National Policies toward Foreign Direct Investment

Throughout the 1970's the United States attracted a growing inflow of foreign direct investment as exchange rate changes and other developments spurred foreign companies to establish facilities here. For instance, between 1973 and the third quarter of 1979, direct investment inflows totaled $29.5 billion, or over three and one-half times the amount that flowed in during the preceding thirteen years. Moreover, the degree of foreign participation in the United States economy is larger than these statistics might suggest since foreign companies finance much of their activities locally rather than with funds brought in from abroad.

The rising foreign direct investment inflows to this country, long accustomed to being the world's largest source of international direct investment outflows, has generally been welcomed, especially in the states and cities where they have been concentrated Employment opportunities have been increased, both directly and indirectly Often new technology has been brought in State and local tax bases have been expanded. At the same time, however, questions have been raised about the appropriate role of public policy in influencing foreign direct investment The central issue is whether foreigners' direct investment should be subsidized, as it is in some states through tax and other incentives, restricted under some circumstances, or left free to respond to market forces

In other industrial countries, policies and attitudes toward inward direct investment have been debated throughout the postwar period The degree of encouragement or discouragement to foreign direct investment has varied considerably both across countries and over time.

This article reviews the evolution of national policies toward inward foreign direct investment. It examines how the larger industrial countries differ in their approaches and how United States policies compare with them. That review is prefaced by a description of recent trends in foreign direct investment and the shortcomings in the data that hinder full analysis of the presence of foreign companies in an economy.

The main conclusion is that, among major industrial countries, national policies toward foreign direct investment appear to be converging although differences in attitudes and approaches have by no means disappeared All countries restrict foreign direct investment to some extent. Most of them seem to follow the sometimes conflicting principles of encouraging investment in weak sectors of the economy or in industries where domestic investment is inadequate, while resisting increased foreign dominance of any important industry The growing similarity of policies does not mean, however, that the potential for friction has been eliminated Difficult questions remain—for example, harmonization of industrial subsidy programs as well as the regulatory treatment of multinational corporations Their resolution will require a sustained cooperative effort by governments and international agencies.

Recent trends in international direct investment

Direct investment flows

International direct investment has been defined as "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise"[1] That contrasts with what are called portfolio

[1] International Monetary Fund, *Balance of Payments Manual* (fourth edition 1977)

investments, where investors buy stocks or bonds of a company in order to diversify their assets rather than to exercise control.

Direct investment may take a number of forms One is the creation of a new wholly owned business enterprise, accompanied by investment in plant and equipment Well-known examples are Volkswagen's recent establishment of an auto assembly plant in the United States or United States auto manufacturers' establishment of factories in Canada in the 1960's. A second common form is the takeover of an existing domestic company, such as the purchase of controlling interest in Gimbels and Saks Fifth Avenue by the British firm, British-American Tobacco. A third form is the acquisition of a substantial minority interest in a company The French government-owned firm, Renault, has recently initiated such an investment, leading to an eventual 22 5 percent interest in American Motors. And, finally, there is the joint venture whereby two or more independent investors of differing nationalities collaborate in a specific enterprise. A very recent example is the creation of Sony-Prudential Life Insurance Company to underwrite life insurance in Japan.

There has long been an active interchange of direct investment among the major industrial countries, as well as between those countries and the rest of the world. Chart 1 presents the statistics on international direct investment as reported by the large industrial countries. The data are not strictly comparable since the United Kingdom, Germany, France, Canada, and Italy report as direct investment a varying but narrower range of capital flows than do the United States and Japan.[2] But the broad trends are clear from the figures.

Foreign direct investment flows into the United States have risen much more rapidly in recent years than similar flows into other industrial countries. Meanwhile, outward direct investment of the other six industrial countries has risen much more rapidly than outward investments from the United States. Allowing for their narrower definitions, it is likely that combined outward investment from the other six exceeded the $16.7 billion reached by the United States in 1978 At the same time, foreign investment flows into the United States, at over $6 billion, were rapidly approaching the magnitude of foreign investment flows into the other major industrial countries combined.

These developments have produced important changes in patterns of international net direct investment flows, the difference between outward and inward flows In the ten years ended in 1967, the United States was the preponderant net investor, investing abroad about ten times as much as foreigners invested here. The only other consistent net investors were the United Kingdom, which made a modest contribution, and Japan, whose contribution was insignificant. The other industrial countries were net recipients of direct investment, receiving nearly three times as much inward investment as they invested abroad Since that time the investor status of the United States and the other six has been converging gradually All but France and Italy now report net outward investment In 1978, the ratio of outflows to inflows for the six as a group was 2.1, only moderately lower than the 2 6 ratio for the United States.

Outstanding foreign direct investments

Because this convergence of direct investment experience is fairly recent, the book value of outstanding investments by foreigners in the United States is still substantially less than in the other six countries The latest information available (Chart 2) records foreign investments in the United States at $41 billion as compared with over $100 billion recorded as outstanding in the five other large industrial countries for which information is available. Again, the data are not strictly comparable from country to country, so the figures should be viewed as illustrative rather than as precise measurements

The importance of two-way direct investment among the major industrial countries is also apparent In the five countries for which full country source information is available, the proportion of total foreign investment coming from other large industrial countries ranges from 53 percent to 94 percent Adding investments from four smaller industrial countries—the Netherlands, Belgium-Luxembourg, Switzerland, and Sweden—pushes the percentage close to 90 percent or more in all cases. Thus the main source of foreign direct investment in all industrial countries remains other industrial countries Developing nations, including OPEC (Organization of Petroleum Exporting Countries) members, account for only a minor share

Foreign-controlled firms in national economies

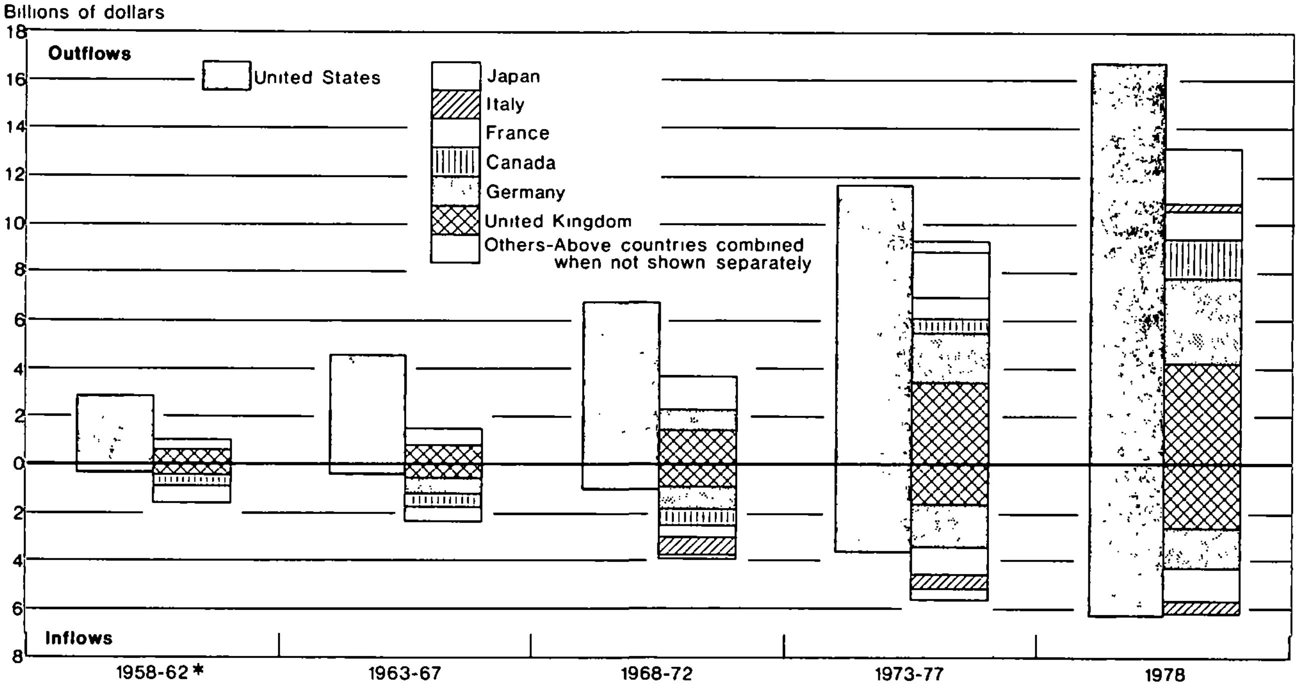
The importance of foreign-controlled firms in the major industrial countries is even greater than the book value of foreign investment outstanding might sug-

[2] The International Monetary Fund (IMF), which collects and publishes balance-of-payments statistics compiled by member countries, has proposed a standard definition This includes equity investment, reinvestment of retained earnings, long-term loans, and (except for banks) short-term loan transactions between the affiliate and the foreign parent and other related foreign companies The United States and Japan have accepted this definition The United Kingdom has also accepted it but in so doing has found it impossible to provide any statistics at all on direct investment in three especially important industries oil, banks, and insurance companies Canada, Germany, France, and Italy report a narrower range of transactions They omit some or all loans and, in the case of Canada and Italy, retained earnings as well

Chart 1

International Direct Investment Flows from and to Major Industrial Countries

Average annual rates



*1960-62 only for the United States and France

Sources International Monetary Fund, Balance of Payments Yearbook through 1977, country sources for 1978

gest. The reason is that such firms obtain a major portion of their financing from sources other than the foreign parent These sources include:

- Borrowing from banks in the host country, in Eurocurrency markets, or at times even from the host government,
- Securities issued in the host country or elsewhere,
- Trade credits from unaffiliated suppliers, and
- Equity positions of host country residents

In Germany, for example, a recent survey indicates that in 1976 foreign equity and loans from parent companies accounted for only 27 percent of foreign-affiliated firms' total balance-sheet liabilities[3] And in the United States, the 1974 *Benchmark Survey* of foreign-affiliated firms showed the direct investment position of foreigners to be only 15 percent of those firms' assets[4]

The most recent information on the importance of foreign-controlled firms in the major industrial countries is assembled in the table on page 26 In the industrial sector, where this influence is generally strongest, foreign-controlled firms accounted for close to 20 percent of total sales or output in Germany, France, and the United Kingdom The percentage was much higher, nearly 60 percent, in Canada, but only 5 percent in Japan In the United States, the percentage was also only 5 percent in 1974 but, given the rise in foreign investment since then, is almost certainly higher now[5]

[3] "The Level of Direct Investment at the End of 1976", *Monthly Report of the Deutsche Bundesbank* (April 1978)

[4] Report of the Secretary of Commerce, *Benchmark Survey, 1974, Foreign Direct Investment in the United States,* Vol 2 (United States Department of Commerce, April 1976)

[5] A Department of Commerce sample survey of foreign-controlled firms (the BE-15) for 1977, taken to coincide with economic censuses for that year, will eventually permit verification of this impression A comprehensive survey is planned to cover 1979

The areas of greatest foreign influence were much the same in most countries: petroleum, chemicals, rubber, transportation equipment, electrical machinery, and other engineering. These are all high-technology industries where the economies of the scale in production and distribution have been conducive to the development of large multinational enterprise.

For other economic sectors, information is incomplete. But the evidence available for Germany, Japan, Canada, and the United States suggests that the foreign influence in other nonfinancial sectors is lower than in industry. In the United States, where concern over foreign investment in farmland has increased recently, preliminary results of a comprehensive Department of Agriculture survey[6] indicate that foreigners own less than ½ percent of United States land classified as agricultural.

Factors contributing to changing investment patterns

The declining comparative importance of the United States as a source of international direct investment, along with its growing host country role, has a number of causes. A rise in the wealth of other industrial countries and their large business firms, relative to the United States, greatly increased their potential for investment throughout the world During the 1970's, a significant share of that investment was attracted to the United States as numerous factors raised the expected profitability of investing in this country.

One sign of the growing wealth of other industrial countries and their potential for investing abroad was their sustained stronger output growth. From 1955 to 1975 the yearly rise in real gross national product (GNP) averaged 5 percent in all OECD (Organization for Economic Cooperation and Development) countries[7] other than the United States but only 3 percent in the United States. At the same time the scale of operations of firms outside the United States rose much more rapidly than that of United States firms. In 1958, for example, the average sales of the fifty largest industrial corporations outside the United States, as reported by *Fortune,* was only about 40 percent as large as the average sales of the largest fifty United States industrials. But by 1978 this ratio had risen to about 80 percent.[8] Part of this growth of sales was based on increased exports to the United States, in some cases reaching a level that justified large-scale manufacturing facilities in the United States.[9]

Equally important in fostering changes in direct investment patterns have been shifts in profit incentives during the 1970's. These stem from several sources:

- Exchange rate-related changes in relative labor and capital costs,
- Depressed stock market values in the United States,
- A decline in United States petroleum costs relative to other countries due to United States price controls in this area,
- Foreigners' fears that United States trade policy was becoming more restrictive,
- Rising importance attached to ownership of raw materials in view of international supply and price developments, and
- A spurt in United States growth beginning in 1975 which raised expectations regarding the growth of the United States market.

Exchange rate changes appear to have had a lasting effect on international wage differentials. Measured in dollars, average hourly earnings in United States manufacturing were 36 percent higher than in Germany, 74 percent higher than in Japan, 80 percent higher than in the United Kingdom, and 2.6 times the level in France in 1973. But, by 1978, United States average earnings were only 6 percent higher than in Germany and Japan, whose currencies had appreciated most relative to the dollar, 65 percent higher than in the United Kingdom and 95 percent higher than in France. Because of the close economic ties between Canada and the United States, wage differentials between the two have long been small.[10]

Exchange rate changes also tended to reduce the cost to foreigners of purchasing existing manufacturing facilities in this country. And, in addition, depressed prices in United States stock markets may have en-

[6] Preliminary results from reports of foreign land ownership required by the Agricultural Foreign Investment Disclosure Act of 1978 Under the act, all foreign owners of United States farm, range, and forest land are required to report these holdings to the Department of Agriculture

[7] OECD has twenty-four country members eighteen industrial countries in Europe plus Canada, Japan, Australia, New Zealand, Iceland, and the United States

[8] The fifty-largest lists used in this comparison were derived by eliminating foreign-owned companies operating in the United States and United States companies operating abroad from *Fortune's* 1958 and 1978 lists of the 500 largest United States industrial corporations, ranked according to sales, and its similar lists for industrial companies operating outside the United States

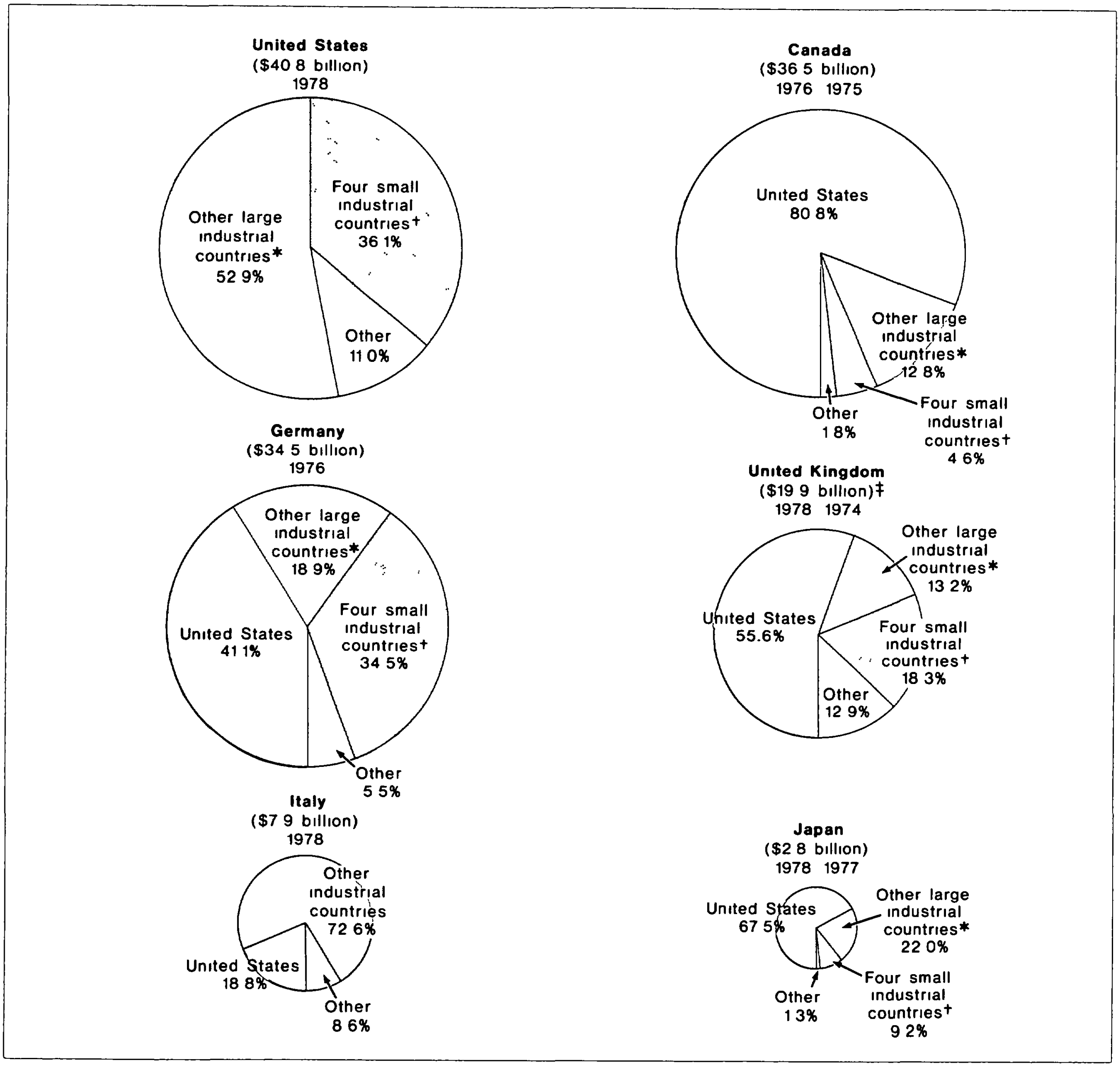
[9] For a more detailed discussion of these developments, see Appendix G of *Foreign Direct Investment in the United States* (United States Department of Commerce, April 1976)

[10] Average hourly earnings in domestic currency as published in *Monthly Bulletin of Statistics*, United Nations, converted to dollars at average exchange rates United Kingdom data is for male workers only

Chart 2

Country Sources of Foreign Direct Investment Outstanding in Selected Industrial Countries

In percent



When two dates are given, the first date refers to outstandings (all local currency data converted at end-1978 exchange rates) Second date refers to percentage distributions

*Other large industrial countries are Canada, Japan, United Kingdom, Germany, France, and Italy

†Four small industrial countries are the Netherlands, Belgium-Luxembourg, Switzerland, and Sweden.

‡Excludes direct investments in oil, banking, and insurance

Sources Latest country data available

The Relative Importance of Foreign-Controlled Enterprise in Large Industrial Countries

Percentage of total sales or output*

Sector	United States 1974	Canada 1976	Japan 1977	United Kingdom 1975	Germany 1976	France 1977
All business firms	**2**	**35†**	**2†**	‡	**16¶**	‡
Industrial sector§	**5**	**58**	**5**	**19‖**	**19¶**	**23**
Of which						
Food and kindred products	7	36	2	14	12	**
Chemicals and allied products	12	82	6	25	28	33
Rubber	2	90	20	**	**	30
Electrical machinery	2	68	3	23	25	35
Transportation equipment	††	87	**	26	26	18‡‡
Other nonelectrical machinery	2	67	6	21	18	21
Petroleum exploration, extraction, and refining	18	96§§	49	58§§	87	59
Mining and smelting	6	66‖‖	**	‡	‡	12
Other						
Of which:						
Construction	††	14	**	‡	3	‡
Distribution	2	21	**	‡	13	‡

* United States gross product, United Kingdom. gross output, Germany: turnover, other countries sales

† Nonfinancial corporations only.

‡ Not available

§ Manufacturing, mining, and petroleum exploration, extraction, and refining

‖ Manufacturing only If petroleum extraction were included, foreign operations in North Sea oil would probably raise the importance of foreign-controlled firms in United Kingdom industry as a whole

¶ Industrial, construction, and distribution.

** Not reported separately

†† Less than 0 5 percent

‡‡ Automobiles only

§§ Processing of petroleum and coal

‖‖ Includes mineral fuels

Sources: United States "Gross Product of U S Affiliates of Foreign Companies", *Survey of Current Business* (January 1979); Japan *Current State of Foreign and Foreign-Affiliated Firms Operating in Japan*—1979 (12th series) for year ended March 1978 (Ministry of International Trade and Industry press release); Germany: "The Level of Direct Investment at the end of 1976", *Monthly Report of Deutsche Bundesbank* (April 1979), France *L'Implantation Étrangère dans L'Industrie au Ier Janvier 1977* (Ministère de l'Industrie, STISI, July 1979), United Kingdom Census of Production, 1975, as reported in *Trade and Industry* (July 27, 1979 and March 2, 1979), Canada: *Corporations and Labour Unions Returns Act, Report for 1976, Part I Corporations* (Statistics Canada, March 1979).

couraged foreigners to acquire controlling interest in United States companies. Both of these developments increased the expected profitability of operating in the United States rather than exporting to this country.

As for petroleum costs, prior to 1973 the price of petroleum in the United States had been held above world levels by import quotas. Since then, however, a complicated set of United States price controls has kept average domestic prices somewhat below the world price levels imposed by OPEC policies. Thus in the first half of 1979 the United States wholesale price index for crude petroleum was 2.6 times the 1970 level. But for Japan, which is almost entirely dependent on imports for its oil supply, the wholesale price index for petroleum products and coal (converted to a dollar basis) increased 5.5 times over the same period These price trends have reduced relative energy costs in the United States.

New restraints on imports into the United States include stricter enforcement of antidumping legislation and negotiated restrictions on exports to the United States. These restrictions have produced some immediate investment responses from foreign exporters directly affected. For example, a three-year orderly marketing agreement between the United States and Japan in 1977, limiting Japan's exports of color television sets to the United States to 1,750,000 annually, induced five major Japanese companies—Matsushita, Mitsubishi, Sanyo, Sony, and Toshiba—to switch to the United States a part or all of their production for this market. These restrictions may have also created the impression abroad that the United States is moving toward greater protectionism. Consequently, some foreign firms in industries considered possible targets for future restraints may have chosen direct investment rather than exports as a method of expanding their sales in this country.

Foreign interest in raw materials has been especially strong in the case of oil, coal, and forest products. The British and Dutch influences have been strong in oil and coal. The Japanese have lumber interests in the Northwest.

Finally, the spurt in the United States growth rate beginning in 1975 at least temporarily reversed the long-standing relationship between the United States growth rate and that of other industrial countries. United States real GNP growth averaged 5.2 percent between 1975 and 1978, nearly 1 percentage point above the average for other OECD countries. The expectation of expanding markets that accompanied this shift appears to have been especially encouraging to foreign investment in wholesale and retail trade. In the three years ended in 1978, foreign investment outstanding in that sector increased by 83 percent, compared with 40 percent in other sectors.

Host country policies in major industrial countries

The issues

Country policies on foreign direct investment inflows reflect in varying degrees three diverging views—each extensively developed in academic, political, and business forums. The views are (1) that direct investment should be left to respond to market forces, (2) that it should be encouraged by subsidies or other means, or (3) that it should be restricted, possibly severely.

Those commentators who favor leaving foreign direct investment to market forces usually have the same attitude toward other international capital flows and trade. The belief is that allowing owners of capital to maximize its rate of return, without policy barriers or inducements, will maximize the productivity of capital in the world as a whole. In the process, capital will flow from countries where it is more plentiful relative to labor to countries where it is less so, thereby maximizing labor productivity in the world economy. Since international direct investment is often associated with the transfer of new technology, world output is also increased by the investing firm's efforts to maximize returns from technology.

These are the standard free trade arguments, as refined over the past fifty years by a host of leading economists, extended to cover the case of free capital flows. An early contribution to this line of argument was made by R. A. Mundell,[11] who pointed to the role that free capital flows can play in maximizing world income, substituting for trade flows when that trade is restricted. This analysis does not imply that leaving direct investment to market forces necessarily maximizes the income of each country and income group. But countries following this prescription generally believe that their economies will benefit on balance.

Those favoring subsidies or other devices to attract foreign investment do not accept the view outlined above. Instead, they believe that the extra foreign investment generated by the subsidy will increase income for the country offering it by an amount greater than the cost of the subsidy.

In a variation of the infant industry argument, it has been suggested that an import tariff imposed to encourage direct investment could increase income in the tariff-imposing country and the world at large, so long as the foreign investment introduced economies of scale in production. It has also been argued that a country would gain from foreign direct investment because of increased tax revenues from foreign profits (reduced by any tax concessions given), "external" economies as local firms were forced to adopt more efficient methods in order to remain competitive, and increased employment opportunities.[12] However, recent writers have warned that subsidies or tax concessions offered to attract new investment may well prove to be greater than the benefits derived from the investment.[13]

The third view—that foreign direct investment should be restricted—differs fundamentally in its analysis of the costs and benefits of foreign direct investment. It does not deny that foreign direct investment can increase income, raise employment, disseminate new technology, and ease attendant balance-of-payments pressures in the host country. But it holds that all these benefits can be achieved by external borrowing and

[11] R. A. Mundell, "International Trade and Factor Mobility", *American Economic Review* (June 1957). Reprinted in *Readings in International Economics* (R. E. Caves and H. G. Johnson, eds.), 1968.

[12] G. D. A. MacDougall, "The Benefits and Costs of Private Investment from Abroad: A Theoretical Approach", *The Economic Record* (March 1960). Reprinted in *Readings in International Economics*.

[13] For example, J. Bhagwati, "The Theory of Immiserizing Growth: Further Applications" in M. B. Connally and A. K. Swoboda, eds., *International Trade and Money* (University of Toronto Press, 1973).

purchase of foreign technology, provided the host country has or can hire people with the necessary managerial skills. This alternative would avoid some of the economic and social costs associated with foreign direct investment.

Canada's "Gray Report"[14] has presented an extensive analysis of these costs. The report distinguishes two types: (1) the distortions which result from government policies (such as tariffs) in host or home country, which encourage an inefficient use of both domestic and foreign capital, and (2) drawbacks inherent in foreign direct investment itself. Examples of the first type of costs include plants too small to realize economies of scale or "truncated" operations, such as mineral extraction without metal fabrication facilities. Examples of the second type of costs include the possibility that foreign-controlled firms would be less responsive than domestic firms to national policy objectives and that a large-scale foreign presence in a country might have unfortunate effects on domestic cultural institutions.

The notion that multinational companies are less controllable than purely domestic firms is quite widely held throughout the world. It is based in part on the sheer size of the multinationals and the geographic distribution of their production facilities. These factors may allow them to shift output from one country to another, at least in the medium to longer term. Another serious difficulty appears to be that a host country government may see itself as competing with other possibly stronger national governments, which also play host or home to the same multinationals. Each government may attempt to control or manipulate the activities of multinationals to its own advantage, only to find its efforts neutralized or overriden by others.

Country policies[15]

These three views of inward direct investment appear to lead to strikingly different policy prescriptions. But in fact country policies usually encompass strands of all three of them. In the United States, for instance, this is partly because policies affecting direct investment are made by state and local governments, as well as by the Federal Government. And policy positions at the various government levels have sometimes differed. It is also true that each view may be considered pertinent to some industries or regions but not others. Consequently, a country may see no inconsistency in preventing some direct investments, encouraging others, and being neutral to the rest.

The policy of leaving direct investment to free market forces has long been stronger in the United States and Germany than elsewhere. These are the only two large industrial countries that have not subjected incoming investment to a formal review process at any time in the postwar period. Nevertheless, policies that encourage or restrict foreign investment do exist in both countries.

In all countries except Japan, there are inducements to foreign investors to enter areas where investment is especially wanted: depressed geographic areas or new industries or technologies where domestic investment is lagging. This encouragement, in the form of tax concessions and a wide variety of other subsidies, is offered by the central governments in all countries except the United States and Japan and also by local governments in the United States, Germany, France, and Canada.

Such inducements are generally available to both domestic and foreign investors. However, some governments, including numerous state governments in this country, have gone out of their way to bring their offers to the attention of foreign investors, even establishing promotional offices in likely investor countries. Further, many multinational firms contemplating new foreign investment routinely shop host countries for the best subsidy offer tailored to their needs. The size of these offers has escalated in recent years.

As already noted, tariff policy can also have the effect of encouraging direct investment in the protected area. This has been true of Canadian tariffs The creation of the European Common Market, a unified market with no internal tariffs but surrounded by a common tariff wall, may have had a similar but possibly unintended effect. The recent international rounds of reciprocal tariff reductions have reduced this sort of inducement to foreign direct investment. But other negotiated trade restraints, especially those between Japan and other industrial nations, are apparently encouraging Japanese direct investment in Europe as well as in the United States.

However, all industrial countries also restrict foreign direct investment in differing degrees. All countries bar foreign-owned firms from industries considered to be of strategic national importance. The barriers are sometimes the result of nationalization of certain industries—most commonly the telephone, railroads, and public utilities. But foreign firms are also excluded from other strategic industries, most frequently air

[14] *Foreign Direct Investment in Canada*, report by a working group assisting the Honorable Herb Gray, P C , M P , Government of Canada, 1972

[15] Two good sources of information on host policies of foreign industrial countries are the Price Waterhouse series on *Doing Business in (country)* issued in 1975 and "Policies and Laws in Other Countries", Appendix N of *Foreign Direct Investment in the United States* (United States Department of Commerce, April 1976)

transport, shipping, broadcasting, and defense-related industries. In addition, Canada and Japan limit the permissible percentage of foreign ownership of any given firm in certain other industries considered of special national interest. And France and the United Kingdom sometimes subsidize domestic firms to strengthen their competitive position relative to foreign-owned firms.

At times during the postwar period, all countries except the United States and Germany have also subjected foreign direct investment to a review process, ranging from severely restrictive in Japan to largely formal in Italy. In recent years, Britain, France, and Canada have used the review process as a means of favoring investments which increase employment and introduce new technology. Since 1972 the federal and certain provincial governments in Canada have reduced their dependence on foreign capital by buying out foreign firms

Since the early 1970's, countries that formerly pursued policies of extreme restriction or encouragement in regard to direct investment have tended to moderate them. Japan, whose very low levels of foreign direct investment attest to the former restrictiveness of its policies, has relaxed them somewhat during the seventies. On the other hand, Canada, which has historically given strong encouragement to foreign direct investment, adopted a more discriminating attitude in the 1970's. For countries occupying a middle ground, there has been a trend toward less emphasis on restrictions and more on encouragement. A closer look at country policies follows

The ***United States*** government is committed to general policies of noninterference with foreign direct investment as such. What percentage of this investment has received state or local subsidies is unknown. However, the sudden growth of liquid funds in the hands of OPEC countries in 1974 and 1975 aroused public fears of possible OPEC takeovers of United States firms, and this in turn led to minor modifications in Federal Government policy. In 1975, an interagency Committee on Foreign Investment in the United States (CFIUS) was created by executive order and required to (1) analyze trends in foreign investments, (2) conduct advance consultations with foreign governments wishing to make investments in the United States (foreign governments were requested to inform the United States government of any intended direct investment), (3) review investments which might, in its opinion, have major implications for United States national interests, and (4) consider proposals for new legislation or regulations of such investment. However, both the Carter and Ford administrations have been reluctant to interfere with international direct investment flows, and little use has been made of these powers.[16]

The ***German*** government is also basically committed to a policy of nonintervention. But the sudden rise in OPEC financial wealth has prompted some modification of policy. Following several large direct investments from OPEC countries, the authorities established an informal notification system whereby banks and major companies report to them large impending foreign acquisitions. The government has in a few instances quietly encouraged purchase by German investors of the equity interests being offered for sale.

Further, Germany's antitrust policy, probably the most stringent in Europe, has necessarily affected foreign direct investment since those making such investments are ordinarily large multinational firms. The strength of the multinationals in Germany is clear evidence that anticartel policy has not been employed to effect a wholesale embargo. But, over the years, a number of Federal Cartel Office decisions have served to set limits on the expansion of foreign enterprise in Germany.

In ***Italy,*** policy is to encourage direct investment. A law enacted in 1956 requires that all proposed inward direct investments be screened to determine whether or not they are "productive", in the sense of increasing national output. While no investments are barred, only those determined to be productive are assured of unlimited remittance of earnings and capital repatriation. The law provides that other investors may be limited in their transfer of earnings or profits to 8 percent a year and barred from repatriating capital until two years after the original investment. But in fact, under long-standing administrative procedures, no restrictions have been applied, even in periods of heavy external deficit, on either capital repatriation or remittance of earnings

United Kingdom[17] policy has combined encouragement to foreign investment with concern for its impact on the balance of payments and on the competitive position of domestic firms. Until October 1979, authorities used their extensive powers (under the

[16] CFIUS has reviewed several investment proposals but has found no reason to intervene It has also reacted negatively to two proposals to expand the government's powers to regulate foreign direct investment a 1976 proposal by the Federal Energy Administration that foreigners' investment in energy resources be regulated, and a 1978 proposal that foreign investment in farmland be restricted For further details, see Statement by the Hon C Fred Bergsten, Assistant Secretary of the Treasury for International Affairs, before the Subcommittee on Commerce, Consumer, and Monetary Affairs, Committee on Government Operations, House of Representatives, July 30, 1979

[17] The most comprehensive history of United Kingdom policy in the postwar period is M D Steuer and others, *The Impact of Foreign Direct Investment on the United Kingdom* (Department of Trade and Industry, HMSO, 1973)

Exchange Control Act of 1947) to protect the balance of payments by requiring that some portion of foreigners' direct investment be financed by converting foreign currency into sterling. However, the severity of conversion requirements fluctuated with the balance-of-payments situation, the type of investment, and in later years the nationality of the investor. Investment in manufacturing, especially in depressed areas, was treated more leniently than other investments. Occasionally, the government also used its review powers under the Exchange Control Act to obtain assurances from multinationals on crucial policy matters. These included output goals, employment, exports, imports, and British representation on boards of directors. In some cases, when a proposed takeover would have produced an undesired foreign concentration in an industry, approval was delayed and domestic counteroffers encouraged. In 1973, following British entrance into the European Community, all EC residents were permitted to borrow sterling to finance investment in Britain. In 1977, the same privileges were given to all foreigners making direct investment in manufacturing. In October 1979, all remaining financing restrictions were eliminated as part of the overall scrapping of exchange controls.

Foreign direct investments will continue to be affected by various industrial policy measures Over the years, the government has made loans to foreign firms, either to encourage their investment in the United Kingdom, as in the case of depressed areas of Scotland, Wales, and Northern England, or to discourage their departure, as in the case of a loan to Chrysler-United Kingdom in the years before its sale to Peugeot. The government has subsidized foreign investment in depressed areas on the same basis as domestic investment. But, in a few strategic industries such as computers, it has subsidized domestic firms to strengthen their position in competing with foreign-controlled firms operating in the United Kingdom. These aspects of industrial policy will most likely continue.

In ***France,*** host policies also combine encouragement and restraint. All foreign direct investments are subject to review by the authorities, although those from other EC countries can be blocked only for balance-of-payments reasons. For others, additional criteria used in judging investment desirability include the investment's contribution to increased output, employment, exports, and improved technology.

The government has subsidized foreign investment in depressed areas and growth industries. But it has also resisted foreign domination of any given industry, subsidizing domestically owned firms or joint foreign-domestic ventures in an effort to restrict or to reduce the role played by strong wholly foreign-owned firms. One important recent case has been the government subsidies provided to CII Honeywell Bull (a computer firm formed by the merger of the French Compagnie Internationale pour L'Informatique with the United States-controlled Compagnie Honeywell Bull) to allow it to compete effectively against IBM.[18]

Canada traditionally encouraged foreign direct investment, especially in manufacturing, whose development has tended to lag relative to the United States. However, as foreign-affiliated corporations gained prominence in the Canadian economy there was growing concern about the implications of this development for the government's economic sovereignty. Concern was also prompted by extraterritorial application of the United States antitrust laws and the Trading with the Enemy Act and other similar regulations during the 1960's.[19] These problems generated a series of government reports, the last and most influential being the "Gray Report" of 1972 already mentioned. The report drew attention to the very high levels of foreign ownership and control of Canadian industry And it concluded that, despite the benefits of foreign investment, the investment had also brought the social and economic costs enumerated earlier.

One immediate consequence was the enactment of the Foreign Investment Review Act in 1973. While foreign entry had previously been restricted in a few industries, the new act required a case-by-case review of proposed new direct investment in all industries. It also specified the broad criteria for acceptance to be considered by the new review agency in making recommendations to the government that the application be accepted or rejected These criteria included: the effect of investment on output and employment, new technology introduced, compatibility with national objectives, contribution to industry competitiveness, and Canadian participation in ownership and management. The agency has recommended acceptance of 90 percent of all applications received. However, it seems likely that only projects considered to be roughly in line with the published criteria have been submitted to the agency.

At the provincial level, Manitoba, Saskatchewan, and Alberta have enacted legislation to regulate foreign or nonresident ownership of land. And Ontario enacted a land transfer tax, applying to foreigners' purchases of land but exempting purchase of land for commercial or industrial use.

[18] *Business Week* (March 21, 1977), page 48

[19] Under the act, the United States Treasury applied its licensing authority to transactions between Canadian affiliates of United States companies and governments or nationals of China, North Korea, and Vietnam Other regulations covered similar transactions with Cuba

The federal government has also moved to reduce Canada's dependence on foreign capital by establishing the partly government-owned Canada Development Corporation (CDC). The CDC has made equity investments in strategic sectors which might otherwise attract foreign capital—petrochemicals, oil and gas, health care, pipelines, venture capital, and mining. The mining investment takes the form of a 30 percent interest in Texas Gulf Corporation, a United States firm with a major stake in Canadian mining. The government has also purchased from foreigners companies operating in the aerospace and petroleum industries.[20] Moreover, the province of Saskatchewan has taken over foreign firms in the potash and oil industries and Quebec is currently attempting to purchase a foreign asbestos company.

In part as a result of these policies, net foreign investment flows into Canada have declined. On the basis of Canada's narrow definition of direct investment (*i.e.,* excluding retained earnings and short-term financial transactions between parent and affiliate), the direction of net direct investment flows has reversed from inward to outward. However, partial information on broadly defined direct investment flows, provided by United States statistics on United States-Canada bilateral balance of payments, suggests that direct investment flows more broadly defined continue inward but at a substantially reduced rate.[21]

Japan, the only large industrial country to have maintained stringent restrictions on foreign direct investment during much of the postwar period, has moved toward liberalization in the 1970's [22] The restrictions on inward investment, an integral part of its broader policies for industry and trade, were motivated by a strong drive to catch up with the West, a distrust of foreign ownership and control, and a fear of foreign competition with fledgling domestic industries. However, exceptions were made in the case of petroleum refining and distribution and the rubber industry, where major international companies were permitted to make substantial investments.

The government was also liberal in authorizing the importation of technology. In this way, Japan obtained one of the major benefits often associated with direct investment. During the decade ended in 1978, for example, Japan's payments of patent royalties to foreigners totaled \$6.8 billion, nearly three times as much as foreigners' earnings from direct investments in Japan.

Restraints on inward investment have been of two types: (1) designation of the percentage of foreign ownership of any given firm allowable in each industry and (2) a required "validation" of each investment proposal. The validating authorities have in the past required that would-be investors meet certain conditions such as limitations on the scale of output, marketing arrangements, and the number of Japanese directors and senior executives in joint enterprises.

Liberalization got under way in 1967 in response to pressure from other countries. The process was accelerated in the 1970's (possibly in part to forestall retaliatory restrictions on Japanese investment by other countries as Japan became an important outward direct investor) By 1976, liberalization reached the stage where 100 percent foreign ownership of Japanese firms was permissible in most industries. However, foreign investment is limited to 50 percent ownership in mining. And investment in leather and leather products, agriculture, forestry, fisheries, and petroleum is severely restricted.[23]

For industries where 100 percent foreign ownership is permitted, validation is still required but is often fairly automatic. However, validation of takeovers requires the consent of the Japanese firm being taken over. Most are traditionally reluctant to consent to any takeover bid, even from Japanese firms. Thus foreign firms not prepared to organize new companies have been limited to joint ventures with, or acquisitions of strong minority positions in, Japanese firms. A recent example of the latter is Ford's acquisition of a 25 percent interest in Toyo Kogyo, maker of Mazda cars.

Even when a foreign firm proposes a new wholly owned venture in a liberalized industry, the validation procedure has occasionally proved time consuming. In one exceptional and well-publicized case, validation of a proposed investment in a new plant by an American chemical company was delayed for two years, reportedly because of opposition from Japanese competitors.

[20] In October 1979 the government announced its intention to seek private Canadian buyers for the government-owned corporations In November it announced a plan to reduce its ownership in the Canada Development Corporation A proposal to give shares in Petrocan to each Canadian is also under consideration In all cases, there is a proviso that ownership remain in Canadian hands

[21] United States bilateral payments statistics show net direct investment flows from the United States to Canada were 1975· \$2 4 billion, 1976 \$1 9 billion, 1977· \$1 2 billion, and 1978· \$0 8 billion.

[22] For an extended discussion of Japan's policies, see Robert S Ozaki, *Control of Imports and Foreign Capital in Japan* (Praeger, New York· 1972) and OECD, *Liberalization of International Capital Movements· Japan* (Committee for Invisible Transactions, OECD, Paris, 1968)

[23] The change in attitude toward the petroleum investment may reflect an official desire to reduce the influence of foreign-controlled firms in that sector In fact, the foreign presence in the petroleum industry has been reduced from nearly two thirds (measured by sales) early in the 1960's to less than half now through government support of domestic firms, increased direct dealings between OPEC suppliers and Japanese companies, and the operations of the government's own National Petroleum Corporation.

Since liberalization got under way, the position of foreign-controlled firms in the Japanese economy has gradually increased but remains quite small. For all industries including services, the sales of foreign firms grew from 1.4 percent of sales made by all firms in Japan in 1967 to 2.2 percent in 1977. In manufacturing, the ratio rose from 2.8 percent to 4.7 percent despite a loss of shares for foreign petroleum companies.

Some unresolved issues

Traditionally, policy discussion has focused on the domestic consequences of inward direct investment. But, in the past few years, greater recognition has been given to international implications and, in particular, the need to construct mutually compatible national policies. This is true of both national inducements to inward investment and restrictions against them. It also applies to the conflicts between home and host country regulation of multinational firms.

National inducements and restrictions have been studied extensively by the OECD and by the United Nations But concrete progress in harmonizing policy remains modest. As far as inducements to inward investment are concerned, the industrial countries are well aware that competitive escalation of subsidy offers makes them more expensive for everyone and reduces the gain that the successful bidder can hope to realize from the foreign direct investment that it attracts

In 1976, an OECD Declaration on International Investment and Multinational Enterprise stressed the need to strengthen international cooperation in this field, but stopped short of agreeing to any specific actions or guidelines. Three years later, in October 1979, the OECD Committee on International Investment tackled the problem once again, this time embarking on a three-year study. The study will begin by cataloging investment incentive programs in all countries and the amount of the subsidies given It will then analyze their effect on recipients and their broader economic effects on home, host, and third countries

The OECD committee will also study discrimination against increased foreign investment Governments have been requested to submit descriptions of their activities in this field. The committee apparently hopes for frank statements on such matters as the support given to domestic companies to fend off foreign takeover bids or other foreign attempts to enter or dominate important industries

The third area of conflict—home and host country regulation of multinational firms—raises the problem of extraterritoriality As already mentioned in the discussion of Canadian policy, foreigners have been irritated by the occasional attempts of United States agencies to regulate the trade of foreign affiliates of United States companies Some have also been angered by law suits brought against foreign enterprises in United States courts on the grounds that the actions of those firms had consequences within the United States. A recent case is a suit brought by Westinghouse against an alleged international uranium cartel. The suit was filed against twenty-nine uranium producers, twelve of them foreign. The foreign defendants claim that their price-stabilizing activities had the support of the governments of Canada, South Africa, Australia, Britain, and France. Such episodes have stimulated Australia to enact legislation blocking enforcement of foreign court judgments on companies based in that country. Similar legislation is being considered in the United Kingdom and Canada.[24] However, the United States approach to these problems is by no means unique. The European Economic Community Commission maintains that its rules on competition extend to actions outside the Community if they affect competition within it. And the Supreme Court of the Federal Republic of Germany has supported the right of that country's Federal Cartel Office to require that foreign subsidiaries of German companies notify that Office of its foreign acquisitions.[25]

Although these international conflicts remain unresolved, the desirability of harmonizing national policies in this area is widely recognized. An important reason is the converging patterns of direct investment flows in the major industrial countries. Now that nearly all industrial countries are important as both host to inward investment and home country for outward investment, their policy perspectives are both broader and more similar to one another than in the 1960's. For example, the new sense of urgency animating OECD discussion of inducements to some inward investment and restrictions against others is largely due to a United States interest in those topics This interest is a new one, stimulated by our recent experience as an important host to inward direct investment On the other hand, the increasing importance of outward investment for Japan, Germany, and Canada is likely to have modified their approach to conflicts between home and host countries. Thus, there is some prospect that industrial countries will eventually move from study to action in harmonizing policies toward direct investment and the regulation of multinational firms.

[24] *The Economist* (September 5, 1979), pages 79-82

[25] *Financial Times* (November 29, 1979), page 12

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