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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Foreign Direct Investment In The United States--The Federal Role

What is known about the growth and effects of foreign investment in the United States? Should the Federal Government assist States which are actively seeking more foreign investment, and if so, how? Has the use of investment incentives to attract new investment increased and what is known about their costs and effects?

GAO asked these questions in connection with foreign direct investment in the United States which reached an estimated $48.5 billion by December 1979. GAO recommends that the Secretary of Commerce:

--Do more to analyze and publish studies on the economic effects of foreign direct investments.

--Provide more support, particularly at U. S. Embassies, to assist the States seeking foreign investments.

--Study the costs and effects of incentives offered by State and local governments to attract foreign investments in order to assist Federal, State, and local authorities to assess their use.

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To the President of the Senate and
the Speaker of the House of Representatives

This report discusses the growth of and concerns over foreign direct investment in the United States, the Federal Government's efforts to assist the States in attracting foreign investment, and the interstate and international competition for investment. We made this review to assess the role of the Federal Government because these matters have received considerable congressional attention.

We are sending copies of this report to the Secretaries of Commerce, State, and the Treasury; the U.S. Trade Representative; the Director, Office of Management and Budget; and to interested individuals and organizations in the public and private sectors.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FOREIGN DIRECT INVESTMENT IN THE UNITED STATES--THE FEDERAL ROLE

D I G E S T

Foreign direct investment in the United States more than tripled in the 1970s, reaching an estimated $48.5 billion as of December 1979. This totals about 25 percent of U.S. direct investment in other countries.

Current Federal and State laws restrict foreign investment in such areas as aviation, coastal shipping, atomic energy, radio and television broadcasting, and mineral development on Federal lands. Proposals for further Federal restrictions were rejected, but legislation was enacted to meet concerns about the lack of information on the nature and effects of foreign investment.

The Commerce Department's Bureau of Economic Analysis gathers data designed to measure investment flows (a component of the U.S. balance of payments) between foreign sources and the United States. This data is not intended for purposes of analyzing foreign direct investments. However, Commerce recognizes the need for such information and has recently expanded its statistical program to obtain more comprehensive data. (See p. 7.)

Responsibility for monitoring and analyzing the effects of foreign direct investment belongs to the Commerce Department's Office of Foreign Investment in the United States. The Office provided some analysis in the Commerce Department's 1976 Report to the Congress on Foreign Direct Investment in the United States. However, it has published little analytic work since that time and the Office has not systematically collected studies by the private sector on foreign direct investment. (See p. 10.)

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RECOMMENDATION

The Secretary of Commerce, in cooperation with the interagency Committee on Foreign Investment in the United States, should place greater emphasis on analyzing and publishing studies on the economic impact of foreign direct investment. More emphasis should also be placed on reviewing and collecting similar studies made by the private sector.

STATE EFFORTS TO ATTRACT FOREIGN INVESTMENT - THE FEDERAL FACILITATING ROLE

Most States actively seek foreign investments, particularly the establishment of new manufacturing facilities and joint ventures with U.S. manufacturers. They seek foreign investment through overseas offices, overseas visits by State officials, and through offering site location assistance and tax, financial, and labor-training incentives.

State and local officials believe they are better able than Federal officials to deal directly with prospective investors and to work out with them the detailed financial, manpower, and logistical matters. They prefer that the Federal Government's role continue to be limited to facilitating State efforts and maintaining a policy conducive to investment, and to avoiding restrictions to foreign entry. State officials believe that Federal officials could do more to help identify investment prospects. GAO agrees. (See p. 17.)

In implementing U.S. policy, the Department of Commerce and officials in U.S. Embassies may facilitate planned foreign investment, but may not promote or attempt to generate interest. The State Department advises its Embassies that promotional activities disrupt market forces while facilitative services provide better knowledge about market opportunities, therefore allowing market forces to function more effectively.

This distinction between facilitative and promotional activities is unclear and has led to a reluctance on the part of some Embassies to provide facilitative services. (See p. 20.)

RECOMMENDATION

The Secretary of Commerce should develop and issue operational guidance on inward investment that encourages the facilitation of State efforts to attract foreign investment. The Secretary should:

- --Designate Embassy commercial officers as focal points to support the States overseas promotional efforts.
- --Require commercial officers to place more emphasis on developing investment leads and furnishing such leads directly to States that request them.
- --Ensure that the Department's facilitative efforts support the needs of Embassy commercial officers, State domestic programs, and foreign visitors who are considering U.S. investments.

INTERSTATE COMPETITION FOR INVESTMENT

Competition among States for investment has resulted in the increasing use of investment incentives. The number of incentives the States offer to attract business increased sharply in the 1960s, leveled off in the early 1970s, and has again shown increases in recent years.

Incentives differ according to each State's view as to their usefulness in attracting investments and the extent to which a State perceives a need to offset the economic disadvantages it has relative to competing States. Incentives include tax exemptions or rebates, assistance in financing the investment, and training prospective employees. Indirect incentives benefit a community as well as the investor and include the construction of roads, sewers, and utilities. An investor's perception that a particular State is a good place to live and work is also viewed by State officials as a factor that influences site selection.

Opinion differs as to whether there should be some restraints on investment incentives for industrial development. GAO believes not enough is known about the costs and effects of incentives. GAO is recommending an approach for obtaining better information on incentives so that Federal, State, and local authorities can assess their use. (See p. 40.)

INTERNATIONAL COMPETITION FOR INVESTMENT

Other nations compete aggressively for new investment but, except for Canada, international competition has not generally affected the United States. Several States compete with Canadian Provinces for new auto investments and the competition has led to increased incentive offers. Both the United States and Canada view the increases as undesirable and are currently negotiating to limit future offers. Coordination with U.S. States and Canadian Provinces is needed to ensure acceptance of whatever ground rules are negotiated. (See p. 48.)

AGENCY COMMENTS

Department of Commerce

The Department of Commerce generally agreed with the findings and thrust of GAO's recommendations. (See app. IV.) It said that, subject to budgetary and personnel constraints, it is taking steps to provide the resources necessary to analyze the economic effects of foreign investment. Commerce also said that it is keenly interested in providing expanded facilitative support directly and through the commercial officers in Foreign Service posts. It plans to examine GAO's recommendations to determine what specific steps can be taken.

Commerce agrees with the need to study the costs and benefits of investment incentives but was reluctant to limit itself to GAO's recommended approach, since tying the analysis to Bureau of Economic Analysis survey data may present confidentiality problems. GAO believes its approach is workable because the cost/benefit analyses would not be obtained through the survey forms but through visits to the companies. GAO also recognizes that there may be other ways to get the information.

U.S. Trade Representative

The U.S. Trade Representative supports GAO's recommendation that the Office of Foreign Investment in the United States place greater emphasis on collecting, making, and distributing studies concerning the economic impact of foreign direct investment. He commented that commercial officers at U.S. Embassies generally are doing a good job but can and should do more to assist States in locating potential foreign investors. He also stated that information about the use and costs of investment incentives would be useful to those making policy decisions. (See app. V.)

Department of the Treasury

The Treasury Department said that the Committee on Foreign Investment in the United States, which is chaired by the Treasury representative, would assist in implementing recommendations dealing with analyzing the economic effects of foreign direct investment and facilitating State efforts to attract such investments. (See app. VI.)

Department of State

The Department of State commented that, under U.S. policy, it does not seek out potential investors but facilitates investment by those who have decided to come to the United States. (See app. VII.) As discussed in chapter 2, U.S. policy discourages Federal promotional action, such as providing special incentives or disincentives which would disrupt the operation of market forces. GAO's review has shown that market forces such as demand for a product or service, transportation costs, labor rates, and availability of raw materials largely determine investment locations. (See p. 34.) GAO believes, therefore, that attempts to identify additional investment opportunities would complement the functioning of market forces.

C o n t e n t s

ABBREVIATIONS

GAO	General Accounting Office
OECD	Organization for Economic Cooperation and Development
OFIUS	Office of Foreign Investment in the United States

CHAPTER 1

FOREIGN DIRECT INVESTMENT

GROWTH AND CONCERNS

The United States has become increasingly attractive to foreign investors. Generally, the Federal Government and State governments welcome foreign direct investment, 1/ such as new manufacturing facilities and joint ventures with U.S. firms, because it offers substantial economic benefits.

The foreign direct investment position grew in the 1970s to an estimated $48.5 billion as of December 1979. This increase was accompanied by congressional and public concern which resulted in several proposals to control the flow of inward investment. Congressional and executive agency examinations of these proposals indicated that more information was needed on the nature and effects of foreign direct investment but did not indicate a need for further restrictions.

The Commerce Department's Bureau of Economic Analysis gathers data designed to measure direct investment flows (a component of the U.S. balance of payments) between foreign sources and the United States. This data is not intended for purposes of analyzing foreign direct investments. However, Commerce recognizes the need for such information and has recently expanded its statistical program to obtain more comprehensive data. Its Office of Foreign Investment in the United States (OFIUS) has primary responsibility for analyzing the effects of foreign direct investment; however, it has completed and published few analytic studies since 1976 and needs to improve in this area.

GROWTH AND COMPOSITION OF INVESTMENTS

The foreign direct investment position grew slowly, from about $7 billion in 1960 to $13.3 billion in 1970 and to $20.6 billion by 1973. Sample surveys conducted by the Bureau of Economic Analysis show that foreign direct investment has doubled since 1973, totaling $40.8 billion by the end of 1978, and preliminary estimates show an increase to $48.5 billion as of December 1979, as shown in the following table.

1/ Investment resulting in 10 percent or greater foreign ownership; portfolio investments involve less than 10 percent ownership.

Year	Cumulative amount (billions)	Percent of increase
1973	$ 20.6	
1974	25.1	21.8
1975	27.7	10.4
1976	30.8	11.2
1977	34.6	12.3
1978	40.8	17.9
1979 (estimated)	48.5	18.9

Foreign direct investment in the United States totals about 25 percent of U.S direct investment in other countries. In 1978, for example, the outflow of U.S. direct investment abroad was about $16.7 billion, more than twice the $6.2 billion inflow of foreign direct investment. Also, the size of foreign direct investment is small in relation to the size of the U.S. economy. The Treasury Department estimates that in 1977 firms with 10 percent or greater foreign ownership accounted for only about 2.6 percent of the total value of U.S. output.

OFIUS reported that during 1977 and 1978 acquisitions and mergers were the leading forms of investment activity. In 1978 they accounted for 33 percent of the completed cases and 53 percent of the reported investment values while new plant construction and expansions accounted for 13 percent and 9 percent, respectively.

Completed Transactions in 1978

	Total all forms	Acquisitions and mergers	Equity increases	Joint ventures	Plant construction or expansion	Real Estate	Other
Total cases	677	225	36	26	85	149	156
Cases with value known	334	125	30	12	49	106	12
Value in millions	$6,059	$3,190	$854	$167	$551	$1,170	$127

Appendix I lists the more significant completed and pending foreign investments made since 1977.

Of the total $40.8 billion in foreign investments reported by the Bureau of Economic Analysis at the end of 1978, $16.3 billion was concentrated in manufacturing industries (principally chemicals, metals, and machinery); $8.9 billion in wholesale and retail business (e.g., electrical goods and food suppliers); and $7.9 billion in petroleum (exploration, extraction, and transportation). Investments in these three sectors increased by 16, 23, and 20 percent, respectively, from 1977.

A 1979 study 1/ showed that foreign-owned manufacturers have located primarily in the Eastern United States (the Northeast, Middle Atlantic, and Southeast) and in a few other States, such as California and Texas. The Southeastern States, in particular, experienced a very noticeable and significant surge of foreign direct investment in the 1970s. South Carolina, for example, reported that 30 percent of its direct investment during 1977 and 1978 was from foreign sources and that foreign investment was running at 36 percent of total investment during the first six months of 1979.

The United States is second only to Canada as a host country for foreign direct investment. Between 1970-78 the list of countries comprising prominent foreign direct investors in the United States has changed only slightly. Of the seven countries which account for about 83 percent of the total value of foreign direct investment, the Netherlands, the United Kingdom, and Canada have been the most prominent as shown below.

Country	Investment at the end of 1978 (billions)	Percent of total investment
Netherlands	$9.8	24
United Kingdom	7.4	18
Canada	6.2	15
West Germany	3.2	8
Switzerland	2.8	7
Japan	2.7	6
France	1.9	5

1/ Arpan, Jeffrey S. and Ricks, David A., Directory of Foreign Manufacturers in the United States, Publishing Services Division, College of Business Administration, Georgia State University, Atlanta, Georgia, 1979.

In recent years, Japanese, Dutch, and West German investments have shown the greatest rate of growth. From 1976 to 1978, Japanese investments increased about 125 percent, from $1.2 billion to $2.7 billion; Dutch by 56 percent, from $6.3 billion to $9.8 billion; and West German by 52 percent, from $2.1 billion to $3.2 billion. According to Commerce Department figures, direct investments by members of the Organization of Petroleum Exporting Countries account for $325 million, less than 1 percent of the 1978 total.

WHY FOREIGNERS INVEST IN THE UNITED STATES

Foreign investors are attracted to the United States for some or all of the following reasons.

--It is the largest single homogeneous market and one of the most open and accessible to foreign investments.

--It is more free from governmental economic controls and is politically more stable than most other countries.

--It has technological, managerial, and marketing leadership in many fields, along with extensive research and development capabilities.

--European investors are wary of the growing militancy of labor in Europe.

--Foreign firms, such as the Japanese, want to protect themselves from growing protectionist sentiments toward rapidly increasing imports.

--The depreciation of the dollar in relation to the currencies of many investing countries has lowered the cost of investing in the United States while increasing the costs to U.S. buyers of imported products.

--The depressed U.S. stock market of the past several years makes foreign acquisition of U.S. companies less expensive.

--The gap in labor costs between the United States and its developed trading partners is narrowing; in some cases, foreign labor costs are greater.

THE U.S. MARKET HAS FEW RESTRICTIONS

Generally, foreign direct investment, such as new manufacturing facilities and joint ventures with U.S. firms is welcomed because it offers substantial benefits and contributes to U.S. economic development. Benefits can include increased tax revenues, jobs, productive capacity, research and development, and new technology. Some investments lead to expanded exports and capital inflows which help the U.S. balance of payments and strengthen the dollar. Added investment and increased competition in the industries penetrated by foreign investment can also help to reduce the effect of inflation on the prices such industries charge their customers.

The United States does not restrict remittances of profits, interest, and royalty payments or repatriation of capital. However, like many countries, the United States limits or prohibits foreign direct investments in specific national interest sectors, such as aviation, coastal shipping, atomic energy, radio and television broadcasting, and mineral development on Federal lands. The Commerce Department reports that 25 States have some limits on foreign ownership of land and 40 States limit foreign banking operations.

Foreign firms operating in the United States are subject to the same laws and regulations as U.S. firms. For example, foreign firms are subject to antitrust, environmental protection, and worker safety legislation and to the requirements of the Securities and Exchange Commission. Exports of most commercially available commodities are regulated by the Secretary of Commerce under authority of the Export Administration Act of 1979, which states that controls may be used to (1) protect the national security, (2) further foreign policy, or (3) prevent excessive drain of scarce materials.

LEGISLATIVE AND ADMINISTRATIVE RESPONSES TO FOREIGN INVESTMENT INCREASES

The rise in foreign direct investment in the United States since 1973 led to increased public and congressional concern as to the extent and effects of foreign investment. The result was a number of legislative proposals to further prohibit, curb, or regulate foreign investment.

In studying these proposals, the administration saw no basis for modifying existing policy and it opposed additional restrictions. Congressional examination generally supported this position but revealed a lack of detailed information regarding the nature and effects of foreign direct investment in the United States.

Recent legislation includes:

--The Foreign Investment Study Act of 1974 (Public Law 93-479), which directed the Secretaries of Commerce and the Treasury to conduct a comprehensive overall study of foreign direct and portfolio investment in the United States. This resulted in the 1976 Commerce benchmark study on foreign direct investments and a Treasury benchmark study on portfolio investments.

--The International Investment Survey Act of 1976 (Public Law 94-472), which directed the President to set up a regular and comprehensive data collection program on foreign investment, and to conduct benchmark surveys of direct and portfolio investment at 5-year intervals.

--The Domestic and Foreign Investment Improved Disclosure Act of 1977 (Public Law 95-213, title II), which requires expanded disclosure to the Securities and Exchange Commission of beneficial owners of more than 5 percent of specified kinds of securities.

--The International Banking Act of 1978 (Public Law 95-369), which regulates some of the activities of foreign-controlled banking in the United States.

--The Agricultural Foreign Investment Disclosure Act of 1978 (Public Law 95-460), which established a nationwide system for monitoring current agricultural landholdings and future U.S. farmland purchases by foreigners and requires the study and analysis of the effects of these purchases on U.S. agriculture.

In response to continued congressional interest, GAO has issued 13 reports concerning foreign investment in the United States. Appendix II lists these reports.

To oversee monitoring of the effects of foreign investment and to coordinate the implementation of U.S. policy for such investment, the President established in 1975 an interagency Committee on Foreign Investment in the United States. The Committee's responsibilities are to (1) arrange for analyses of trends and significant developments of foreign investment, (2) provide guidance on arrangements with foreign governments for advance consultation concerning their major investments in the United States, (3) review investments which might have major implications for U.S. national interests, (4) consider proposals for new legislation or regulations, (5) submit, as necessary, recommendations to the National Security Council and the Economic Policy Board, and (6) arrange for the preparation and publication of periodic reports. The Committee is currently composed of representatives from the Departments of Treasury, State, Defense, and Commerce; the Office of the U.S. Trade Representative; and the Council of Economic Advisors, with the Treasury representative as chairman.

The Department of Commerce established the Office of Foreign Investment in the United States in 1975 to (1) develop a consistent and timely data collection and processing system on foreign direct investment in the United States, (2) evaluate and report on the impact of foreign direct investment, and (3) prepare reports for publication.

CURRENT FOREIGN DIRECT INVESTMENT FIGURES SHOULD BE QUALIFIED

The Bureau of Economic Analysis and OFIUS both collect information on foreign direct investment in the United States. Information published by OFIUS on individual transactions includes the type of transaction (i.e., new plant construction and expansion, acquisition, merger, joint venture), country of the investor, and amount when known. Because OFIUS relies on published sources, such as newspapers and filings with Federal agencies to obtain data for its releases on foreign transactions, the investment value is not always known. For example, OFIUS obtained values for only about half the transactions it identified in 1978. Also, OFIUS does not verify the value of the transactions beyond the published source.

The direct investment position data currently used to identify the total value ($40.8 billion at the end of 1978) and source of foreign direct investment is gathered by the Bureau of Economic Analysis. It collects data through confidential surveys and publishes the information in aggregate form.

The Bureau of Economic Analysis gathers data designed to measure direct investment flows (a component of the U.S. balance of payments) and the direct investment position between foreign sources and the United States. The investment flow includes capital invested in, loans made to, and earnings reinvested in the U.S. affiliate. The resulting position figures represent direct claims of the foreign firm on its affiliate. This data is not intended to provide information for analyzing such things as the total asset value of U.S. companies with foreign direct investment. For example, if a U.S. affiliate expanded its manufacturing facilities and financed half of the expansion with funds from its foreign parent and half with funds borrowed in U.S. capital markets, the Bureau's figures would reflect only that amount financed by the foreign parent. Because increases in a U.S. affiliate's assets may be financed in a variety of ways, some of which do not affect the direct investment position, current foreign direct investment figures are lower than the actual value of assets controlled by U.S. affiliates.

Also, Commerce information does not always identify the ultimate or beneficial owner. The Bureau's records show an affiliate's ownership by the country of first foreign parent outside the United States in a foreign chain of ownership and, in some instances, this differs from the beneficial owner. For example, the first foreign parent may be a holding company or otherwise acting as an intermediary for owners in another country or countries. Bureau officials do not know the extent to which this occurs, but they believe a large portion of investments attributed to the Netherlands Antilles, Panama, and Bermuda (and, to a lesser extent, the Netherlands and Switzerland) represent investments owned beneficially by residents of other countries.

Commerce officials recognize the need for more comprehensive information on the value and source of foreign direct investment and have taken some steps to obtain it through the new BE-15 1/ and BE-13 2/ survey forms. The BE-15 must be

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1/ Interim Survey of Foreign Direct Investment in the U.S.

2/ Report on a Foreign Person's Establishment, Acquisition, or Purchase of the Operating Assets of a U.S. Business Enterprise, Including Real Estate.

filed by existing U.S. affiliates and is intended to partially update the 1976 Commerce Department benchmark study of foreign direct investment. The first BE-15 mailing in November 1978 went to 1,700 U.S. affiliates of foreign firms and requested 1977 financial and operating data on such things as, the affiliate's size, number of employees, domestic and foreign financing, export and import volume, property, plant, and equipment. The BE-15 does not attempt to collect beneficial ownership information, but Commerce plans an extensive benchmark survey covering 1980 or 1982 operating data that will attempt to identify the beneficial owners of existing firms.

The Bureau expects to publish results from the first BE-15 mailing in the spring of 1980, followed by a report in the fall that will be based on 1978 data. Subsequently, the Bureau plans to report BE-15 data annually.

The BE-13 must be filed no later than 45 days after a U.S. business has been established or acquired by a foreign person or existing U.S. affiliate of a foreign person. The BE-13 will identify the amount, location, type, financial structure, and beneficial owner for each transaction. Bureau officials are relying on the U.S. affiliate to identify the beneficial owner because they are unsure whether they have the legal authority to get the information from outside the United States. The officials believe, however, that a newly established affiliate would know its beneficial owner.

The BE-13 is required to be filed for affiliates established on or after January 1, 1979, and Commerce expects to publish the first results by November 1980. Subsequently, results will be reported at least annually. Data from the BE-13 will also be used by OFIUS in a manner consistent with confidentiality requirements.

SOME REMAINING CONCERNS

Congressional concerns remain on the need for better monitoring and analysis of foreign investment. In a series of hearings, the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, is examining the adequacy of Federal efforts to monitor, evaluate, and formulate policy on the effects of foreign investments in the United States. The Subcommittee's concerns include the:

--Duplication of monitoring efforts and the need for increased sharing of information on foreign investments, particularly among Commerce's

Bureau of the Census and Bureau of Economic Analysis, and the Internal Revenue Service.

--Gaps in Federal foreign investment data collection, such as (1) the absence of foreign ownership information in data gathered between 1970-78 by the Securities and Exchange Commission, and (2) serious gaps in the Bureau of Economic Analysis reporting system.

--Need for improved identification of beneficial ownership, i.e., identifying the ultimate controlling interest in an investment.

--Need for a substantially more active role by the interagency Committee on Foreign Investment to (1) identify significant issues resulting from foreign investments, (2) arrange for analyses of these issues and recommend solutions, (3) improve ongoing data collection efforts, and (4) review those investments having "major implications for the national interest".

--Need for improved publicizing of the requirement to complete Form BE-13.

We share the Subcommittee's concern on the need to better analyze how foreign direct investments affect the United States. OFIUS provided some analysis for Commerce's 1976 Report to the Congress on Foreign Direct Investment in the United States, but it has published little information on the economic impact of such investments since that time. For example, its studies on market share and employment effects of foreign investment in four basic industry areas have been long in preparation. The first, Foreign Direct Investment in the U.S. Chemical Industry, was published in January 1980. Also, the Office contracted three years ago for a study of foreign investment and technology transfer which is due for completion in June 1980. OFIUS has not clearly defined what areas it plans to address in the future.

Moreover, while OFIUS maintains some academic contacts and is consulted by private researchers, it has not systematically collected studies on foreign direct investment being made by the private sector. For example, we identified studies not available at OFIUS on such subjects as (1) reasons why foreigners invest in the United States, (2) decisions of foreign investors to locate in particular areas, (3) employment effects of foreign direct investment, and (4) effects on the U.S. balance of payments of foreign direct investment.

OFIUS officials told us that their analytic efforts were impeded because of a lack of staff and because no research director is authorized for the Office. In fiscal year 1980, OFIUS has allocated 11 positions and $386,500 for monitoring foreign investment and 7 positions and $396,600 for research and analysis.

We discussed with OFIUS officials several areas of study which had surfaced in congressional testimony and in our discussions with individuals knowledgeable in foreign investment matters. The officials concurred on the desirability and feasibility of studying

--borrowing patterns of foreign firms for expansions, new establishments, and acquisitions;

--productivity and growth trends of foreign firms;

--trade patterns between a foreign parent and its U.S. affiliate; and

--costs and benefits of providing Federal, State, and local investment incentives.

CONCLUSIONS

If Commerce is successful in its attempts to obtain more information on beneficial owners and the extent of foreign direct investment in the United States, it will permit improved analysis of investment trends and implications.

We believe that Commerce should place more emphasis on analyzing and publishing studies on the economic impact of foreign direct investment. By doing this, it can keep the public adequately informed about foreign investment activity and the administration, the States, and the Congress can determine whether there are policy issues that need to be addressed.

RECOMMENDATION

We recommend that the Secretary of Commerce, in cooperation with the interagency Committee on Foreign Investment in the United States, place greater emphasis on analyzing and publishing studies on the economic impact of foreign direct investment. More emphasis should also be placed on reviewing and collecting analytic studies made by the private sector.

AGENCY COMMENTS

The Department of Commerce agrees with the importance of and need for analyzing the economic effects of foreign direct investment and said it is taking steps to provide the necessary resources as promptly as budgetary and personnel constraints permit. (See app. IV.)

In our draft report, we said that since the Bureau of Economic Analysis figures are intended to measure the U.S. balance-of-payments position, they understate the total value of foreign direct holdings in some cases. Our point was that the Bureau's figures, for example, would not necessarily reflect the value of the holdings measured by assets. Commerce correctly noted that the Bureau of Economic Analysis direct investment position data is designed to measure the value of direct claims on U.S. business enterprises by foreign direct investors. Commerce commented, however, that there are other ways to measure foreign investment, e.g., the total assets of foreign controlled enterprises. As discussed in this chapter, Commerce recognizes the need for such information in analyzing foreign direct investment and plans to obtain it through additional surveys.

The United States Trade Representative agreed that more information is necessary about the nature, extent, and effects of foreign direct investment and that OFIUS should provide some of that information. (See app. V.)

The Department of Treasury stated that the Committee on Foreign Investment in the United States, which is chaired by the Treasury representative, would assist in implementing recommendations dealing with analyzing the economic effects of foreign direct investment. (See app. VI.)

CHAPTER 2

STATE EFFORTS TO ATTRACT FOREIGN INVESTMENT-

THE FEDERAL FACILITATING ROLE

The States actively seek foreign direct investments leading to increased employment and would prefer that the Federal Government's role continue to be limited to facilitating their efforts. We agree with the States views, because State and local officials are better able to deal directly with prospective investors and to work out with them an investment's financial, manpower, and logistical details.

The Federal Government generally assists the States to attract new investment. However, it could do more, particularly through U.S. Embassies. More positive operational guidance would be helpful to encourage the Embassies to place greater emphasis on providing investment leads and assisting the States to follow up with prospective investors. The focal point for such efforts should be Embassy commercial officers who, under the President's reorganization plan, were recently transferred from the Department of State to the Department of Commerce. Some increased support by the Department of Commerce in Washington may also be needed.

STATES ACTIVELY SEEK FOREIGN DIRECT INVESTMENT

Most States aggressively pursue foreign investments just as they pursue investments from domestic sources. We sent a standardized questionnaire to the 50 States and Puerto Rico inquiring about State policy toward foreign direct investment and Federal assistance to State programs to attract it. Thirty-five States and Puerto Rico 1/ responded that they strongly encourage 2/ foreign direct investment in most areas, 12 said they mildly encourage it, and only 3 were neutral or had no specific policies to encourage it. (See app. III, question 1.)

1/ In future references to questionnaire results, Puerto Rico is included in the State data.

2/ We defined "encourage" as providing promotional information, assisting in site location, arranging financial assistance, or training and recruiting employees.

States particularly encourage investments that create or maintain a substantial number of new jobs. For example, over 90 percent of the responding States mildly or strongly encourage new manufacturing facilities, joint ventures, and licensing agreements with U.S. manufacturers. About 80 percent encourage acquisition of existing but ailing manufacturing facilities. (See app. III, question 10.)

About half the responding States discourage foreign acquisition of agricultural land. As of May 1978, 25 States placed some restrictions on foreign ownership of agricultural land, and 9 of the 25 prohibit or place major restrictions on foreign ownership.

States treat foreign and domestic investors equally in terms of investment assistance. In recognition of the growing interest that foreign investors have shown in the United States, many States have increased their efforts to attract them. In the last 10 years, 36 States began budgeting funds to attract foreign investment, with 15 beginning in the last 3 years. Average annual State administrative expenditures for salaries, travel, and other operating costs to attract foreign investment were approximately $245,000 in fiscal year 1978. Five States reported annual expenditures of $500,000 to $1 million. Forty-three States expect moderate or substantial growth in their programs to attract foreign investment. (See app. III, questions 2, 5, and 30.)

HOW STATES ENCOURAGE FOREIGN INVESTMENT

State programs to attract foreign investment reduce uncertainty on the part of the foreign investor considering a U.S. investment, generate investor interest, and assist the investor. All three factors are designed to convince a firm, first, that the United States is a good place to invest and, second, to locate in a particular State.

The majority of the States have international groups within their economic development or commerce departments whose functions are to increase exports by businesses in the States and to encourage foreign direct investment into the States. State agencies encourage foreign investments through overseas offices, investment missions and seminars, financial incentives, and site selection assistance.

Overseas offices

As of June 1979, 33 States were represented in foreign countries by about 43 State offices, regional economic development commissions, and consultants. State programs to attract investment are also assisted by port authorities which, as of January 1979, had 11 European offices. Also, regions within a few States have opened their own offices; e.g., the Northeast Pennsylvania office in Switzerland. At least four States are seriously considering opening new or additional foreign offices. Many State development officials consider foreign offices essential to success in attracting foreign investments.

States' offices are concentrated in Europe and Japan, the most likely sources of new investment. Twenty-one States and the Old West Regional Commission representing Montana, Wyoming, Nebraska, and North and South Dakota have offices in Europe. Seven States and the Pacific North West Regional Commission representing Washington, Oregon, and Idaho have offices in Japan and at least three more States are represented there by consultants.

States' offices promote trade, investment, and tourism and employ as few as one to as many as six persons to encourage investment. These offices locate and establish contacts with prospective investors, provide basic information on the geographic or economic advantages of their States, and encourage and arrange visits to their States. Prospective investors are located through personal contacts, advertising in foreign business publications, U.S. Embassy referrals, and investment conferences and seminars.

Investment missions and seminars

States conduct investment missions to generate investor interest. An investment mission typically involves visits to foreign countries by a delegation of a State's public and private officials and may include such top-level officials as the governor.

Investment seminars bring State representatives and prospective investors together to discuss issues of common interest. In the past, investment seminars have been sponsored by some U.S. Embassies, the Department of Commerce, and such interest groups as the National Association of State Development Agencies.

In 1977 and 1978, States reported that they participated in 142 investment missions and seminars, 113 sponsored by individual States; 19 by cities, regional development groups, or interest groups; and 10 by the Federal Government. (See app. III, question 9.)

Financial incentives

States' financial incentives to investors can take many forms, including financing through loans or loan guarantees, tax exemptions, training programs, and sales of industrial sites and buildings at less than market value. Some incentives may be tied in to locating within economically disadvantaged areas. However, most financial and tax incentives are available to an investor regardless of where he locates within a State, and many States offer the same or similar incentives. State and local officials usually attempt to locate investors at a site within the State that best meets the investor's needs. Chapter 3 discusses the types of financial incentives provided to businesses.

Site selection assistance

For an investment that will create new jobs, a State is usually prepared to provide a wide range of services to assist the investor's location decision. Besides providing general statistics, States can offer (1) customized studies on markets, transportation systems, energy availability, labor rates, and public services, (2) advice on State and Federal tax and regulatory requirements, and (3) details on available sites. State developers will also arrange meetings with bankers, utility companies, lawyers, etc., to answer more detailed questions. If a prospective investor visits the State, he can expect to be provided with transportation when he enters the United States and to be taken to available sites in a plane or helicopter, mobile camper, or automobile. State officials may also help investors to arrange financing and to obtain necessary permits once an investment decision has been made. Not all States provide these specialized services due to budget limitations but, for those that do, the personal touch is considered important in convincing an investor that his investment is welcomed.

It usually takes several years from the time a foreign business first considers a U.S. investment until a location is selected. For example, Volkswagen established a team to consider a U.S. investment in 1973 but did not select a plant site in Pennsylvania until 1976, and production did not begin until 1978. After a firm selects a site, State and local officials assist in recruiting, training, and hiring employees and resolving problems as they arise. In most cases, the investor's needs are specific to his business and to the community in which he will locate and require an indepth knowledge of local factors.

STATES FAVOR LIMITED FEDERAL ROLE

State development officials perceive the Federal role to be a limited one. According to the development officials in the States we visited, the Federal Government should help the States to attract foreign investment rather than adopting a lead role. States are reluctant to have the Federal Government involved in helping investors decide where to locate, as they view this as a State perogative. State and local officials doubted whether a Federal agency could make a practical contribution in the industrial location process and thought they were better able to devote the necessary time and provide the specifics required.

A wide range of assistance is also available from the private sector. For example, investment banking firms usually work with large companies and can arrange financing, help to locate U.S. partners, arrange introductions, assist in negotiations, and provide overall policy and strategic advice. Several U.S. management consulting firms specialize in assisting foreign businesses and provide such services as identifying and recommending available sites and analyzing labor, tax, and market conditions. Local groups, such as Chambers of Commerce, may also assist in plant location.

We agree with the States that the most effective Federal approach to attracting foreign investment is to facilitate States efforts. State officials believe this can be done by maintaining a policy that is conducive to investment and by avoiding restrictions on foreign entry. They also believe that Federal officials, particularly at the U.S. Embassies, could assist in the early stages of the investment decision process by helping to identify investment prospects.

LIMITED FOREIGN USE OF FEDERAL FINANCIAL ASSISTANCE

The limited Federal role is also evident because foreign investors currently seem to make little use of Federal financial assistance programs intended to encourage investment. These Federal programs include:

--Commerce's Business Development Assistance Program (Economic Development Administration), which offers financial assistance to private firms to establish, expand, or maintain operations in distressed areas. Assistance may take the form of direct loans or loan guarantees for fixed assets or working capital.

--Agriculture's Business and Industrial Loans Program (Farmers Home Administration), which guarantees loans to businesses that create and maintain employment in rural areas. Loans may be used for business and industrial acquisition; construction or repairs; purchase of land, machinery, or equipment; and start-up and working capital, among other things.

--The Housing and Urban Development Department's Urban Development Action Grant Program, which makes grants to private companies that have firm commitments to provide jobs and bring about urban revitalization. Projects eligible for assistance are rehabilitation of existing structures, acquisition of land, and construction of new facilities to retain industry in a declining area, and construction of streets, sewers, etc., to support private firms.

These agencies do not systematically monitor how much assistance goes to foreign firms, but States officials explained that Federal programs are usually targeted to disadvantaged population sectors or geographic areas, both of which have had limited appeal to foreign investors. Also, Federal funds are usually designed to serve as funds of last resort and foreign investors are generally well enough financed not to require them. A recent report prepared for the Department of Housing and Urban Development stated:

> "It appears that (foreign) investors favor the more economically healthy and growing areas of the country as sites for new plants. When foreign investment does occur in distressed areas, it is more often in the form of acquisition of existing firms rather than creation of new ones."

Some forms of Federal financial assistance indirectly benefit business. Federal funds go to local governments, which combine them with their own resources to enhance the overall economic attractiveness of the community, thus providing an incentive to industry in general. General improvements might include the development of mass transit, water, and sewer systems; access roads; hospitals; and energy or utility projects. The Economic Development Administration provides local governments with grants and loans for improving infrastructure in communities where plants have been shut down and for technical planning assistance.

U.S. POLICY TOWARD INWARD INVESTMENT

The present U.S. policy toward direct international investment was stated in July 1977 following a formal review by a task force of the Economic Policy Board, the administration's top policymaking body for economic issues. Their statement concluded that:

> "The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward flows or activities.
>
> "The Government therefore should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest."

The Board based the policy statement on the following premises.

> "--First, international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces.
>
> "--Second, there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest.
>
> "--Third, unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments with adverse effects on the U.S. economy and U.S. foreign policy.

"--Fourth, the United States has an important interest in seeking to assure that established investors receive equitable and non-discriminatory treatment from host governments."

Statements by executive department officials affirm that foreign investment is welcomed. For example, the Assistant Secretary of the Treasury for International Affairs stated in June 1979, "In sum, our posture toward inward investment is quite positive--we have an open door and the welcome mat is out * * * ." The former Assistant Secretary of Commerce for Industry and Trade stated in June 1979:

> "Perhaps the needs of our economy are such that we can no longer afford to be 'neutral' on inward investment. Perhaps now is the time, with productivity declining, capital in short supply, and our balance of payments in deficit, to take advantage of the benefits offered by foreign investors. Maybe our next move should be toward a policy of 'positive neutrality,' in which we, as a government, genuinely encourage foreign investment in the U.S."

NEED TO IMPROVE THE FEDERAL FACILITATING ROLE

In implementing U.S. policy, the Department of Commerce and the U.S. Embassies may facilitate planned foreign investments, but may not promote or attempt to generate interest in making U.S. investments. The State Department advises its Embassies that promotional activities may disrupt the operation of market forces, while facilitative services provide better knowledge about market opportunities and, therefore, allow market forces to function more effectively. We believe the distinction between facilitative and promotional activities is unclear and has led to a reluctance to provide facilitative services.

Current facilitative support by U.S. Embassies

Embassy commercial officers are frequently a first point of contact for foreign businessmen considering U.S. investments. For example, a prospective investor may ask about relevant U.S. laws and regulations, market opportunities in connection with establishing a U.S. subsidiary, U.S. joint venture partners, or U.S. firms interested in producing under licensing arrangements.

When inquiries are received, a commercial officer's primary responsibility is to refer investment prospects to U.S. States for further assistance. The details of the inquiries are forwarded to the Department of Commerce, which in turn notifies each State development office. In Europe, inquiries are also referred to the Embassy in Brussels, which then notifies the States representatives in Europe.

Some Embassies have arranged investment seminars that bring States representatives and foreign businessmen together. For example, the Embassy in Germany regularly arranges seminars where representatives from German business firms and U.S. States discuss trade and investment opportunities and other topics of mutual interest. The Embassy in Switzerland has also been active in arranging investment seminars.

The States overseas representatives were generally complimentary of the support provided by Embassies, but some thought that the quality of support varied considerably from country to country. Embassy commercial officers and the States development officials told us that the inconsistent support stems from differing interpretations of U.S. policy, which does not clearly distinguish between facilitative and promotional activities. A reluctance to engage in what might be considered promotional activities has inhibited the support some Embassies provide to States.

Embassies have also assigned a low priority to helping States attract investment. In December 1978, the Embassy in London noted that, in accordance with the neutral policy toward reverse investment, it was devoting limited resources to facilitating efforts to attract investment. Other Embassy officials in Europe also indicated that reverse investment commanded a low priority in relation to their other functions, even though some had helped States on their own initiative. Our review of Country Commercial Programs 1/ for fiscal year 1980 showed that reverse investment activities received very low priority by most Embassies; in some Embassies, including those in France and Italy, reverse investment activity was not even listed as a function.

1/ Internal planning documents, developed jointly by the Departments of State and Commerce, which cover Embassy activities for individual countries. We looked at the programs for Austria, Belgium, France, Germany, Italy, Japan, the Netherlands, and Sweden.

Opportunities for improved Embassy support

Under the President's reorganization plan, about 160 commercial officer and 490 foreign national staff positions in 65 countries were transferred in April 1980 from the Department of State to the Department of Commerce. As presently defined, the primary function of commercial officers will be to promote U.S. exports. At the time of the transfer, responsibilities for assisting inward investment were not clearly defined. We believe the transfer provides a good opportunity to upgrade the facilitative services that commercial officers provide.

Developing investment leads

The States are currently alerted when investment inquiries are made, but commercial officers do not solicit inquiries or otherwise attempt to identify investor interest. A 1977 report by the Council of State Governments concluded that Federal-State cooperation could be improved if commercial officers were authorized to inform the States representatives upon request of known local interest in U.S. trade or investment opportunities.

As part of their normal duties, commercial officers and their foreign national staffs, as well as economic officers and other Embassy employees, are likely to make contacts with investment prospects who might not initiate investment inquiries. For example, the States development officials and bankers in Europe stated that many small to medium-sized firms are either not aware that U.S. investments would be to their economic advantage or they are awed by the large U.S. market. Commercial officers in Germany and Belgium agreed that they could provide leads of this type if directed to do so. One approach would be to have States register with Embassies in countries where they were seeking investment, and leads obtained by Embassy officials would be sent directly to these interested States.

Commercial officers should concentrate on identifying the leads sought by States. Examples include investments in new U.S. manufacturing facilities, joint ventures with U.S. firms, and licensing agreements which allow U.S. firms to produce a foreign company's product. Foreign firms which currently export to the United States would be candidates to produce in the United States. The Council of State Governments estimates that any business which exports 25 percent or more of its total output to the United States is a prime investment candidate.

Hosting investment seminars

Investment seminars were highly regarded by the States representatives and foreign investors as an effective method of identifying investment prospects. Some Embassies have been reluctant to host seminars and prefer that groups, such as banks or consulting firms, take the lead, apparently to avoid the appearance of promoting investment. Many U.S. and States officials believe the seminars would be more effective if the U.S. Government could lend its name to the proceedings and provide an overview of U.S. investment policies and programs. We see no need for Embassies to incur costs other than for staff time in sponsoring seminars, as interested States are generally willing to pay for these seminars.

Improving commercial officer understanding of States investment interests

Eleven of the 15 States we spoke with agreed that Embassy commercial officers would gain a greater understanding of trade and investment interests at the State level if allowed to make short visits to the States development offices in the United States. The visits could be made in connection with home leave or prior to overseas reassignments.

Commerce Department's role

The Department of Commerce has historically provided investment assistance at the Federal level through its Invest in the USA program, which maintains contact with the States, foreign investors, the U.S. business community, and U.S. Embassies. Because U.S. policy discourages promotional activities and because States have the primary role in encouraging foreign investment, Commerce's program has remained small, consisting of a staff of three and an annual budget of $100,000.

Nevertheless, Commmerce offers a number of useful services by:

--Counseling potential foreign investors about the overall advantages and opportunities of investing in the United States and supplying interested parties with requested information on foreign investment by telephone or mail or through meetings.

--Arranging contacts for investors with private individuals, banks, and the States development agencies.

--Helping States to prepare for investment missions abroad by briefing them on the types of information that foreign investors would be seeking (e.g., how to establish new markets, costs of plant and equipment, availability of labor and raw materials, and costs and availability of financing) and, through the Department of State, arranging visits with Embassy officials.

--Making presentations at investment seminars and conferences concerning the Federal role in foreign investment.

--Advertising in its Business America magazine when a foreign firm seeks a U.S. partner to manufacture a product jointly or through a licensing agreement. This information is also passed on to pertinent industry associations or, when possible, directly to the specific companies. Also requests by U.S. companies for joint ventures or licensing agreements are sent to U.S. Embassies in industrialized countries.

--Coordinating investment activities with U.S. Embassies and providing information and assistance when requested.

The extent of the States contacts with Commerce varies, but States that have worked with Commerce were generally appreciative of its efforts. When asked how often they contacted the Invest in the USA Office in connection with efforts to encourage foreign direct investment, 15 States reported frequent contacts, 22 States reported occasional contacts, and 13 States reported few, if any, contacts. (See app. III, question 28.) Of the 15 States reporting frequent contacts, 8 said that Commerce had greatly assisted their efforts to attract foreign investment and 7 said that they and Commerce worked smoothly together and Commerce sometimes helped them to encourage foreign investment.

The National Association of State Development Agencies, a Washington interest group which represents 42 States, wants Commerce to continue helping States to attract foreign investment. The Association disagreed when Commerce cut back its investment assistance activities in 1976 and 1977, and in March 1978 asked Commerce to increase its help to States. It suggested for example, that Japanese executives needed more information about U.S. investment opportunities, attitudes, and requirements.

A participant in the President's Executive Exchange Program recently reviewed Commerce's investment assistance program and, in a November 1979 memorandum, concluded that reverse investment was not being effectively addressed in the reorganization of Commerce's trade functions. He added that, unless the investment assistance program was upgraded, strengthened, and properly placed organizationally, Commerce might lose influence in what has become a very major trade issue. He recommended that Commerce (1) make a firm and lasting commitment to a program capable of comprehensively servicing foreign investment inquiries, (2) grant the modest staff increases requested by the program's director, (3) provide appropriate office space for discussing large investments in a reasonably comfortable atmosphere, and (4) place more importance on the program by assigning it to a higher organizational level within the Department. We would agree that these recommendations deserve consideration by the Department of Commerce.

CONCLUSIONS

The Federal Government's role in attracting foreign investment into the United States is limited for several reasons. U.S. policy discourages Federal promotional activities that would disrupt the operation of market forces. States actively pursue foreign investments on their own and are best able to assist in the specifics required to make an investment location decision.

We concur with the States view that the Federal Government's role should continue to be limited to facilitating States efforts. We believe, however, that the Federal Government could improve its facilitative support which, in some instances, has been inhibited by an unclear distinction between promotion and facilitation. More positive operational guidance would be helpful to encourage the Embassies to place greater emphasis on providing investment leads and assisting the States to follow up with prospective investors. Some increased support by the Department of Commerce in Washington may also be needed. The focal point for assisting the States should be Embassy commercial officers who, under the President's reorganization plan, are now Department of Commerce employees.

RECOMMENDATIONS

We recommend that the Secretary of Commerce develop and issue operational guidance on inward investment that encourages the facilitation of State efforts to attract foreign investment. The Secretary should:

--Designate Embassy commercial officers as focal points to support the States overseas promotional efforts.

--Require commercial officers to place more emphasis on developing investment leads and furnishing such leads directly to States that request them.

--Ensure that the Department's facilitative efforts support the needs of Embassy commercial officers, State domestic programs, and foreign visitors who are considering U.S. investments.

AGENCY COMMENTS

The Department of Commerce stated that it is keenly interested in providing expanded facilitative support directly and through the commercial officers in the Foreign Service posts. The Department added that it is also interested in making certain that prospective foreign investors are aware of investment opportunities in distressed communities and of Federal programs applicable to such areas. The Department generally agreed with our recommendations and commented that they are prepared to examine them closely to determine what specific steps can be taken. (See app. IV.)

The U.S. Trade Representative believes that commercial officers at U.S. Embassies are generally doing a good job, but that they can and should do more to assist the States in locating potential foreign investors. (See app. V.)

The Department of State said that under U.S. policy it does not "promote" inward investment in that it does not actively seek out potential investors in the United States. However, according to the Department, it can and does facilitate investment by investors who have decided to come to the United States. (See app. VII.)

As discussed in this chapter, U.S. policy discourages Federal promotional activities, such as special incentives or disincentives which would disrupt the operation of market forces. (Underscoring supplied). Our review has shown that market forces, such as demand for a product or service, transportation costs, labor rates, and availability of raw materials largely determine an investment location. We do not believe the additional actions we discuss--developing investment leads for interested States, supplying information on U.S. laws and regulations, and otherwise supporting the States efforts--would disrupt market forces. Rather, we believe that such actions would complement the functioning of market forces.

The State of Pennsylvania agreed that the Federal role should be limited to facilitating the States efforts. It concurred that the direct and timely flow of potential investment information is of the utmost importance and added that too much time is lost in information being routed from Embassies to Washington to the States. (See app. IX.)

CHAPTER 3

INTERSTATE COMPETITION FOR INVESTMENT

Competition among States for investments has resulted in the increasing availability of investment incentives. Opinion differs as to whether there should be some restraints on the increasing tax and fiscal incentives for industrial development. Studies by the Advisory Commission on Intergovernmental Relations 1/ have identified and assessed the significant issues. The Commission concluded in November 1978 that it saw neither the need nor a suitable method for Federal intervention to restrict States from granting tax and fiscal incentives to business. In general, we concur with the Commission's assessment; however, we believe that more needs to be known about the costs and effects of incentive arrangements in order to assist Federal, State, and local authorities to assess their use.

TYPES OF INCENTIVES AVAILABLE

Investment incentives are equally available to foreign and domestic investors. The types and amounts of incentives offered by States differ according to each State's view of their usefulness in attracting investment and the extent to which the State perceives a need to offset economic disadvantages it has relative to competing States.

Incentives can be provided directly or indirectly to business. States and localities provide incentives to investors through tax exemptions or rebates, assistance in financing the investment, and training prospective employees. Indirect incentives benefit a community as well as the investor and include the construction of roads, sewers, and utilities. An active interest by the State government in seeking investments and an investor's perception that a particular State is a good place to live and work are also viewed by State officials as factors that influence site selection.

1/ The Commission was created by Congress in 1959 to monitor the operation of the American Federal system and to recommend improvements. It is a permanent, national, bipartisan body, representing the executive and legislative branches of Federal, State, and local governments and the public.

Tax incentives

State tax policy can encourage industrial growth through low overall tax rates and specific exemptions or abatements. For example, a 1978 Commerce Department study reported that five States levy no corporate income tax and the remaining States levy taxes varying from about 2 to 12 percent of taxable income. Similarly, four States have no sales/use tax, while other States have rates up to 15 percent.

Comparison of overall tax rates can be misleading, however, as many States offer tax exemptions. The Industrial Development Research Council of Atlanta, Georgia, annually surveys the number of incentives offered by the 50 States, and its results are published in Industrial Development magazine by Conway Publications, Inc. It reports, for example, that in 1978, 23 States offered corporate income tax exemptions, 46 had tax exemptions on raw materials used in manufacturing, 43 had an inventory tax exemption for goods in transit, and 35 had sales/use tax exemptions on new equipment.

The Commerce Department study indicates that the States which have higher general tax rates tend to offer the greatest number of tax exemptions and financial incentives. Therefore, when exemptions and general tax rates are combined, tax differences between the States are reduced.

Financial assistance incentives

Financial assistance incentives include industrial revenue bond financing and State, city, and/or county loans and loan guarantees. Local development authorities sometimes provide free or low-cost land in order to attract new business.

Industrial revenue bonds are issued by a State, city, or county, and the proceeds are used to finance a plant, equipment, or other facilities used in a company's business. Subject to several conditions, interest income from bond issues is exempt from Federal and, where allowed, State income taxes if the bond does not exceed $10 million or if it is issued for such purposes as pollution control, which have no dollar limit. The Public Interest Research Group of Washington, D.C., reported that $3 billion worth of the $3.5 billion in tax-free securities issued in 1977 were for pollution control purposes.

Industrial revenue bonds appeal to investors because the lender, or bond buyer, passes some of their tax savings along to the borrower. The savings usually amount to reduced borrowing rates of 2 to 3 percent. In a State where the municipal issuer is treated as the owner 1/ of the facilities being financed, the corporation may also be entitled to total or partial exemption from property taxes and sales taxes on the materials and equipment used in constructing the facilities.

Financing can also involve State and local funds. For example, Conway Publications reports that 21 States make loans for construction of buildings and/or purchase of machinery and equipment and that city and/or county governments in 8 of the 21 States can make similar loans. West Virginia's Economic Development Authority can finance up to 50 percent of the cost of land and buildings for a period up to 25 years. The loans are made and administered by a nonprofit community development corporation which provides an additional 10 percent of financing. The remaining 40 percent is provided by outside sources.

The Pennsylvania Industrial Development Authority provides loan funds to local industrial development corporations for up to 50 percent of the cost of constructing new plants or acquiring existing buildings for industrial purposes. These loans can carry a 4 percent annual interest rate if the project creates jobs in a high unemployment area. From 1956 through 1977, 1,500 projects received approved loans totaling $459 million.

Labor training incentives

All the States support programs to recruit, screen, and/or train employees. Depending on the availability of skilled labor, the programs can vary from a referral system to training that is tailored to providing employees skilled at specific plant operations. For example, South Carolina provides general training at 16 technical colleges and will also adapt a training program to a particular company's needs. Its program includes, at no cost to the company:

--Recruiting and screening of applicants according to company criteria.

1/ Usually the company leases the plant and/or equipment from the bond issuer; the rent is structured to cover payments to bondholders.

--Training prospective employees, with equipment borrowed, rented, or bought from the company, at a site near the new plant location.

--Hiring company supervisors and/or executives as instructors or consultants.

--Funding selected trainees' travel to the home company in another State or country when additional technical training is needed.

Trainees are not paid while participating in the training program nor is the company obligated to hire training graduates, although, according to South Carolina officials, most are hired. The State will also retrain employees at no company expense in the event equipment or production methods are changed at a future date. Development officials in Alabama, Georgia, and Florida characterized their training programs as similar to the South Carolina program.

Other incentives

Some of the ways States attempt to attract new investment do not involve financial and training incentives but are considered just as important. The personal commitment of the governor to the State's economic development, for instance, reflects a favorable business climate. A governor may prevail on the State legislature to lower its business taxes or to use State funds to upgrade utilities or transportation facilities. State development officials will usually help businesses to meet State and local regulatory requirements, prepare license applications, and process environmental permits.

State officials try to convince investors that their State is a good place to live as well as to work. These "quality of life" advantages vary with the State or community, but include climate, recreation facilities, schools, and public safety. Officials in one State told us that a Japanese company's decision to invest in a particular community was influenced by the mayor's assurance that the company employees would have access to local golf facilities.

ADVISORY COMMISSION STUDY ON INTERSTATE COMPETITION

Consistent with U.S. policy to avoid measures which give special incentives or disincentives to affect investment flows, the Treasury Department has expressed concern about the increasing use and level of incentives to attract investments. The Advisory Commission on Intergovernmental Relations recently studied this issue in connection with interstate competition for industry 1/ as part of its concerns about differing rates of growth in frostbelt and sunbelt States. The Commission's studies apply to foreign as well as domestic investment since States compete and offer the same incentives for both types of investment. The Commission's arguments, pro and con, on the use of incentives to attract industry are summarized below. Arguments for the use of incentives are:

--State and local policymakers, in being responsive to constituents' demands for jobs, must provide for those instances in which all market factors balance out to an extent that taxes play the deciding role in determining the ultimate, and perhaps optimum, location.

--States and localities sometimes need to offset an unfavorable business climate reputation with tax and fiscal incentives and concessions.

--Tax and fiscal incentives are a prompt and available means for reducing business costs.

--Tax concessions have value as signs and pledges of long-run sympathy and accommodation for the needs of the businessmen.

--Recent tax concessions also reflect the importance that State policymakers attach to encouraging expansion from firms already located in the State.

--Since business taxes are shifted forward to consumers or backward to labor or shareholders, reductions in business taxes may, therefore, be beneficial on balance.

Arguments against the use of incentives are that tax and fiscal incentives:

1/ The Commission prepared two internal papers: "Study of Interstate Competition for Industry", Nov. 20, 1978, and "Interregional and Interstate Tax Competition", May 18, 1979.

--Are frequently offered only to newcomers and therefore may discriminate against established firms.

--Can thwart other objectives of State and local fiscal policy, such as uniform treatment of taxpayers, ease tax administration, and neutrality with respect to intrastate location considerations.

--Tend to distort market decisions and, correspondingly, adversely affect economic efficiency.

--Are of doubtful significance because they deal with but one of many cost factors that enter into location decisions and, indeed, tax costs are likely to be swamped by differential costs for labor, raw materials, transportation, and the like.

--Are substantially diluted by the operation of the Federal income tax. State and local taxes foregone presumably increase profits of firms availing themselves of the incentives. The profits are then subject to a a Federal tax liability, which for a corporation can be 46 percent. Thus, the value of the incentive to many firms is effectively cut in half. Correspondingly, the revenue foregone by the State or local government is about twice as large as the benefit the firm actually receives.

--For the most part redistribute existing production facilities. They do not stimulate the demand for new goods and services, which, in the long run, is the foundation of national economic growth. Therefore, from the standpoint of the national economy, interstate tax competition is essentially a zero-sum game.

The Commission concluded that it saw neither the need nor a suitable method for Federal intervention to restrict States from granting tax and fiscal concessions to business, because (1) State tax and fiscal concessions to business have had little if any effect on the long-term economic trends toward regional decentralization of industry and (2) Federal intervention in State and local fiscal policies would violate the concept of federalism and the traditional sovereignty of States in this area.

Based on currently available data, we concur with the Commission's assessment, but we believe that more needs to be known about the costs and effects of incentive arrangements so that Federal, State, and local authorities can assess their use.

STATE VIEWS ON INCENTIVES

Most States oppose any attempt by the Federal Government to restrict their use of incentives. In response to our questionnaire, 31 States strongly opposed Federal legislation to limit the amount of State assistance to foreign investors, 8 mildly opposed it, 8 were neutral, and 1 mildly favored it (3 did not respond). Concerning mutual agreement to a code of conduct limiting assistance offered to foreign investors, 23 States were strongly opposed to such an agreement, 2 were mildly opposed, 17 were neutral, 3 were mildly in favor, and 2 were strongly in favor (4 did not respond). (See app. III, question 21.)

One State official summarized the prevailing view about competition leading to the overuse of incentives when he stated that:

> "This view of frantic competition and constant one-upsmanship when it comes to incentives comes from the outside observer. States really aren't all that flexible (in what they can offer); they operate programs based on strict budgets within parameters which can't be changed every week simply because a neighboring State offers something different."

Other State officials pointed out that tax and fiscal incentives must be authorized by State legislatures, which are not about to give away more than they expect back in return.

Some States believe, however, that foreign as well as domestic investors take advantage of the State's competition for investment. In our questionnaire, 24 of the 48 responding States said that foreign investors frequently or almost always shopped around to negotiate greater financial assistance, using another State's offer as leverage. (See app. III, question 18.)

All States agreed that the major reasons that foreign investors came to the United States were related to market factors and not incentives. Incentives were considered to be a factor involved in where investors located within the United

States but not a dominant factor, since labor rates, transportation costs, and access to raw materials had a much greater effect on operating costs. The Advisory Commission on Intergovernmental Relations reports that State and local tax differentials become increasingly important, however, as the location decision narrows down to specific possible sites. At this point, presumably, each site already meets the basic market requirements of the investor. State officials also placed importance on the value of incentives as an expression of the State's commitment to establishing a good business climate.

EXAMPLES OF INCENTIVES GIVEN TO THREE FOREIGN INVESTORS

With the variety and number of financial incentives made available to business, States are able to combine various forms of assistance to meet an investor's specific needs. For example, full or partial tax exemptions can be linked with public improvements for highways, sewers, or rail lines and combined with Federal, State, and local funds for workforce training.

For several recent foreign investments, we attempted to identify the extent that States had provided or arranged financial assistance. We concluded that the amount of assistance can vary considerably and depends on such factors as (1) the perceived value of the investment to the State, (2) the number of States competing for the investment, (3) a State's ability and willingness to furnish assistance, and (4) the interest of the investor in obtaining financial assistance. Below are examples of assistance provided to three large foreign investors which each State considered important to its economic development.

Volkswagen of America, Inc.

In 1978, Volkswagen of America, Inc., opened an automobile assembly plant in Westmoreland County, Pennsylvania. The plant represents an investment of $250 million to $300 million, presently employs about 6,000 persons, and will eventually produce up to 1,000 vehicles a day.

State governments, particularly Ohio and Pennsylvania, competed aggressively for the Volkswagen plant during the final site location decision. To locate in Pennsylvania, Volkswagen received a combination of Federal, State, and local incentives.

--A $40-million loan from the Pennsylvania Industrial Development Authority to buy and complete a former Chrysler Corporation plant. Repayment terms were set at 1.75 percent interest annually for the first 20 years and 8 percent annually for the last 10--an average 4 percent over the life of the loan. The Development Authority offers low-interest loans to locate industry in high unemployment areas. A Pennsylvania official told us that because the loan amount exceeded established program limits, the State legislature was required to authorize the loan and to appropriate an additional $10 million to the Authority.

--A $20-million general obligation bond issue by the State to finance completion of a highway link between the Volkswagen plant and major highways. The bonds have tax exempt status, pay 6 percent interest, and will be retired out of general tax revenues.

--A $10-million general obligation bond issue by the State to finance a railroad spur linking the Volkswagen plant and major rail lines. The issue was made under the Railroad Revitilization and Regulatory Reform Act of 1976. The bonds are tax exempt and will, in large part, be repaid by revenue generated from railroads using the rail link.

--A $6-million loan for plant completion made from Pennsylvania State employees' retirement funds. Repayment terms are 8.5-percent interest over 15 years.

--About $3.8 million in Federal funds under the Comprehensive Employment and Training Act was made available by State, county, and city authorities to train Volkswagen workers.

--A 5-year property tax abatement by Westmoreland County and the local school district, which the State estimates was worth about $200,000 to Volkswagen.

--The State Office of Employment Services screened job applications before forwarding them to

Volkswagen, which relieved the company of some administrative burden.

--The Westmoreland plant was designated a subzone of the Pittsburgh Foreign Trade Zone so that Volkswagen could pay duty of about 3 percent on the finished car rather than duties as high as 20 percent on some of the components.

A recent study by the Northeast-Midwest Institute 1/ estimates the value of the incentives at $51.7 million in 1978 dollars.

Honda of America Mfg., Inc.

In 1979, Honda opened a $30-million motorcycle manufacturing facility in Ohio. The plant is expected to employ 450 people initially but will reportedly add about 2,000 employees when Honda completes an adjacent $200-million automobile assembly plant.

The incentive package for the Honda project includes:

--A special $2.5-million grant by the Ohio legislature to develop the Honda site. Site improvements included construction of a municipal water system, sewer line, and expanded sewage treatment facilities; construction of a railyard on Honda property; $35,000 in matching funds for a Federal grant to rehabilitate a rail line to connect Honda's plant with a main line; and widening a State highway fronting the Honda property.

--A Federal grant of $229,000 for rail improvements.

--County property tax abatements on all improvements, estimated to reduce Honda's annual tax liability by $90,000.

--Installation of a cafeteria at the Honda facility by the Ohio Rehabilitation Services Commission.

1/The Institute serves a congressional coalition of 18 Northeastern and Midwestern States and was established to analyze and seek solutions to problems common to the two regions.

--Tutoring for Japanese children by Ohio State University.

--Designation of the facility as a subzone of the Cincinnati Foreign Trade Zone, relieving Honda of duty charges for imported Japanese parts assembled in the United States and reexported.

Originally, Ohio planned to make available $1 million in State and Federal training funds to Honda, but in June 1979 an Ohio official said it was unlikely that the funds would be used.

Raritan River Steel Company

Raritan River Steel, a wholly owned subsidiary of Co-Steel International, Ltd., of Canada, is investing $94 million to build a steel rod mill in New Jersey. Initial employment is estimated at 500 persons. A combination of Federal, State, and local incentives will be provided to the company, as follows.

--Loan guarantees of $9 million from the Department of Commerce's Economic Development Administration and $1.5 million from New Jersey.

--The city council acted to bring the site under a 1977 New Jersey law enabling a company that locates in an economically depressed area to receive property tax abatements. A New Jersey official stated the abatement amounts up to 35 percent of the total property tax liability. A company official estimated tax savings for Co-Steel of $3 million over 15 years.

--The Governor personally assured the President of Co-Steel that all necessary environmental permits could be obtained from the State Division of Environmental Protection within a 90-day period.

--The State negotiated with a local utility company to set a more favorable electricity rate for the plant, which could reduce the company's energy bills by up to $700,000 annually.

--The State helped Co-Steel negotiate a labor agreement whereby construction unions agreed to refrain from striking during the construction of the plant.

Legislation enacted by New Jersey to encourage investment in general also influenced Co-Steel's location decision. Effective January 1, 1978, the State eliminated sales taxes on new machinery and equipment used in manufacturing. This saved Raritan River Steel an estimated $2 million. The State also abolished the business personal property tax on machinery and equipment acquired on or after January 1, 1977.

NUMBER OF INCENTIVES INCREASING

The number of incentives the States offer to attract business increased sharply in the 1960s, leveled off in the early 1970s, and has again shown increases in recent years. The following table compares the number of States offering particular types of incentives in 1966, 1970, and 1978.

	Number of States offering incentive		
Tax incentive:	1966	1970	1978
Corporate income tax exemption	11	21	23
Personal income tax exemption	15	20	18
Excise tax exemption	5	9	13
Tax exemption or moratorium on equipment and machinery	15	21	27
Inventory tax exemption on goods in transit (free port)	32	39	43
Tax exemption on raw materials used in manufacturing	32	39	46
Sales/use tax exemption on new equipment	16	26	35
Accelerated depreciation on industrial equipment	9	14	26
Tax exemption or moratorium on land and capital improvements	11	17	25
Financial assistance:			
State-sponsored industrial development authority	25	29	32
Privately sponsored development credit corporation	31	36	34
State revenue and/or general obligation bond financing	10	16	26
City and/or county revenue and/or general obligation bond financing	28	43	46
State loans for building construction	11	13	20
City and/or county loans for building construction	8	5	9
State loan guarantees for building construction	11	11	16
State financing aid for existing plant expansion	14	26	29

Source: "The Fifty Legislative Climates," annual survey published by Conway Publications Inc., of Atlanta, in the November-December issue of Industrial Development for 1966 and 1970, and the January-February issue for 1979.

COSTS OF INCENTIVES DIFFICULT TO DETERMINE

Despite the growing use of incentives, very little is known about their costs. State development officials gave the following reasons why it is difficult for them to determine financial assistance costs.

--Some incentives are given by local development authorities which have no requirement to report to State officials. For example, tax exemptions are authorized by States but are granted by cities and counties; price concessions on land are also usually made by local development authorities.

--Cost estimates for tax incentives, (i.e., tax revenue foregone), if made at all, are rough approximates because they rely on projections of company operations. Companies receiving tax incentives may be reluctant or unable to provide data on future operations.

--Costs (Federal taxes foregone) of such assistance as industrial revenue bonds are in large part Federal costs; the State has little interest or need to monitor these costs. Other financial assistance may involve a mix of Federal, State, and local money.

--Infrastructure improvements may benefit the general community as well as particular investors. Apportioning the cost may be difficult.

MORE INFORMATION NEEDED ON INCENTIVES

We believe that more information on the costs of incentives being given to business would help Federal, State, and local planners to assess the merits of the use of incentives. As a first step, the Commerce Department could use its Form BE-13 to identify the types of incentives that foreign investors receive. Although this approach would focus on foreign firms, we believe it is reasonable to apply the results to all investments, since foreign and domestic firms are equally eligible to receive incentives.

The BE-13 must be filed no later than 45 days after a U.S. business has been established or acquired by a foreign person or existing U.S. affiliate of a foreign person. The forms are analyzed by the Bureau of Economic Analysis, whose officials told us the BE-13 could be used to identify the types of incentives received by foreign firms without imposing an undue reporting burden. Bureau officials doubted, however, whether a questionnaire, such as the BE-13, could provide reliable data on the costs of incentives. We agree with these officials and suggest that the Office of Foreign Investment in the United States make a more detailed review of a sampling of investors. In all likelihood, the identification of incentive costs will require discussions with Federal, State, and local officials and with the investors.

Once the costs of individual investments are identified, we believe it would be useful to compare incentives given to different investors. Such a comparison was made in the October 1978 Northeast-Midwest Institute study on incentives given in three automotive industry investments. The study was prompted by a $57.8-million grant from the Canadian and Ontario Governments to induce Ford Motor Company to locate in Ontario instead of Ohio. (See ch. 4.)

The Institute compared Canada's grant to Ford with two recent U.S. incentives agreements: (1) Pennsylvania's agreement with Volkswagen, and (2) Ohio's agreement with Ford Motor Company to provide tax abatements and site purchase and preparation funds as an inducement for Ford to build a transmission manufacturing facility in Clermont County, Ohio. The Institute considered the Ford-Ohio agreement typical of industrial development agreements between firms and U.S. government units.

The Institute compared the three incentive agreements by first estimating the value to the firms of the incentives less any nontax reimbursements to the Government, such as loan repayments. The value to Volkswagen of Pennsylvania's subsidy was estimated at $51.7 million and Ohio's subsidy to Ford was estimated at $13.6 million--both stated in 1978 dollars.

To provide a basis for comparing the three agreements, the subsidy values were stated in terms of number of jobs created and total capital outlay for the investment, as shown in the following table. The number of jobs created reflected those directly resulting from each new plant and also those estimated to result from the effect of the new plant on nearby related industries.

Incentive recipient	Subsidy value per job	Subsidy value as percent of project cost
Ford-Canada	$7,410	12.7
Volkswagen-Pennsylvania	4,103	19.6
Ford-Ohio	1,700	2.6

The Institute did not attempt to conclude whether the three incentive agreements were excessive in relation to the benefits received from the investments, but it recommended that governmental subsidies to business be more closely studied.

CONCLUSIONS

Competition among the States for investments has led to the increasing availability of investment incentives. The types and amounts of incentives offered differ according to each State's view of their usefulness in attracting investment and the extent to which the State perceives a need to offset economic disadvantages it has relative to competing States. Investment incentives are equally available to foreign and domestic investors.

The Advisory Commission on Intergovernmental Relations studied the pros and cons of the use of incentives to attract industry and concluded that it did not see the need nor a suitable method for Federal intervention to restrict States from granting tax and fiscal incentives to business. In response to our questionnaire, a majority of the States opposed Federal legislation to limit the amount of State assistance to foreign investors. Also, most States were either opposed or neutral toward a code of conduct limiting assistance offered to foreign investors.

Based on currently available data, we agree with the Commission's assessment but believe that more information on the costs and effects of incentives would help Federal, State, and local planners to better assess the merits of their use. The Commerce Department's Form BE-13 could be used to determine the types of incentives provided. Once the incentives have been identified, OFIUS could make a more detailed review to determine the costs and effects of such incentives. The incentives could then be compared, using methods similar to those used in the Northeast-Midwest Institute study.

RECOMMENDATIONS

We recommend that the Secretary of Commerce:

--Revise Form BE-13 to provide for identifying the types of investment incentives being received by foreign investors.

--Make periodic studies of investments to determine the costs of incentives provided and to relate these costs to such factors as the number of jobs created and capital outlay for the investment.

This information will, we believe, be useful to Federal, State, and local officials in their assessment of government-provided investment incentives.

AGENCY COMMENTS

The Department of Commerce agrees with the objective of our recommendation that it undertake cost/benefit analyses of investment incentives received by foreign investors. However, it was reluctant to limit itself to our recommended approach since tying the analysis to Bureau of Economic Analysis survey data may present confidentiality problems. (See app. IV.) We believe our approach is workable, because the cost/benefit analyses would not be obtained through the survey forms but by visits to the companies. We also recognize that there may be other ways to get the information.

The U.S. Trade Representative stated that, to the extent OFIUS can provide information about the use and costs of investment incentives, it would be useful to those making policy decisions in the area. (See app. V.)

The Department of the Treasury believes that this chapter's discussion of State investment incentives programs presents a useful treatment of some of the important developments and issues on foreign direct investment in the United States. (See app. VI.)

CHAPTER 4

INTERNATIONAL COMPETITION

FOR INVESTMENT

Other countries compete aggressively for new investment but, except for Canada, international competition for investment has not generally affected the United States. As discussed in chapter 1, a firm's decision to invest in the United States is usually based on market or other factors unrelated to government-provided investment incentives. The United States is concerned about the increasing use of incentives internationally, however, and is seeking greater international cooperation in limiting their use. Progress has been slow, because most governments do not agree on the need to restrain the use of incentives and because of complexities in devising groundrules.

INTERNATIONAL COMPETITION HAS LITTLE EFFECT ON THE UNITED STATES

Other industrialized nations, particularly in Europe, compete aggressively and offer substantial incentives to attract new investment. Competition in the United States occurs at the State level, but in Europe it occurs largely at the national level, which makes more resources available for use as incentives.

Except for Canada and a few other isolated examples, the United States does not compete directly with other countries for investment. In response to our questionnaire, 27 States responded that they experienced little, if any, competition with foreign countries, 6 experienced little competition, 4 experienced moderate competition, and 7 experienced significant or very significant competition. (See app. III, question 19.) A firm's decision to invest in the United States is usually based on factors which outweigh and are unrelated to government-provided incentives. Although State-provided incentives may play a role in where a firm will locate within the United States, they are unlikely to affect a decision to come to the United States.

Decisions by U.S. firms to invest in Europe seem to be based on a similar rationale, even though incentives provided by European governments may be larger. For example, officials at General Motors and Ford told us that, given the choice, it is usually preferable to locate near the market being served. They believe such factors as transportation costs and duty rates make it impractical to locate an automobile plant in the United States to produce cars for the European market.

U.S. CONCERNS ABOUT INVESTMENT INCENTIVES

The Federal Government has expressed concern about the growing international use of incentives. The Assistant Secretary of the Treasury for International Affairs stated in February 1980 that, "* * * governments at both federal and subfederal levels frequently adopt measures (incentives) which can distort the allocation of investment among nations, reduce the potential gains from international specialization, and prompt countermeasures by other governments." In a March 1980 letter to GAO, the Assistant Secretary of State for Economic and Business Affairs outlined the Department of State's concerns about investment incentives.

> "First, incentives could, in some cases, result in an uneconomic allocation of resources and less output and income for the world as a whole. Second, these practices may direct benefits from investments from one country to another, at the extreme, leading to nationalistic economic policies which disregard consequences for neighboring countries. Third, since firms consider many factors more important than incentives in making investment decisions, government payments made or future revenues lost to attract new investment may be 'wasted' in that these incentives may play only a peripheral role in the decision process of the firm." (See app. VII.)

For example, in August 1978 the British Government and the Government of Northern Ireland provided a package of grants and loans estimated at $104 million to the DeLorean Motor Company. The plant will eventually have 2,000 employees and will initially produce about 20,000 automobiles a year, most of which will be exported to the United States. Before accepting the Northern Ireland offer, DeLorean had negotiated with other governments, including the city of Detroit and the State of Alabama, and had come close to a final agreement with Puerto Rico earlier in the year. Reportedly, the Puerto Rican arrangement would have included a $17.6-million loan and a $3-million training grant from the Government of Puerto Rico and guarantees for two $20-million loans, one each from the Commerce Department's Economic Development Administration and the Agriculture Department's Business and Industrial Development Loans Program.

The Ford Motor Company may establish an automobile assembly plant in Europe which will cost up to $1 billion and result in about 8,000 jobs. European governments have competed aggressively for the plant. Press reports placed a French offer at $400 million to $500 million for Ford to locate in eastern France, where there is considerable unemployment. In July 1979, Austria was reportedly offering $300 million in investment grants, a free site near Vienna, and a guarantee of trained labor. The French and Austrian locations are apparently no longer under consideration but, as of February 1980, incentive offers by Portugal and Spain were still being studied.

In June 1979, General Motors Corporation announced that it was expanding its European automobile production capacity with a $2 billion investment in Austria and Spain. No value was placed on the incentives General Motors received, but a company official told us that one country offered financial assistance approaching 25 percent of the value of the investment.

EFFORTS TO ESTABLISH INTERNATIONAL COOPERATION

To forestall an uneconomic use of incentives, the United States has sought more cooperation in how nations compete for investments. Several international bodies have discussed the issue, but as yet very little progress has been made. Some countries may agree in principle with the U.S. position, but few believe it is in their self-interest to cut back on attempts to attract new investments.

In 1976 the Organization for Economic Cooperation and Development (OECD), composed of members from 24 industrialized nations, signed a declaration containing several broad principles on the use of investment incentives and disincentives for international direct investments. Members agreed to recognize the need to strengthen international cooperation and to make incentives and disincentives offered by members more visible. A member can request consultations if it considers its interests to be adversely affected by the actions of another member, but the results of consultations are not binding on either party.

U.S. officials consider the 1976 agreement only a first step and hope a second round of OECD meetings will lead to something more substantive. In September 1979, OECD members began discussions on how incentives and disincentives affect international investment flows and competition between governments. A final report is not expected until late 1981. On the basis of the report, OECD members will consider whether to initiate discussions on agreements limiting the use of incentives. U.S. officials also hope for improvements in the consultative mechanism and procedures to increase the transparency of incentive offers.

The European Economic Community attempts to control investment incentives by setting ceilings on subsidies that member countries provide to business. The ceilings vary according to the economic needs of particular areas and are expressed as (1) a maximum value per job created or (2) a maximum percent of total investment costs. For example, the ceiling in the central, more industrialized regions of the Community is 20 percent of fixed investment costs, or about $4,500 per job created subject to an absolute limit of 25 percent of fixed investment cost. In less developed areas, the ceilings may increase up to 75 percent of investment costs and $16,500 per job created. As a comparison, the Northeast-Midwest Institute estimated that Canada granted Ford $7,410 per job and that Pennsylvania subsidies to Volkswagen totaled 19.6 percent of investment costs.

Officials of the European Economic Community's Commission told us that the ceilings have had limited succcess in controlling investment incentives. For example, the ceilings are flexible and members can offer special incentives to large investors if the economic needs of an area or the particular benefits of an investment are judged to require special treatment. Also, the Commission does not believe it has the resources to effectively monitor incentives provided by member countries.

Investment problems are also addressed internationally by the:

--Task force of the International Monetary Fund/World Bank Development Committee which is seeking ways to increase direct investment flows to developing countries. Among the issues being discussed are how the policies of developed countries affect direct investment flows to developing countries and how incentives might be used to increase investment flows and aid the development process.

--General Agreement on Tariffs and Trade which, through the Subsidies/Countervailing Measures Code, has established new international rules on government practices affecting investment. A signatory to the Code can take countermeasures if it determines that another nation's subsidy programs, including incentives to attract investment, have resulted in exports which cause injury to one of the signatory's industries. This type of remedy, however, may not be practical because it does not address the use of incentives when they are offered. Instead it occurs subsequent to the establishment of trade, which is long after the incentives have been provided.

--United Nations Conference on Trade and Development, which is developing a code of conduct on the international transfer of technology, focusing on general principles and the responsibilities of governments and enterprises. Also, the United Nations Commission on Transnational Corporations is working on a comprehensive code of conduct for transnational corporations. Still another United Nations group is examining various aspects of restrictive business practices, taking into account the need for appropriate remedial measures at international levels.

U.S.-CANADIAN COMPETITION FOR AUTOMOTIVE INVESTMENTS

Several States compete with Canadian Provinces for new automotive investments. This competition is marked by substantially increased offers of financial incentives and is viewed by both countries as undesirable. The United States and Canada are currently negotiating in an effort to control the level and type of incentives offered to attract these investments. Agreement may be difficult because of problems in setting limits on types and amounts of incentives. Coordination with the States and Canadian Provinces is needed to ensure acceptance of whatever groundrules are negotiated.

Competition for new auto investments has been particularly intense, since the industry plans to spend several billion dollars in the 1980s to build more fuel-efficient cars. The industry's relatively high wages also make auto plants attractive to many communities. Ontario and Quebec Provinces are competitive for auto investments because they adjoin the major auto producing States. Trade flows freely across the border because in 1965 Canada and the United States signed an "auto pact," which removes duties on most automotive parts and equipment.

In August 1978, Ford Motor Company agreed to build a large engine production company in Windsor, Ontario, in return for \$57.8 million (U.S. dollars) in cash grants, almost 60 percent of which was provided by the Canadian Federal Government. The facility is expected to cost about \$450 million and to have about 2,600 employees when completed.

Prior to announcing its intent to locate in Canada, Ford considered expanding an existing facility in Ohio. The United States strongly objected to the Canadian grant on the basis that it may have diverted a planned investment and resulted in lost U.S. jobs and export opportunities. Several disturbing precedents were also set that would escalate future competition. The Canadian Federal Government became significantly involved in the competition that was previously confined to the States and the Canadian Provinces. Also, Ford was given a cash grant, which is considered more attractive than the tax concessions and loans normally provided by States. Finally, Ford was not locating in an economically disadvantaged area, so the Canadian grant was not part of the regional economic development programs that both nations employ.

The Canadian Federal portion of the grant was justified by Canadian officials on the basis that Provinces do not have the resources necessary to compete with States. Ontario officials pointed out their need to offset other advantages that States enjoy, such as a large consumer market, good transportation, more favorable climate, and availability of energy, raw materials, and technology. To meet competition, Ontario has established a \$200-million employment development fund to provide grant assistance to businesses making investments in 1979 and 1980.

Both nations agree that the increasing use of incentives is undesirable. In March 1979, the Canadian Minister of Industry, Trade and Commerce stated:

> "Its [Canada's] involvements in competitive subsidization with U.S. federal, state or municipal governments is a costly, no-win proposition for the governments. Such intervention in the investment decision making process will lead to uneconomic decisions."

* * * * *

"The Government will pursue, on an urgent basis, discussions with U.S. authorities on the question. The objective of the discussion will be to reach agreement to contain such investment incentives."

Pending an agreement, however, the Minister added that his government would not stand by while investment was lost as a result of incentives available in other countries. To this end, Canada plans to offer special assistance to the Provinces when they lack the resources to compete.

Bilateral talks between the United States and Canada began in September 1978, but U.S. officials told us that it is too early to say what type of agreement, if any, will result.

Since Canada competes primarily with the U.S. States for investment, the States cooperation will be essential to a successful agreement. However, as discussed in chapter 3, States may be reluctant to have limits placed on what they can offer investors. In our questionnaire, 22 States strongly opposed an international agreement that limited bidding between countries for investment, 5 were mildly opposed, 21 were neutral 1 was strongly in favor, and 2 gave no opinion. (See app. III, question 21.)

Responses from four auto-producing States--Michigan, Ohio, Pennsylvania, and Wisconsin--followed the same general pattern as the responses from all the States; one State was strongly opposed to an agreement, one was mildly opposed and two were neutral. An official from one auto-producing State commented that an agreement with Canada would probably be to the States advantage since it did not have the resources to compete with the Canadian Federal Government, but he was wary of the U.S. Government establishing a precedent which could result in further restrictions.

The Advisory Commission on Intergovernmental Relations acknowledged that competition between the States and the Canadian Provinces for major new auto plants could lead to competitive tax undercutting. The Commission concluded, however, that a successful agreement between the two countries would depend on the States agreeing that the granting of incentives was counter to their own interests. The Canadian Government would also need to persuade its Provinces that an agreement was in their interests.

We agree with the Commission that successful negotiations with Canada will depend on convincing States that an agreement is needed. Several intergovernmental organizations could provide some useful input on this issue, including the National Governors Association because of the role played by State governors in the industrial location process, and the United States Conference of Mayors whose 750 members represent cities of more than 30,000 and would be expected to represent the views of local governments.

CONCLUSIONS

A firm's decision to invest in the United States is usually based on factors which outweigh and are unrelated to government-provided incentives. Therefore, with the exception of Canada, the United States generally does not compete directly with other countries for investment. Competition in the United States normally occurs at the State level.

Competition for investment internationally, such as in Europe, occurs largely at the national level, which makes more resources available for use as incentives. The United States is concerned that the increasing use of incentives internationally will distort the allocation of investment among nations and prompt countermeasures from other governments. In an attempt to forestall this activity, the United States is seeking more cooperation in how nations compete for investment through such international bodies as the Organization for Economic Cooperation and Development. Progress has been slow because most governments do not agree on the need to restrain the use of incentives and because of complexities in devising groundrules.

Competition for new auto investments between some U.S. States and Canadian Provinces has recently resulted in substantial offers of financial incentives. The United States and Canada view this as undesirable and are currently negotiating to control the use of incentives to attract these investments. Any agreement between the United States and Canada will be difficult because of problems in setting limits on the types and amounts of incentives. Most important to a successful agreement will be the participation by the U.S. States and Canadian Provinces in developing whatever groundrules are negotiated. Two groups which could be helpful are the National Governors Association because of the role governors play in the industrial location process and the U.S. Conference of Mayors which represents the views of local governments.

AGENCY COMMENTS

At the Department of State's suggestion (see app. VII.), we elaborated in this chapter on the U.S. rationale for holding discussions in various international fora on ways to control incentive schemes worldwide.

CHAPTER 5

SCOPE OF REVIEW

This report looks at what is known about the growth and effects of foreign direct investment in the United States, the Federal Government's role in assisting States which seek such investment, and the increasing use of incentives by States and foreign governments in competing for investments. Our review concentrated on foreign direct investment, which involves 10 percent or more foreign ownership of a U.S. enterprise (as opposed to portfolio investment which involves less than 10 percent ownership).

To obtain an understanding of how States encourage foreign direct investment, we sent a standardized questionnaire to the 50 States and Puerto Rico inquiring about State policy toward foreign direct investment and Federal assistance to State programs to attract it. (See app. III.) We followed up the questionnaire responses by contacting 15 States which host varying amounts of foreign investment and spend varying amounts to attract more. The States are Alabama, Florida, Georgia, Indiana, Kansas, Kentucky, Louisiana, Michigan, New Jersey, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas, and West Virginia. We also met with 10 municipal and county organizations that work at the local level to attract foreign investment.

On the basis of suggestions made by State and local officials, we contacted 19 foreign investors from 7 countries to discuss their reasons for investing in the United States and for locating where they did. From the 19, we chose Volkswagen of America, Inc., Honda of America Mfg. Inc., and the Raritan River Steel Company as examples to show how the States can arrange financial assistance for foreign investors. We also discussed investment strategies with two U.S. automotive manufacturers.

Domestically, we discussed U.S. foreign direct investment policy with officials at the Departments of Commerce, State, and Treasury and analyzed Federal efforts to assist the States in attracting such investment. In addition, we met with congressional staff to discuss their concerns over Federal efforts to monitor, evaluate, and formulate policy on the effects of foreign investment in the United States.

We reviewed executive agency files and documents, congressional hearings and testimony, reports and studies of foreign investment in the United States, and media articles. We discussed various foreign investment issues with officials from the Conference Board of New York City, four banks and four universities, the Northeast-Midwest Institute, the U.S. Chamber of Commerce, the National Association of State Development Agencies, and the Academy for Contemporary Problems in Columbus, Ohio. To assist our review, we also employed a New York City-based consultant who dealt with foreign investment matters in a newsletter developed for foreign investors coming to the United States.

We met with U.S. Embassy representatives in Belgium, Canada, Germany and the United Kingdom and with the overseas representatives of Illinois, Louisiana, Michigan, New York, Ohio, Virginia, Massachusetts, the Pennsylvania Southwest Association, Puerto Rico, and the Old West Regional Commission to discuss their activities regarding foreign direct investment. We also contacted officials from the European Economic Community and the Organization for Economic Cooperation and Development. Embassy officials arranged meetings with representatives of the British, German, and Canadian Governments to discuss their countries' policies on inward investment.

SIGNIFICANT FOREIGN DIRECT INVESTMENTS IN THE UNITED STATES SINCE 1977

1978 transactions

Country	Investor	Description of transaction	Amount invested by foreign firms (note a) (millions)
Netherlands/ United Kingdom	Unilever Group	The Unilever Group acquired National Starch and Chemical, a New York City-based manufacturer of starches, adhesives, resins, and other products.	$485
United Kingdom	BOC International Ltd.	BOC, which has owned a minority interest in Airco since 1973, increased that interest to about 54 percent. Airco, based in New Jersey, produces industrial gases and other products.	298
United Kingdom	B.A.T. Industries Ltd.	B.A.T. purchased the Appleton Papers Division of NCR. Appleton produces carbonless paper and other products and has facilities in Wisconsin and Pennsylvania.	280
Switzerland	Thyssen-Bornenizsa	Thyssen acquired all outstanding shares of the Budd Co., a Michigan-based producer of railroad passenger cars, truck trailers, and automotive components.	273
Germany	Friedrich Flick Group	The Flick Group increased its equity holdings of W.R. Grace & Co. to 31 percent from 12 percent. Grace, located in New York, is a chemical and fertilizer producer.	256
Japan	Mitsui & Co. Ltd.	Eastalco Aluminum (which is 50 percent foreign-owned) with the assistance of Mitsui is expanding its plant at Frederick, Md; boosting output by 50 percent.	165
Canada	Seaman Brothers	Bow Valley Industries Ltd., a natural resources company owned by Seaman Brothers of Canada, acquired all outstanding shares of Flying Diamond Oil Corp. of Denver.	122

a/ OFIUS relies on published sources, such as newspapers and filings with Federal agencies, for transaction values and does not verify the values beyond the published source.

Source: Office of Foreign Investment in the United States

Country	Investor	Description of transaction	Amount invested by foreign firms (note a) (millions)
United Kingdom	Sir James Goldsmith	Grand Union Co., a supermarket subsidiary of Cavenham Ltd. of the United Kingdom, acquired about 90 percent of the common stock of Colonial Stores, Inc., an Atlanta supermarket chain operator.	$114
Canada	Northern Telecom	Northern Telecom purchased Data 100 Corp., A Minneapolis-based computer manufacturer.	113
United Kingdom	General Electric Co. Ltd.	General Electric of the United Kingdom acquired the A.B. Dick Company, which produces business machines and has plants in Illinois, Kentucky, and South Carolina.	103
Germany	Siemens AG	The Utility Power Co., a U.S. affiliate of Siemens, is building a turbine-generator factory in North Sarasota, Fla.	102
Germany	Friedrich Flick Group	The Flick Group purchased 34.5 percent interest in U.S. Filter Corp. of New York, which manufactures pollution control equipment.	100
Canada	Cadillac Fairview Corp. Ltd.	Cadillac Fairview, in partnership with Bergen County Associates, is constructing a shopping center in New Jersey, near the meadowlands sports complex in Bergen County.	100
1979 transactions			
Netherlands	Royal Dutch/ Shell Group	Shell Oil Co., an affiliate of the Royal Dutch/Shell Group acquired the outstanding shares of Belridge Oil Co., of Los Angeles, California. Belridge will merge into the Kernridge Oil Co., a Shell subsidiary.	3,700

Country	Investor	Description of transaction	Amount invested by foreign firms (note a) (millions)
United Kingdom	National Westminster Bank Ltd.	National Westminster Bank, second largest commercial bank in Britain, acquired the C.I.T. Financial Corp. banking subsidiary, National Bank of North America. National Westminster origially agreed to acquire 75.1 percent of National Bank for about $300 million, but a Federal Reserve ruling that C.I.T. would continue as a bank holding company after the sale prompted the complete purchase.	$429
United Kingdom Belgium	ICI Ltd. Solvay et Cie	The U.S. subsidiaries of these two companies are building a new petrochemical plant in Texas--Corpus Christi Petrochemicals Inc. The foreign portion of the investment represents about 62.5 percent of the total project cost of $600 million, with the remaining portion financed by Union Pacific Corp. of New York.	375
United Kingdom	Standard Chartered Bank Ltd.	Standard Chartered of London acquired Union Bancorp Inc. headquartered in Los Angeles, Calif. The agreement calls for Standard's California subsidiary, The Chartered Bank of London, to be merged into Union Bank.	372
France	Schlumberger Ltd.	Schlumberger acquired Fairchild Camera and Instrument Corp. of California. The company was merged into a U.S. subsidiary of Schlumberger, and the Fairchild name will be retained. Fairchild Camera manufactures semi-conductors, electronic components, and electronic testing equipment.	363

Country	Investor	Description of transaction	Amount invested by foreign firms (note a) (millions)
Japan West Germany	Government of Japan Government of West Germany	The two governments are participating in a project with the U.S. Government to build a coal liquefaction plant in West Virginia. Gulf Oil Co. is planning the project which will convert coal into synthetic fuels. Japan and West Germany will each have a 25 percent interest in the plant, contributing $175 million each. The U.S. Government will contribute the other 50 percent.	$350
Netherlands	Nationale-Nederlanden, NV	The Dutch insurance firm purchased the outstanding stock of Life Insurance Company of Georgia.	349
Japan	Mitsui & Co. Ltd. and Nippon Steel Co.	These companies agreed to invest in Alumax Inc.'s $400-million aluminum refining plant now under construction in South Carolina. Alumax Inc. is a joint venture company, owned 50 percent by Amax Inc., 45 percent by Mitsui, and 5 percent by Nippon Steel Co. In addition to sharing in the plant's construction costs, Mitsui will be entitled to 25 percent of the plant's production.	250
Germany	Heidelberg Zement AG	Lehigh Portland Cement Co., a U.S. affiliate of Heidelberg, will build a 750,000 tons/year plant in Alseu, New York, and add 500,000 tons/year capacity at a plant at Union Bridge, Md. Facilities in Iowa and Indiana will also be expanded.	220
United Kingdom	Imperial Chemical	Imperial will build a facility near Houston, Tex. to make ethylene oxide, a petrochemical used to make shampoos, detergents, and other products.	200
Switzerland	Alusuisse (Swiss Aluminum Ltd.)	Alusuisse, a Swiss Aluminum producer, acquired the Maremont Corp. in Chicago, which manufactures automotive parts.	168.8

Country	Investor	Description of transaction	Amount invested by foreign firms (note a) (millions)
France	Renault Vehicles Industries	Renault, the state-owned French auto maker, acquired a 20-percent interest in Mack Trucks, Inc. of Allentown Pa. Mack Trucks will market Renault medium-duty diesel trucks on an exclusive basis in the U.S. and Canada.	$115
France	Michelin	Michelin will build a plant near Columbia, S.C., to produce radial passenger tires. The 700,000 sq. ft. facility will be completed in 1981 and employ about 1,000 people. A Michelin rubber-mixing plant near Anderson, S.C., will be expanded to supply the new plant; an additional 200 workers will be added. Michelin will also build a radial tire plant near Austin, Tex., which is expected to be completed in 1982, and employ about 1,200 workers. Figures were not available for this facility.	100
Pending transactions			
United Kingdom	Imperial Group Ltd.	Imperial, a diversified British foods concern, announced plans to acquire Howard Johnson Company for about $630 million. Howard Johnson, the 6th largest American restaurant and lodging chain, operates approximately 1,000 restaurants and 500 motor lodges. Imperial is Britain's 6th largest corporation.	630
United Kingdom	Hong Kong and Shanghai Banking Corp.	The Corp., a major British bank based in Hong Kong, is attempting to acquire a 51-percent controlling interest of Marine Midland Banks, Inc., headquartered in Buffalo, N.Y. The acquisition would be handled primarily through the purchase of new securities at a cost of about $260 million. Marine Midland would become the Nation's largest foreign-owned bank if acquired by the Corp.	260

GAO REPORTS ON FOREIGN DIRECT INVESTMENT

Changes Needed to Improve Government's Knowledge of OPEC Financial Influence in the United States (EMD-80-23)	Dec. 19, 1979
Implementation of the Agricultural Foreign Investment Disclosure Act of 1978 (CED-80-38)	Dec. 18, 1979
Should Canada's Screening Practices For Foreign Investment Be Used By the United States? (ID-79-45)	Sept. 6, 1979
Considerable Increase In Foreign Banking In The United States Since 1972 (GGD-79-75)	Aug. 1, 1979
Foreign Investment in U.S. Agricultural Land--How It Shapes Up (CED-79-114)	July 30, 1979
Federal Systems Not Designed To Collect Data On All Foreign Investments In U.S. Depository Institutions (GGD-79-42)	June 19, 1979
Are OPEC Financial Holdings A Danger To U.S. Banks Or The Economy? (EMD-79-45)	June 11, 1979
Collection Of Data On Foreign Investment In U.S. Farmland (CED-78-173)	Sept. 15, 1978
Foreign Ownership of U.S. Farmland--Much Concern, Little Data (CED-78-132)	June 12, 1978
Domestic Policy Issues Stemming From U.S. Direct Investment Abroad (ID-78-2)	Jan. 16, 1978

GAO REPORTS ON FOREIGN DIRECT INVESTMENT

Controlling Foreign Investment In National Interest Sectors Of The U.S. Economy (ID-77-18)	Oct. 7, 1977
Impact of Foreign Direct Investments: Case Studies In North and South Carolina (ID-76-43)	Apr. 26, 1976
Emerging Concerns Over Foreign Investment In the United States (ID-75-58)	Mar. 24, 1975

U.S. GENERAL ACCOUNTING OFFICE

SURVEY OF FOREIGN INVESTMENT POLICIES

INTRODUCTION

This questionnaire is to provide input to a U.S. General Accounting Office (GAO) study of policies to attract foreign direct investment. For the purpose of this study foreign direct investment is defined as ten percent or more foreign ownership of a U.S. enterprise. The GAO study singles out foreign investment because of its recent growth, and because the Congress has recognized the need for more information to assist them in examining U.S. international investment policy. GAO is examining how the current Federal policy of neither promoting nor discouraging foreign direct investment relates to the policies and programs of State and local governments.

The following questions are primarily concerned with the emphasis foreign direct investment receives in the State's industrial development program as well as the extent of Federal involvement in that aspect of the State's program. As it was necessary to use a standardized instrument to gather information, some of the questions may not accommodate every unique situation. Please make an effort to generalize your answers to the responses which most closely describe the majority of cases, and whenever necessary clarify your answer with additional written comments.

I Background Information

1. Recognizing that some types of investment may be encouraged or discouraged more than others, we would like to ascertain your State's overall policy towards direct investment (greater than 10 percent ownership) within your State by individuals or groups from foreign countries? (By "encourage" we mean your State might; for example, provide promotional information to a prospective investor or work with him to locate a suitable site, arrange financial assistance, train and/or recruit employees, etc. By "discourage" we mean your State might, for example, have restrictive legislation or use disincentives to otherwise reduce the level of foreign direct investment.) Which of the following phrases best describes the State's general policy toward foreign direct investment in the State? (Please check only one.)

   1. /35/ Strongly encourage foreign direct investment
   2. /12/ Mildly encourage foreign direct investment
   3. /2/ Neither encourage nor discourage foreign direct investment
   4. /_/ Mildly discourage foreign direct investment
   5. /_/ Strongly discourage foreign direct investment

   6. /1/ No specific policy

2. For approximately how long has the State actively encouraged foreign direct investment (i.e., how long has the State committed budgetary resources to attracting foreign direct investment)? (Please check only one.)

   1. /3/ Not applicable -- not actively encouraging foreign direct investment
   2. /1/ Less than 1 year
   3. /14/ 1 - 3 years
   4. /11/ 4 - 6 years
   5. /10/ 7 - 10 years
   6. /10/ More than 10 years

   (2 No response)

3. Approximately how many full time or equivalent staff positions (administrative and professional — including overseas positions) has the State currently allocated to encouraging foreign investment? (Please check only one.)

   [2] None
   1. /24/ 1 - 3
   2. /11/ 4 - 6
   3. /4/ 7 - 10
   4. /5/ 11 - 20
   5. /_/ More than 20
   6. /4/ Unable to determine

   (1 No response)

4. Approximately what percent of the State's current total number of staff positions allocated to encouraging investment from all sources (domestic as well as foreign) have been allocated to encouraging foreign investment? (Please check only one.)

   1. /7/ Less than 1%
   2. /11/ 1 - 5%
   3. /7/ 6 - 10%
   4. /10/ 11 - 20%
   5. /12/ 21 - 50%
   6. /1/ More than 50%
   7. /3/ Unable to determine

5. What is the total amount of the State's annual administrative expenditures (salary, travel and other operating costs) associated with encouraging foreign investment? If possible, provide the amount of expenditures for October 1, 1977 through September 30, 1978. If data is not available for this period, please provide the most recent available annual figure.

   $__________,000 (total annual administrative expenditures)
   (in thousands)

   NOTE: If a precise figure is not available, please indicate the range within which the annual amount falls. (Please check only one.)

   1. /18/ Less than $100,000
   2. /19/ $100,000 to $499,999
   3. /3/ $500,000 to $999,999
   4. /_/ $1 million to $2.5 million
   5. /_/ $2.6 million to $5 million
   6. /_/ Over $5 million
   7. /4/ No basis to judge

   (5 No response)

6. Approximately what percent of the State's current total annual administrative expenditures for industrial development has been allocated to encouraging foreign direct investment? (Please check only one.)

   1. /8/ Less than 1%
   2. /9/ 1 to 5%
   3. /13/ 6 to 10%
   4. /8/ 11 to 20%
   5. /5/ 21 to 50%
   6. /1/ More than 50%
   7. /3/ Unable to determine

   (4 No response)

7. Does your State maintain representatives or offices in other States or in foreign countries as part of its efforts to encourage investment in the State by individuals or groups from foreign countries?

   1. /29/ Yes
   2. /21/ No (If no, please skip to Question 9.)

   (1 No response)

8. Approximately how many, if any, full-time or equivalent positions does the state maintain in each of the following areas? (Please enter the approximate numbers including zeros (0's) if applicable.)

Location	No. of staff	No. of States
Canada	3	3
Mexico		
Japan	20	10
Other countries in the Far East	3	3
Central America		
Venezuela		
Other countries in South America	2	2
Germany	18	8
Belgium	31	10
United Kingdom	2	1
Netherlands	1	1
Other countries in Europe	16	5
Saudi Arabia		
Other countries in the Middle East		
Other Foreign countries		
Other States in the USA	7	4

9. During the two-year period 1977 and 1978 (calendar year) approximately how many, if any, missions to foreign countries did the State conduct or participate in for the purpose of encouraging foreign investment in the State? (Please fill in the blanks to indicate the number of such missions sponsored by each of the listed organizations.)

No. of States	Total Missions	
31	113	Missions sponsored by this State
9	9	Missions sponsored by the U.S. Department of Commerce
1	1	Missions sponsored by the U.S. Department of State
10	19	Missions sponsored by other organizations

10. How mildly or strongly does the State encourage or discourage each of the following specific types of foreign direct investment? (Check one box for each row.)

	Strongly encourage (1)	Mildly encourage (2)	Neither encourage nor discourage (3)	Mildly discourage (4)	Strongly discourage (5)	(No response)
1. Acquisition of agricultural land		2	22	5	15	7
2. Acquisition of real estate for commercial purposes (such as the future location of a business)	11	14	23		1	2
3. Acquisition of an existing, but ailing, manufacturing activity	23	15	10			3
4. Acquisition of an existing, healthy, manufacturing activity	11	12	23	1		4
5. Acquisition of an existing, but ailing, financial institution	5	3	36		2	5
6. Acquisition of an existing, healthy, financial institution	3	2	37	1	2	6
7. Opening of a new manufacturing facility(ies)	41	9	1			
8. Opening of a new financial institution or branch(es) thereof	15	11	17		2	6
9. Initiation of a joint venture with a U.S. manufacturer	33	15	3			
10. Entering into a licensing agreement with a State manufacturer	32	15	4			

II Specific Investment Information

11. Which of the following types of information does your office collect (when possible) concerning foreign investments in the State? (Please check all that apply.)

1. /42/ Name of investor
2. /30/ Name of beneficial owner
3. /43/ Country of origin
4. /36/ Amount invested
5. /40/ Name of U.S. enterprise acquired or established
6. /42/ Location of investment
7. /32/ Percentage of foreign ownership

9. /4/ No information collected

12. We are interested in how States decide what, if any, financial assistance to offer a prospective foreign investor. Does your State make a quantitative analysis of the specific benefits associated with each prospective investment?

1. /28/ Yes
2. /22/ No (If no, please skip to question 14.)
(1 No response)

13. In which of the following areas are specific benefits estimated? (Please check all that apply.)

1. /20/ Multiplier effect on business activity within the State
2. /20/ State tax revenue impact
3. /28/ Employment effect
4. /5/ Decreased transfer payment resulting from reduced welfare payments, unemployment compensation, etc.

14. Does your State estimate on a case by case basis the costs associated with attracting foreign investment?

1. /10/ Yes
2. /40/ No (If no, please skip to question 16)
(1 No response)

15. Which of the following costs does your State typically estimate? (Please check all that apply.)

1. /8/ Administrative costs of encouraging the investment (i.e. personnel, travel and other operating costs)
2. /3/ State tax revenue foregone as a result of specific tax relief granted to investors
3. /5/ State subsidy costs from low interest loans
4. /1/ Cost of additional government services required by a new facility
5. /10/ State cost of training and recruiting work force for new facility

16. Would you be willing to share with us your detailed data on the associated costs and benefits of foreign investment if we visited your office?

1. /20/ Yes
2. /13/ No
(18 No response)

III Encouraging For Foreign Investment

17. At what point in the investment decision process does your State typically establish substantive contact with a potential foreign investor? (Please check only one.)

1. /3/ When the investor begins to consider investing, but has not yet determined the country in which the investment will occur.
2. /24/ When the investor has expressed general interest in locating in the United States, but has not yet decided on a specific region or State.
3. /6/ When the investor has chosed the region of the country in which to locate, but has not yet decided on a specific State.
4. /6/ When the investor has narrowed the choice down to a few sites located in various states including your State.
5. /3/ When the investor has made a general decision to locate somewhere within your State.
6. /_/ When the decision has narrowed down to potential sites in your State only.
7. /1/ Other

(8 No response)

18. How frequently, if at all, has the State observed foreign investors "shopping around" for the best State financial assistance when deciding on a location for their investment? (i.e. how often do foreign investors negotiate for greater financial assistance using another State's or country's offer as leverage?) (Please check only one.)

1. /5/ Always or almost always
2. /19/ Frequently
3. /12/ Occasionally
4. /9/ Rarely
5. /3/ Never or almost never

(3 No response)

19. In seeking to attract foreign investment, how much (if any) competition does the State experience from each of the following sources? (Please check one box in each row.)

	Very significant competition (1)	Significant competition (2)	Moderate competition (3)	Little competition (4)	Very little, if any, competition (5)	(No response)
1. Neighboring State governments	30	9	5	3	2	2
2. State governments in other regions of the U.S.A.	17	13	12	4	3	2
3. Foreign governments	3	4	4	6	27	7

APPENDIX III

20. How much competition has your office observed at the local level (communities, counties, local development authorities) to attract foreign investment? (Please check one box in each row.)

	Very significant competition (1)	Significant competition (2)	Moderate competition (3)	Little competition (4)	Very little, if any, competition (5)	(No response)
1. Between local groups within your State	9	10	13	9	6	4
2. Between local groups in your State and local groups in other States	12	8	13	5	9	4

21. Please indicate below whether your State would be likely to favor or oppose each of the following alternative ways of bringing about a reduction in the level of State competition for foreign investment. (Please check only one box for each row.)

	Strongly favor (1)	Mildly favor (2)	Neither favor nor oppose (3)	Mildly oppose (4)	Strongly oppose (5)	(No response)
1. Mutual agreement among states on a code of conduct that limits the assistance which can be offered to a foreign investor	2	3	17	2	23	4
2. Federal legislation limiting the amount of state assistance that can be provided to a foreign investor		1	8	8	31	3
3. An increased facilitative and liaison role at the Federal level similar to what is now provided on a limited scale by Commerce's Invest in the USA office	12	18	6	3	10	2
4. International agreement on a code of conduct that limits "bidding" between countries for investment	1		21	5	22	2
5. More federally directed financial assistance to investors to replace that now offered by States and communities	6	6	10	6	20	3

IV Assistance For Foreign Investment

22. Approximately how many foreign direct investments (transactions not dollar amounts) were made in the State during 1977 and 1978? (calendar years)

		States responding
353	1977 (number of foreign investments)	35
454	1978 (number of foreign investments)	35

16 States either did not respond or had no information available on the number of foreign direct investments.

23. In approximately how many of the foreign direct investments made in the State during that same period was the investor provided with specific financial assistance from the State government? (This would not include general tax incentives for which all new investments might be eligible; rather those transactions in which the state provided particular assistance - a loan, revenue bond financing, employee training, etc.)

		States responding
123	1977 (number of foreign direct investors receiving State financial assistance)	19
147	1978 (number of foreign direct investors receiving State financial assistance)	20

24. What is the approximate dollar value of the foreign direct investments made in the State during 1977 and 1978?

$\_\_\_$,000 1977 value of foreign direct (in thousands) investment

$\_\_\_$,000 1978 value of foreign direct (in thousands) investment

If an approximate dollar value is not available, please indicate the range within which that dollar value probably falls.

1977	1978	
1. [3]	1. [2]	Under $500,000
2. [1]	2. [3]	$500,000 to $999,999
3. [7]	3. [7]	$1,000,000 to $9,999,999
4. [2]	4. [3]	$10,000,000 to $19,999,999
5. [7]	5. [4]	$20,000,000 to $49,999,999
6. [5]	6. [3]	$50,000,000 to $99,999,999
7. [7]	7. [9]	$100,000 million or more
8. [11]	8. [13]	Unknown
(8	7	No response)

25. Approximately what percent of the dollar value of foreign direct investments made in the State during 1977 and 1978 was by foreign investors who received specific financial assistance from the State? (Please check only one box for each year.)

1977	1978	
1. [18]	1. [17]	Less than 5%
2. [1]	2. [1]	5 to 10%
3. [2]	3. [4]	11 to 25%
4. [2]	4. [1]	26 to 50%
5. [2]	5. [4]	Over 50%
6. [14]	6. [16]	No basis to judge
(12	8	No response)

26. Next, we are interested in learning about your State's reasons for offering specific financial assistance to foreign investors. In those instances in which your State has offered such tailored assistance which of the following are usually the two most important reasons for doing so? (Please place a "1" by the reason that is usually the most important reason and a "2" by the reason that is usually the second most important reason.)

States ranking this factor #1	States ranking factor #2	
1	1	To partially compensate the investor for his perceived additional costs of locating in the State (i.e. higher tax rates, wage cost, etc. relative to competing States)
5	6	To provide sufficient financial support to permit the investment
10	6	To be competitive with other States offering incentive packages
6	8	To convince the investor of the State's sincere interest in the investment
	1	To be competitive with other countries offering incentive packages
1		Other reason
(28	29	No response)

27. How frequently, if at all, have foreign investors locating in your State received financial assistance from each of the following Federal funding sources, either directly or through the State or a local government to assist them in establishing their operations? (Please check one box per row.)

Federal Source	Rarely, if ever (1)	Occasionally (2)	Frequently (3)	No basis to judge (4)	(No response)
1. Economic Development Administration	26	4		13	8
2. Small Business Administration	23	7	1	14	6
3. Farmers Home Administration Business and Industrial Loan Program	23	6		16	6
4. Department of Housing and Urban Development, Urban Development Action Grant Program	25	2		18	6
5. Department of Labor, Employment and Training Administration	23	7	1	14	6
6. Other Federal funds received through revenue sharing	24	1		19	7

28. How frequently, if at all, is your State in contact with the following Federal offices in conjunction with efforts to encourage foreign direct investment? (Please check one box per row)

	Rarely, if ever (1)	Occasionally (2)	Frequently (3)	(No response)
1. Economic Development Administration	31	9	4	7
2. Small Business Administration	31	8	5	7
3. Farmers Home Administration	34	8	2	7
4. Department of Housing and Urban Development	41	3	1	6
5. Department of Labor	35	5	2	9
6. Invest-in-the-USA, Department of Commerce	13	22	15	1
7. Department of Commerce, district or local office	7	25	16	3
8. Department of Treasury	38	4		9
9. U.S. Customs Office, Department of Treasury	24	17	4	6

29. For those Federal offices with which your State has frequent or occasional contact, as indicated in your response to Question 28, we are interested in what the State's experience has been when working with each Federal office to encourage foreign direct investment. Please indicate for each Federal office the phrase as defined below that best describes the kind of coordination that the State has experienced.

Excellent coordination:	The Federal office has greatly assisted the State in its efforts to attract foreign investment
Good coordination :	The State and Federal offices work together smoothly and the Federal office sometimes assists the State in its efforts to encourage foreign investment
Minimal coordination :	State and Federal office touch base as necessary without helping or hindering efforts to encourage foreign investment
Counter productive coordination :	Involvement of the Federal office is determental to the State's efforts to encourage foreign investment

	Excellent coordination (1)	Good coordination (2)	Minimal coordination (3)	Counter productive coordination (4)	No basis to judge (5)	(No response)
1. Economic Development Administration	5	7	8		17	14
2. Small Business Administration	7	6	7		16	15
3. Farmers Home Administration	2	5	5		22	17
4. Department of Housing and Urban Development		2	4		25	20
5. Department of Labor	3		8	2	22	16
6. Invest-in-the-USA, Department of Commerce	11	15	12		8	5
7. Department of Commerce, district or local office	14	20	10		2	5
8. Department of Treasury	1		9		23	18
9. U.S. Customs Office, Department of Treasury	3	5	12	2	14	13

V. State Views on Foreign Investment

30. In the future, what changes, if any, would you expect in your State's level of effort to attract foreign direct investment? (Check one.)

1. /14/ Substantial growth
2. /29/ Moderate growth
3. /8/ Little, if any, growth or reduction
4. / / Moderate reduction
5. / / Substantial reduction
6. / / Uncertain

31. In your judgment, what is the relative importance of each of the following factors in terms of attracting foreign investment to your State: Please place "1" by the most important of the five factors, "2" by the second most important and so on up to "5" by the least important factor. Please read through the list of factors before making your first ranking. (NOTE: Each of the numbers 1 through 5 should be entered once and only once.)

	*Average ranking
1. General economic attractiveness of the State (i.e. availability of labor at attractive wage rates; proximity to markets, supplies, and/or transportation, etc.)	1.2
2. General tax climate (i.e. tax or other economic incentives which are set by the State and generally available to all investors)	2.9
3. Tailored financial or tax incentives (i.e. loans, loan guarantees, tax abatements, revenue bonds, etc. which are made available to specific investors on a case by case basis)	4.0
4. Quality of life features (i.e. the weather, schools recreation services, cost-of-living, public safety services, etc.)	3.4
5. General marketing skill of the State and communities (i.e. ability to effectively advertise, make a foreign investor welcome, provide necessary information, etc.)	3.5

*Based on responses from 47 States.

VI Related Topics

Next we have some questions about how other government investment policies affect your state.

32. How frequently, if at all, has your State lost a potential foreign investment to a competing State because of the financial assistance offered by that State to the investor? (Check one.)

1. /12/ Rarely, if ever
2. /24/ Sometimes
3. /6/ Frequently
4. /8/ No basis to judge

(1 No response)

33. How frequently, if at all, has your State lost a potential foreign investment to a competing foreign country as a result of that country having given a large cash grant to the investor? (Check one.)

1. /16/ Rarely, if ever
2. /6/ Sometimes
3. /1/ Frequently
4. /29/ No basis to judge

(1 No response)

Finally, we have two questions concerning foreign investors that have located in your State.

34. First, of those that are subsidiaries of foreign companies, what portion are required by either their parent company or the country of their parent company to make most or all purchases from their parent company regardless of whether this is the most economical course of action? (Please check only one.)

1. /17/ Few, if any
2. / / Between 10 and 30%
3. / / Between 30 and 50%
4. /1/ Between 50 and 70%
5. / / More than 70%
6. /36/ No basis to judge

(2 No response)

35. Second, what portion of these same subsidiaries are precluded by their foreign parent company from exporting their products outside of the United States? (Please check only one.)

1. /8/ Few, if any
2. / / Between 10 and 30%
3. / / Between 30 and 50%
4. / / Between 50 and 70%
5. / / More than 70%
6. /41/ No basis to judge

(2 No response)

UNITED STATES DEPARTMENT OF COMMERCE
International Trade Administration
Washington, D.C. 20230

MAR 13 1980

Mr. J. K. Fasick, Director
International Trade Division
General Accounting Office
Room 4804
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Fasick:

This responds to the letter of February 4, 1980 from Mr. Henry Eschwege, Director, Community and Economic Development Division, to Secretary Klutznick, asking for review and comment respecting the draft GAO report on "Foreign Direct Investment in the United States -- The Federal Role."

The study represents a well-planned and conducted research effort and we agree substantially with the findings and the thrust of the recommendations. There have been extensive consultations between GAO study staff and relevant offices in the Department of Commerce, both during the preparation of the study and after delivery of the draft report. Since the GAO staff has received detailed comments on specific sections of the report, my observations will be of a broader non-technical nature dealing with four major subjects -- the adequacy of data on foreign direct investment here, analysis of the economic effects of such investment, Federal Government facilitation of state and local efforts to attract foreign investments, and analysis of the costs and benefits of investment incentives.

On the matter of adequacy of data, the report states that data published by the Department's Bureau of Economic Analysis understate the total value of foreign holdings. The foreign investment position data gathered and published by BEA are designed to measure the value of direct claims on U.S. business enterprises by foreign direct investors. Their accuracy has not been challenged, and there is no understatement. There are, of course, other ways to measure foreign investment, e.g., the total assets of foreign controlled enterprises. We feel, however, that between BEA's balance of payments related presentations, their annual interim surveys (BE-15) and reports on new foreign investments (BE-13) and the transactions reports which the

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Office of Foreign Investment in the United States publishes semi-annually, based on publicly available data, we are able to provide the Congress and other interested parties the insights on the growth and extent of foreign investment necessary to meet information and policy needs.

On the matter of analysis of the economic effects of foreign direct investment here we fully agree with the report's stress on the importance of and the need for such analysis. We have discussed with the GAO staff the status of studies undertaken by the Office of Foreign Investment in the United States and have provided them with studies that were published recently and have advised them of others that are forthcoming soon. Our own and Congressional interest in an expanded and more expeditious research effort coincide, and we are taking steps to provide the necessary resources as promptly as budgetary and personnel constraints permit.

With reference to facilitation of State and local efforts to attract foreign investments the Department has been the principal vehicle, working in tandem with the Foreign Service, for Federal facilitation efforts since the early 60s. The Department's present principal officers are keenly interested in providing expanded support, both directly and through the commercial officers in our Foreign Service posts, and also in making certain that prospective foreign investors are aware of investment opportunities in distressed communities and of Federal programs applicable to such areas. We, therefore, generally agree with the report's recommendations in this area, and are prepared to examine them closely to determine what specific steps can be taken.

The report contains discussion and recommendations to the effect that the Federal Government should not try to take a lead role in helping foreign investors make locational decisions. The Department of Commerce has worked closely with the states for almost two decades. It has directed prospective investors to the state economic development agencies, and those agencies have pressed for expanded Commerce help along the same lines. We have had no problems with the states and localities respecting their lead role in dealing with foreign investors on locational decisions and have no reason to anticipate any in the future.

The report addresses another area of considerable interest -- investment incentives -- and recommends that the Department undertake cost/benefit analysis of investment incentives received by foreign investors. We have already done extensive work in cataloguing state incentives and have also been examining possible methodologies for identifying the incentives actually provided and analyzing their costs and effects. Thus we agree with the objective of the

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recommendation. However, we believe it would be preferable if it were not limited to a particular approach, especially since tying the analysis in to Bureau of Economic Analysis survey data may present confidentiality problems.

Sincerely,

Abraham Katz

Abraham Katz
Assistant Secretary-Designate
International Economic Policy

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

MAR 10 1980

Mr. J. K. Fasick
Director of International
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Fasick:

I noted with great interest your draft Report on the federal government's role in monitoring and facilitating foreign direct investment in the United States. While I am not, of course, in a position to evaluate critically the Report's conclusions about the record of the Office of Foreign Investment in the United States (OFIUS), I do agree that we need to learn more about the nature, the extent and the effects of foreign direct investment and I think it is appropriate that we look to OFIUS to provide us with at least some of that information. Accordingly, I support the Report's recommendation that OFIUS place greater emphasis upon collecting, making and distributing studies concerning the economic impact of foreign direct investment.

I was quite interested in the Report's recommendation that the Department of Commerce issue guidelines making clear that commercial officers attached to U.S. Embassies should more actively support the States in their overseas promotional efforts. As you may know, the State of Florida undertook while I was Governor a vigorous campaign to attract foreign direct investment. Based upon my experiences in that effort, I believe that the commercial officers at U.S. Embassies generally are doing a good job but they can and should do more to assist the States in locating potential foreign investors. As a member of the interagency Committee on Foreign Investment in the United States, this Office will cooperate in drafting guidelines for commercial officers.

As you know, the use of investment incentives is being subjected to increasingly critical scrutiny both within our own government and in various international fora. During the past three years the United States has sought increased

 APPENDIX V

- 2 -

multilateral cooperation and discipline on investment issues, including the use of incentives. Since this is an exceedingly difficult and complex set of issues, I think that it behooves all of us who have responsibility in this area to base any assumptions we may make about the relationship between investment incentives and investment (and trade) flows on a careful and extensive analysis of the best available empirical data. To the extent that OFIUS can compile information about the use and the costs of incentives, I think that it would be rendering a most useful service to those of us who must make policy decisions in this area.

Very truly yours,

Reubin O'D. Askew

APPENDIX VI

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

March 21, 1980

Dear Mr. Fasick:

This is in response to your letter to Secretary Miller of February 1 with which you sent a copy of your draft report, "Foreign Direct Investment in the United States -- the Federal Role," for review and comment.

In general we believe that the report, particularly its discussion of the states' investment incentive programs, is a useful treatment of some of the important developments and issues in this area. I understand that members of the Treasury staff have met with the authors of the report and offered a number of detailed comments and suggestions on the draft you sent us. We were gratified to hear later that most of these will be taken into account in your final report. I intend, therefore, to limit my comments at this time to two of your recommendations that are of particular concern to the Treasury Department.

One of your recommendations is that the Secretary of Commerce should "place greater emphasis on collecting, making and publishing studies concerning the economic impact of foreign direct investments." Another is that he should "develop and issue operational guidance on inward investment to encourage the Department's facilitative efforts to help the States attract foreign investment." Both efforts are to be undertaken in cooperation with the Committee on Foreign Investment in the United States (CFIUS), which is chaired by Assistant Secretary of the Treasury C. Fred Bergsten.

We have discussed these recommendations with the responsible officials in the Department of Commerce. They say that they agree with the recommendations' basic thrust and intend to see what can be done to implement them, within the constraints of existing resources. As to the role of the CFIUS, it stands ready to offer whatever assistance or guidance may be appropriate.

Thank you for the opportunities you have given us to offer our views.

Sincerely,

Gary Hufbauer

Gary C. Hufbauer
Deputy Assistant Secretary
for Trade and Investment Policy

Mr. J. K. Fasick
Director
International Division
United States General
Accounting Office
Washington, D.C. 20548

DEPARTMENT OF STATE
Comptroller
Washington, D.C. 20520

March 12, 1980

Mr. J. Kenneth Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C.

Dear Mr. Fasick:

I am replying to your letter of February 1, 1980, which forwarded copies of the draft report: "Foreign Direct Investment In The United States -- The Federal Role."

The enclosed comments on this report were prepared by the Assistant Secretary in the Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger B. Feldman

Roger B. Feldman

Enclosure:

As Stated

GAO DRAFT REPORT: "FOREIGN DIRECT INVESTMENT IN THE UNITED STATES -- THE FEDERAL ROLE"

I appreciate the opportunity to comment on this report. I found it to be highly informative, containing a wealth of useful information on foreign direct investment in the United States and on state investment incentive programs.

I would, however, like to make two general observations concerning the relationship of the report to current investment policy and ongoing investment negotiations. First, as you are aware, the fundamental policy of the U.S. Government toward international investment is neither to promote nor discourage inward or outward investment flows or activities. We support foreign direct investment responding to market forces since such investment can lead to increased economic growth. Under our policy we do not "promote" inward investment in that we do not actively seek out potential investors in the United States. We can, and do, facilitate investment by investors who have decided to come to the U.S. Such facilitation is now being provided through U.S. embassies including working with state offices overseas and hosting "Invest in USA" seminars. The report speaks of "promoting" and "encouraging" increased investment, thus blurring the distinction between USG support for increased worldwide investment flows, and our policy to "facilitate" rather than "promote" inward investment. Unless the report contemplates a change in current U.S. policy, I would recommend that the language be changed to preserve this distinction.

My second point concerns investment incentive programs in the U.S. The report makes clear that many states have extensive programs. The report also points out the U.S. Government is carrying out discussions in several international fora on ways to control incentive schemes worldwide. I think it would be worthwhile to emphasize our rationale for this effort. Our concern about investment incentives stems from the belief that they can adversely effect the international economic system. First, incentives could, in some cases, result in an uneconomic allocation of resources and less output and income for the world as a whole. Second, these practices may direct benefits from investments from one country to another, at the extreme, leading to nationalistic economic policies which disregard consequences for neighboring countries. Third, since firms consider many factors more important than incentives in making investment decisions, government payments made or future revenues lost to attract new investment may be "wasted" in that these incentives may play only a peripheral role in the decision process of the firm. As discussions in the international fora proceed, it may be useful for individual states to take note of any consensus reached and to re-examine their individual programs accordingly.

Sincerely,

Deane R. Hinton
Assistant Secretary for
Economic and Business Affairs

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

February 20, 1980

Mr. Allen R. Voss
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss,

The draft GAO report, "Foreign Direct Investment in the United States--The Federal Role" contains several references to ACIR work with which we would not agree. The report, we believe, incorrectly relates on p. 41 how the Commission came to study the interstate tax competition issue. Also, on pg. 41, the report implies that the Commission's internal documents on the issue are formal publications which they are not. On pg. 43, the report interprets the effect of the federal income tax on state and local fiscal incentives from the viewpoint of the business firm whereas we believe the Commission would and did consider the effect of the federal income tax on incentives from the governmental perspective.

To reflect our views on these three matters we have provided specific suggested language in the manuscript we are returning with this letter. Other nonsubstantive corrections are also shown on the manuscript.

Thank you for the opportunity to suggest revisions to the document.

Sincerely yours,

Wayne F. Anderson

Wayne F. Anderson
Executive Director

GAO note: Report was revised to incorporate Commission's comments.

APPENDIX IX

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF COMMERCE
HARRISBURG, PA 17120
U.S.A.

BUREAU OF INTERNATIONAL COMMERCE
John E. Newlin Jr., Director

TELEPHONE: (717) 787-7190
TWX: 510-650-4924

February 22, 1980

Mr. J. K. Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fasick:

Subject: Draft Report/Foreign Direct Investment

We have studied the draft of the proposed report on "Foreign Direct Investment in the United States -- The Federal Role".

We agree wholeheartedly that the Federal role should be limited to facilitating the States' efforts.

We concur with the recommendation that the direct and timely flow of potential investment information directed to the individual states is of the utmost importance. Currently, there is much too much time lost going from the embassy to Washington then on to the states. Since the Economic Counselors are being transferred from State Department to Commerce, we assume the lead time can be cut down and we would hope that the overseas personnel would take a much more active role in reverse investment.

The proposed publication is a good and complete summary of reverse foreign investment, and we feel that if its recommendations are implemented, it should serve a useful purpose.

This book can serve as a useful tool for persons unfamiliar with reverse foreign direct investment, but to those already involved it has very limited appeal.

Very truly yours,

John E. Newlin, Jr.

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