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The United States Policy toward Inward Foreign Direct Investment

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THE UNITED STATES POLICY TOWARD INWARD FOREIGN DIRECT INVESTMENT

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I. INTRODUCTION AND SUMMARY

This paper presents the perspective of the author, a trade and investment policy official, on the most significant aspects of the United States policy toward foreign direct investment. The summary in this section is presented to give the author's policy view-

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point in order to assist the reader in evaluating the paper's arguments.

A number of developed and most developing countries place substantial controls on the admittance and treatment of foreign direct investment.[1] Such controls may be part of a domestic regulatory system that also applies to domestic investment (e.g., antitrust laws, banking regulations), or they may apply in a discriminatory manner to foreign investment. Discriminatory controls on inward foreign direct investment imply a basic skepticism about the national benefits of such investment — for political or economic reasons.

United States policy, at both the federal and local levels, reflects a strong positive attitude concerning the general benefits of inward foreign direct investment. While foreign ownership of United States assets is restricted in certain sectors, the general United States approach is one of "national treatment" — i.e., foreign investors are treated as favorably as domestic investors with respect to the application of United States laws and regulations.

The United States policy is an "open" one compared to that of many other countries including most other countries of the Western Hemisphere. This fact reflects several special conditions in the United States: (1) the fundamental market orientation of the United States economy and the absence of pervasive national governmental controls over the economy; (2) the historical experience of the United States in developing its economy through the early part of this century on the basis of foreign capital and immigration; and (3) the vast size of the United States economy in which foreign ownership of United States assets, albeit growing, is relatively small.

The United States policy of openness and national treatment toward foreign investment is beneficial to the United States economy and should be preserved and strengthened. At a time when the United States is going through a major adjustment to changes in the conditions of global competition — with the growing competitive challenges of Japan and a number of newly industrializing countries — the basic objectives of the United States are the

1. For a description of specific developed countries' policies, see A. SAFARIAN, GOVERNMENTS AND MULTINATIONALS: POLICIES IN THE DEVELOPED COUNTRIES (1983). For a discussion of Western Hemisphere policies, see H. Bale, *Foreign Investment Policy*, presented at Center for International Affairs, Harvard University, Cambridge (April 1984) (copy on file at VAND. J. TRANSNAT'L L.).

accelerated formation of capital and the adoption of new technology to assure the maintenance of and increase in United States living standards and employment opportunities. This requires savings and innovation.

The United States has not been generating sufficient domestic savings during the past decade to meet the demands of domestic individuals, corporations and governments, nor does it any longer possess a near-monopoly over advanced technology and its application. It would be preferable for the United States to obtain foreign equity capital rather than borrow heavily abroad. However, while there has been a substantial increase in recent years in foreign direct (equity) investment in the United States, it has only been a fraction of the increase in United States indebtedness to foreigners.[2] This trend of increased foreign indebtedness is largely related to the combination of large deficits in recent federal budgets and the rapid expansion of private domestic investment since 1982.

Foreign indebtedness provides financing with the burden of future scheduled interest payments. In contrast, foreign direct investment can be an important supplement to domestic savings, investment and technology; furthermore, payments to foreign owners reflect returns on their risk capital which are made only if the investment succeeds in generating a profit.

The following sections examine the major elements of United States policy toward foreign investment — both the general policy and the major exceptions to it. There is also a discussion of the recent experience of Canada in more extensively regulating foreign investment. The paper concludes with a few observations about the needs and prospects for a continued open United States investment policy.

II. THE GROWING INTERNATIONALIZATION OF THE UNITED STATES ECONOMY

Since the middle of the last decade, there has been a marked acceleration in the process of internationalization of the United States economy. One index of this change is the measure of the size of our international commerce in relation to our total economic activity. In 1960, United States merchandise exports amounted to 4.1 percent of the United States gross national prod-

2. *See* ECONOMIC REPORT OF THE PRESIDENT at 349 (1985).

uct (GNP). By 1970, this ratio had risen only to 4.4 percent; but in 1980 it had reached 8.5 percent. The increase in the ratio of United States imports to GNP has been even more dramatic. Between 1960 and 1970 it had increased from 2.9 percent to 4.1 percent. In 1980, this ratio had climbed to 9.5 percent.[3]

The growing United States economic interdependence with the rest of the world has been accompanied by a growing national debate over United States trade performance and policy — particularly in light of a trade deficit that exceeded $120 billion in 1984, and is expected to reach $140 billion in 1985.

The international exchange of goods is, however, only one aspect of the growing internationalization of the United States economy. International capital flows have also become an increasingly important element of United States economic activity. United States firms have invested heavily in overseas operations since World War II. Between 1950 and 1984, the estimated value of funds directly invested by United States companies and individuals in enterprises abroad increased from $12 billion to $233 billion.[4]

The substantial foreign operating presence of United States firms is a well-recognized phenomenon in the United States. The latest available survey (1977) of United States-affiliated companies operating overseas showed that 3,540 United States companies had almost 25,000 affiliates abroad with over $829 billion in assets, or over one-quarter of the assets of their United States parent companies.[5] Foreign direct investment in the United States is currently valued at less than United States direct investment abroad; however, it is growing rapidly and is becoming an important economic phenomenon in the United States economy. By the end of 1984, the cumulative level of such investment will exceed $150 billion. While this is only two-thirds of the level of

3. U.S. TRADE REPRESENTATIVE, ANNUAL REPORT OF THE PRESIDENT OF THE UNITED STATES ON THE TRADE AGREEMENTS PROGRAM: 1983 183 (1984) [hereinafter cited as ANNUAL REPORT].

4. BUREAU OF ECONOMIC ANALYSIS, U.S. DEP'T OF COMMERCE, 31 SURVEY OF CURRENT BUSINESS at 7 (Dec. 1951) & 64 SURVEY OF CURRENT BUSINESS at 30 (Aug. 1985). Direct investment, according to the official United States definition, requires a beneficial ownership interest of at least 10 percent of assets by a single United States national or company in a foreign enterprise. 63 SURVEY OF CURRENT BUSINESS at 14 (Aug. 1983).

5. BUREAU OF ECONOMIC ANALYSIS, U.S. DEP'T OF COMMERCE, U.S. DIRECT INVESTMENT ABROAD, 1977 at 20 (Apr. 1981).

United States direct investment abroad, it had amounted to less than one-fifth of the latter in 1970, and less than one-third as late as 1979.[6] After 1979, the United States became the largest cumulative recipient of foreign direct investment.[7] Substantial capital inflows have been occurring over the past half-decade, and it is likely that large direct capital inflows will continue. Since 1977, inward foreign direct investment has increased relative to the growth of the United States economy. According to a recent Commerce Department study, the percentage of total United States assets owned by domestic affiliates of foreign companies increased substantially in three major categories — mining, manufacturing and wholesale trade. In mining, the foreign ownership ratio increased from 9 percent in 1977 to 15 percent in 1981. Foreign ownership of United States assets in manufacturing doubled, from 6 to 12 percent; and in wholesale trade, the foreign ownership ratio increased from 17 to 28 percent.[8]

United States employment in affiliates of foreign companies in 1977 was 1.13 million, or 1.4 percent of total United States nonagricultural employment. In 1981, affiliates' United States employment rose to 2.34 million or 2.7 percent of nonagricultural employment. Approximately 24 percent of the employees of affiliates of foreign companies were located in the Southeast region of the United States. An estimated 580 thousand employees in the Northeast constituted approximately 3.4 percent of the nonagricultural employment in the region. In 1977, the comparable ratio was 1.4 percent. Between 1977 and 1982 the Southeast became the region with the greatest concentration of employees of foreign affiliates, surpassing the Middle Atlantic region by 23 thousand employees in 1982. The leading Southeast states in employment by affiliates were North Carolina (92,170), Georgia (78,938), Florida (75,981), South Carolina (60,914) and Tennessee (58,709).[9]

Most foreign direct investment in the Southeastern part of the

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6. 64 SURVEY OF CURRENT BUSINESS, *supra* note 4, at 27 (Oct. 1984).

7. INT'L TRADE ADMIN., U.S. DEP'T OF COMMERCE, INTERNATIONAL DIRECT INVESTMENT: GLOBAL TRENDS AND THE U.S. ROLE 19 (Aug. 1984).

8. *Id.* at 21.

9. *See* N. Howenstine, *U.S. Affiliates of Foreign Companies: Operations in 1982*, in 64 SURVEY OF CURRENT BUSINESS, *supra* note 4, at 38, 40 (Dec. 1984); INTERNATIONAL DIRECT INVESTMENT, *supra* note 7, at 22, 72; BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1984 408 (104th ed. 1984); BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1979 409 (100th ed. 1979).

United States is in petroleum, real estate, chemicals and a variety of manufacturing activities.[10] Approximately one-third of all of the gross book value of property, plant and equipment of manufacturing affiliates of foreign companies operating in the United States is located in the Southeast.[11] This suggests that the Southeast is particularly suited to attract foreign manufacturing operations, compared with other regions of the United States.

The most important country of origin of foreign direct investment in the United States is, as of the end of 1983, the United Kingdom ($32.5 billion). Other countries at the top of the list of foreign investment sources are the Netherlands ($28.8 billion), Japan ($11.1 billion), West Germany ($10.5 billion), and Switzerland ($7.1 billion). The countries of OPEC, as a group, have placed $4 billion in direct investment in the United States (or 3 percent of the total).[12] As of 1983, more than half of the OPEC countries' direct investment in the United States consisted of a single investment of $2.5 billion by Kuwait in the 1981 purchase of Santa Fe International Corporation, an oil exploration and engineering firm.[13]

III. Reasons for the Inward Flow of Foreign Direct Investment

A recent survey of Dutch firms with operations in the United States reported on reasons that Dutch investors gave for establishing their United States operations. The primary reasons given were: (1) to better service United States customers; (2) to expand markets in the United States; and (3) to diversify the parent firms' financial and operating resources. A much smaller group cited access to United States technology as an important motivation.[14] The reasons given in this survey of Dutch investors are quite understandable and are probably typical of the motives of most foreign investors. Yet, there are more fundamental reasons as to why the United States market has been singled out in recent years as a market for foreign investors to establish operations.

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10. International Direct Investment, *supra* note 7, at 22.
11. Bureau of Economic Analysis, U.S. Dep't of Commerce, Foreign Direct Investment in the United States: 1980 76, 80 (Oct. 1983).
12. 64 Survey of Current Business, *supra* note 4, at 38 (Dec. 1984).
13. International Direct Investment, *supra* note 7, at 79.
14. Arthur Young International, Results of a Survey of Dutch Investors That Have Established Operations in the United States 7 (1983).

Table 1 shows the distribution of inward direct investment of major industrialized countries since 1960. In the decade of the 1960s the United States received less than 3 percent of the total inward direct investment of these countries; however, in the last several years, the United States has received most of such investment. Meanwhile, flows of foreign direct investment to Canada, Australia, Italy, and Germany have declined in relative importance. Why? After all, have not the European and Japanese economies grown, even relative to the growth of the United States for much of the past decade?

TABLE 1

Inward Direct Investment Flows
Percentage Distribution Among 13 Countries

(Percentages)

	1961-67	1968-73	1974-78	1979-82
Canada	16.2	12.1	3.2	Negative
United States	2.6	11.4	26.7	50.9
Japan	2.0	1.7	1.2	1.0
Australia	15.6	12.9	9.5(1)	6.6
Belgium	4.5(2)	6.1	9.4	6.2
France	8.2	8.2	15.2	8.6
Germany	21.3	16.4	14.7	3.0
Italy	11.5	8.3	5.0	2.4
Netherlands	4.7	8.5	6.0(3)	4.5
Sweden	2.4	1.7	0.5(4)	0.6
United Kingdom	9.7	7.4	6.1	11.8
Spain	2.7	3.7	3.7	5.6
Norway	0.8	1.4	4.1	1.4

1) From 1974 to 1976; 2) From 1965; 3) From 1974 to 1978; 4) From 1974 to 1977
SOURCE: Recent International Direct Investment Trends, OECD Paris, 1981; *Balance of Payments Yearbook*, International Monetary Fund.

Among the basic reasons for the rapid growth of foreign investment in the United States in recent years are the following: (1) the postwar maturation of the economies of Europe and Japan has featured the growth of "world-class" companies which can compete with United States companies in both international and the United States markets; in 1960, forty-two of the world's largest companies had their headquarters in the United States; in 1980, however, the number had dropped to twenty-one;[15] as these companies entered world markets, they behaved like their United States counterparts and invested overseas, in the United States and elsewhere; (2) the United States has the world's largest market virtually free of any internal barriers to the movement of goods and services; the development of Europe's "Common Market" is, in this regard, still far off, as many trade barriers between its members still exist; (3) the United States has a relatively stable economic and political environment, with a trend toward a lower degree of taxation, regulation and inflation in recent years; (4) there are generally good labor relations in the United States; for example, more than 90 percent of the Dutch investors surveyed as mentioned above, experienced no significant labor disruptions or strikes over a recent two year period; and (5) there are few restrictions on the establishment of foreign enterprises in the United States; that is, unlike many countries where foreign investment proposals are screened by governmental bodies, the United States has no systematic process of screening (and rejecting) foreign investments.

The remainder of this paper will address the last point in more detail. Policies toward foreign investment at the federal and state levels can potentially do much to affect the volume of investment flows. The foreign investment regulations in Canada briefly discussed below illustrate this point.

IV. THE UNITED STATES POLICY TOWARD FOREIGN DIRECT INVESTMENT

In September of 1983, the Administration issued a statement of its policy toward foreign direct investment. The basic policy hypothesis is summed up in the statement that "an open international investment system responding to market forces provides the best and most efficient mechanism to promote global economic development." And with respect to foreign direct investment in the United States, the statement outlines the following:

> The United States has consistently welcomed foreign direct investment in this country. Such investment provides substantial benefits to the United States. Therefore, the United States fosters a

15. INTERNATIONAL DIRECT INVESTMENT, *supra* note 7, at 7.

> domestic economic climate which is conducive to investment. We provide foreign investors fair, equitable, and non-discriminatory treatment under our laws and regulations. We maintain exceptions to such treatment only as are necessary to protect our security and related interests and which are consistent with our international legal obligations.[16]

Three key phrases in the paragraph essentially describe the general policy approach of the federal government toward foreign investment.

A. Nondiscriminatory Treatment

Under United States laws and regulations, the principle of "national treatment" prevails toward inward foreign investment. That is, foreign nationals and companies are treated as favorably as nationals or companies of the United States with respect to the establishment and operation of enterprises in this country. Thus, with regard to antitrust, security, environmental, trade or other regulations, there is no differentiation between United States or foreign ownership in their application to business activities.[17]

The nondiscriminatory principle adhered to under United States laws and regulations also applies to treatment of investors of different foreign nationalities. The basic United States policy is generally not to give preferential treatment to investments from one country of origin relative to those from another country. This is the so-called most-favored-nation (MFN) principle.[18] Thus, Canadians can make and operate investments on the same basis as investors from the United Kingdom. Further, on the basis of the national treatment principle, investors from other countries can generally make investments in this country on the same legal terms as American investors.[19]

Few countries pursue a national treatment policy as broadly as

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16. ANNUAL REPORT, *supra* note 3, at 174.

17. *See* Vagts, *United States of America's Treatment of Foreign Investment*, 17 RUTGERS L. REV. 374, 377 (1963).

18. Fry, *Foreign Investment in the United States and Canada: The Setting*, in REGULATION OF FOREIGN DIRECT INVESTMENT IN CANADA AND THE UNITED STATES 1, 5 (E. Fry & L. Radebaugh eds. 1983).

19. Bale, *The U.S. Federal Government's Policy Towards Foreign Direct Investment*, in REGULATION OF FOREIGN DIRECT INVESTMENT IN CANADA AND THE UNITED STATES 29, 41 (E. Fry & L. Radebaugh eds. 1983) [hereinafter cited as *U.S. Federal Government's Policy*].

does the United States.[20] Most industrial and developing countries maintain a wide range of discriminatory measures against foreign investors. For example, the establishment of enterprises may be limited or restricted to joint ventures with local enterprises; or foreign-owned enterprises may also not have access to local credit markets, government procurement contracts, or government financial assistance. United States investors find a considerable degree of obstacles even to investing in many Western Hemisphere countries, particularly Canada and Mexico.[21]

If foreign countries do not permit United States investors to establish and operate enterprises in their territory, why shouldn't the United States government pursue a policy of reciprocity, instead of national and MFN treatment? Should we not treat the investors from companies of foreign countries in the same way as the treatment provided by the home government of the investor? The United States government's response to the suggestion of reciprocity as a general policy rule applicable to foreign investment issues has traditionally been negative. The reason is that most businessmen, labor leaders and consumers, as well as federal, state and local government officials believe that foreign investment is a positive addition to the economic resources and technology of this country, regardless of the treatment accorded foreign investment in other countries. To copy the practices of other countries and restrict the establishment and acquisition of companies in this country would be to deny employment and income opportunities to United States workers and shareholders.[22]

B. International Legal Obligations

In accordance with these policy attitudes, the Federal Government has entered into a number of international treaties that require it to provide national and MFN treatment to foreign investors. In return, foreign treaty partners agree also to provide nondiscriminatory treatment to United States investors. The United States has treaties of this type with a number of countries

20. *See* Business and Industry Advisory Committee to the Organization for Economic Cooperation and Development (OECD), *National Treatment: A Major International Investment Issue of the 1980s* (1982).

21. *See generally U.S. Federal Government's Policy, supra* note 19.

22. For further discussion of the national treatment policy of the United States and the reasons therefor, see *U.S. Federal Government's Policy, supra* note 19, at 29-46.

including Japan, Korea, Germany, Israel, Taiwan and the Netherlands.[23] These treaties are voted upon by the Senate and are binding at both the federal, state and local levels. Such treaties are beneficial instruments in securing political commitments to maintain liberal policies governing foreign investment flows. Thus, Japanese investors are guaranteed nondiscriminatory treatment for their investments in the United States by agreements that are legally enforceable in United States courts. United States government officials have traditionally held that treaties of the type described above help to encourage the flow of international investment. In 1981, the United States Government launched a major effort to negotiate such treaties with developing countries, in order to help stimulate the flow of private equity capital to countries that have depended too much on external debt financing.[24]

C. Exceptions to National and MFN Treatment

As noted above, the United States has a nondiscriminatory policy which is attractive to foreign investors. It generally treats the establishment and operation of foreign-owned enterprises under its laws as it treats domestically owned ones. It was also mentioned that the United States generally does not favor one nationality of investor over a different nationality with respect to the application of its laws. Further, this policy is backed up by international treaty obligations. Nevertheless, there are exceptions to these principles. The exceptions are based upon consideration of: (a) national security; (b) state-level restrictions; and (c) reciprocity.

1. *National Security Related Exceptions*

The United States Government restricts foreign ownership in areas where the national security may be affected. These restrictions exist in areas such as aviation, ocean and coastal transportation, public communications and energy production. For example, United States citizens must own at least seventy-five percent of

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23. C. Sullivan, *Study on the Standard Draft Treaty of Friendship, Commerce and Navigation*, Washington, Department of State (copy available on file with author).

24. U.S. TRADE REPRESENTATIVE, ANNUAL REPORT OF THE PRESIDENT OF THE UNITED STATES ON THE TRADE AGREEMENTS PROGRAM 1980-81 78-79 (1982).

the voting interests of United States airlines. United States registered vessels must be owned by United States citizens or by companies whose boards of directors are largely United States citizens. Foreigners may not generally receive licenses for United States nuclear power facilities. Radio and television broadcast licenses may not be held by aliens.[25]

Furthermore, under United States defense programs, security clearances are required for personnel of companies who have necessary access to classified information or who work on classified projects. Such clearances are difficult to obtain by companies whose owners are foreign, although voting trusts may be established under which the foreign owners benefit, but do not manage, the controlled firm doing classified work.[26]

Department of Defense officials have, at times, also been concerned that foreign acquisitions could threaten the continuity of companies in the United States which produce goods of actual or potential military use. For example, in 1984, Pentagon officials expressed fears about the continued existence of a ball-bearing company under plans for acquisition by a Japanese-owned firm. A Pentagon spokesman stated that the concern was that a "viable industrial base" be maintained for ball-bearing products.[27] The acquisition was also reviewed under antitrust statutes by the Justice Department, which in February 1985, approved the takeover.[28]

2. *State Restrictions*

State governments regulate the entry of firms into the banking and insurance industries under their jurisdiction. In doing so, a number of them have placed limitations on the degree of participation by foreign investors in both of those sectors, although some restrictions also apply to out-of-state investors as well. In both the banking and insurance sectors states often stipulate a minimum proportion of residents and United States citizens on boards of directors, and require more paid-in capital or less reserves. Also, many states apply a reciprocity criterion to inves-

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25. *See U.S. Federal Government's Policy*, *supra* note 19, at 45-46; *see also* U.S. TREASURY DEP'T, FOREIGN INVESTMENT IN THE UNITED STATES, (Sept. 1979) [hereinafter cited as FOREIGN INVESTMENT IN THE UNITED STATES].
26. *See* FOREIGN INVESTMENT IN THE UNITED STATES, *supra* note 25, at 11, 12.
27. Wall Street J., Oct. 5, 1984, at 14, col. 1.
28. Wall Street J., Feb. 27, 1985, at 22, col. 1.

tors from out-of-state and abroad; that is, the investor's home state or country must allow participation by the bank or insurance companies of the state into which the investor wishes to enter. In any case, the conditions placed on foreign investors tend, on the whole, to be greater than those placed on out-of-state investors.[29] And some states, though not a very large number, also restrict foreign holdings of real estate, state-owned lands, or state-owned mineral deposits.[30]

One barrier to foreign investors that is frequently cited is the use by some states of the worldwide unitary system of tax apportionment, or "unitary tax." A small number of states, including California, Oregon and Florida, have based their taxation of corporate incomes in recent years on the worldwide income of related units of an enterprise. For foreign investors, such a taxation scheme subjects their various business operations (which typically constitute the predominant properties of their worldwide business) to review and factoring by state tax officials. This tax system has raised substantial protests by foreign investors and the governments of the United Kingdom, Japan, the Netherlands and Canada. Nevertheless, the tax system per se is not discriminatory: United States firms with substantial overseas operations have also claimed to be adversely affected. Yet, foreign investors do tend to be more greatly affected given their higher ratio of foreign to United States business activities. Following considerable opposition raised to the worldwide unitary tax approach by organized groups of foreign investors, most states using this method have or are considering its repeal, including the three states mentioned above.[31]

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29. *See generally* Cohen & Murphy, *Foreign Investment in United States Banking*, in MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES 326-95 (J. Marans, P. Williams, J. Griffin & J. Pattison, eds., 2d ed. 1984).

30. For a summary of state laws governing foreign ownership of and interests in real estate, see MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES, *supra* note 29, at 508-36.

31. DEP'T OF THE TREASURY, THE FINAL REPORT OF THE WORLDWIDE UNITARY TAXATION WORKING GROUP: CHAIRMAN'S REPORT AND SUPPLEMENTAL VIEWS 1-3 (Aug. 1984); H. Bale, *International Trends and Investment Implications of Worldwide Unitary Taxation*, Statement before the Subcommittee on International Economic Policy, Senate Committee on Foreign Relations (Sept. 20, 1984) (copy on file at VAND. J. TRANSNAT'L L.).

3. *Federal Reciprocity*

Despite a general policy which rejects investment reciprocity, federal laws and policies are not entirely free of elements of reciprocity in the determination of whether a foreign investor can engage in certain lines of business in the United States. Under the Mineral Lands Leasing Act of 1920,[32] foreign investors may acquire leases or interest in coal, oil and gas deposits on federal lands only if they do so through a domestic corporation and if the investors' home country grants "similar or like" rights to United States investors.[33] For example, in 1983 the Secretary of the Interior, responsible for administering the 1920 Act, found that Kuwait's customary treatment of United States investors is discriminatory against the latter compared to treatment accorded other foreign investors. As a result, Kuwait was found to be nonreciprocal under the Act. This decision prevented access to federal mineral lands for Santa Fe International, a United States corporation wholly owned by the Kuwait Petroleum Corporation (KPC). KPC is a government-owned Kuwait corporation. However, in 1984, a United States District Court remanded the matter to the Interior Department. The Court found that the Secretary did not have a proper basis for finding Kuwait nonreciprocal.[34] In February 1985 the Interior Department reversed its earlier finding and determined that Kuwait met the reciprocal requirements of the Act.[35]

Additional elements of reciprocal treatment of foreign investors have been introduced into federal legislation through the International Trade and Investment Act of 1984.[36] Section 304 states that the President may take actions to restrict or deny the authorization of foreign investments in the service sector, if the

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32. Pub. L. No. 86-705, 74 Stat. 781 (codified as amended in scattered sections of 30 U.S.C.).

33. FOREIGN INVESTMENT IN THE UNITED STATES, *supra* note 25, at 3.

34. Santa Fe Int'l Corp. v. Watt, 591 F. Supp. 929 (D. Del. 1984).

35. Interior's finding was based upon the fact that Japanese interests were not nationalized along with U.S. ownership interests in Kuwait in 1974. However, the Court accepted Santa Fe International's contention that Kuwait's nationalizations were not directed at U.S. nationals, but were based upon objective economic considerations, independent of nationality or ownership of oil interests. 591 F. Supp. at 942. *See* U.S. Department of the Interior, Decision on the Status of Kuwait Under the Mineral Leasing Act of 1920, March 10, 1983 and February 7, 1985.

36. Pub. L. No. 98-573, 98 Stat. 3000 (codified in scattered sections of 19 U.S.C. and 22 U.S.C.).

home country of the foreign investor places undue restrictions on United States service sector investments.[37] Thus, if a foreign country restricts United States banking activities, then the President may take action similarly to limit banking investments by residents of that country.

V. Federal "Review" of Foreign Investment

In response to increasing Congressional concerns about the growing inward financial flows from OPEC and other countries after the first "oil shock" in 1973, President Ford issued Executive Order 11858 in May of 1975, establishing the Committee on Foreign Investment in the United States (CFIUS).[38] The Committee is charged with monitoring the impact of foreign direct and portfolio investment in the United States. It has, *inter alia*, the duty to "review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests."[39] It is also charged to consult with foreign governments on prospective major governmental investments in the United States and propose legislation as appropriate.[40] The Committee has interpreted its mandate so that, in practice, almost all cases which undergo a formal CFIUS review involve a foreign government or foreign-government entity as the investor. Concern, both within and without the Administration, has been expressed about the possible adverse impact of foreign government controlled investments on the United States economy. For example, large state-owned French and Kuwaiti oil companies have made substantial acquisitions of energy companies in the United States in recent years.

There is increasing participation of governments abroad in foreign enterprises that are, or are becoming, multinational in their operations. One broad category of concerns is related to United States security. There is concern that such investments in United States strategic resources may lead to underdeveloping or otherwise manipulating these resources to the disadvantage of the United States in periods of resource-supply shortage. Another related concern is the acquisition of sensitive military United States technologies by foreign governments through their investments in

37. *Id.* § 304.
38. Exec. Order No. 11858, 40 Fed. Reg. 20263.
39. *Id.*
40. *Id.* at 20263-64.

the United States. A further concern is that foreign governmental investors will place their own national concerns above the best interests of the United States affiliate and consequently, contribute to inefficiencies in the United States economy. With their taxpayers backing an investment, for example, foreign governments might subsidize their United States subsidiary and destroy all United States fair market competition by taking a below market return on its investment. Foreign governments might impose "buy-national" policies on its foreign subsidiaries even if locally produced products were more competitive. It should be noted, however, that the CFIUS has not yet found a foreign investment, even by governmentally controlled or owned enterprises, to be contrary to the national interest.

In any case, under its current mandate the CFIUS has no authority itself to block any foreign investment in the United States. Were CFIUS to find a certain investment to be a threat to United States national interests, it would have to identify other existing laws for a remedy — or propose legislation.[41] For example, the United States could block an investment through a Presidential invocation of the International Emergency Economic Powers Act.[42] The action would require him to declare a national emergency; however, this power certainly does not lend itself to frequent or regular use.

Another "shortcoming" of CFIUS as a screening mechanism is that the Committee cannot compel a foreign investor to delay an investment while the CFIUS is reviewing the case. It can only request a delay.[43] There has been some sentiment in the United States Congress and private sector recently for more effectively controlling foreign governmental investments in the United States. However, there have been only few concrete legislative proposals introduced in the Congress so far, and they have not been given much attention.

Because there are concerns in the United States about foreign government controlled investments and the absence of effective tools to deal with the issue, the Administration itself has reviewed in the recent past possible legislative approaches for enhancing the powers of the Committee. The current position of the Administration is, however, that the enhancement of governmental pow-

41. 40 Fed. Reg. at 20263-64.
42. 50 U.S.C. §§ 1701-1706 (1982).
43. *See* 40 Fed. Reg. at 20264.

ers in the area of foreign investment control should not be pursued. Any regulatory approach which would still maintain a basically open United States policy toward United States foreign investment has not been found.

VI. Financial Incentives to Direct Investment

Financial aids to direct investment given by governments at both the national and local levels are an important aspect of federal and state policies toward foreign direct investment in the United States. Nearly all governments of market oriented economies provide incentives to promote investments, and make many of those incentives (and, often, additional ones) available to foreign investors. Certainly, the United States federal government currently seeks to expand domestic private investment, whether or not sourced from abroad as a stimulus to greater growth, employment and productivity through tax and financial incentives (e.g., accelerated depreciation). All of our state governments have programs to attract investment, particularly to less prosperous regions. Tax relief, land grants, infrastructure and labor subsidies, and preferred borrowing terms have been made available by states and localities to both domestic and foreign investors.

The Paris-based Organization for Economic Cooperation and Development (OECD) has been examining the role and impact of incentives on international investment decisions for several years. The work there suggests that the major impact of incentives offered to foreign investors is on the location of investments within a region of neighboring countries or subnational political units comprising, more or less, a common market zone.[44] That is, firms tend to make decisions about where to locate their investments within a broad area independently of competing investment incentives; however, within the region, incentives can be an important factor in a location decision. On the other hand, basic business decisions (e.g., whether to invest abroad or export) are not significantly affected by incentives. Business, it is often argued, evaluates investment projects *net* of any incentives offered, in terms of business risks, costs, political stability and investment climate. To quote one recent study:

> Perhaps one reason why businesses base investment decisions on

44. OECD, Investment Incentives and Disincentives and the International Investment Process 66-70 (1983).

factors other than incentives is linked to their desire for flexibility. If a project requires incentive aid to make it attractive, then the business must depend on continued governmental support to justify the position. By selecting options which are sensible, net of incentives, businesses can better guarantee that their decisions will be sensible whatever happens to aid programs.[45]

Nevertheless, incentives can positively affect the *timing* and *location* of investments if financial aids are significant, predictable and free of accompanying performance requirements that are costly from a business perspective (such as local purchasing requirements or inflexible employment requirements).[46]

In the United States, the state and local governments use incentives to compete against each other. In addition, United States localities may often be in competition with Canadian provinces and Mexico for investment. An advantage that our states have over locations in either Mexico or Canada is that the national governments of the latter two countries utilize investment screening procedures and have very often, in recent years, imposed onerous performance requirements on foreign investors.[47] These requirements have offset, to a considerable degree, the abundant financial incentives, labor cost advantages and low exchange rates of these neighboring, and competing, countries. To the author's knowledge, United States states have limited their "performance requirements" almost exclusively to geographic target areas and environmental standards.

VII. A Comparative Analysis of Investment Policies: The Case of Canada

Since 1974, Canadian federal government has screened most foreign investments according to whether individual investments were likely to be of "significant benefit" to Canada. Under the Foreign Investment Review Act (FIRA),[48] Canada's screening ap-

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45. Business and Industry Advisory Committee, OECD Committee on International Investment and Multinational Enterprises, Relationship of Incentives and Disincentives to International Investment Decisions 24 (1981).

46. *Id.* at 24, 28-30.

47. *See* H. Bale, *Foreign Investment Policy*, *supra* note 1; *see also* H. Bale, *Trade Policy Aspects of International Investment Policies*, in NBER Conference Report: Recent Issues and Initiatives in U.S. Trade Policy 72-82 (R. Baldwin ed. 1984).

48. Foreign Investment Review Act of 1973, Act of Dec. 12, 1973, ch. 46,

plies to the opening of new establishments by foreigners, the entry into new bases of activity by foreign-owned Canadian enterprises and the acquisition of Canadian enterprises by foreigners (whether or not the Canadian enterprises acquired were initially foreign-owned or controlled).[49]

Until 1974, Canada's regulation of inward foreign direct investment was limited to a sectoral approach similar to that in the United States, with controls applied at both the federal and provincial levels. Only foreign ownership and control in Canada's banking, insurance, broadcasting, airlines, newspapers, and trust companies were restricted under Canadian law.[50] After 1974, however, the general screening procedure established by the FIRA was overlaid onto the sectoral restrictions. According to the Canadian government, the purpose of the screening was not to curtail foreign investment — although a political debate had occurred since the late 1950's over the high degree of foreign ownership in Canada. Rather, the purpose was to ensure that foreign investment brought significant benefits to Canada. Foreign investors were requested to legally bind themselves to commitments regarding local employment, purchases of locally produced goods, exports, research and development in Canada, Canadian management, etc.[51] Nevertheless, while most investment proposals were accepted by the Canadian authorities (each project requiring a decision by the Canadian federal Cabinet), many proposals were not made, and many others were discouraged from being made.

A further major development in Canada's investment policy came in 1980. In that year, the administration of Prime Minister Pierre Trudeau introduced a new National Energy Program (NEP) which sought, *inter alia*, to decrease the degree of foreign ownership of Canada's oil and gas investments from almost seventy percent in 1980 to fifty percent by 1990. The goal of

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1973-1974 Can. Stat. 619, *amended by* ch. 52, 1976-1977 Can. Stat. 1274.

49. J. Turner, *Canadian Regulation of Foreign Direct Investment*, 23 HARV. INT'L L. J. 333, 338-42 (1983); S. GLOBERMAN, U.S. OWNERSHIP OF FIRMS IN CANADA: ISSUES AND POLICY APPROACHES (1979); Hufbauer & Samet, *Investment Relations Between Canada and the United States*, in CANADA AND THE UNITED STATES: DEPENDENCE AND DIVERGENCE 103 (W. Armstrong & L. Armstrong, eds. 1982).

50. A. SAFARIAN, GOVERNMENTS AND MULTINATIONALS, *supra* note 1, at 15.

51. *See* H. Bale, Investment Frictions and Opportunities in Bilateral U.S.-Canadian Trade Relations 17-18, (Nov. 18, 1983) (available on file at VAND. J. TRANSNAT'L L.).

"Canadianization" under the NEP was intended by the Trudeau government to be achieved by purchasing foreign-owned companies.[52] Measures designed to favor Canadian-owned energy companies were introduced, including subsidies for costs of exploration based directly upon the degree of Canadian ownership of an exploration company, and a maximum fifty percent limitation on foreign ownership in companies operating the Canadian federal lands.[53]

The NEP represented a very significant change in Canada's investment policy affecting a major economic sector. Certainly, Canadian concerns about the ownership of a majority of new investments in its oil and gas industry can be understood. However, Canadian policy affected *existing* investments in Canada. The exploration costs subsidies discriminated against foreign-owned companies. In effect, Canada reversed its policy toward foreign investment in the energy field, which had been welcomed before 1980. In doing so, the Canadian government's policy created an atmosphere of uncertainty among foreign investors even outside of the energy industry. The NEP was perceived as a program forcing divestiture by foreign investors, and concerns were expressed that the NEP approach might be copied in other sectors. The combination of the application of the FIRA and the NEP also led to a political reaction in the United States companies and the Reagan Administration that threatened to materially worsen bilateral economic relations.[54]

The effect of Canada's FIRA and NEP can be seen in the flows of direct investment across Canada's borders. Table 2 shows that the flow of direct investment into Canada peaked in the early 1970's. After 1975, inward flows actually declined, and then became negative after the NEP was announced. Meanwhile, Canadian investment going abroad had continued to climb, with a very substantial amount in 1981, so that Canada became a net exporter of direct investment capital after 1975.

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52. A. SAFARIAN, GOVERNMENTS AND MULTINATIONALS, *supra* note 1, at 16; MINISTRY OF ENERGY, MINES AND RESOURCES CANADA, THE NATIONAL ENERGY PROGRAM 49 (1980).

53. MINISTRY OF ENERGY, MINES AND RESOURCES CANADA, THE NATIONAL ENERGY PROGRAM 39-41 (1980).

54. *See* HOUSE COMMITTEE ON ENERGY AND COMMERCE, 97th CONG. 2D SESS., IMPACT OF CANADIAN ENERGY AND INVESTMENT POLICIES ON U.S. COMMERCE (Comm. Print 1982).

TABLE 2

Flows of Foreign Direct Investment To and From Canada

(1965-1983)
(C$ Millions)

	(1) Flows of Foreign Direct Investment into Canada	(2) Canadian Direct Investment Abroad	(3) Net [(1)-(2)]
1965	C$ 535	C$ 125	C$ 410
1966	790	5	785
1967	691	125	566
1968	590	225	365
1969	720	370	350
1970	905	313	592
1971	925	230	695
1972	620	400	220
1973	830	770	60
1974	845	810	35
1975	725	915	-190
1976	-300	590	-890
1977	475	740	-265
1978	135	2,325	-2,190
1979	750	2,550	-1,800
1980	800	3,150	-2,350
1981	-4,400	6,900	-11,300
1982	-900	950	-1,850
1983	200	2,700	-2,500

SOURCE: Statistics Canada - Quarterly Estimates of the Canadian Balance of International Payments, Second Quarter 1984

NOTE: Excludes reinvested earnings

The lessons of the Canadian experience are that a policy of excessive intervention in the decision-making of foreign investors (as carried out under the FIRA), and sharp negative shifts in policy affecting existing investors (such as occurred under the NEP) will have an adverse effect on the ability to attract foreign direct investment. It is interesting to note that Canada has, for some years, offered substantial financial incentives to investors, both foreign and domestic, at the federal and provincial levels.[55] Canada's experience since 1974 exemplifies the weakness of incentives as an attraction to foreign investors in the context of a national policy according to which foreign ownership is considered, per se, undesirable.

The new Canadian federal administration of Prime Minister Brian Mulroney has recognized the adverse effects that excessive government regulation have had on the flows of foreign investment into Canada. In December 1984, a bill to amend the FIRA was introduced into the Canadian parliament. The new "Investment Canada" agency would be limited to reviewing acquisitions by foreigners which exceed C$5 million. It would not review proposals to establish new businesses (except in "sensitive" sectors). The purpose of the new bill is to "encourage as much as possible" the stimulation of trade and industrial development.[56] By retaining the right to screen large acquisitions, the Canadian government will not make the most of the opportunity to attract foreign investment; however, the government will be making an important substantive improvement by exempting new businesses established by foreigners. Also, foreign investors will tend to be assured of favorable consideration and fairer treatment under a government whose basic attitude is more positive toward foreign investment, as noted by Minister Sinclair Stevens who is directly responsible for administering Canada's foreign investment law: "Perceptions play a vital role in the world of investment. The words and actions of a government can tip the delicate balance underlying a country's reputation as a place to invest."[57]

VIII. CONCLUSIONS

Few countries can afford to discriminate against foreign investment for a prolonged period of time. Perhaps Japan, which has been able to generate sufficient savings to finance internal credit needs, is one of those few. It is unlikely that the United States will ever return to a condition in which inward direct investment

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55. Grenier, *Theoretical and Real Investment Restrictions and Incentives in the Province of Quebec*, in REGULATION OF FOREIGN DIRECT INVESTMENT IN CANADA AND THE UNITED STATES 65-66 (E. Fry and L.H. Radebaugh, eds. 1983).

56. Investment Canada, *Press Release and Background Statement by the Honorable Sinclair Stevens Following the Tabling of the Investment Canada Bill*, Ottawa, December 7, 1984.

57. *Id.*

does not make a significant contribution to the national economy by supplementing domestic savings and investment.

There is, of course, more that could be done to encourage greater rates of business, individual and particularly government saving. Our nation's fiscal policies should be examined from a perspective of whether they meet the current and future need to stimulate greater domestic saving and investment. We should consider shifting our basis of taxation from income to expenditures, perhaps through some type of value-added tax.

Foreign investment will continue to be a necessary supplement to the capital and technology resources of the United States. In order to continue to be an attractive location for direct investment for overseas, the federal and state governments must continue to pursue certain policies that provide an environment conducive to attracting such investment. These policies include the following:

(1) monetary and fiscal policies which promote noninflationary growth: reduction of the federal deficit, maintainance of relatively low taxes, and keeping the growth of the United States money supply under control will assure foreign investors that the value of their investment will be measured both in dollar and foreign currency terms;

(2) the avoidance of discriminatory regulatory and tax measures that adversely affect investments already in place, and that may discourage future investment: while technically not discriminatory, the unitary tax applied by some states in recent years adversely affected foreign investments and created an unfavorable climate for foreign investments in these states; and

(3) the maintenance of a clear understanding on the part of foreign investors as to the sectors which are open to foreign investors: the scope of United States national security related exceptions to national treatment could be a problem for foreign investment in United States high technology firms in the future, given the large volume of private sector classified activity in defense-related research and production.

There is a strong interest on the part of states and localities today to strengthen the United States environment for investment—from both domestic and foreign sources. In the absence of stable and nondiscriminatory political and economic conditions for foreign investors, financial incentives will not be sufficient to attract the foreign direct capital important for long-term United States noninflationary growth.

From a practical point of view, state and local officials could become more aware of policy trends at the federal level which could affect the flows of foreign investment to the United States. In the past, some members of Congress have proposed a tightening of regulations of inward foreign investment. While no serious proposal to restrict foreign investment is on the Congressional agenda presently, the states should monitor possible future developments in order to avoid a federal intrusion into this field — such as that which occurred in Canada under the FIRA and NEP with substantial negative economic consequences for that country.