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EMERGING CONCERNS OVER FOREIGN INVESTMENT IN THE UNITED STATES

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C o n t e n t s

CHAPTER 1

INTRODUCTION

According to Department of Commerce statistics, total foreign investments in the United States at the end of 1973 are estimated at $62.2 billion--$17.7 billion in foreign direct investments and $44.5 billion in foreign portfolio investments. However, the accuracy of these figures has been sharply questioned in recent months and new efforts to more accurately determine the extent and impact of these investments are just beginning.

U.S. AUTHORITY FOR KEEPING ABREAST OF FOREIGN INVESTMENT ACTIVITIES

Official statistics on foreign investments have been collected primarily for inclusion in the balance-of-payments data reported to the International Monetary Fund pursuant to section 8 of the Bretton Woods Agreements Act, as amended (22 U.S.C. 286-286k-1). The focal points for compiling and maintaining these statistics have been the Department of Commerce's Bureau of Economic Analysis (for direct investments) and the Department of the Treasury's Office of the Assistant Secretary for International Affairs (for portfolio investments).

Additional authority, directed toward developing more comprehensive data, was enacted on October 26, 1974, when the President signed Senate Bill 2840, the Foreign Investment Study Act of 1974 (Public Law 93-479). The act authorizes and directs the Secretaries of Commerce and the Treasury to conduct a comprehensive overall study of foreign direct and portfolio investments in the United States. To the extent that the

Secretaries determine feasible, the study is to include analyses of the effects of these investments in various areas of the economy.

DIRECT vs PORTFOLIO INVESTMENTS

Foreign direct investment is described as ownership by a single person or organization of at least 10 percent of a U.S. enterprise's voting stock or equivalent interest and is considered to be aimed at controlling the management of the organization.

Foreign portfolio investments, on the other hand, assume a passive management role and, along with bonds and other securities, include ownership of less than 10 percent of an enterprise's voting stock. Until the new study of foreign investments began, the level of stock acquisition differentiating the two types of investment was 25 percent.

SCOPE OF GAO SURVEY

Because of the lack of adequate information in the face of accelerating foreign investment activities and because of intense congressional and public interest, we made a survey of foreign investments in the United States. We talked with Federal, State, and local government officials, chambers of commerce, trade associations, academicians, bankers and corporate officials, and visited officials in Hawaii, Oregon, Washington, Colorado, Montana, Georgia, Pennsylvania, and New York City. We also talked by telephone with State officials in North and South Carolina. Also, as a result of a congressional request received after our survey was underway, we made specific inquiries into the extent that foreign investments are occurring in U.S. timber, mining, and agricultural businesses.

We did not attempt an exhaustive analysis of the laws of other countries relative to foreign investment. Several such legal studies have already been undertaken by the Library of Congress, the executive branch of the Government, and independent private organizations and scholars. Our comments on United States and other countries' constraints on foreign investments are in chapter 4.

CHAPTER 2

ACCELERATION OF FOREIGN INVESTMENT ACTIVITIES

Foreign investments in the United States accelerated at a record pace during 1973. Direct investments, which had increased at an annual rate of about $613 million since 1960, increased by $3.5 billion.[1] The growth of foreign direct investments is charted in appendix I.

Portfolio investments, including a record $2.8 billion in net stock purchases, increased by $4.5 billion. Despite this inflow, the overall valuation of foreign portfolio investments decreased by nearly $1.5 billion in 1973 as the result of a $6 billion negative valuation adjustment reflecting the drop in stock and bond prices.

Some factors contributing to this accelerated investment included the:

--1971 and 1973 devaluations of the U.S. dollar.

--Size of and opportunities offered by the U.S. market.

--Decline of U.S. stock prices, thus making domestic firms available at bargain prices.

--Development of large, foreign-owned multinational corporations, which are competitive in U.S. markets and equivalent to U.S. multinationals in size.

--Significantly higher rate of inflation abroad, at least until recently.

--Narrowing wage gap between the United States and other developed countries.

--Abundance of raw materials, commodities, and land as well as expertise, technology, and labor in the United States.

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[1] Figures for 1974, according to Commerce officials, will not be available until the spring of 1975. However, one unofficial estimate indicates that foreign direct investments have increased from $17.7 billion at the end of 1973 to $20 billion in early 1975.

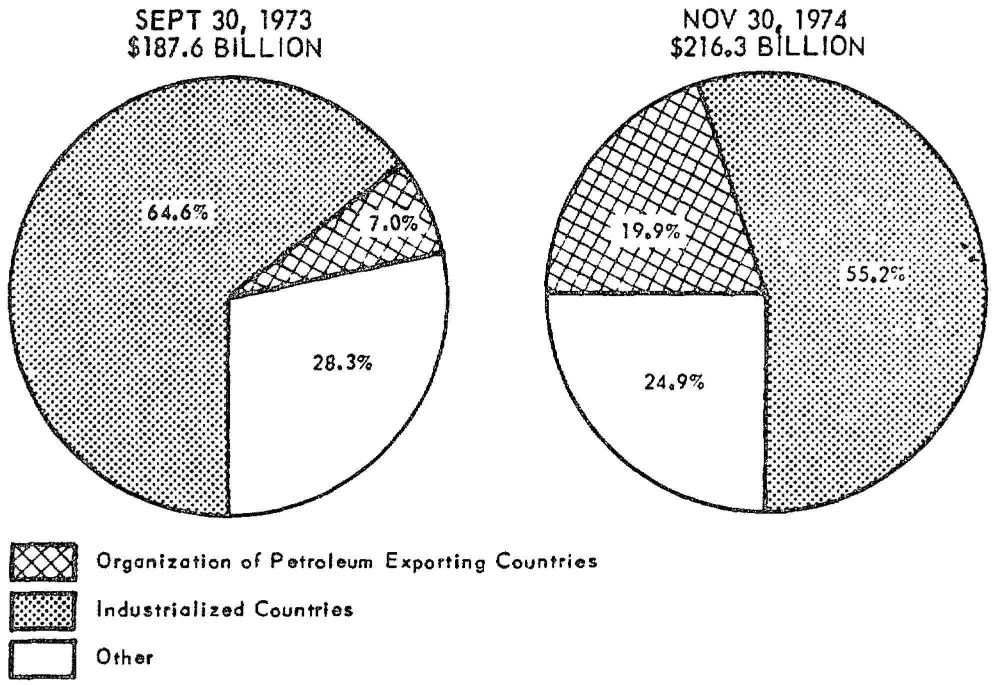
POTENTIAL FOR U.S. INVESTMENTS BY OIL-PRODUCING NATIONS

A dramatic new element of foreign investment has been the record $11 billion invested in marketable U.S. Government securities, bank deposits, and other short-term investments by the oil-producing nations during 1974. Although no official projections exist concerning the eventual magnitude of oil-revenue investments, we found the consensus of knowledgeable persons to be that such vast sums are potentially involved as to constitute a situation without precedent.

In 1974 the Ford Foundation's Energy Policy Project issued a report which pointed out that during the the 4-year period ending January 1, 1974, the price of oil rose about 515 percent. This price rise reflected the fact that since 1970, member nations of the oil-producing cartel raised taxes virtually at will on their oil production.

By November 30, 1974, about a year following the period of oil price escalations, monetary reserves of the oil-producing countries grew from $13.2 billion to about $43.1 billion. Their share of total world monetary reserves increased from 7 to 19.9 percent, as shown in the chart on the following page.

WORLD MONETARY RESERVES



A World Bank forecast indicates that these countries' reserves will reach levels of some $650 billion by 1980[1]. One estimate based on these figures shows that by 1979 these countries will have sufficient surplus revenues to buy all the stock of all the companies listed on the New York Stock Exchange.

An official of the First National City Bank in New York City told us in November 1974 that he expects the transfer of wealth to be only a temporary phenomenon and that the 1980s will see a reversal of the imbalance in world monetary reserves that is now occurring. As oil production from most of these countries begins to diminish and their capacity for consumption increases, their trade balances should go into deficits--ultimately forcing drawdowns against accumulated reserves and returning the overall system to a somewhat better balance. The banking official foresaw this happening to these countries as a group and pointed out that there could be individual exceptions where oil reserves are exceptionally large and/or populations very sparse.

PROSPECTS: HOW SURPLUS OIL REVENUES MIGHT BE USED

Little is known about how the oil-producing nations will use their newly acquired wealth. To date, indications are that these countries have tended to place the bulk of their money in short-term deposits at high interest in European money markets and, more recently, in the New

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[1] More recent calculations by private economists and the Treasury Department have revised the World Bank's estimate downward to a $200 to $300 billion range. It is contended that the Bank's estimate was based on inflated 1980 dollars, whereas using constant 1974 dollar values would reduce the estimate to $400 billion. Further reductions are attributed to overestimating demand for oil by importing nations and underestimating the oil-exporting nations' capacity to increase their imports of goods and services.

York money market. Thus, the oil producers are, in effect, forcing intermediaries to shoulder the risk of lending funds to the oil-consuming nations--some of which ultimately may not be able to repay their borrowings to cover oil imports.

It is fairly well recognized that private banking institutions can safely accept only a certain level of such deposits before becoming vulnerable to insolvency; i.e., the inability to continue long-term lending with funds that are subject to near immediate withdrawal by depositors.

According to the First National City Bank official, however, this problem with liquidity can be handled by manipulating interest rate differentials to encourage longer term investments over short-term deposits. Also, through interest rate manipulation, private institutions can, in effect, encourage prospective investors to seek higher returns in corporate stocks and other investments calling for more direct involvement and greater risk assumption by the investors.

According to the Bank official, the same tactic could be used to encourage oil-producing nations to increase their direct lending to high-risk, oil-consuming countries. (It should be noted that this, in turn, would exacerbate the difficulties of heavily indebted countries in meeting their international obligations and could add an element of leverage useful to producers in achieving other objectives. See pp. 35-36)

SOME TYPICAL U.S. INVESTMENTS

Iran, an example of a rapidly modernizing oil producing nation, is reportedly spending heavily in the United States and Europe for military hardware. Moreover, it is making and will probably continue to make substantial internal investments to build up its own economic and social institutions. This implies massive imports of technology, equipment, and facilities necessary for a modern infrastructure and industrial base.

According to a joint communique dated March 4, 1975, the United States and Iran have jointly set a target of $15 billion for non-oil trade between the two countries over the next 5 years. In addition to a series of large nuclear power plants for which the United States is expected to provide nuclear reactors, projects to be undertaken include:

--Water desalination plants (associated with the nuclear power plants).

--20 factories for the production of prefabricated housing.

--100,000 apartments and other housing units.

--5 hospitals, with a total of 3,000 beds.

--A major port for handling agricultural products, plus other port facilities.

--Super highways.

--Vocational training centers.

--Joint ventures for the production of fertilizers, pesticides, farm machinery, and processed foods.

--Establishment of an integrated electronics industry.

--The development of petrochemical industries.

However, Iran is also investing abroad. In addition to the substantial funds provided to the International Monetary Fund and the World Bank, Iran's recently reported foreign investments include:

1. $100 million for a 25-percent interest in the steelmaking subsidiary of Krupp, the German iron and steel producer which is among the 50 largest industrial companies outside the United States.

2. The purchase of a major, multimillion-dollar office building on New York City's Fifth Avenue.

3. The purchase of a large tract of land in the Ozarks.

4. A $75-million loan to the Grumman Aircraft Corporation.

According to news articles in March 1975, President Ford has tentatively endorsed Iran's proposed $300-million financial rescue-plan for Pan American Airways. Iran would provide $245 million in loans and another $55 million in exchange for a controlling interest in Pan American's international chain of hotels. Moreover, Iran would be given options to buy up to 6 million nonvoting shares, or about 13 percent of the airline's outstanding common stock. Final settlement is not yet complete.

See appendix II for additional examples of recent foreign investments. Details of these or other possible investments--particularly those involving real estate--are difficult to come by, and the accuracy of the reports cannot always be verified. As acknowledged by a number of government and private officials, "Nobody really knows what the investment picture is. The last thing an investor wants people to know is where he's putting his money."

For these reasons, it is difficult to determine the full range of investments or where investments might be made in the future.

CHAPTER 3

CONGRESSIONAL CONCERNS

Uncertainty over the magnitude and type of foreign investments likely to be made in the United States and lack of reliable data on the extent and effects of existing foreign investments have stimulated serious concern within the Congress over the past several months.

The recently enacted Foreign Investment Study Act of 1974 is a result of this concern. Among the numerous tasks assigned by this legislation, the Secretaries of Commerce and the Treasury, to the extent they deem feasible, are to include analyses of the effects of both direct and portfolio investments on the U.S. balance of payments and the effects of financing methods on American financial markets. Also, analyses of direct investment effects on employment opportunities and practices and on U.S. national security, energy, natural resources, agriculture, environment, real property holdings and balance of trade are required.

A Senate bill (S. 3955, 93d Cong., 2d sess.) introduced in August 1974 called for the establishment of a Foreign Investment Review Administration within the Department of Commerce for registration purposes. It was intended to complement the Foreign Investment Study Act of 1974 in that it provides a continuing informational base on the extent of foreign investments beyond the tenure of the study. Hearings were held in September 1974, but no further action was taken and the bill has not been reintroduced in 1975. However, a related bill (S. 329, 94th Cong., 1st sess.) was introduced in January 1975 to require informational reports from foreign investors and their agents.

Another Senate bill (S. 425, 94th Cong., 1st sess.) introduced in January 1975 and to be known as the Foreign Investment Study Act of 1975 is, among other things, also directed toward providing a system for identifying the extent of foreign investments in the United States. The bill requires foreign investors to notify the Securities and Exchange Commission 30 days prior to acquiring 5 percent or more of any U.S. company having assets of $1 million or more. It authorizes the President to deny such proposed acquisitions for reasons of national security, furtherance of foreign policy, or protection of the domestic economy. And disclosure of beneficial owners--foreign as well as domestic--of all publicly traded corporations is required.

On March 3, 1975, Amendment 24 to S. 425 was introduced to prohibit the acquisition of more than 5 percent of any U.S. company's stock by any foreign investor who has forced or attempted to force other firms to boycott an American business because of its transactions with or in a foreign country with which the United States has diplomatic relations. The amendment is intended to assure that foreign investors with a known pattern of using economic power to advance political objectives do not obtain control of U.S. business interests. Hearings were held on S. 425 on March 4-6, 1975, but the bill has not yet been enacted into law.

Other foreign investment legislation introduced in the 93d Congress included the following bills (none of which was enacted):

--H.R. 14136 (93d Cong., 2d sess.), establishing a National Foreign Investment Control Commission designed to restrict foreign ownership or control of U.S. industries, real estate, or other resources deemed vital to U.S. economic security or national defense. (Reintroduced on January 14, 1975, as H.R. 945, 94th Cong., 1st sess.)

--H.R. 14138 (93d Cong., 2d sess.), establishing a joint congressional committee for overseeing and monitoring activities of the above Foreign Investment Control Commission. (Reintroduced on January 14, 1975, as H.R. 954, 94th Cong., 1st sess.)

--H.R. 8951 (93d Cong., 1st sess.), restricting foreign ownership of U.S. enterprise to no more than 5 percent of corporate voting stock. (No hearings were held and the bill has not been reintroduced in 1975.)

Neither H.R. 945 nor H.R. 954 of the 94th Congress has yet been enacted into law.

There is, however, a body of opposition to most forms of restrictive measures. An editorial in the October 1974 issue of "Fortune" magazine inferred that it was in the U.S. interest to encourage the Arabs to move their money from volatile bank deposits into long-term investments. Similarly, one of the conclusions from a recent congressionally-sponsored study advocated that:

"* * * a major goal of U.S. policy must be to provide sufficient investment opportunities for the oil exporting countries and to facilitate the recycling of international capital flows."

To improve the climate for international trade and investment, it was recommended that the United States:

"Facilitate the productive investment of surplus oil revenues in the U.S. Oil exporting country investment in oil refining and marketing facilities should be encouraged in particular."[1]

State and Federal officials have joined with private spokesmen in opposing any abrupt reversal of U.S. policy toward foreign investment. In general, they oppose screening and restricting of foreign investment

[1]Taken from a report entitled "Oil Imports and Energy Security: Analysis of the Current Situation and Future Prospects." The report was prepared by a team of economists from Southern Illinois University and published by the House Committee on Banking and Currency in Sept. 1974.

at this time, preferring an official Government policy which neither agressively encourages nor actively discourages foreign investment.

CHAPTER 4

UNITED STATES AND OTHER COUNTRIES' RESTRAINTS ON FOREIGN INVESTMENTS

The United States has selective restrictions on foreign ownership of U.S. enterprises engaged in such areas as commercial aviation, communications systems, hydroelectric power, nuclear energy, and national defense. (See app. III.) However, because of the difficulty of identifying ownership of U.S. corporations, there is concern over how effectively these restrictions can be enforced. Even with regard to national defense, it is nearly impossible to determine whether a listed stockowner of a large defense contractor is acting on behalf of foreign interests. Nevertheless, an Iranian attempt to acquire a controlling interest in Lockheed Aircraft Corporation was thwarted in December 1974.

By and large, the executive branch advocates unrestricted free flow of capital and is reluctant to take any action that could be viewed as screening or otherwise restricting foreign investments. The President, in signing the Foreign Investment Study Act of 1974, stated:

> "As I sign this act, I reaffirm that it is intended to gather information only. It is not in any sense a sign of a change in America's traditional open door policy towards foreign investment. We continue to believe that the operation of free market forces will direct worldwide investment flows in the most productive way. Therefore my administration will oppose any new restriction on foreign investment in the United States except where absolutely necessary on national security grounds or to protect an essential national interest."

Though continuing to reaffirm an open-door policy, the President stated in February 1975 that foreign investors would be welcome in the United States as long as they conformed to the principles of U.S. society--an obvious response to reports concerning the Arab boycott of U.S. firms (see p. 35). Also, Administration spokesmen are favoring increased disclosure of the beneficial owners of any investments held in nominee or third-party names. At the same time, the executive branch wishes to negotiate agreements with key foreign government investors to provide for consultation with the U.S. Government prior to making major direct investments in the United States. The executive branch also wishes to retain the freedom to establish its own system for monitoring foreign investment, analyzing trends and evaluating prospective impacts of significant investment proposals.

As noted in congressional hearings, there are few State or local restrictions on foreign investments. Indeed, States are in sharp competition with each other to attract foreign investments, and many maintain staffs in other countries to actively promote their State's advantages for investment opportunities, particularly in the area of new plant facilities.

In some instances, however, U.S. corporate management and stockholders have successfully opposed foreign takeovers. The unsuccessful tender offer by Liquifin, A.G., an Italian firm, for 50 percent of the Ronson Corporation was settled by court action. In another example, a Saudi financier withdrew his offer of $14 million for a 33-percent interest in the First National Bank of San Jose when it became apparent that stockholders would vote it down.

Other countries have more restraints on foreign investments than does the United States. The intensity of these restraints may vary, however, depending on a country's status as a developed or less-developed nation.

Generally, foreign investment regulations in the developed nations do not appear to have been imposed to limit such investments so much as to monitor them for consistency with national balance-of-payments, antitrust, or other policies and to lessen the effect on the domestic economy of international economic fluctuation.

A singular exception among such nations is Japan, where all proposed foreign investments have been screened by the government since 1950, when legislation was enacted to protect the orderly development of Japan's economy. In a like manner, Kuwait's acquisition of 14 percent of the Daimler-Benz automotive firm has generated speculation that West Germany may now be considering the need for reporting and other constraints on incoming investments. It was reported that, following Kuwait's acquisition, one of West Germany's largest private banks acquired the controlling interest in Daimler-Benz in a move calculated to retain ownership and control of the firm within the country.

In Belgium, foreigners are required to obtain government permission before acquiring stock in a Belgian corporation and foreign transactions of the country's banks are government-regulated. A regulatory agency is responsible for enforcement, but the King is authorized to intercede where necessary in the case of foreign transactions.

Great Britain examines all foreign acquisitions to determine whether the transaction is made at a fair market price. However, only extremely large foreign investments are screened by the British Government.

In Switzerland, the permission of the National Bank must be obtained before foreigners can establish or take over a business. In an effort believed to be related to the control of inflation, the Swiss recently adopted measures preventing foreigners from buying Swiss securities or real estate. The majority of a firm's directors must also be Swiss citizens living in the country.

Canada has recently adopted laws limiting foreign participation in such areas as communications, transportation, airlines, fishing or shipping companies, mines, and loan companies. Canada screens all foreign takeover bids of enterprises having assets of $250,000 or greater, proposed new foreign-controlled businesses, and new businesses to be established by foreigners already doing business there.

In contrast to the foregoing examples of legislative and other constraints, it is generally recognized that South American countries have effectively placed much of their basic industry off limits to foreign investors by the simple device of nationalizing it.

The trend of less-developed nations of the world appears to be toward regulating foreign investment and consequent foreign influence in order to (1) prevent external control of important sectors of the economy or of raw materials, (2) stimulate or facilitate national participation in the investment, and (3) diminish the risk of having national policies unduly influenced by the policies or practices of foreign nationals.

U.S. OPPOSITION TO EXCLUSIONARY POLICIES AND RESTRICTIONS

Government and private spokesmen have expressed consistent opposition to formulating U.S. policies and restrictions on the basis of what is done in other countries. Some of their arguments are as follows.

1. The policies of certain countries have been based upon purely domestic political considerations within those countries.
2. Some countries' restrictions were applied--as in the case of Canada--because foreigners already dominated important sectors of the economy.
3. Foreign investment has been such a small proportion of the U.S. economy (2 percent of gross domestic investment in 1973) compared with that of many other developed countries that adopting other countries' policies would be unwarranted.
4. There is no current reason for the United States to totally abdicate or reverse its international leadership role with regard to easing restrictions on foreign investment and international capital flows.

As of early 1975, most industrial, financial, and government leaders in the United States oppose extreme restrictions because they fear (1) needed foreign capital would be driven away and (2) limitation or retaliation against the United States own $120 billion in overseas investments.

Many of these leaders, however, believe that limited legislation is needed because all investors have a right to know in what economic sectors they are welcome. Investors should never be vulnerable to hostile publicity, which the virtually unrestricted investment situation in the United States so clearly invites. The overall idea--conveyed to us in numerous discussions with knowledgeable officials--is that it is better to begin now to define limited Government policies and regulations reassuring to the American public and foreign investors alike than to wait until events create a mood of outrage or panic.

CHAPTER 5

EXISTING FOREIGN INVESTMENT STATISTICS

Owing to the historically small volume of foreign investments in the United States, the need for accurate statistics has received relatively little attention or priority. Consequently, existing Government statistics, although providing reasonably satisfactory balance-of-payments data, are outdated, incomplete, and readily acknowledged by executive branch officials to be subject to wide margins of error. Reliable statistics are not available from the private sector, either.

The statistical bases of official U.S. foreign investment data are a 1959 benchmark survey of foreign direct investment and a 1941 benchmark survey of foreign portfolio investment updated in 1949 using Internal Revenue Service data.

Information on portfolio investments is especially difficult to develop because the identity of corporate stockholders is often concealed via nominee or third-party names. Thus the beneficial owner and the investment country of origin are obscured. Similarly, information on investments in U.S. real estate, whether in commercial, farm, ranch or timber lands, is equally difficult to acquire.

Direct investments are somewhat more visible, although statistics on these also are generally recognized as inadequate. The Commerce Department's 1959 direct-investment survey consisted of data taken from questionnaires filed by 1,170 foreign-controlled enterprises. These statistics, according to Commerce officials, have been periodically updated based on questionnaires filed quarterly by selected firms. Currently, quarterly reports are filed by some 400 firms having investments of at least $2 million in the United States. Press reports and public announcements are used in determining new eligible firms to be included among those required to report.

These statistics have been developed primarily for balance-of-payments purposes and are intended to measure capital flows. Book values are recorded rather than market values. This data does not include any portion of investment financed through borrowing in the U.S. market. For example, if $20 million is borrowed in the U.S. market and $5 million is furnished from foreign powers, only $5 million of a $25-million investment will appear in Commerce statistics--a statistical understatement of 80 percent.

STATUS OF THE NEW SURVEY

The Departments of Commerce and the Treasury initiated a new benchmark survey prior to the enactment of the Foreign Investment Study Act of 1974. Each Department proceeded independently to establish its own reverse-investment survey staff, draft its own survey questionnaire, and develop its own mailing list, with Commerce concentrating on direct investments and the Treasury on portfolio investments. Both parts of the survey will be based upon yearend 1974 data but will be independently processed. Final reports are expected to be available in 1976.

The act requires the amassing of more extensive data on foreign investment; places new emphasis on the analysis of reverse-investment impact on employment, domestic business competition, and financing methods; and requires both full and interim reporting to the Congress on the survey findings.

Although we were assured by Commerce representatives that the analytical effort would be structured to respond as closely as possible to the legislation's full requirements, independent observers have raised the following questions in discussions with GAO about the validity of the Departments' approaches.

1. Whether the benchmark effort would be less efficient, or even less accurate, because it would be pursued by two separate Government departments rather than by a single specialized group.

2. Whether the Commerce survey was too similar in design and emphasis to the "companion piece[1]" being circulated to U.S. investors abroad to meet the requirements of the legislation.

3. Whether there had been sufficient participation in the early preparation of the survey questionnaire by persons who work, and are therefore familiar, with the manner in which large business enterprises conduct their accounting and recordkeeping activities.

4. Whether the survey would study the possible inflationary impact of foreign investment, an aspect of great interest.

5. Whether valid data on foreign ownership of real estate could be obtained.

6. Whether the ultimate country of origin of foreign investments could be accurately determined.

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[1]The "companion piece" is the 1973 Commerce survey questionnaire to U.S. businesses operating abroad, a mandatory periodic report pursuant to the provisions of sec. 8 of the Bretton Woods Agreements Act.

7. Whether certain historical foreign investment impacts, such as employment and/or export-import, could be ascertained from the questionnaire or would have to be based on comparisons over time.

8. Whether, in addition to the traditional "financial statement" approach with its emphasis on balance-of-payments and employment considerations, attention should also be given to developing data on technology.

Although other independent observers also consistently affirmed to GAO the value of a new benchmark survey, they pointed out potential difficulties, such as how the United States might impose and enforce reporting requirements on foreign nationals, the possibility of elaborate schemes to evade investor identity, and the exceptional nature of oil revenue investments, which--unlike past foreign investments--attach new importance to the investor nation rather than to the investor individual or group.

The final version of the Commerce questionnaire is a reasonably comprehensive 12-page document that seems complete and easy to understand. However, it does not provide for data, such as State and local income taxes paid, that would be helpful in analyzing the local impact of direct investments. On the other hand, Commerce does not plan for the survey to include sample case studies on local community impact. A Commerce official told us in December 1974 that guidelines were being developed for the analysis effort and that the work description for seven to nine planned contracts was being revised. The official said the contracts would require field visits, but only to make inquiries into such areas as motivations for investing, techniques of operations, and labor practices. He also told us that Commerce efforts would be oriented toward studies of key industries and would give special attention to such selected States as Hawaii and Alaska where the foreign investment profile is prominent.

According to agency officials, at the end of December 1974 the Treasury mailing list totaled some 12,000 firms and the Commerce list was estimated at 10,000 to 11,000 firms. Deadlines for respondents to file the questionnaires are March 1, 1975, for the Treasury and April 30, 1975, for Commerce. Both agencies expect to grant time extensions to respondents who justify such requests. Although Treasury expects to meet both the interim and final reporting deadlines established by the act (an interim report to the Congress in October 1975 and a final report in April 1976), Commerce has indicated that it may be necessary to seek a time extension on the final report date.

Respondent questionnaires will require extensive processing and analysis before the two reports to the Congress can be prepared. We learned that the Treasury intends to rely heavily on its in-house staff for analytical work, while Commerce intends a substantial portion of its analysis to be handled by contractors. Commerce officials told us late in January 1975, however, that overall plans for the necessary contracting had not been finalized.

CONCERNS OVER POSSIBLE IMPEDIMENTS TO FOREIGN INVESTMENT INFLOWS

In discussions with bankers, investment specialists, and commerce-oriented private groups in New York City, hopes were expressed to GAO representatives that the U.S. Government would avoid raising the impression that the survey is the first step toward rigid antiforeign investment policies. These private spokesmen also suggested that investor anxiety could reduce foreign capital inflows and thus aggravate the United States' current economic problems. The consensus of the individuals interviewed was that the United States should not reverse its basic commitment to an open world economy.

CHAPTER 6

INFORMATION SOURCES

Information on foreign investment in the United States is available from numerous public and private sources, but none of it provides an accurate measure of the nature, extent, or effects of foreign investment in this country.

FEDERAL LEVELS

The various Federal departments, agencies, and commissions maintain records appropriate to their particular functions and interests both at their headquarters and field offices. However, except for the data collection efforts of Commerce and Treasury previously discussed, identification of foreign investment has been incidental to the purposes for which these records were maintained.

A certain amount of foreign investment is identified in this manner, but agencies have not made concerted efforts to determine the extent of such investment, nor are their records complete or extensive enough to provide an accurate picture of foreign investment in this country.

The Securities and Exchange Commission (SEC), for example, had information only on the larger, publicly held corporations and their major stockholders of record. Furthermore, SEC's various reporting requirements were not keyed to distinguish between domestic or foreign securities issuers and investors except in the case of foreign governments. Thus, difficulties are encountered in identifying beneficial owners and their countries of residence when "nominee" or third-party names appear in SEC records. Because of these limitations, SEC officials stated that it would be burdensome and costly to research their mass of reports and that such efforts would yield neither accurate nor complete data.

The Internal Revenue Service, with its extensive coverage, is another potential source of data on foreign investments, although present law limits access to this information. It presently collects foreign investment information through corporation income tax returns, both those of foreign corporations with U.S.-based branches (Form 1120F) and those of U.S. corporations (Form 1120). Information is also available from Form 1042, a report by withholding agents on taxes withheld and amounts of dividends, interest, rent, royalties, and other income paid to nonresident alien individuals, foreign partnerships, or foreign corporations.

U.S. corporation tax returns (Form 1120) provide for the identification of any alien corporation, individual, partnership, trust, or association owning 50 percent or more of the reporting corporation's voting stock. This data provides potentially useful supplementary information on foreign investment in the United States but not a comprehensive picture because:

1. Corporations having less than 50 percent of their stock owned by a single foreign corporation, individual, partnership, trust, or association are exempt from disclosing such ownership. Thus, a corporation could be 100-percent foreign-owned, but if no one individual or entity had a 50 percent or greater share, this fact of ownership would not be reported.

2. A Department of Agriculture report, "Foreign Investment in U.S. Agriculture and the Food System," noted that 366,000 U.S. corporations did not answer the questions concerning alien ownership on their 1970 tax returns (the latest year for which summarized data was available). The Internal Revenue Service, according to the report, did not attempt to insure compliance with this reporting requirement. The principal reason for corporations' failure to report foreign ownership is probably that they do not know the identity of beneficial owners--as opposed to owners of record--of corporate stock or the owners' nationalities.

3. Information concerning foreign ownership was sought only from corporate enterprises; other forms of business organizations were not solicited.

It should also be noted that aggregate data is compiled by the Internal Revenue Service, making it impossible to identify foreign investment in individual firms. There is no valid reason to release such information to the public, but the question arises as to whether it would be feasible, under controlled conditions, to allow such access by Federal agencies responsible for monitoring foreign investment activity in the United States. It would seem that such access could be useful, not only as a source of information but also to confirm information ultimately developed.

STATE LEVELS

A scarcity of information on foreign investments also exists at the State level. The various records kept--corporation registrations, property records, etc.--are not designed to distinguish between alien and domestic investors.

Even the State development agencies, whose responsibility is to attract investment, are unaware of the total extent or impact of foreign investment in their States. Existing information, which varies in quality from State to State, is compiled from such sources as public announcements, press articles, trade journals, and Commerce Department's annual publication, "Foreign Direct Investors in the United States." Manufacturing is emphasized and there is little or no information available on such areas as real estate, portfolio, or nonmanufacturing investments.

To point out the lack of information at the State level, the National Association of State Development Agencies--the Washington-based headquarters of the State development agencies--attempted to study the extent of foreign investment and its impact on State economies. The Association has encouraged its member States to maintain certain discrete foreign investment data on manufacturing; however, these records cover only the last 3 or 4 years. Only one State was pointed out as maintaining reasonably detailed records.

PRIVATE SOURCES

In response to the lack, or inadequacy, of official statistics or studies on foreign investment, the private sector has made increased efforts in recent years. However, it has been confronted by the same obstacle, the lack of a sufficient data base from which a reliable listing of foreign investors may be compiled or from which major, comprehensive, and definitive research can be done.

Various lists of foreign investors do exist, but they too are compiled using the same inexact and uncertain sources employed at Federal and State levels, i.e., public announcements, press articles, and trade journals which are generally manufacturing oriented. No source purports to be comprehensive or totally accurate.

As to studies by the private sector, those that have not been aborted early in the survey process due to the data void have not resulted in the type of conclusive information necessary for making coherent policy decisions on foreign investment. In at least two cases (one at the

University of Colorado and one at Lewis and Clark University in Oregon) attempts to study foreign investments were terminated because of the lack of data. A joint effort by professor Jeff Arpan, Georgia State University, and assistant professor David A. Ricks, Ohio State University, was hampered by lack of responses to their questionnaires. Of nearly 2,000 questionnaires circulated, only 98 were returned completed as requested.

Other attempts have been made to study only certain aspects of foreign investments. For example, a 1971 book, entitled "Recent Foreign Direct Manufacturing Investment in the United States; An Interview Study of the Decision Process," was limited to manufacturing and was an assessment of the reasons foreign firms have invested in the United States. Also, the Wharton School's study, entitled "Foreign Investment in Pennsylvania," seemed to be oriented more toward gauging Pennsylvania's competitiveness with other States in attracting foreign investment than toward analyzing the impact of existing investments. Additional published materials examined and sources used are in appendix IV.

As a consequence of the lack of impact studies, theories abound, speculations exist, and questions are raised, but few supportable conclusions have been reached through private sector studies.

CHAPTER 7

EFFECTS OF FOREIGN INVESTMENTS

We found no published studies as of December 1974 that would demonstrate the effect or impact of foreign investments on national, State, or local economies. The consensus of opinion among our contacts at national and local levels was that foreign investments, particularly in manufacturing, were highly beneficial. However, the sources of this consensus could provide little concrete evidence to support their conclusions.

Notwithstanding the lack of studies, a number of observations on the potential impact of foreign investments can nevertheless be made. We believe that whether the effects are beneficial, detrimental, or neutral would depend upon a range of factors, including (1) investor motivations, (2) type, magnitude, and location of investments, and (3) methods of financing. Moreover, the effects will differ at national, State, and local levels.

PROBABLE EFFECTS AT STATE AND LOCAL LEVELS

Investment in new manufacturing facilities is generally believed to mean more jobs and an improved tax base for the State and local economies. New plant facilities--with their potential for employment, production, and consumption of raw materials and energy--generally have greater impact than investments in such areas as real estate and recreation facilities. Moreover, a new plant would tend to be of greater benefit to an economically depressed area than to an industrialized region. However, individual foreign investments may have only negligible impact on the national economy.

PROBABLE EFFECTS AT NATIONAL LEVEL

Interest in foreign investments at the national level traditionally has been focused on balance-of-payments effects resulting from capital flows. Theoretically, if investment capital comes from abroad, the host country has an immediate short-term benefit from the balance-of-payments standpoint. However, as profits and interest are repatriated to the home country and exceed invested capital, the balance-of-payments effects ultimately become adverse. The United States, according to this theory, thus stands to face future balance-of-payments problems.

Investment factors other than capital flows, however, also affect the balance of payments. For example, much depends upon the import and export activities of the investor and upon whether a formerly imported product is now being produced for the domestic market. Imports adversely affect the balance of payments while production for export improves the balance.

Little data exists for the foregoing factors, but, if investment impact on balance of payments is to be measured, these factors must be examined together with such other fundamental considerations as the extent to which investments are financed from domestic money markets and/or reinvested earnings. Also to be considered in any overall assessment would be the investment impact on environment, employment, commodity shortages, and inflation.

POSSIBLE EFFECTS OF INVESTOR MOTIVATION

The single greatest influence on the effects of foreign investments may prove to be the investors' motivations. Investors of the past have traditionally been profit motivated: they sought new markets, to hold or increase their shares of traditional markets, or to take advantage of differing tax laws and other government regulations.

Faced with today's world shortages, however, some investors are doubtless seeking to insure their home countries' access to sources of food, energy, and other scarce commodities. Some of this access is being provided through forward-contracting for U.S. firms' output rather than through acquisition of production facilities. A timber industry representative told us that U.S. firms, when bidding on tracts of timberland, were occasionally financed by foreign interests in return for exporting stipulated quantities of the timber cutting. We found industry representatives very reluctant, however, to discuss information of this nature.

Other countries, principally oil-producing countries of the Middle East, are seeking to invest surplus oil revenues. As pointed out by the Chairman of the New York Stock Exchange, the bulk of these financial resources will be government-controlled.[1] Consequently, the investment outlets sought with these funds could differ considerably from those sought by privately owned funds. Moreover, there arises a

[1] Testimony before the Subcommittee on Foreign Commerce and Tourism, Senate Committee on Commerce, Sept. 18, 1974.

question of how a legal judgment rendered against a foreign government in a commercial transaction could be enforced. Thus, private enterprise would seem to be at a disadvantage in dealing with such investors.

It is generally held that oil producers lack the capacity to use their revenues for domestic consumption. Rather than hold excess funds idly, it would seem that they must ultimately seek those investments in resources and industry that will insure their continued prosperity long after their oil reserves are exhausted.

The search for investment opportunities would, therefore, seem likely to extend across a number of national boundaries in an effort to diversify holdings into several key economic power bases. Investments adequately diversified among a number of countries could then be used as a protective hedge against unfavorable actions by any single country.

The imposition of the oil embargo against the United States in October 1973 demonstrates rather clearly that the governments of oil-producing countries can subvert economic goals to political objectives which may be detrimental to U.S. interests. Also, there has been a longstanding Arab boycott of U.S. and other western firms doing business with Israel.[1] Thus, the United States is caught between its desire to promote an open world economy and its desire to avoid official or private cooperation with discriminating Arab policies it disapproves.

[1] While the boycott has not been totally effective over the years, its status is receiving renewed attention now that increased oil revenues may provide the leverage needed to obtain results. Recent press articles have cited examples of U.S. and other nations' firms exhibiting less interest in trade and commerical relations with Israel.

Moreover, as U.S. dependency on foreign oil grows and as the oil-producing nations acquire greater independence and latitude from accumulating surplus monetary reserves, an embargo or threat of an embargo could be employed with greater intensity and frequency and for a wider variety of purposes. The report published by the House Banking and Currency Committee (see p. 13) acknowledges that the threat to the United States from an embargo--particularly Middle Eastern--is very real indeed.

That report also recommended that, as a matter of U.S. policy, oil exporting countries should be actively encouraged to invest in the United States, particularly in oil-refining and marketing facilities. The rationale for this suggestion, in addition to minimizing immediate balance-of-payments impact, seems to rest on the presumption that the threat of expropriation of such investments could counteract unfavorable acts from abroad. However, it was acknowledged that this assumes that:

> "* * * U.S. will act on the basis of the economic threat of foreign oil on the U.S. economy alone. To the extent that the U.S. acts to 'bail out' a friendly oil consuming nation, the cost of doing so becomes an additional economic burden on the U.S. Ignoring this aspect of the problem perhaps understates the potential economic cost of an embargo to the United States."

Not only can an embargo or its threat act to influence the United States, but it is also conceivable that the nature of the oil-revenue investments in oil-consuming countries could provide oil producers with additional leverage with host governments. Additionally, oil investments might be in areas that could be used to curtail U.S. access to needed raw materials or resources other than oil. Thus, resorting to expropriation or other economic sanctions against oil producers might be effectively precluded.

CONCLUSIONS AND SUGGESTIONS

The United States has no registration or screening procedures that would enable incoming foreign investments to be systematically tabulated and monitored. The mixture of information and statistics available at national and State levels is not adequate for determining the extent of such investments, either in general or in such specific areas as U.S. timber, mining, and agricultural businesses. Moreover, we could find no studies supporting the economic benefits generally postulated for foreign investments.

Theoretically, investments from oil-producing countries can provide an infusion of capital needed by U.S. industry and, at the same time, provide some short-term relief for the U.S. balance of payments. Even long-term relief is possible if earnings are continously reinvested.

As oil country investments move from their present short-term liquid accounts into longer term capital investments, some officials think the investors will acquire a vested interest in the U.S. economy and be reluctant to take any action that would disrupt it. However, in the absence of supportable impact studies of foreign investments and reliable analyses of the pressures that can be brought to bear on friendly nations to influence U.S. policies, actively encouraging U.S. investments by oil-producing countries seems premature. Moreover, encouraging investments in downstream oil facilities or other energy areas would seem to provide even further leeway for monopolistic pricing.

If there were some assurance that capital flows could be stabilized long enough for the United States to develop alternative energy resources, an active program of investment promotion might prove worthwhile. However, without a reliable conception of the nature, extent, and effects of foreign investment activities, it is exceedingly difficult, if not impossible, for the executive branch to develop national U.S. policies on foreign investments. Until national policies are developed, individual States can be expected to continue actively seeking and promoting foreign investments, with no awareness of whether these investments are in the overall national interest.

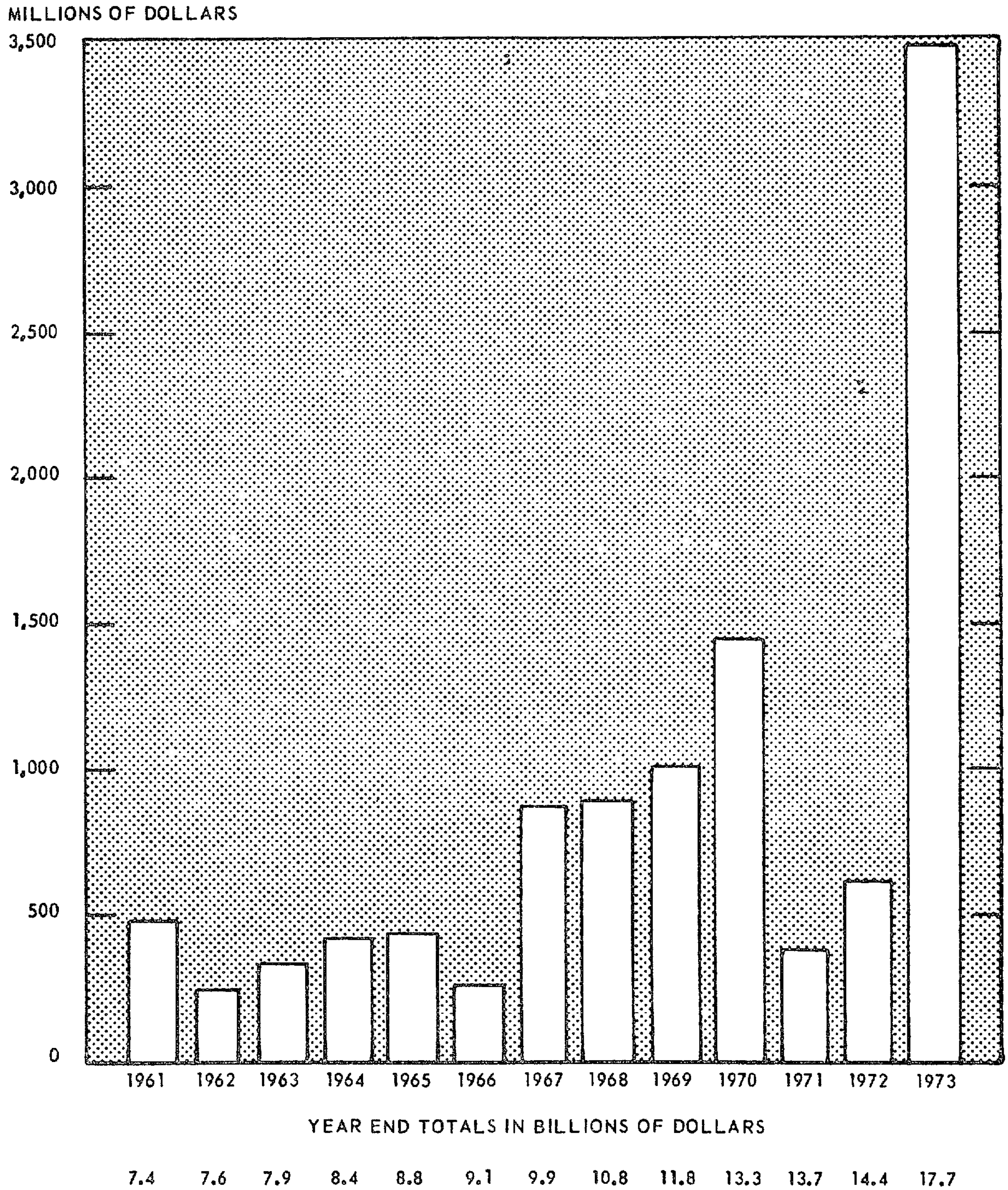
Considering the lack of reliable records and the acceleration of investments coming into the United States, there is a pressing need to develop a data base from which the extent of these investments can be determined and the fields of activity identified. There is also a need for studies to analyze import, export, employment, and other activities to test the actual impact of these investments, with an overall view toward developing national policies.

The Foreign Investment Study Act of 1974 will help meet these needs. It should be noted, however, that the study termination date (18 months following enactment) might not allow sufficient time for testing the effects from oil-revenue investments. Therefore, agencies and contractors making impact analyses for the overall study should be mindful of possible differing effects from investor motivations when drawing their conclusions.

This legislation also calls for study and recommendations on how information and statistics on foreign direct-investment activities can be kept current. Accomplishment of this objective might be helped through national registration and disclosure processes similar to those recently proposed in Senate Bills 3955 and 425. It should be noted, however, that the provisions of Senate Bill 425 cover only those corporations whose equity securities are publicly traded, whereas Senate Bill 3955 applies to closed, privately held corporations and such other business entities as trusts, partnerships and joint ventures, and real estate ownership.

Another method that might be considered would include using the Internal Revenue Service, since it already obtains a considerable amount of information from U.S. business enterprises, whether they operate as corporations, partnerships, or sole proprietorships. However, present information collected on foreign investments by the Internal Revenue Service would have to be expanded and some provision would have to be made for sharing this information with other U.S. Government agencies.

ANNUAL ADDITIONS TO FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 1961–1973



EXAMPLES OF 1974 FOREIGN INVESTMENTS IN THE UNITED STATES (note a)

Country of origin	Parent company	Investment	Location	1974	Amount (millions)	Product
Belgium	Solvay and Cie	Celanese	-	Sept.	$ 80.0	Chemicals
Canada	Thompson Newspapers	Speidel Newspapers	-	Nov.	160.2	Newspaper publications
	International Nickel Co. of Canada, Ltd.	ESB, Inc.	Pa.	July	235.0	Battery
	Canadian Development	Texas Gulf	-	Feb.	240.0	-
France	USINOR	Chessy System, Inc.	W. Va.	Aug.	33.0	Coal mining
	Michelin Tire Co.	-	S.C.	Feb.	175.0	Tires
Germany	Boehringer Ingelheim, Ltd.	-	Conn.	Sept.	-	Pharmaceuticals
	Ruhrkohle/Verba	Appalachian Resources	-	Nov.	25.0	-
	AEG-Telefunken	-	Conn.	July	-	Electronics
	Bayer, A.G.	Cutter Laboratories	Calif.	July	-	Pharmaceuticals
	Boechst, A.G.	National Laboratories Corp.	Ma.	Aug.	-	Pharmaceuticals
	Boechst, A.G.	-	Tex.	Sept.	250.0	Chemicals
	Sul-Chemi, A.G.	Chemetron toys	-	Sept.	-	Chemicals
	Knoll, A.G.	-	N.J.	Sept.	-	Chemicals
	BASF, A.G.	-	-	Oct.	800.0	Pharmaceuticals
Iran	Bank Melli Iran	Grumman Corp. (loan)	-	Oct.	75.0	Aircraft manufacturing
	-	Office building	N.Y.	May	-	-
	-	Land	Ariz.	June	-	-
Italy	Olivetti Co.	-	Pa.	July	-	Typewriters
Japan	Yamaha Int'l.	Everett Piano Co.	Mich.	July	-	Pianos
	Yoshida Vogyo Kaisha (YVK)	-	Calif.	July	-	Zippers
	Daiwabo Spinning Mills	-	Tex.	Aug.	-	Textiles
	Matsushita	Motorola	Ill.	May	100.0	Electronics
	Tokyo Pulp Co.	Pulp plant	Idaho	June	25.0	Wood, paper
	Ataka American, Inc.	Auburn Steel Co. Inc.	N.Y.	Sept.	35.0	Steel
	Mitsubishi Int'l Corp./Soko Seiren	Somitex Prints of Calif., Inc.	Calif.	June	1.2	Fabrics
	-	Sheraton Waikiki, Royal Hawaiian, and Sheraton Maui Hotels	Hawaii	Aug.	105.0	-
	Mitsui	American Metals Climax	-	Jan.	125.0	Mining
Kuwait	-	Hotel and shopping area	Ga.	June	10.0	-
	-	Recreational land	S.C.	Sept.	17.4	-
	-	Land	Calif.	June	-	-
	-	Land	Ky.	June	50.0	-
	-	Feedlot operation	Idaho	June	-	-
Netherlands	North American Philips	Maganovox	-	Sept.	160.2	Electronics
	Dutch AK20	-	Tex.	July	-	Chemicals
	Holec, NV	-	N.Y.	Apr.	-	Machinery
Saudi Arabia	-	Land	Calif.	June	-	-
	-	Industrial park	Utah	-	250.0	-
	-	Hotel	Nev.	June	70.0	-
	-	Development company	Ariz.	-	9.2	Land and cattle
Sweden	AB Electrolux	National Union Electric	Conn.	Aug.	-	Electronics
	Volvo	-	Va.	Feb.	100.0	Automobiles
Switzerland	Walter Halfner Holding, A.G.	Wyly Corp., Data Transmission Co.	Tex.	Oct.	30.0	Data communications
	Ciba-Geigy	Airwick Industries	-	Aug.	-	-
	Bruderer, A.G.	-	Ala.	May	-	Machinery
United Kingdom	EMI	Electron Technology	N.J.	Oct.	.6	Electronics
	General Engineering, Ltd.	-	Conn.	July	-	Wire manufacturing
	Contronvincial Estates	Office building	N.Y.	July	-	-
	British Petroleum	Signal Oil & Gas Co.	-	Jan.	480.0	Crude oil supplies
	Bird Group	Pack Iron & Metal Co.	Va.	Aug.	-	Scrap processing
	Barclays Bank	First Westchester Bank	N.Y.	Aug.	-	Banking

a/ This list is a representative sampling and is by no means complete.

SUMMARY OF U.S. RESTRICTIONS ON FOREIGN INVESTMENT

Foreign investments in certain sensitive industries in the United States are restricted or prohibited by Federal law. These industries--communications, aviation, coastal and fresh water shipping, exploitation of public lands, hydroelectric power, and atomic energy--are considered vital to the national interest.

There are administrative restrictions on foreign ownership in firms engaged in U.S. Government contracting, and foreign banks may not be members of the Federal Reserve System and/or the Federal Deposit Insurance Corporation. There is, however, no limitation on the percentage of foreign ownership in a domestic member bank. (12 U.S.C. 321, 1813, and 1814.)

COMMUNICATIONS

Foreign-owned or controlled corporations may not be licensed to operate an instrument for the transmission of communications. A corporation is considered foreign-owned if a director or officer is an alien, if more than one-fifth of its capital stock is owned by aliens, or if it is set up under the laws of another country. Neither may a foreign government be licensed. The corporation is considered foreign-controlled if one-fourth of its capital stock is owned by foreign interests. (47 U.S.C. 310.)

AVIATION

The registration of aircraft is limited to U.S. citizens or U.S. corporations in which U.S. citizens constitute at least two-thirds of the directorship and own at least 75 percent of the stock. Some exceptions allow foreign-registered aircraft to operate within the United States when reciprocal privileges are extended to U.S. aircraft by the country of registration, but these operations are not to include intra-country movement of goods or passengers. (49 U.S.C. 1301, 1401, and 1508.)

COASTAL AND FRESH WATER SHIPPING

Only U.S. citizens may own vessels conducting shipping operations in the United States or between the United States and its territories, even if the goods are shipped via a foreign port. The vessels must be built and registered in the United States.

If reciprocity is granted by a foreign country, that country's vessels may be granted an exemption by the United States, permitting intercoastal transportation of empty items, such as barges or tanks. (46 U.S.C. 883.)

ACQUISITION OR LEASING OF PUBLIC LANDS

Public or Federal-owned lands may be transferred or leased only by U.S. citizens or persons who have declared their intent to become U.S. citizens, by partnerships or associations whose members are U.S. citizens, or by corporations domestically incorporated. Foreign individuals or associations could form or acquire a domestic corporation and qualify to lease or own public lands provided their country of origin granted reciprocal privileges to U.S. citizens and associations. (48 U.S.C. 1501-1508 and 43 U.S.C. 682a-e.)

Somewhat similar provisions apply to acquisition of leasing rights to mineral deposits on public lands. (30 U.S.C. 22, 24, 71, 181, and 352.)

Laws governing the transfer of private or State-owned lands rest with the individual States.

HYDROELECTRIC POWER

Development of hydroelectric power projects on navigable U.S. streams may be undertaken only by U.S. citizens or domestic corporations. However, the law does not prohibit foreign ownership or control of such domestic corporations. (16 U.S.C. 797e.)

ATOMIC ENERGY

Foreign-owned or controlled corporations may not be granted licenses to operate atomic energy utilization or production facilities. (42 U.S.C. 2133.)

GOVERNMENT CONTRACTING

In awarding Government contracts, no distinction is made between U.S. contractors on the basis of their foreign or domestic ownership or control. However, security clearances may be required for the contractor's personnel, and most foreign nationals are ineligible for security clearances.

Defense contractors voluntarily submit certificates of foreign affiliation, but no special procedures exist to verify this information. Although penalties can be imposed for false statements, it is difficult to ascertain the extent to which voting stock is in fact owned or controlled by non-citizens since stock can be held in any name. (Department of Defense Industrial Security Regulation, DoD 5220. 22-R.)