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Foreign Direct Investment Regulations: The Effectuating Calculus

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COMMENT

Foreign Direct Investment Regulations: The Effectuating Calculus

_We must ever observe this rule, to sell more to strangers yearly than we consume of theirs in value._

THOMAS MUN, _ENGLAND'S TREASURE BY FOREIGN TRADE_ (1664).

ON JANUARY 1, 1968, President Johnson announced a new program to reduce the deficit in the nation's balance of payments. In the last 18 years, the United States has poured out $37.4 billion more than it has taken in from the outside world.¹ Preliminary reports indicated that the 1967 balance of payments deficit, 37,417—Total deficit since 1950

Balance of payments problems, while relatively new to the United States, have been around for over 300 years.

After the decline of feudalism, it was assumed that each nation's chief function was to increase its power and wealth by taking in more money than it paid to foreigners.... Business writers of the 17th century were called bullionists because they advocated a policy of doing everything possible to bring gold and silver into a country. _FINANCE_, Jan. 1968, at 22.

For the history, methodology, and theory of balance of payments from the year 1381 onward, see M. WASSERMAN & R. WARE, _THE BALANCE OF PAYMENTS_ (1965). _See also THE BALANCE OF PAYMENTS ADJUSTMENT PROCESS_ (Org. for Econ. Coop. and Devel. 1966); H. GEORGIADIS, _BALANCE OF PAYMENTS EQUILIBRIUM_ (1964) (chal-

¹ The following figures are taken from Commerce Department and Federal Reserve data as reported in _U.S. NEWS & WORLD REPORT_, Jan. 15, 1968 at 32.

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance of Payment in Millions of Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>3,489</td>
</tr>
<tr>
<td>1951</td>
<td>8</td>
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<td>1952</td>
<td>1,206</td>
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<td>1955</td>
<td>1,242</td>
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<td>1956</td>
<td>973</td>
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<tr>
<td>1957</td>
<td>578 (Surplus)</td>
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<tr>
<td>1958</td>
<td>3,365</td>
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<td>1959</td>
<td>3,870</td>
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<td>3,881</td>
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<td>1962</td>
<td>2,203</td>
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<td>2,671</td>
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<td>1965</td>
<td>1,335</td>
</tr>
<tr>
<td>1966</td>
<td>1,357</td>
</tr>
<tr>
<td>1967</td>
<td>3,500 (Estimate)</td>
</tr>
</tbody>
</table>
which is the excess of remittances abroad over receipts, would be close to $4 billion — the highest since 1960. The President's dramatic New Year's Day announcement was aimed at pushing the nation towards a payments equilibrium in 1968. The mandatory restrictions on private investment abroad form an integral part of the program. These restrictions, the first in the history of the

lenes the belief that a fixed exchange rate system can be sustained by an international mechanism).

2 Balance of Payments, Statement by the President Outlining a Program of Action, Jan. 1, 1967 (sic), at 2. This fact as well as the statement concerning the cost of the Vietnam war were omitted from the text reproduced in N.Y. Times, Jan. 2, 1968, at 15, col. 2 (city ed.).

3 Theoretically, after Vietnam, the nation's balance of payments account should return to "relatively good order — in the black, or almost"; Treasury Secretary Henry H. Fowler has repeatedly said he would settle for "equilibrium." FINANCE, Jan. 1968, at 23.

Prof. Haberler holds that the [balance of payments] program could be justified as a temporary measure if at the same time something decisive were done to correct the fundamental disequilibrium; but nothing of that sort has been proposed. On the contrary, he says, the Fed continues to pump money into the [domestic] economy at a record rate. BANKING, March 1968, at 57.

4 President Johnson's authority for making the investment restraints mandatory is derived from section 5(b) of the Trading with the Enemy Act of October 6, 1917, as amended under section 95(a) of the National Banking Act. 40 Stat. 415, as amended, 12 U.S.C. § 95(a) (1964).

The Trading with the Enemy Act provides a criminal penalty for violation of up to 10 years imprisonment, or a fine of up to $10,000, or both. The violation must be willful, and the burden of proof beyond a reasonable doubt is on the government. Violation of the foreign investment regulations, however, does not necessarily mean a violation of the Trading with the Enemy Act. See Baker, Legal Considerations in Operating Under the New Regulations, CCH BALANCE OF PAYMENTS § 9032, at 9158 n.3 (1968). Pursuant to this Act the President can issue rules and regulations through any agency he might designate in areas affecting foreign commerce during a declared period of national emergency. The United States has been under such a declared period of national emergency since the Korean crisis in 1950 when President Truman issued Proclamation No. 2914 on December 16, 1950. 64 Stat. 454 (1950). This proclamation referred to the Korean crisis and the world menace of the forces of communist aggression. A declared national emergency was accepted by the Second Circuit in 1966 as a valid basis for the freezing of Cuban-owned assets in the United States. Sardino v. Federal Reserve Bank of New York, 361 F.2d 106, cert. denied, 385 U.S. 898 (1966). In this case Judge Friendly stated for a unanimous court: "While the courts will not review a determination so peculiarly within the province of the chief executive, there can hardly be doubt as to the existence of an emergency today when thousands of United States troops are in action and many more are in readiness around the globe."

Attorney General Ramsey Clark has written a letter supporting the constitutionality and legality of President Johnson's mandatory restrictions. See CCH BALANCE OF PAYMENTS § 9031 (1968).

Besides curtailing investments, the President's program for solving the polycentric problem of the United States balance of payments deficit included proposed restrictions on travel abroad and voluntary restraints on banks and other financial institutions to reduce lending abroad and induce the return to the United States of certain foreign bank deposits and short-term credits. Exec. Order No. 11387, 33 Fed. Reg. 47 (1968). Other objectives of the President's program were to "restrain travel by Americans outside the Western Hemisphere and to reduce the amounts they spend abroad, to save on military expenditures abroad without reducing the number of troops" (the number was in-
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United States,⁵ are broadly applicable to all Americans investing abroad, and they place a moratorium on direct investment capital outflows to continental Western Europe and other developed nations not heavily dependent on United States capital.⁶ Net new investment, including capital outflows from the United States and reinvested earnings, in other developed countries and certain oil-producing countries are restricted to 65 percent of the investor's 1965-66 average of direct investment.⁷ In developing countries, investments are limited to 110 percent of the 1965-66 average.⁸ As an alternative to these limits, an optional investment quota will be permitted early in 1969 which is equal to 20 percent of the yearly earnings of an investor's foreign affiliates in each of the above groups of countries.⁹ Although Canada has been excluded from the general scope of the mandatory restrictions, investments into Canada from the United States are governed by a special set of rules.¹⁰ Initially, the regulations required foreign business earnings to be repatriated in at least the same proportion as they were repatriated in 1965-66.¹¹ Currently, in the more developed countries, the amount reinvested may not exceed the lesser of 35 percent of the 1965-66 average of new capital outflows plus reinvested earnings or an amount whose computation is a function of the investor's total earnings and the total earnings of the affiliated for-

⁵ "Secretary [of Commerce, Alexander B.] Trowbridge said it was the first time in history that mandatory controls had been established on United States private investment abroad." N.Y. Times, Jan. 2, 1968, at 1, col. 8 (city ed.). See also Text of President's Statement on Balance of Payments Problem and Steps to Meet It, id. at 15, cols. 1-6; BUSINESS WEEK, Jan. 6, 1968, at 15.

⁶ Schedule "C" countries. Discussed in notes 45-51 infra & accompanying text.

⁷ Schedule "B" countries. Discussed in notes 42-44 infra & accompanying text.

⁸ Schedule "A" countries. Discussed in notes 38-41 infra & accompanying text.

⁹ § 1000.504 (proposed change), 33 Fed. Reg. 18041, at 18043 (1968); see Statement by Under Secretary of Commerce, Joseph W. Bartlett, N.Y. Times, Nov. 16, 1968, at 53, col. 3 (city ed.).

¹⁰ § 1000.1101-07 (Subpart K — Direct Investment in Canada), 33 Fed. Reg. 8665 (1968). Basically, Canada cannot be used as a conduit through which to transfer capital to other schedule areas.

eign nationals.\textsuperscript{12} American business firms are also required to reduce their short-term financial assets held by non-related foreign nationals to an amount not in excess of the average end-of-month short-term assets held during 1965 and 1966.\textsuperscript{13} The goal of the controls on American direct foreign investment is a $1 billion balance of payments saving.\textsuperscript{14} In this regard, the controls show signs of success; the Department of Commerce recently noted that the third quarter of fiscal 1968 yielded a surplus in the balance of payments for the first time in more than 3 years.\textsuperscript{15}

The purpose of this Comment is to outline the basic calculus for effectuating the program established by the Foreign Direct Investment Regulations. This discussion will be restricted to the basic limitations placed on new American investments abroad; the basic exclusions from the scope of the regulations; the base period formula for determining the positive overseas investment allowance; the optional quota system; additional positive direct investments based on incremental earnings; the transfer of capital between foreign countries; and the revocation of the repatriation of earnings requirement. This discussion is by no means meant to be an analysis of the regulations in their entirety nor is it an attempt to resolve their inherent complexities.

It should be noted at the outset that the total yearly outflow of new private investment amounts to considerably less than the $5.6 billion the United States earns on dividends and interest from foreign sources.\textsuperscript{16} From an econometric viewpoint, placing mandatory controls over private foreign investments which have consistently developed surpluses through dividends, interest payments, royalties, and technical fees will eventually kill the goose that lays the golden eggs.\textsuperscript{17}

Basic Limitations on New Investment.— The Foreign Direct Investment Regulations\textsuperscript{18} provide three basic limitations on new investments abroad. First, annual limits are placed on the amount of new transfers of capital\textsuperscript{19} and reinvestment of earnings in the aggregate excess of $200,000\textsuperscript{20} which direct investors (American individuals or companies owning or acquiring a 10 percent or more interest of the voting power or of the earnings in any foreign oper-

\textsuperscript{12} Discussed in text accompanying notes 69-73 infra.
\textsuperscript{14} Balance of Payments, Statement by the President, supra note 2, at 3.
\textsuperscript{15} Statement by Under Secretary of Commerce, Joseph W. Bartlett, N.Y. Times, Nov. 16, 1968, at 53, col. 3 (city ed.).
at (16) may make abroad (17). It has been indicated that the minimum overseas investment allowance will be increased to $300,000 (18). Initially, the second requirement was that a specified share of total

<table>
<thead>
<tr>
<th>Year</th>
<th>Outflow</th>
<th>Income</th>
<th>Net Balance of Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>-0.6</td>
<td>1.4</td>
<td>0.8</td>
</tr>
<tr>
<td>1951</td>
<td>-0.5</td>
<td>1.6</td>
<td>1.1</td>
</tr>
<tr>
<td>1952</td>
<td>-0.9</td>
<td>1.5</td>
<td>0.6</td>
</tr>
<tr>
<td>1953</td>
<td>-0.7</td>
<td>1.6</td>
<td>0.8</td>
</tr>
<tr>
<td>1954</td>
<td>-0.7</td>
<td>1.9</td>
<td>1.2</td>
</tr>
<tr>
<td>1955</td>
<td>-0.8</td>
<td>2.1</td>
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<td>-2.0</td>
<td>2.4</td>
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<td>-3.1</td>
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<td>2.0</td>
</tr>
<tr>
<td>1967</td>
<td>-3.2*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* CCH Balance of Payments p 133, at 126-27. Source: Department of Commerce
  a. Excludes direct investment outflows financed by borrowing abroad through United States financing corporations.
  b. Includes direct investment fees and royalties.


18 By Executive Order 11387, the President delegated authority to the Department of Commerce to administer the investment control program. 33 Fed. Reg. 47 (1968). Subsequently the Foreign Direct Investments Regulations were issued. 33 Fed. Reg. 49 (1968). "Shaw and his people had five days to prepare the direct investment regulations, and three days to organize their office before President Johnson unveiled the mandatory controls on New Year's Day." Business Week, Jan. 13, 1968, at 20. The Office of Foreign Direct Investments was established on January 2, 1968. 33 Fed. Reg. 54 (1968). The organization and assignment of functions within the Office were prescribed on February 16, 1968. 33 Fed. Reg. 4222-23 (1968). For an organ-
annual earnings from affiliated foreign nationals had to be repatriated at least once a year. This requirement was made unnecessary by the limitations on reinvestment of foreign earnings inherent in the limitations on all direct investments. The changes of June 13, 1968, revokes the requirement calling for repatriation of that amount of earnings of affiliated foreign nationals which exceeds the specified amount of authorized foreign direct investment for that year. Lastly, balances of short-term financial assets held abroad by each direct investor must be reduced to the average level of 1965-66.

Basic Exclusions from the Scope of the Regulations.— The regulations presently do not place limitations on: (1) current trans-
izational chart and a current list of personnel in the Office, see CCH BALANCE OF PAYMENTS § 1050, at 591, and § 1051, at 592 (1968).

20 Transfer of capital means any transfer of funds or property by or on the behalf of any direct investor to an affiliated foreign national. § 1000.312, 33 Fed. Reg. 11709, revising 33 Fed. Reg. at 11271, 8776, 8661, 806, 49 (1968).


22 § 1000.201, 33 Fed. Reg. 16443, revising 33 Fed. Reg. at 11710, 8664, 49 (1968) ($100,000). See also § 1000.503 (proposed change), 33 Fed. Reg. 18044 (1968) ($300,000). See note 9 supra and text accompanying note 23 infra. When the regulations were first issued, it was not clear that all investments abroad would be totaled to determine the excess over the minimum overseas investment allowances. Compare § 1000.504, 33 Fed. Reg. 49, at 52, with § 1000.504, 33 Fed. Reg. 806 (1968). The revision of this section is a further clarification. See 33 Fed. Reg. 8659, at 8664 (1968).

23 § 1000.503 (proposed change), 33 Fed. Reg. 18041, at 18043 (1968); see Statement by Under Secretary of Commerce, Joseph W. Bartlett, N.Y. Times, Nov. 16, 1968, at 53, col. 3 (city ed.).

24 The term "affiliated foreign nationals" means a foreign national in which a United States person (§ 1000.307) is, or becomes, a direct investor, i.e. the United States national owns or acquires a 10 percent or more interest in a foreign national. § 1000.304, 33 Fed. Reg. 11708, revising § 1000.305, 33 Fed. Reg. at 806, 51 (1968). Before the revision, "the definition was only in the present tense, and did not explicitly state that the term includes foreign nationals which became affiliated as a result of a capital transfer after January 1, 1968." Ernst & Ernst, Int'l Business Series, Special Bulletin 68-1, at 2 (Jan. 15, 1968).


26 For example, it would be meaningless to require a direct investor to repatriate $500,000 in earnings if under section 1000.504 he would be allowed to directly invest abroad $1 million. See Gen. Auth. No. 2, 33 Fed. Reg. 3578 (1968).


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actions involving goods or services, "except that an increase in open account may constitute a transfer of capital";\(^{29}\) (2) purchases of portfolio securities of an unaffiliated foreign national, where the total interest of the purchaser is less than 10 percent;\(^{30}\) (3) direct investors who do not invest capital or reinvest foreign earnings abroad in the aggregate of more than $200,000 in each year;\(^{31}\) (4) loans to, or horizontal transfers of capital within, the same schedule group of countries;\(^{32}\) (5) loans to, or financing of, unaffiliated foreign nationals, such as a distributor, so long as the unrelated party is not an agent;\(^{33}\) (6) the purchase, from an affiliated party, of property located abroad, so long as such activity does not result in the creation of a branch, a subpart, or a subsidiary of the purchaser who is actually in the United States;\(^{34}\) (7) all direct investments in Canada and in other exempted countries;\(^{35}\) or (8) banks participating in the Federal Reserve Foreign Credit Restraint Program.\(^{36}\)

Effectuating Calculus for "A", "B", and "C" Schedule Countries.— The annual limitations on new foreign investments that each direct investor can make in a scheduled group of countries is measured as a percentage of the direct investor's historical invest-

\(^{29}\) See Baker, Legal Considerations in Operating Under the New Regulations, CCH BALANCE OF PAYMENTS, § 9032, at 9169 (1968). It can be assumed that the value of the "goods or services" must fall within the $200,000 limitation. See revision of § 1000.309, 33 Fed. Reg. 8659 at 8661 (1968) (includes "value of services performed" as "property" within the section 1000.308, 33 Fed. Reg. 49, at 51 (1968) (definition of "transfer").

\(^{30}\) "It must be remembered, however, that such a purchase would be subject to the Interest Equalization Tax." Baker, supra note 29, at 9169. The first compulsory limitation placed on the outflow of nongovernmental capital to foreign countries came with the Interest Equalization Tax in 1963. INT. REV. CODE OF 1954 § 4911. See generally CCH BALANCE OF PAYMENTS § 5502, at 5505 (1968).

\(^{31}\) See note 20 supra & accompanying text.


\(^{34}\) Baker, supra note 29, at 9169.

\(^{35}\) Exempted countries are American Samoa, Guam, Puerto Rico, Trust Territories of the Pacific Islands, Virgin Islands, Wake Island, and the Canal Zone. 33 Fed. Reg. 6205 (1968).

\(^{36}\) Exec. Order 11387, §1(c), 33 Fed. Reg. 47 (1968). "The Executive Order gives authority to the Board of Governors to subject banks to a program similar to that set forth in the new regulations if the Board believes this action is needed to strengthen the balance of payments." DEPARTMENT OF COMMERCE, OFFICIAL SUMMARY OF REGULATIONS ON FOREIGN DIRECT INVESTMENT 2 (Jan. 2, 1968). See also CCH BALANCE OF PAYMENTS § 1160, at 653 (1968). For the Revised Guidelines for Banks and Nonbank Financial Institutions, see 54 FED. RESERVE BULL., March 1968, at 257.
ment record in that specific group during a specified base period. Thus, the limitations vary depending on the nationality of the foreign affiliate to which new capital is directed. Direct investments are the total of capital input from the United States to another country, including all loans and advances on open account, plus the direct investor’s share of annual earnings of all operations within the specific schedule of countries. The regulations group foreign countries into three schedules.

(1) Schedule "A" Countries.—A direct investor in operations located in less-developed countries, which, generally, includes all countries in South and Central America, Africa, and Asia outside the Sino-Soviet Bloc, can make new capital transfers in amounts which when added to retained earnings do not exceed the aggregate of 110 percent of the annual average direct investments made by the direct investor in enterprises within schedule "A" countries in 1965 and 1966. The revision of this section of the regulations adds, to this amount, the amount of unused authorized investment from previous years or from other schedules.

Example: If an American corporation had made direct investments of $1 million in 1965 and $2 million in 1966 in various subsidiaries and branches located in schedule "A" countries, then in 1968 it can make direct investments in schedule "A" country enterprises of up to $1.650 million (110 percent of the average of 1965 and 1966). This conclusion has been orally confirmed by personnel at the Department of Commerce.

(2) Schedule "B" Countries.—A direct investor in ventures located in certain developed countries, which generally includes the sterling area, Japan, and oil-producing Middle East countries,

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88 There are 141 countries in this group. For a list of these countries, see 33 Fed. Reg. 6205 (1968). Countries are designated "less-developed" by Executive Order of the President pursuant to the Interest Equalization Tax. INT. REV. CODE OF 1954, § 4916(b); § 1000.319(a), 33 Fed. Reg. 49 at 51 (1968). These countries can be generally characterized as purchasing from the United States in amounts in excess of the annual input of American dollars into the country, and being politically or geographically important to the United States government.
91 Ernst & Ernst, supra note 24, at 1. For another example, see Morris, supra note 28, at 703.
92 The countries in this group are Abu Dhabi, Australia, Bahamas, Bahrain, Bermuda, Hong Kong, Iran, Ireland, Japan, Kuwait, Kuwait-Saudi Arabia Neutral Zone,
can make new capital transfers which together with retained earnings in all operations in schedule "B" countries do not exceed in the aggregate 65 percent of the annual average direct investments (i.e., capital input plus retained earnings) in such countries during the 1965 and 1966 base period.\textsuperscript{43} Commencing with 1969, the proposed revision of this particular section of the regulations would add the sum of unused authorized investment carried forward from prior years and from schedule "C".\textsuperscript{44}

(3) Schedule "C" Countries.— A direct investor in operations located in continental Western European countries (except Finland and Greece) and certain developed countries\textsuperscript{45} may not make any new capital investments in such ventures.\textsuperscript{46} Although a moratorium is imposed on any new capital outflows from the United States to schedule "C" countries, earnings may be retained or reinvested to the extent that they do not in their aggregate exceed 35 percent of the direct investor's average annual direct investments in all schedule "C" countries in 1965 and 1966.\textsuperscript{47} The revision of this section of the regulations limits the amount of permitted reinvested earnings to the lesser of the above 35 percent rule or 

\[ \text{[a]} \text{In amount computed by multiplying the portion of the direct investor's share in the total earnings of all such incorporated affiliated foreign nationals during such year by a fraction, the numerator of which is the portion of the direct investor's share in the total earnings of incorporated affiliated foreign nationals in schedule "C" countries which was reinvested during the years 1964, 1965, and 1966, and the denominator of which is the direct investor's share in the total earnings during such years of such affiliated foreign nationals.}\textsuperscript{48} \]

A recent amendment allows greater flexibility in schedule "C" than before. The offset of a negative net transfer of capital against reinvested earnings of incorporated affiliated foreign nationals is now allowed in order to soften the harshness of the "div-

\textsuperscript{43} § 1000.504(b)(2), 33 Fed. Reg. 8664 (1968).
\textsuperscript{44} § 1000.504(a)(2), 33 Fed. Reg. 8664 (1968).
\textsuperscript{45} The countries in this group are Andorra, Austria, Belgium, Denmark, France, Germany (Federal Republic), Italy, Liechtenstein, Luxemburg, Monaco, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the Sino-Soviet Bloc. 33 Fed. Reg. 6205 (1968).
\textsuperscript{47} Id.
idends only" rule.\textsuperscript{49} Previously, the only method available for
reducing the direct investor's share in the reinvested earnings was
the payment of dividends. However, this amendment does not
authorize "negative reinvested earnings in Schedule C to be offset
against a positive net transfer of capital to that Schedule Area."\textsuperscript{50}

Example 1: If an American corporation had directly invested a
total of $300,000 during 1965 and 1966, in all schedule "C"
countries, then, although it may not make any new capital input
investments in these countries, it may retain or reinvest earnings
in schedule "C" countries to the extent that they do not exceed
an aggregate total of $105,000 (35 percent of the 1965 and
1966 average of direct investment).

Example 2: If the corporation during 1968 is entitled to an ag-
gregate total of $220,000 in earnings from its ventures in all
schedule "C" countries, and it had reinvested $200,000 of its
total schedule "C" earnings during 1964, 1965, and 1966 which
amounted to $400,000 then it may reinvest earnings up to
$110,000 ($220,000 X $200,000).

Example 3: The corporation is allowed to reinvest earnings in
1968 up to an amount of $400,000. Its share of the earnings
of its incorporated affiliated foreign nationals is $900,000 in
1968. In September 1968 the corporation receives a dividend
of $250,000 from an affiliated foreign national, and in Novem-
ber it receives $250,000 as a repayment of a 1967 loan. As a
result of these transactions, the direct investor has reinvested
earnings in the amount of $650,000 and a negative net transfer
of capital to schedule "C" in the amount of $250,000. No vio-
lation of the regulations occurs, because $400,000 of reinvested
earnings are allowable, and the $250,000 negative net transfer
of capital permits the reinvestment of an additional $250,000
of earnings.\textsuperscript{51}

Optional Quota System.— As an alternative to the base-period
formula discussed above, Under Secretary of Commerce Joseph W.
Bartlett recently announced the optional investment quota system
whereby 20 percent of the direct investor's share in the previous
year's "annual earnings" on both incorporated affiliated foreign
nationals and unincorporated affiliated foreign nationals is used to
determine the amount of investment or reinvestment allowable.\textsuperscript{52}

\textsuperscript{49} § 1000.504, 33 Fed. Reg. 16441, at 16443 (1968).
\textsuperscript{50} Id.
\textsuperscript{51} Id.
\textsuperscript{52} § 1000.504 (proposed change), 33 Fed. Reg. 18041 (1968).
rector of the Office of Foreign Direct Investments is required to return to the base-period formula. 53

The optional quota system, which can be chosen as an alternative to the base-period formula on which the program was established, represents "a significant departure," Mr. Bartlett said.

Coupled with the recently announced incremental earnings formula, 54 which will go into use in 1970, they "establish the more logical concept that investment quotas should ultimately bear a close relationship to current and future earnings from foreign investment, rather than being rigidly tied to . . . base years," he added. 55

Example: The direct investor's share of the 1968 "annual earnings" of its schedule "C" affiliated foreign nationals is $1 million and of its schedule "A" affiliated foreign nationals is $1.5 million; its schedule "B" affiliated foreign nationals incurred total loses of $200,000. Under the newly proposed revisions in 1969, the direct investor's allowables in schedule "C" will be $200,000 (20 percent of $1 million), zero in schedule "B" (due to losses the previous year), and in schedule "A" $300,000 (20 percent of 1.5 million). 56

Transfer of Capital Between Foreign Countries.— It should be emphasized that the investment quota for a given schedule may be concentrated in whole, or in part, in any country or countries within the same schedule. However, while the regulations permit horizontal transfers of capital within a schedule group, they do not permit vertical downstream transfers, i.e., from a schedule "A" to "B", or "A" and "B" to "C". 57 It is permissible to transfer capital from one schedule to another so long as it is upstream, not borrowed from an affiliated foreign national, and not in excess of the annual limits. 58 The revisions to the regulations treat all transfers of capital between schedule areas as subject to the aggregate limitations, unless the direct investor does not own or acquire 50 percent of the voting power, earnings, or equity assets. 59 A proposed amendment would limit upstream use of the base-period formula

53 Id.
54 See notes 64-68 infra & accompanying text.
55 Statement by Under Secretary of Commerce, Joseph W. Bartlett, N.Y. Times, Nov. 16, 1968, at 1, col. 2 (city ed.).
56 This example is adapted from one given in the Proposed Amendments for section 1000.504, 33 Fed. Reg. 18041 at 18043 (1968).
58 Id.
59 Id.
where the direct investor has selected the optional investment quota system.\(^\text{60}\)

**New Investors.**— It is readily apparent that an American person (individual or corporate) who was not a direct investor in 1965 or 1966 is precluded from becoming one, except that such a person may make investments abroad so long as: (a) the aggregate does not exceed $200,000 per year;\(^\text{61}\) or, (b) if these investments exceed the $200,000 limitation in any year, the funds for the investment are borrowed abroad;\(^\text{62}\) or, (c) if neither (a) nor (b) applies, special authorization is obtained from the Office of Foreign Direct Investments.\(^\text{63}\)

**Additional Positive Direct Investments Based on Incremental Earnings.**— The concept of incremental earnings allows increased positive direct investments in 1970 and thereafter to be made in all schedule areas as a result of increased earnings recorded by incorporated and unincorporated affiliated foreign nationals on a worldwide basis.\(^\text{64}\) Incremental earnings are the amount by which the annual earnings of all affiliated foreign nationals of the direct investor exceed the average of the total affiliated foreign nationals earnings for 1966 and 1967. The positive direct investments authorized will be an amount equal to the amount by which 40 percent of the incremental earnings exceed the greater of the direct investor’s minimum overseas investment allowance or the total of the direct investor’s allowances based on either the base period formula or the optional quota system.\(^\text{65}\) These additional investments can be split among schedule areas or may be concentrated in one area at the discretion of the direct investor. It is noteworthy that these investments when made to schedule “C” countries are not limited to reinvested earnings but can be made in the form of positive net transfers of capital.\(^\text{66}\) In addition, incremental earnings not used in any given year may be carried forward for use in subsequent years.\(^\text{67}\)

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\(^{60}\) § 1000.504 (proposed change), 33 Fed. Reg. 18041, at 18043 (1968).


\(^{66}\) Id.

\(^{67}\) § 1000.506(c), 33 Fed. Reg. 16444, as explained at 33 Fed. Reg. 16442 (1968).
Example: A direct investor had one incorporated affiliated foreign national in 1966 and 1967 which incurred losses of $100,000 each year. In 1970 the direct investor has three wholly owned incorporated affiliated foreign nationals which earn an aggregate of $600,000 ($400,000 in schedule "C", $300,000 in schedule "B", and $100,000 loss in schedule "A"). This corporation has an additional authorized investment of $40,000.68

Repatriation of Earnings.— Initially, the regulations required the repatriation of earnings in an amount based upon the direct investor's 1964, 1965, and 1966 voluntary repatriations.69 The direct investor was required to repatriate its share of the earnings of the foreign operations within each schedule group in an amount equal to the greater of the average of all earnings within the schedule group repatriated in the above years,70 or the earnings of the current operations which exceeded the amount of allowable direct investment, or reinvestments computed by the base period formula and the percentage applicable to the particular schedule.71 Recently the repatriation of earnings provision in the regulations was revoked in its entirety.72

In conclusion, it should be remembered that the mandatory investment controls are only a temporary solution to but one aspect of the nation's balance of payments deficit. If left in effect too long, the program will inevitably reduce America's earnings on its investments abroad. The program can be criticized because it favors least the countries of Western Europe which provide "the quickest and best payout on investment."73 Also, by using the 1965

68 Total 1970 earnings of all AFNs

<table>
<thead>
<tr>
<th></th>
<th>$600,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduct: Average 1966-67 base period earnings</td>
<td>0*</td>
</tr>
<tr>
<td>Incremental earnings in 1970</td>
<td>600,000</td>
</tr>
<tr>
<td>40 percent of 1970 incremental earnings</td>
<td>240,000</td>
</tr>
<tr>
<td>Deduct: Total allowable under § 503</td>
<td>200,000</td>
</tr>
<tr>
<td>&quot;Incremental earnings allowable&quot;</td>
<td>40,000</td>
</tr>
</tbody>
</table>

*For purposes of § 1000.506, base period annual earnings cannot be less than zero.

This example is adapted from one given in the explanation to section 1000.506, 33 Fed. Reg. 16441, at 16443 (1968).

73 Baker, supra note 27, at 9162. "Foreign direct investment has been a plus
and 1966 base period in the effectuating calculus, the regulations favor direct investors who violated the voluntary restraints program which was in effect at that time. A direct investor who violated the voluntary program will have a larger and more favorable base period quota. Those who refrained from making any investments in 1965 and 1966 are virtually precluded from making any sizable investments under the mandatory program.

The purpose of this Comment has been to outline the basic calculus for effectuating this very complicated program. The goal of the Comment has not been to resolve the inherent complexities of the regulations and the practical and interpretation problems they generate. Not only are the regulations complex and sometimes ambiguous and vague, but also they are subject to constant revisions, amendments, and new interpretations by the Office of Foreign Direct Investments. A direct investor may obtain specific authorization to engage in otherwise prohibited transactions if he can show justifiable cause for special treatment. The underlying policy of the controls is to give the appearance of reducing the nation's balance of payments deficit by actually limiting outflow of capital and forcing inflow of earnings and assets to the United States. This policy should be kept firmly in mind when dealing with the Office and in framing requests for specific authorizations. In this connection the importance of the lawyer's role of planning cannot be overemphasized. This is particularly obvious in the area of

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74 See notes 38-47 supra & accompanying text.

75 The voluntary balance of payments program, which began in 1965, called upon the business community (1) to cooperate in observing target limitations (stated as a percentage of capital transactions during the years 1962-1964) in their foreign direct investment transactions in developed countries and (2) to maximize their overall contributions to the balance of payments through such means as expanded exports and remittances of earnings on existing direct investments abroad through foreign borrowing. DEPT OF COMM., OFFICIAL SUMMARY OF REGULATIONS ON FOREIGN DIRECT INVESTMENT (Jan. 2, 1968); also reprinted in N.Y. Times, Jan. 2, 1968, at 15, col. 6 (city ed.). It is estimated that between 1964 and 1966, over 700 American corporations participated in the "Voluntary Cooperation Plan." These companies increased their overall contributions to the United States balance of payments from $15.1 billion to $18.6 billion. A $2 billion goal was established for 1967, and mid-year revised projections indicated that an overall improvement of $2.4 billion over the 1966 level would take place. CCH BALANCE OF PAYMENTS § 151, at 132 (1968). See text accompanying note 15 supra.

76 See Statement of Joseph W. Bartlett, INTERNATIONAL COMMERCE, April 19, 1968, at 42.

77 The deficit appears on line 33 of table 8 in DEPT OF COMM., SURVEY OF CURRENT BUSINESS (June 1968).
obtaining foreign capital in order to achieve corporate objectives abroad and in the area of maximizing tax benefits. The policy underlying the program is reduction of the balance of payments deficit, but if the mandatory controls continue for very long, American companies may start losing their competitive edge in world markets. This would result in reduction of America's foreign investment earnings — which brings to the forefront once again the slow death of the golden egg-laying goose.

JNG/JLH/JFS