volkswagen, who established its United States manufacturing facility to avoid loss of the United States market due to higher dollar costs of German-produced Volkswagens.

Sixth, the United States provides ready access to new technology. United States technology still leads in many key industrial sectors. Computer and related technologies are the prime examples. European and Japanese firms have acquired specialized United States firms to gain access to this technology. There have been, for example, acquisitions of United States firms involved in development and production of silicon chips—a key element in micro-processing technology. As long as the United States remains a technological leader in such key areas, and as long as the economic strength of foreign enterprises increases, such acquisitions will continue. Note, however, that these technology flows are a two-way street as will be discussed hereinafter.

III. WHAT FOREIGN INVESTMENT BRINGS TO THE UNITED STATES

The reasons for the increase in foreign investment are clear, but what does this increased investment bring to the United States? There are a number of important benefits that flow from such investment.

First, jobs will be created. With continued high unemployment, one of the most important benefits of foreign investment is increased employment within the United States. Any new investment will do this; but foreign investment, to the extent it replaces exports to the United States, provides a double employment benefit—United States workers
are producing products that previously were imported. Certain recent foreign investments involve assembly operations of components produced in home or third countries. Such investment has less employment benefit than an investment involving locally-produced components. Nevertheless, these enterprises may turn to local procurement as cost differentials, which presently favor foreign over domestic components, narrow.

Second, foreign investment produces a demand for domestic goods and services. This secondary benefit of foreign investment is often overlooked. The following quote from a Washington Post article describing the new Volkswagen plant in New Stanton, Pennsylvania graphically illustrates this point.

Mufflers from a Maremount Corp. factory in Louden, Tenn., are bolted onto floor panels stamped from American steel in West Virginia. Wheels made by Rockwell International in Brazil roll onto tires from several Akron plants and are stopped by Bendix brakes.

The worker who drives the newly built cars off the conveyor steers a wheel made in Detroit by Olsonite Corp., looks through a windshield that came from a Pennsauken, N.J. Combustion Engineering Co. glass factory and flips on a Motorola radio.

... [The plant's] American Volkswagens are still two-thirds German...

The next goal... is to reverse the ratio of imported to domestic components. Eventually, the only major imported parts will be the engines, clutches, transmission and drive train. ...19

While these benefits are hard to quantify, they are nonetheless real. They mean more business for United States enterprises and more jobs for United States workers.

Third, new technology will be introduced in the United States. In our justifiable pride over United States technological accomplishments, we forget that foreign investors are often the source of technology that we regard as "made in USA." For example, in the early 1920's French interests acquired a large block of DuPont stock in exchange for vicose rayon process and cellophane patents.20 French, British and German chemical firms have continued to be major sources of chemical processes for the United States market. Foreign technology has also been important in the machinery, pharmaceutical and instruments sectors.

20 C. LEWIS, supra note 7, at 149
Specific recent examples of foreign technology transfer include high-pressure hydraulics, electron-beam welding process and double-knit textile machinery. Technology transfer is not, obviously, a one-way street out of the United States. In fact, a Department of Commerce study, *Foreign Direct Investment in the United States*, concluded that foreign direct investment resulted in a net inward flow of technology despite foreign investor acquisition of high-technology United States firms as noted above. It is important to keep in mind that while technology outflows do not diminish the United States technological stock, inflows do increase it.

Fourth, new capital and foreign assistance will be available for troubled United States firms. Capital inflows aid the United States balance of payments and add to the supply of funds available for investment, thereby encouraging lower interest rates. Foreign funds are primarily important in the initial stage of investment. Later debt incurred by new United States affiliates is generally financed from United States markets. Nonetheless, these initial investments can be substantial and beneficial. Foreign capital plays an additional role of assisting capital-starved United States firms in economic difficulties. For example, in the electronics industry, foreign investors have aided United States firms that have fallen on hard times. In some cases (e.g., Chrysler-Puegot and American Motors-Renault), investment-like arrangements rather than direct capital infusions may emerge which benefit the United States partner.

Fifth, increased competition will result as an important side benefit from foreign investment in the United States. Creation of a new subsidiary or the acquisition of a financially-weak United States enterprise can increase competition and encourage enterprises to operate on the most efficient basis possible. This might also lead to the opposite effect, but on balance, the impact is positive. Technological innovations from foreign controlled enterprises may stimulate United States firms to undertake new research and development that otherwise would not occur. In an era of increasing concentration in some sectors, the competition provided by foreign enterprises benefits all Americans.

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FOREIGN INVESTMENT IN THE U.S.

IV. CRITICISMS OF FOREIGN INVESTMENT IN THE UNITED STATES

Despite the benefits of foreign investment in the United States, many Americans continue to express concern about adverse effects and seek to limit, control or even exclude such investment. Several of the specific complaints are set forth below.

The first complaint is that foreigners will control the United States economy. For the same reason that Europeans objected to the "American Challenge" of the 1960's, Americans worry that foreign ownership will mean foreign domination. They fear that if foreigners own United States firms, the United States will not have complete control of the economy in the event of national emergency. Moreover, it is thought that foreigners will attempt to avoid United States tax laws. Other complaints are that products and technology will flow out of the United States to the detriment of the American people. Much of the concern focuses on the vast accumulation of OPEC country reserves. It is feared that OPEC might undertake politically motivated investments. A recent United States opinion survey revealed that thirty-nine percent of those polled felt that the United States should "make it hard" for foreign firms to invest in the United States, while only twenty-six percent felt that the United States should "make it easy" for such investment.24

The second complaint is that foreign firms will take advantage of United States workers. Foreign firms are accused of taking advantage of right-to-work laws and regional wage differentials by locating in low-wage, non-union locations in the "sun belt". Without a doubt, the Southeast is the most attractive region for new foreign investors. Surprisingly, however, its share of new domestic investment has decreased compared to 1973-74.25 Nonetheless, the location decision of foreign firms is too complex to be explained by a single variable; nearness to markets, availability of labor, transportation and port facilities, government incentives and other assistance are probably all important determinents of a firm's location. A recent study indicates that foreign investors seem no more sensitive to the degree of unionization than American investors, although they seem to attach greater importance to state wage differentials than do American investors. Foreign investors may be more sensitive to wage costs because compensation and labor costs between 1967 and 1976 have risen faster in most other in-

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24 Kettering Foundation Polls, Sept.-Dec. 1977 as published in Current Foreign Relations, a weekly telegram circulated in the State Dep't (copy on file with author).

25 Little, supra note 1, at 53.
dustrial countries than in the United States.\textsuperscript{26} To the extent that foreign investment in the Southeast is concentrated in textile machinery and man-made fibre plants, it is hard to say whether foreign firms have located in this area because of low wages or because it is the center of the textile industry.\textsuperscript{27}

Another complaint is that foreign investment in United States farmland has hurt United States agriculture. This is the most recent and most emotional criticism of foreign investment. Foreign investors are alleged to have driven up the price of farmland and taken over family farms, thus limiting opportunities for young American farmers. Further, there are fears that such investment will lead to a deterioration of rural communities, public facilities and services; lack of interest in United States domestic programs aimed at ensuring economic stability of farmers; and depression in capital markets due to increased inflows of foreign control of United States agricultural exports. Moreover, the benefits of foreign investment described above do not fit the specific case of foreign ownership of American farmland.

Despite the scarcity of specific information on this phenomenon, the public outcry over the issue appears to be out of proportion to the actual amount of investment which has taken place. Foreign ownership of United States farmland is estimated at between one and one and a half percent of the present total of 1,081 million acres of United States farmland.\textsuperscript{28} By comparison, when foreign land holding companies were at their peak in 1910, they owned between thirty and thirty-five million acres, which amounted to four percent of the then 879 million acres of United States farmland.\textsuperscript{29}

There is a clear need for more information in this area. The Department of Agriculture's feasibility study on means of gathering adequate information on overall United States land ownership patterns and the Agricultural Foreign Investment Act of 1978 requiring reports on foreign ownership will help provide that information.

Foreign investment in United States farmland is part of the general problem of absentee land ownership. Most public opposition is not against foreigners who use farmland for agricultural production. Rather, the public fears that absentee land ownership, particularly by aliens, threatens the viability of the family farm. Nonetheless, the im-

\textsuperscript{26} Id. at 56.

\textsuperscript{27} Id. at 57.

\textsuperscript{28} BUR. OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES, COLONIAL TIMES TO 1970 PART I 457 (1975).

\textsuperscript{29} C. LEWIS, supra note 7, at 85.
impact of absentee ownership on the family farm, rural land prices and social responsibility in the local community is the same whether the absentee purchaser is a foreigner or a United States citizen. Moreover, there is no evidence that foreign absentee ownership or speculation represents a significant proportion of total absentee ownership or speculation.

The concern over higher rural land prices is real. But the sharp rise in land prices is not attributable to foreign land purchases alone. United States farmers have sought additional land to increase production in response to higher food prices, suburban and industrial encroachment on farmland, and domestic speculation in land for investment purposes. Thus, demand for farmland is a complex phenomenon attributable to both foreign and domestic factors.

Those who would seek federal restrictions on foreign land ownership would limit the rights of United States citizens to dispose of their land. In the past the United States has followed an investment policy of non-intervention regarding the regulation of real estate purchases. The regulation of real estate transactions has traditionally been the prerogative of state governments. Any federal restrictions would apply only to the development and use of federally owned lands. Such restrictions, even if limited to federal lands, would be detrimental to long-term United States interests if the restrictions were based on emotion and incomplete knowledge of the nature of the absentee ownership problem. Absentee ownership is not a new concern. In the mid-1880's, foreign and East Coast absentee ownership of western lands attracted considerable criticism.\textsuperscript{30} Recently, attention has focused exclusively on foreign absentee ownership, evincing an unwillingness to apply the same non-discriminatory principles to foreigners that the United States presses foreign governments to apply to United States investors abroad.

V. UNITED STATES POLICY TOWARD FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

United States policy is the same for incoming and outgoing foreign direct investment—the United States neither encourages nor discourages international investment flows or activities. This, however, does not imply neutrality toward international investment. It is generally believed that increasing levels of global investment are essential for all economies to grow and prosper. The policy means only that

\textsuperscript{30} Id. at 85.
the United States seeks to minimize government intervention in the decision-making process of individual investors.

This policy is founded on United States efforts to create an open international environment for global economic relations. The United States prefers that market considerations determine the location of investments according to international comparative advantage. Market forces rather than government fiat result in the most efficient distribution of economic activity.

Such a policy calls for the United States to apply the general principle of national treatment for foreign enterprises—i.e., foreign investors are treated no less favorably than United States investors. This has been an important element in both bilateral (via a network of friendship, commerce and navigation treaties) and multilateral relationships (via the Organization for Economic Cooperation and Development (OECD) Code on the Liberalization of Capital Movements, the Declaration on International Investment and Multinational Enterprises and the associated Decision on National Treatment). The United States seeks to extend this principle to both the admission of foreign capital and its subsequent treatment.

This is more than a theoretical question of equity. If discriminatory treatment of foreign investors is accepted in principle, the door is open to a pattern of widespread discriminatory government behavior. Performance requirements (e.g., local content, minimum export, ownership or labor requirements) placed on foreign investors as a price for admission or for changes in established investment are particularly damaging forms of discriminatory behavior. These measures tend to "tilt" the benefits of foreign investment to the host country at the expense of home or third countries. For example, if the host country imposes minimum export requirements on foreign investors, this can result in trade diversion from home and third countries as required exports from the host country displace other exports. Such "tilts" would be less likely to occur if there is widespread acceptance of the principle of national treatment.

The United States commitment to this principle is based on the government's conviction that foreign investment behavior primarily reflects market considerations. Nonetheless, United States law does in-

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clude a number of safeguards designed to protect essential security interests. These safeguards constitute exceptions to the national treatment principle, but they are recognized as legitimate government action and are consistent with bilateral and multilateral commitments.32

These safeguards affect only those sectors of the United States economy which relate to national defense, fiduciary duties, or exploitation of government-owned land. Specific sectors include coastal and inland shipping, domestic air transport, federal lands utilization, telecommunications, atomic energy and hydro-electric power. There are also security restrictions on foreign-owned or controlled firms in certain classified defense work. A number of states also maintain restrictions on foreign involvement in banking, insurance and land ownership. These state restrictions, however, must be consistent with United States international treaty obligations.

Beyond these direct measures, there are a number of laws and regulations which affect both foreign and domestic investors. In particular, antitrust laws and Securities and Exchange Commission (SEC) requirements help protect the United States economy from monopolistic domination—whether domestic or foreign.33 Such mechanisms should allay the concerns of those who worry about foreign domination of the United States economy.

While the United States opposes controls on foreign investment, it does monitor foreign investment trends. In 1975, under Executive Order 11858, the President established a high-level interagency Committee on Foreign Investment in the United States.4 The purpose of the group, chaired by the Treasury Department, is to monitor the impact of incoming foreign investment and to coordinate United States policy implementation. Under the Executive Order, the United States notified foreign governments that they should consult with the United States government on prospective major government investments in the United States. At the same time, a Department of Commerce Office of Foreign Investment was created to follow trends in foreign direct investment and to inform the Committee of developments. These ad-

32 See also, Organization for Economic Cooperation and Development, National Treatment for Foreign-Controlled Enterprises Established in OECD Countries (1978).
ministrative actions should prove adequate to minimize the potential problems of foreign investment in the United States.

United States policy toward investment incentives is especially important. The United States does not provide incentives designed to attract foreign direct investment. The government is concerned that certain incentives result in investment flows which respond to artificial, non-market forces. These incentives may shift the benefits of the investment relationship to the host country at the expense of home or third countries. A detailed examination of the incentive problem will be conducted by the OECD Committee on International Investment and Multinational Enterprises. This study will begin in June 1979.

The goals of the OECD Committee are to make other OECD countries aware of the serious implications of competition in this area, to make sure that members' incentive policies are transparent, to develop a means to determine when incentives result in a "tilt" and, if possible, to establish greater consensus on when and how incentives will be used.\(^5\) The major problem for the United States in achieving these goals is the coordination of federal, state and local policy. It is impossible to ask foreign governments (without federal systems) to limit investment incentives if the United States is not prepared to have state and local governments behave likewise.

It is in the interest of global economic growth that investment respond to market forces. It is recognized, however, that incentives can play a role in an economic system which is concerned about distribution of economic benefits and efficiency of investments. Problems arise from the merchandising of the incentives. For example, in the United States, states compete for investments via programs of incentives. Not only do the incentives tend to cancel each other out, but they result in a bidding process characterized by survival of the financially fittest, and inefficient use of incentives. Incentives should equal the minimum necessary to attract a specific investor from a specific industry to a specific location, rather than that necessary to meet another state's offer.

It is difficult to be the first to halt this competitive process if others continue to play the game. Politicians see incentive programs as effective measures for dealing with employment problems and sagging growth. Success stories abound of attracted investments (both foreign and domestic) and of jobs generated by such programs.

Reciprocity is an important element in the United States interna-

\(^5\) Organization for Economic Cooperation and Development, supra note 32.
tional investment policy. For some time, the United States is likely to remain the leading home country of companies who invest abroad. Over the years, the United States has pressed for non-discriminatory treatment of such investment, and has encouraged countries to maintain a sound investment environment and to accept responsibilities under international law. Others will not extend national treatment or minimize incentives if the United States will not accept the same responsibilities toward foreign investment in the United States. It is essential that governments at all levels in the United States assume these responsibilities. With more foreign investment, existing exceptions to the principle of national treatment will be magnified. The United States government must either defend or remove these exceptions. And with more foreign investment will come conflicts with United States law.

VI. FUTURE PROSPECTS

Investment is a dynamic process. Conditions that led to investment patterns ten or twenty years ago have changed. Relative costs, exchange rate adjustments, and government policy shifts lead to investment in some areas, disinvestment in others. For the next few years at least, these movements will favor direct investment in the United States. This is a healthy development. Foreign investment benefits our economy and should therefore be welcomed. Such investment will continue as long as underlying economic conditions are favorable and as long as the United States government maintains its current liberal attitude toward such investment.

There will be pressures to restrict foreign investment in the United States. Most of this pressure will initially be directed against foreign ownership of rural land. Concerns will also remain about the use to which OPEC countries might put their oil revenues. Additionally, continued Japanese and European investment will prick American sensitivities about foreign domination of the United States economy.

The United States government will not stick its head in the sand while proclaiming the virtues of unfettered market forces directing the flow of international investment. Foreign direct investment in the United States will continue to be monitored by the OECD Committee. If there are problems with particular investments, the Committee will not hesitate to present its concerns to the appropriate foreign government. It will work multilaterally to extend the principle of national treatment and limit the competition among nations over investment incentives. The reciprocal nature of the rights and obligations which the
United States seeks from other countries must be kept in mind, along with United States status as both the leading home country and second leading host country for foreign direct investment.

Continued world economic growth depends on adequate investment. Capital flows responding to market forces can ensure that all nations benefit from this investment. This collective responsibility places individual challenges on capital importing as well as on capital exporting countries. United States attitudes will be the key to the behavior of other countries toward foreign direct investment.